

GLOBAL BUSINESS



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Global Business (NWTC)

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This text was compiled on 10/07/2026

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Licensing

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1: INTRODUCTION TO GLOBAL BUSINESS

1.1: Overview

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1.1: Overview

We will begin our journey into the world of International Business with a look at the globalization of business.

Learning Objectives

After completing this section, you will be able to:

- Understand what is meant by “Global Business”
- Describe the general international business environment
- Identify potential impacts of globalization on business operations

Introduction

What does Green Bay have to do with global business? More than you might think.

Start with a truck leaving Green Bay. It might be carrying products made with materials from another country, headed to a customer across the border, or moving goods that arrived through a distant port. Schneider, headquartered in Green Bay, provides transportation and logistics services across the United States, Canada, and Mexico. Nearby, Oshkosh Corporation builds specialized vehicles and equipment for customers around the world. KI, also headquartered in Green Bay, describes itself as a worldwide furniture company. In Marinette, Fincantieri Marinette Marine builds ships for the U.S. Navy as part of an Italian shipbuilding group. Georgia-Pacific makes paper products at its local facilities, while its parent company, Koch, operates businesses around the world. Global business isn't something that happens only in faraway financial centers; it happens right here in Northeast Wisconsin.



Figure 1.1.1: Green Bay Packaging Global Supply Chain

And you don't need a fleet of trucks or offices on several continents to be part of it. Imagine a small Green Bay bakery ordering chocolate made from cocoa grown abroad, selling treats to visitors, and posting a video that reaches someone on the other side of the world. Or picture a local online shop comparing overseas suppliers and deciding how shipping costs will affect its prices. These are hypothetical businesses, but their decisions illustrate a real point: a business can have global connections even if every employee works in one town.

Those connections create opportunities and questions. Where do our products and materials come from? How do culture, exchange rates, transportation, and trade rules affect what we buy and sell? What happens locally when a supplier overseas cannot

deliver? In this book, we'll explore those questions and learn to recognize the international decisions behind familiar products and everyday jobs. By the end of this textbook, "global business" should feel less like a distant concept and more like a way to understand the businesses—and possibilities—all around us.

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1.2: What is International Business?

Learning Objectives

By the end of this section, you will be able to:

- Know the definition of international business.
- Comprehend how strategic management is related to international business.
- Understand how entrepreneurship is related to international business.

The Definition of International Business

International business relates to any situation where the production or distribution of goods or services crosses country borders.

Globalization—the shift toward a more interdependent and integrated global economy—creates greater opportunities for international business. Such globalization can take place in terms of markets, where trade barriers are falling, and buyer preferences are changing. It can also be seen in terms of production, where a company can source goods and services easily from other countries.

Some managers consider the definition of international business to relate purely to “business”. However, a broader definition of international business may serve you better both personally and professionally in a world that has moved beyond simple industrial production. International business encompasses a full range of cross-border exchanges of goods, services, or resources between two or more nations. These exchanges can go beyond the exchange of money for physical goods to include international transfers of other resources, such as people, intellectual property (e.g., patents, copyrights, brand trademarks, and data), and contractual assets or liabilities (e.g., the right to use some foreign asset, provide some future service to foreign customers, or execute a complex financial instrument).

The entities involved in international business range from large multinational firms with thousands of employees doing business in many countries around the world to a small one-person company acting as an importer or exporter. This broader definition of international business also encompasses for-profit border-crossing transactions as well as transactions motivated by non-financial gains (e.g., triple bottom line, corporate social responsibility, and political favor) that affect a business's future.

Strategic Management and Entrepreneurship

A knowledge of both strategic management and entrepreneurship will enhance your understanding of international business. Strategic management is the body of knowledge that answers questions about the development and implementation of good strategies and is mainly concerned with the determinants of firm performance. A strategy, in turn, is the central, integrated, and externally oriented concept of how an organization will achieve its performance objectives.

One of the basic tools of strategy is a **SWOT** (strengths, weaknesses, opportunities, threats) assessment. The SWOT tool helps you take stock of an organization's internal characteristics—its strengths and weaknesses—to formulate an action plan that builds on what it does well while overcoming or working around weaknesses. Similarly, the external part of SWOT—the opportunities and threats—helps you assess those environmental conditions that favor or threaten the organization's strategy. Because strategic management is concerned with organizational performance—be that social, environmental, or economic—your understanding of a company's SWOT will help you better assess how international business factors should be accounted for in the firm's strategy.

Entrepreneurship, in contrast, is defined as the recognition of opportunities (i.e., needs, wants, problems, and challenges) and the use or creation of resources to implement innovative ideas for new, thoughtfully planned ventures. An entrepreneur is a person who engages in entrepreneurship. Entrepreneurship, like strategic management, will help you to think about the opportunities available when you connect new ideas with new markets. For instance, given Google's current global presence, it's difficult to imagine that the company started out as the entrepreneurial venture of two college students. Google was founded by Larry Page and Sergey Brin, students at Stanford University. It was first incorporated as a privately held company on September 4, 1998.

Increasingly, as Google demonstrates, international businesses have an opportunity to create positive social, environmental, and economic values across borders. An entrepreneurial perspective will serve you well in this regard.

Spotlight on International Strategy and Entrepreneurship

Hemali Thakkar and three of her fellow classmates at Harvard found a way to mesh the power of play with electrical power. The foursome invented “a soccer ball with the ability to generate electricity,” Thakkar said. Every kick of the ball creates a current that’s captured for future use. Fifteen minutes of play lights a lamp for three hours.

Called the sOccket, the soccer ball can bring off-grid electricity to developing countries. Even better, the soccer ball can replace kerosene lamps. Burning kerosene is not only bad for the environment because of carbon dioxide emissions, but it’s also a health hazard: according to the World Bank, breathing kerosene fumes indoors has the same effects as smoking two packs of cigarettes per day.

How did the idea of sOccket emerge? All four students (Jessica Lin, Jessica Matthews, Julia Silverman, and Hemali Thakkar) had experience with developing countries, so they knew that kids love playing soccer (it’s the world’s most popular sport). They also knew that most of these kids lived in homes that had no reliable energy.

As of November 2010, the sOccket prototype cost \$70 to manufacture, but the team hopes to bring the cost down to \$10 when production is scaled up. One ingenious way to bring costs down is to set up facilities where developing-world entrepreneurs assemble and sell the balls themselves.

At this point it’s also important to introduce you to the concepts of intrapreneurship and the intrapreneur. **Intrapreneurship** is a form of entrepreneurship that takes place inside a business that is already in existence. An intrapreneur, in turn, is a person within the established business who takes direct responsibility for turning an idea into a profitable finished product through assertive risk-taking and innovation. An entrepreneur is starting a business, while an intrapreneur is developing a new product or service in an already existing business. Thus, the ideas of entrepreneurship can be applied not only in new ventures but also in the context of existing organizations—even government.

Key Takeaways

International business encompasses a full range of cross-border exchanges of goods, services, or resources between two or more nations. These exchanges can go beyond the exchange of money for physical goods to include international transfers of other resources, such as people, intellectual property (e.g., patents, copyrights, brand trademarks, and data), and contractual assets or liabilities (e.g., the right to use some foreign asset, provide some future service to foreign customers, or execute a complex financial instrument).

Strategic management is the body of knowledge that answers questions about the development and implementation of good strategies and is mainly concerned with the determinants of firm performance. Because strategic management is concerned with organizational performance, your understanding of a company’s SWOT (strengths, weaknesses, opportunities, threats) helps you better assess how international business factors should be accounted for in the firm’s strategy.

Entrepreneurship is the recognition of opportunities (i.e., needs, wants, problems, and challenges) and the use or creation of resources to implement innovative ideas. Entrepreneurship helps you think about the opportunities available when you connect new ideas with new markets.

Sources & References

- Challenges and Opportunities in International Business. **Authored by:** Anonymous. **Provided by:** Lardbucket. **License:** CC BY-NC-SA: Attribution-NonCommercial-ShareAlike

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1.3: Video- Globalization Explained

This video introduces **globalization**—the growing connection among countries through trade, investment, technology, and the movement of people and ideas. As you watch, consider how globalization affects markets, economies, and jobs, and how decisions made in one part of the world can influence businesses and consumers elsewhere.

YouTube Video

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[View this YouTube Video online](#)



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1.4: Global Business in Action

Global Spotlight on Strategy: Schneider National

From One Truck to Cross-Border Logistics

What would you risk to start a business? In 1935, Al Schneider sold the family car to buy his first truck. From that entrepreneurial decision in Green Bay, Schneider grew into a company that helps customers move goods throughout the United States, Canada, and Mexico.

Growth required more than adding trucks. Schneider launched *intermodal* service in 1991, combining rail and trucking to move freight; opened an office in Mexico City in 1992; and formed Schneider Logistics in 1993. Each step expanded what the company could do for customers whose supply chains reached beyond a single state—or a single country.

Today, Schneider offers cross-border shipping and logistics services that help businesses coordinate freight between the United States and Mexico, including trucking, intermodal transportation, warehousing, and transfers between carriers or facilities. Consider a manufacturer that needs parts moved across the border: the challenge is not simply finding a truck. It is getting the shipment, paperwork, carriers, and delivery schedule to work together. Schneider's growth shows how an entrepreneur's original idea can evolve into a much broader solution as customers' needs become international.

Explore: Read Schneider's [company history](#) and its [cross-border shipping explainer](#). Find one decision that helped the company expand its reach and one that changed the services it could offer.

Discussion questions

1. What opportunity might Al Schneider have seen when he bought his first truck? What risks did he take?
2. Why might serving a customer across the U.S.–Mexico border require different capabilities from making a delivery within Wisconsin?
3. Was opening an office in Mexico City a continuation of Schneider's original business idea, a new entrepreneurial move, or both? Explain your reasoning.
4. Which created the bigger opportunity for Schneider--expanding where it could serve customers or expanding the services it could provide? Use an example from the reading to support your answer.

2: TRADE THEORY

2.1: Overview

2.2: Why Trade?

2.3: Absolute and Comparative Advantage

2.4: Competitive Advantage

2.5: Video- Porter's National Diamond Framework

2.6: Global Business in Action

2.1: Overview

In this section, we will explore the reasons that nations trade and how they determine what to trade and with whom.

Learning Objectives

After you complete this section, you will be able to:

- Identify and explain the difference between Absolute and Comparative Advantage
- Explain the Heckscher-Olin Theory
- Summarize Porter's Theory of National Competitive Advantage

Why Do Countries Trade?

Take a look at something you use every day: a phone, a pair of shoes, or even a cup of coffee. How many places—and how many people—helped bring it to you? Now imagine a government adds a tariff to one of the imported materials used to make it. Who might benefit? Who might pay more? And would the answer change if a local business depended on that material?

Those questions are why trade theory matters. Countries and businesses do not all have the same resources, skills, or production costs. Trade theories help us explore why they specialize, what they choose to make or buy, and how they compete. In this chapter, we'll move from *absolute and comparative advantage* to theories that examine a country's resources and the conditions that help its industries succeed.

But trade decisions are not made by businesses alone. Governments can shape the choices available through policies such as tariffs—taxes on imported goods. A tariff may help a domestic producer compete with imports, while also raising costs for businesses that use imported materials and, potentially, the prices customers pay. That tension is especially relevant in Northeast Wisconsin, where a manufacturer might welcome protection for a product it sells yet face higher costs for a component it buys.

As you read, don't look for a theory that declares trade simply "good" or "bad." Instead, ask a sharper question: *Who gains, who faces new costs, and what changes when government policy enters the picture?*

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2.2: Why Trade?

Learning Objectives

After completing this reading, you should be able to:

- Discuss globalization of markets, economies, and jobs.
- Explain international trade, foreign direct investments, and global monetary systems.

Link to Learning - Why Trade?

Why might one country export machinery while another exports clothing? “Why Trade?” introduces the Heckscher-Ohlin theory, which suggests that countries tend to specialize in goods that make greater use of resources they have in relative abundance, such as labor or capital. Its jeans-and-cell-phones example makes the idea easier to picture. As you read, notice both the potential gains from specialization and the article’s important qualification: even when a country gains overall, not every group within it necessarily benefits. That distinction will help you think more carefully about trade policy and who is affected by it.

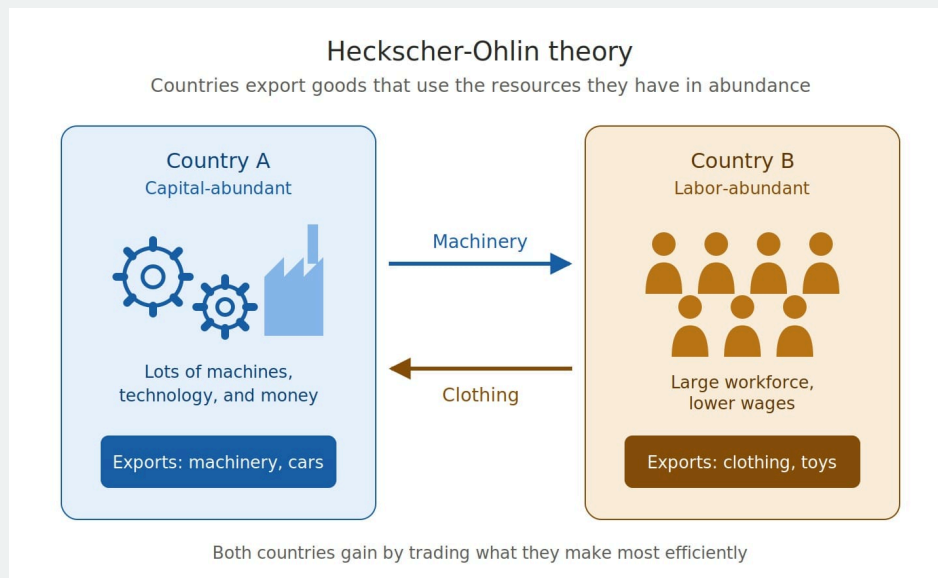


Figure 2.2.1: Heckscher-Ohlin Theory

As you read the article, consider this question: If trade can increase a country’s overall income, why might some workers or businesses still oppose it?

Read the article, “Why Trade?” from the Nobel Prize website linked below.

<https://educationalgames.nobelprize.org/educational/economic-sciences/trade/ohlin.php>

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2.3: Absolute and Comparative Advantage

Absolute advantage and **balance of trade** are two important aspects of international trade that affect countries and organizations.

Key Terms

- **Advantageous:** Being of advantage; conferring advantage; gainful; profitable; useful; beneficial; as, an advantageous position.
- **Absolute advantage:** In economics, the principle of absolute advantage refers to the ability of a party (an individual, a firm, or country) to produce more of a good or service than competitors, using the same amount of (or less) resources.
- **Comparative advantage:** The ability to produce a good or service at a lower opportunity cost than someone else. Opportunity cost means what you give up to produce it.
- **Net exports:** The balance of trade (or net exports, sometimes symbolized as NX) is the difference between the monetary value of exports and imports of output in an economy over a certain period. It is the relationship between a nation's imports and exports.
- **Advantageous trade:** Advantageous trade is based on comparative advantage and covers a larger set of circumstances while still including the case of absolute advantage and hence is a more general theory.

In the drive for international trade, it is important to understand how trade affects countries positively and negatively—both how a country's imports and exports affect its economy and how effectively the country's ability to create and export vital goods affects the businesses within that country. Absolute advantage and balance of trade are two important aspects of international trade that affect countries and organizations.



Figure 2.3.1: European Free Trade Agreement. The European Free Trade Agreement has helped countries international trade without worrying about absolute advantage and increases net exports. (CC-Public Domain, [Wikimedia](#))

Absolute Advantage

In economics, the principle of absolute advantage refers to the ability of a party (an individual, a firm, or a country) to produce more of a good or service than competitors while using the same amount of resources. Adam Smith first described the principle of absolute advantage in the context of international trade, using labor as the only input. Since absolute advantage is determined by a simple comparison of labor productivities, it is possible for a party to have no absolute advantage in anything; in that case, according to the theory of absolute advantage, no trade will occur with the other party. It can be contrasted with the concept of

comparative advantage, which refers to the ability to produce a particular good at a lower opportunity cost.

Comparative Advantage

Imagine two countries each trying to produce a barrel of oil. One can reach a large, accessible deposit with relatively little drilling effort; the other needs more complex equipment and work to produce the same barrel. The first has an absolute advantage in oil production because it uses fewer resources. But that fact alone does not tell us what each country should specialize in: for that, we also need to compare what each gives up to produce oil—its comparative advantage.

Why trade if you can make something yourself? Comparative advantage helps answer that question. It means focusing on what you can produce at the *lowest opportunity cost*—what you give up to make it—even if someone else can produce it faster. When people or countries specialize in different things and trade, both can potentially have more than if each tried to make everything alone. As you watch the video, look for the difference between being *best at making something* and having a *comparative advantage* in making it.

YouTube Video

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2.4: Competitive Advantage

Competitive advantage is defined as the strategic advantage one business entity has over its rival entities within its competitive industry. Achieving competitive advantage strengthens and positions a business better within the business environment.

Key Points

- A country is said to have a comparative advantage in the production of a good (say cloth) if it can produce cloth at a lower opportunity cost than another country.
- Competitive advantage seeks to address some of the criticisms of comparative advantage.
- Competitive advantage occurs when an organization acquires or develops an attribute or combination of attributes that allows it to outperform its competitors.

Key Terms

- **Comparative advantage:** The concept that a certain good can be produced more efficiently than others due to a number of factors, including productive skills, climate, natural resource availability, and so forth.
- **Opportunity cost:** The cost of an opportunity forgone (and the loss of the benefits that could be received from that opportunity); the most valuable forgone alternative. For example, the opportunity cost of cloth production is defined as the amount of wine, for example, that must be given up in order to produce one more unit of cloth.

Competitive advantage seeks to address some of the criticisms of comparative advantage. A country is said to have a comparative advantage in the production of a good (say cloth) if it can produce cloth at a lower opportunity cost than another country. The opportunity cost of cloth production is defined as the amount of wine that must be given up in order to produce one more unit of cloth. Thus, England would have the comparative advantage in cloth production relative to Portugal if it must give up less wine to produce another unit of cloth than the amount of wine that Portugal would have to give up to produce another unit of cloth.

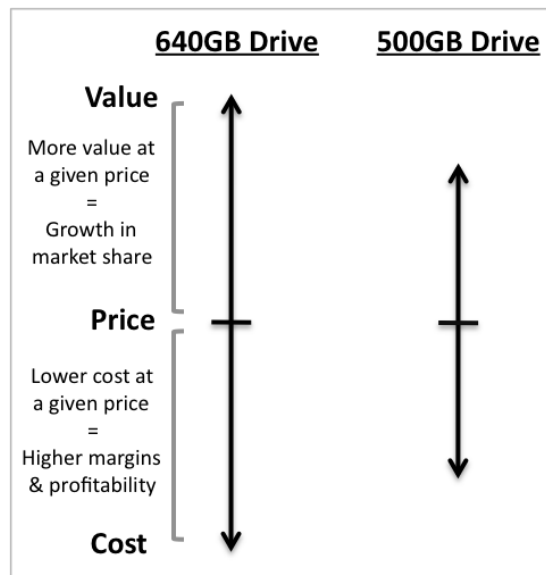


Figure 2.4.1: Competitive advantage example. A 640GB drive has a competitive advantage over a 500GB drive in terms of both cost and value.

Michael Porter proposed the theory of competitive advantage in 1985. The competitive advantage theory suggests that states and businesses should pursue policies that create high-quality goods to sell at high prices in the market. Porter emphasizes productivity growth as the focus of national strategies. This theory rests on the notion that cheap labor is ubiquitous, and natural resources are not necessary for a good economy. The other theory, comparative advantage, can lead countries to specialize in exporting primary goods and raw materials that trap countries in low-wage economies due to terms of trade. The competitive

advantage theory attempts to correct for this issue by stressing maximizing scale economies in goods and services that garner premium prices.

Competitive advantage occurs when an organization acquires or develops an attribute or combination of attributes that allows it to outperform its competitors. These attributes can include access to natural resources, such as high-grade ores or inexpensive power, or access to highly trained and skilled personnel human resources. New technologies, such as robotics and information technology, are either to be included as a part of the product or to assist in making it. Information technology has become such a prominent part of the modern business world that it can also contribute to competitive advantage by outperforming competitors with regard to Internet presence. From the very beginning (i.e., Adam Smith's *Wealth of Nations*), the central problem of information transmittal, leading to the rise of middlemen in the marketplace, has been a significant impediment in gaining competitive advantage. By using the Internet as the middleman, the purveyor of information to the final consumer, businesses can gain a competitive advantage through the creation of an effective website, which in the past required extensive effort finding the right middleman and cultivating the relationship.

Sources & References

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2.5: Video- Porter's National Diamond Framework

Porter's Diamond Model

Why might a business's location help it compete around the world? Porter's Diamond Model suggests that success depends on more than the strengths of an individual company. It also looks at the skills and resources available nearby, the expectations of local customers, the strength of suppliers and related businesses, and the pressure created by local competitors. As you watch, think about Northeast Wisconsin's dairy or paper industries: which of these conditions might help a local company become competitive beyond the region?

Could a region be an excellent place to *make* a product but a less attractive place to *sell* it? Why?

YouTube Video

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Sources & References

- CIMA E3 Porter's Diamond Model. **Authored by:** Professional Finance Education. **Located at:** <https://www.youtube.com/watch?v=FYRnxhQ8XFc>. **License:** All Rights Reserved. **License Terms:** Standard YouTube license

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- [2.6: Video- Porter's National Diamond Framework Explained](#) by Lumen Learning is licensed [CC BY-SA 4.0](#). Original source: <https://courses.lumenlearning.com/suny-internationalbusiness/>.

2.6: Global Business in Action

Global Spotlight on Resources: Why Paper Here?

Why did paper mills take root along the Fox River instead of somewhere else?

Early papermakers could draw on the region's forests for wood fiber and the river for water and power. As the industry grew from Neenah toward Green Bay, businesses and workers developed expertise around making paper and paper products. The region's history is a reminder that a natural resource can give an industry a head start—but that advantage does not stand still.

Today, "resources" means more than trees. Georgia-Pacific's Broadway mill in Green Bay, for example, uses *recovered paper fiber* to make products such as tissue, paper towels, and napkins. Its ability to turn used paper into new products depends on equipment and know-how as well as access to raw material. Wisconsin's broader paper industry also serves markets beyond the state, including international customers.

Trade theory helps us ask a more useful question than "Does Wisconsin have trees?" It asks how the region combines its resources, skills, technology, and industry connections—and how those strengths compare with what producers elsewhere can offer. A place may develop an industry because of its natural advantages, then maintain that industry by finding new ways to use resources.

Explore: Watch PBS Wisconsin's short [Neenah–Menasha: Paper video](#) for the industry's origins, then consider how a modern mill's use of recycled fiber changes the resource story.

Discussion Questions

1. Which resources helped papermaking develop along the Fox River? Which capabilities would a paper company need to compete today?
2. Does using recovered paper reduce a mill's dependence on natural resources, or simply change which resources and capabilities matter most?
3. Suppose a paper company can buy pulp from abroad for less than it costs to make locally. What factors besides the purchase price should it consider?

3: POLITICAL AND ECONOMIC SYSTEMS AROUND THE GLOBE

3.1: Overview

3.2: Video- Political Systems

3.3: Political and Economic Systems

3.4: Video- Economic Systems

3.5: Mixed Economies

3.6: Free-Enterprise

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3.10: Global Business in Action

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3.1: Overview

In this section, we will explore the different economic and political systems and how they impact global trade and business.

Learning Objectives

After you complete this section, you will be able to:

- Identify and explain the different political systems around the globe
- Identify and compare market, command and mixed economies
- Summarize the characteristics of political structures (including socialism, communism, democracy, totalitarianism)

Who Makes the Rules?

Imagine a Northeast Wisconsin business ready to sell its products in another country. It has customers, a shipping plan, and a price. Is it ready to go? Not quite. The business also needs to understand who sets the rules in that market: Can private companies own the facilities they use? How much does the government direct production or prices? What happens if a policy changes?

Every country makes choices about political authority and economic activity, and those choices affect businesses, workers, and customers. In this section, we'll compare political systems and explore market, command, and mixed economies. Rather than treating these as labels to memorize, we'll ask what they mean for real decisions—whether to enter a market, hire employees, invest in equipment, or work with a local partner.

As you read, keep one question in mind: How would the same business plan need to change under a different set of rules?

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3.2: Video- Political Systems

Government Systems

Who makes the decisions in a country—and how do they get that power? *13 Government Systems Around the World Explained* introduces different ways governments are organized, including democracies, monarchies, single-party states, and parliamentary and presidential systems. As you watch, notice that these terms answer different questions: some describe who holds power, while others describe how power is divided or leaders are chosen. A country can therefore fit more than one description. For global businesses, understanding those arrangements is a starting point for asking who makes trade rules, how policies may change, and whom a company needs to work with.

Why might knowing that a country is a democracy tell a business less than it needs to know about how trade decisions are actually made?

YouTube Video

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[Watch the video on YouTube to view the transcript.](#)

American Government

Knowing a government's name is not the same as understanding how it works. In this video, *Civics Made Easy* asks why many Americans struggle to explain their own government and why that knowledge matters. Through conversations with civic educators, it connects understanding our rights and institutions to the ability to participate in decisions that affect our communities. As you watch, consider this question for global business: if a company does not understand *how* a government makes decisions, what important changes might it fail to anticipate?

YouTube Video

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Sources & References

- 13 Government Systems around the World Explained. **Authored by:** World Enthusiast. **Provided by:** YouTube. **Located at:** https://www.youtube.com/watch?v=z_3nS5lkj04. **License:** All Rights Reserved. **License Terms:** Standard YouTube License
- Why Do So Many Americans Not Know How Their Government Works. **Authored by:** PBS. **Provided by:** YouTube. **Located at:** <https://www.youtube.com/embed/hMqEnmDp2m8>. **License:** All Rights Reserved. **License Terms:** Standard YouTube License

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3.3: Political and Economic Systems

Political and Economic Systems Defined

An economic system can be defined as any method a nation uses to allocate and manage its resources among its population. The three aspects of any economic system involve production, distribution, and consumption. Political systems are defined as the organized set of laws, common values, and institutions that make up a nation's government; in this definition is included the method in which a state is actually run and is not only limited to how it is supposed to run. Political and economic systems are deeply interwoven, and changes that affect one usually impact the other.

There are four types of economic systems in today's world; they are:

- **Command** (or Planned)
- **Market**
- **Mixed**
- **Traditional**

The main focus of this section will be on command, market, and mixed systems, since it is these three that make up the majority of the world's economies. Note: Traditional economies can still be found today but are usually limited to regional pockets of tribal, religious, or agrarian subsistence communities.

Link to Learning

To learn more about traditional economies, you can visit [Types of Economic Systems](#) and [What is a Traditional Economy](#).

Resources Defined

Economic systems deal with resource allocation and management. Resources, in this context, are sometimes also referred to as factors of production. All of a country's resources can be classified into these five factors of production:

- **Land:** All the natural resources. It includes farmland, oil deposits, minerals in the soil, bodies of water, wind, etc.
- **Labor:** Manpower and the available workforce.
- **Physical Capital:** Refers to goods that are produced with the purpose of being further processed into finished and consumer goods. They constitute a stage in the manufacturing process. E.g., steel is mass produced and sold wholesale to companies who will then process it into a variety of items from kitchenware to jewelry. Cash is a form of physical capital.
- **Human Capital:** Refers to the knowledge and skill set that labor brings to the manufacturing process. It is an intangible resource, but it is essential in order to create quality products and ensure efficient processes.
- **Entrepreneurship:** Is another intangible resource; it refers to the select individuals who, through ingenuity and self-motivation, bring together some of the other factors of production and create new products or industries. Entrepreneurship is different than human capital, although some economists argue that both are subdivisions of Labor.

The Economic Spectrums

The top spectrum ranges from free-market to command. It is important to understand that in the real world, there is no such thing as absolutes when it comes to economic systems. No economy is purely free-market or command; in practice, every economy is technically a mixed system with some countries leaning more towards command and others towards free-market. Theoretical definitions, although imaginary, help us objectively measure and compare the different systems as used by different countries; so remember, every economy is a mixed economy in practice. That being said, it is generally acceptable to refer to a country based on what end of the spectrum they are closest to. One might say Australia is a free-market economy, while Cuba, up until recently, was a strong command economy.

The middle spectrum contains capitalism, socialism, and communism and refers to the combination of both economic and

political theories. Capitalism is on the same side as free-market, and communism the same as command. Although some of these terms are sometimes used interchangeably in everyday speech, there are a few differences that you must be aware of. Capitalism refers to the private ownership of the means of production, where trade and industry are carried out for profit by people and not by government. Free-market is a broader term which simply refers to a system where the laws of supply and demand dictate the outcome of commerce and industry. In a similar pattern, communism advocates equality amongst members of a society; property is publicly owned, and the government distributes to each according to their needs. The broader term to describe a system where the government controls prices and production is a planned or command economy.

The bottom spectrum indicates what each side favors. A free-market capitalist economy will strongly protect the rights of individuals (companies or people), and each person is left to compete against others for wealth and resources; this can be an unforgiving environment for those who do not fend well. On the other end of the spectrum, collectivism places the well-being of the group above that of the individual, and the group, in theory, takes care of each other; however, this too can have negative outcomes if the authoritative body abuses its power or if the well-being of the whole comes at the expense of a few and you find yourself in the few.

Free-Market Economy

A free market economy is one in which individuals and firms control the means of production through private ownership and minimal government interference. It is a Laissez-faire approach, or a policy of governmental non-interference in economic affairs. Because supply and demand dictate the behavior and direction of the economy, it is, for the most part, self-regulating.

In a free market economy, the market is simply a mechanism of exchange of goods and services between those who have them and those who want them. Innovation and entrepreneurship thrive best in a market economy.

"In market economies, economic decisions are made by individuals. The unfettered interaction of individuals and companies in the marketplace determines how resources are allocated and goods are distributed. Individuals choose how to invest their personal resources—what training to pursue, what jobs to take, what goods or services to produce. And individuals decide what to consume. Within a pure market economy the government is entirely absent from economic affairs." – Ghiya Robins

Countries shifting towards a market economy must undergo three critical steps:

1. **Deregulation** – Removing the legal restrictions to free enterprise in a market economy
2. **Privatization** – The transfer of ownership of state property to the private sector.
3. **Legal Systems** – The creation of laws that protect private property rights and contract enforcement.

Command Economy

A command economy is, in a sense, the opposite of a market economy. A command (or planned) economy is an economic system in which the government or other centralized group determines wages, sets prices, and distributes resources and products to the common group; it also oversees the types of industries it will operate.

There are two basic types of command economy:

- **Communism:** Where the government owns all factors of production and makes all the decisions on how resources within that nation will be used. The government also determines who gets capital and how it is used to build industries.
- **Socialism:** Government controls critical industries but allows individual freedoms, some individual rights to own property and start businesses that the government does not consider critical to the overall economy. This type of command economy is the transition between strictly command and mixed system.

Mixed Economy

A mixed economy is an economic system in which both the state and private sector direct the economy in the way goods and services are bought and sold, reflecting characteristics of both market economies and planned economies. Mixed economies allow many more freedoms than command economies; this promotes healthy competition and results in profit. Some of the freedoms allowed include the freedom to possess the means of production; to participate in managerial decisions; to buy, sell, fire, and hire as needed; and for employees to organize and protest peacefully. It can be thought of as a middle ground between

Free-market and Command. Most mixed economies can be described as market economies with strong regulatory oversight. Overall, businesses, as well as consumers, in mixed economies have freedoms that are important to both. And while government is actively involved and provides support, its control is limited, which is good for structure.

Characteristics of mixed economies on the government side include welfare systems, employment standards, environmental protection, and antitrust policies. The advantage of this type of system is that it allows competition between producers with regulations in place to protect society as a whole. With the government being present in the economy, it brings a sense of security to both sellers and buyers. This security helps maintain a stable economy.

Some economists argue that because social democratic (mixed) programs retain the capitalist mode of production, they also retain the fundamental problems of capitalism, including cyclical fluctuations, exploitation, and alienation. Another disadvantage of mixed economies is that they tend to lean more toward government control and less toward individual freedoms.

Note: The term is also used to describe the economies of countries which are referred to as welfare states (A social system in which the state takes overall responsibility for the welfare of its citizens, providing health care, education, unemployment compensation and social security), such as Norway and Sweden.

Barriers to Free Trade

Free trade means that countries can import and export goods, unencumbered by trade barriers. Trade barriers are government-induced restrictions on international trade. Man-made trade barriers come in several forms, including: tariffs, non-tariff barriers to trade, import licenses, export licenses, import quotas, subsidies, voluntary export restraints, local content requirements, embargo, currency devaluation, and trade restrictions. Employing such barriers is often referred to as protectionism. The methods used to regulate imports and exports strongly depend on the type of political and economic system a country has.

Protectionism

Most trade barriers work on the same principle—the imposition of some sort of cost on trade that raises the price of the traded products. If two or more nations repeatedly use trade barriers against each other, then a trade war results. Economists generally agree that trade barriers are detrimental and decrease economic efficiency. Trade barriers are often criticized for the effect they have on the developing world. Because rich-country players set trade policies, goods such as agricultural products that developing countries are best at producing face high barriers. Tariffs also tend to be anti-poor, with low rates for raw commodities and high rates for labor-intensive processed goods. Another negative aspect of trade barriers is that they would cause a limited choice of products and, therefore, would force customers to pay higher prices and accept inferior quality. An export subsidy can also be used to give an advantage to a domestic producer over a foreign producer. Export subsidies tend to have a particularly strong negative effect because, in addition to distorting resource allocation, they reduce the economy's terms of trade.

Why This Matters

We live in a world where technology draws people closer together every single day. Information travels at the speed of light, and the continued spread of globalization means that there are fewer and fewer commercial barriers between countries. A student might find, once he or she graduates and enters the labor market, that they will be interacting with people from all around the world and from incredibly diverse backgrounds on a daily basis; if not personally, they will undoubtedly find themselves partnering or working for a company with suppliers, customers, or even entire departments that operate in different parts of the world under different economic systems. For this reason, it is crucial to understand economic systems and the role they play in modern business.

Read the following case study.

Case Study

Mark has recently graduated from university with a degree in business administration. He gets an internship with a regional food supplier that is looking to enter the European market. Because the European market has a mixture of different economic systems, the company must develop a strategy on how to enter. Mark is called to sit in on a meeting where the different section heads are discussing the best approach to the situation.

One of the attendees argues that the company ought to establish themselves in the United Kingdom first (free-market system), where barriers to entry are relatively low, but competition is fierce and the company runs the risk of suffering heavy loss if the locals do not embrace their product, on the other hand if the company successfully embeds itself into the way of life, the payout will be extraordinary.

Another attendee argues that the best strategy would be to enter through Eastern Europe, with the help of one of the company's overseas partners if a government contract can successfully be secured. She argues that if they manage to secure a contract as a government supplier, although tariffs on their product may be higher, they minimize other risks by obtaining a steady flow of business for the duration of the contract. Naturally, it would take detailed logistics and analysis to come to a final decision, but this is just one example on the importance of understanding economic systems and what their real-world impact is. In fact, we can relate this back to the three fundamental economic questions: what is produced? How is it produced? And for whom will it be produced? Economic systems impact the answer to all of these questions.

But what about non-business students? How does this affect them?

Understanding economic systems is important for non-business students alike. Economic systems, as stated above, impact everything from what products are available to what taxes should be levied across all levels of income.

Link to Learning

In July of 2016, McDonald's in Venezuela was forced to stop selling Big Macs because it was unable to source the bread needed to make the sandwich. As Venezuela's political system shifts from a democracy towards authoritarian rule, its economic system is also changing (from market to command). In this basic example, we see that people are the ones who are impacted by these matters. [Link to article](#)

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3.4: Video- Economic Systems

What are Economic Systems?

Who decides what gets made, how it gets made, and who receives it? Every society has to answer those questions. This short video introduces four ways of organizing an economy—traditional, free market, command, and mixed systems—and considers the advantages and challenges of each. As you watch, pay particular attention to who makes economic decisions and how much influence the government has. Why might a country combine market choices with government involvement rather than rely entirely on one approach?

YouTube Video

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3.5: Mixed Economies

A **Mixed Economy** exhibits characteristics of both market and planned economies, with private and state sectors providing direction.

Key Points

- The term mixed economy is very broadly defined and has been used to describe economies as diverse as the United States and Cuba.
- The means of production are privately owned, and markets remain the dominant form of economic coordination. However, governments wield significant influence over the economy through monetary and fiscal policy and regulation.
- Characteristics of mixed economies include welfare systems, employment standards, environmental protection, publicly owned enterprises, and antitrust policies.
- Keynesian economics advocates the presence of a mixed economy. This line of thought subsided between 1970 and 2000, but has regained considerable popularity after the financial crisis of 2008.

Key Terms

- **Mixed economy:** An economic system in which both the state and private sector direct the economy, reflecting characteristics of both market economies and planned economies.
- **Welfare state:** A social system in which the state takes overall responsibility for the welfare of its citizens, providing health care, education, unemployment compensation and social security.
- **Mixed economies:** A system in which both the state and private sector direct the way goods and services are bought and sold.
- **Keynesian economics:** The group of macroeconomic schools of thought based on the ideas of 20th-century economist John Maynard Keynes. Advocates of Keynesian economics argue that private sector decisions sometimes lead to inefficient macroeconomic outcomes that require active policy responses by the public sector, particularly monetary policy actions by the central bank and fiscal policy actions by the government to stabilize output over the business cycle.

Examples

- The American School (also known as the National System) is the economic philosophy that dominated United States national policies from the time of the American Civil War until the mid-twentieth century, and is an example of a mixed economy. It consisted of three core policy initiatives: protecting industry through high tariffs (1861–1932), government investment in infrastructure through internal improvements, and a national bank to promote the growth of productive enterprises. During this period, the United States grew into the largest economy in the world, surpassing the UK (though not the British Empire) by 1880.
- Dirigisme is an economic policy initiated under Charles de Gaulle of France, designating an economy where the government exerts strong directive influence. It involved state control of a minority of the industry, such as transportation, energy, and telecommunication infrastructures, as well as various incentives for private corporations to merge or engage in certain projects. Under its influence, France experienced what is called the Thirty Glorious Years of profound economic growth.
- The social market economy is the economic policy of modern Germany that steers a middle path between the goals of socialism and capitalism within the framework of a private market economy and aims at maintaining a balance between a high rate of economic growth, low inflation, low levels of unemployment, good working conditions, public welfare, and public services by using state intervention.
- Did these mixed economies grow? Yes. The United States, France, and West Germany all experienced major periods of growth while combining private enterprise with government involvement in different ways. But “grew while using a policy” is not the same as “grew because of that policy.” To evaluate a policy—such as a tariff—we also need to ask what else was changing and who benefited or faced higher costs.

Mixed Economies

What is a Mixed Economy?

A mixed economy is an economic system in which both the state and private sector direct the economy, reflecting characteristics of both market economies and planned economies. Most mixed economies can be described as market economies with strong regulatory oversight, in addition to having a variety of government-sponsored aspects.



Figure 3.5.1: Restrictions are sometimes placed on private mail systems by mixed economy governments. For example, in the United States, the USPS enjoys a government monopoly on non-urgent letter mail as described in the Private Express Statutes. (CC-BY-SA, [Wikipedia](#))

While there is not one single definition for a mixed economy, the definitions always involve a degree of private economic freedom mixed with a degree of government regulation of markets.

The Plan Behind a Mixed Economy

The basic plan of the mixed economy is that:

- The means of production are mainly under private ownership;
- Markets remain the dominant form of economic coordination; and
- Profit-seeking enterprises and the accumulation of capital would remain the fundamental driving force behind economic activity. However, the government would wield considerable indirect influence over the economy through fiscal and monetary policies designed to counteract economic downturns and capitalism's tendency toward financial crises and unemployment, along with playing a role in interventions that promote social welfare. Subsequently, some mixed economies have expanded in scope to include a role for indicative economic planning and/or large public enterprise sectors.

The relative strength or weakness of each component in the national economy can vary greatly between countries. Economies ranging from the United States to Cuba have been termed mixed economies. The term is also used to describe the economies of countries which are referred to as welfare states, such as Norway and Sweden.

What Do Governments Provide?

Governments in mixed economies often provide:

- Environmental protection,
- Maintenance of employment standards,
- A standardized welfare system, and
- Maintenance of competition.

Who Supports the Ideal of Mixed Economies?

As an economic ideal, mixed economies are supported by people of various political persuasions, typically center-left and center-right, such as social democrats or Christian democrats. Supporters view mixed economies as a compromise between state socialism and laissez-faire capitalism that is superior in net effect to either of those.

Keynesian economics advocates a mixed economy — predominantly private sector, but with a significant role of government and public sector. It also served as the economic model during the later part of the Great Depression, World War II, and the post-war economic expansion (1945–1973), though it lost some influence following the tax surcharge in 1968 and the stagflation of the 1970s. The advent of the global financial crisis in 2008 has caused a resurgence in Keynesian thought.

The Advantages of a Mixed Economy

A mixed economy allows private participation in production while ensuring that society is protected from the full swings of the market.

Key Points

- Mixed economies allow many more freedoms than command economies, such as the freedom to possess the means of production; to participate in managerial decisions; to buy, sell, fire, and hire as needed; and for employees to organize and protest peacefully.
- Mixed economies have a high level of state participation and spending, leading to tax-funded libraries, schools, hospitals, roads, utilities, legal assistance, welfare, and social security.
- Various restrictions on business are made for the greater good, such as environmental regulation, labor regulation, antitrust, and intellectual property laws.
- The ideal combination of these freedoms and restrictions is meant to ensure the maximum standard of living for the population as a whole.

Key Terms

- **Monopoly:** An exclusive control over the trade or production of a commodity or service through exclusive possession.
- **Social Security:** A system whereby the state, either through general or specific taxation, provides various benefits to help ensure the well-being of its citizens.
- **Protectionism:** A policy of protecting the domestic producers of a product by imposing tariffs, quotas, or other barriers on imports.

A mixed economy permits private participation in production, which in turn allows healthy competition that can result in profit. It also contributes to public ownership in manufacturing, which can address social welfare needs.



Figure 3.5.1: Marketplace. Private investment, freedom to buy, sell, and profit, combined with economic planning by the state, including significant regulations (e.g., wage or price controls), taxes, tariffs, and state-directed investment. (Image of a Market in Lhasa. Nathan Freitas. CC-BY-SA, [Wikipedia](#))

Detailed Advantages of a Mixed Economy

The disadvantages of mixed economies can be understood through examining criticisms of social democracy.

Key Points

- One disadvantage of mixed economies is that they tend to lean more toward government control and less toward individual freedoms.
- While most modern forms of government are consistent with some form of mixed economy, the mixed economy is most commonly associated with social democratic parties or nations run by social democratic governments.
- Some critics of contemporary social democracy argue that when social democracy abandoned Marxism it also abandoned socialism and has become, in effect, a liberal capitalist movement.
- Marxian socialists argue that because social democratic programs retain the capitalist mode of production, they also retain the fundamental issues of capitalism, including cyclical fluctuations, exploitation and alienation.
- The democratic socialist critique of social democracy states that capitalism could never be sufficiently “humanized” and any attempt to suppress the economic contradictions of capitalism would only cause them to emerge elsewhere.
- Market socialists criticize social democracy for maintaining a property-owning capitalist class, which has an active interest in reversing social democratic policies and a disproportionate amount of power over society to influence governmental policy as a class.

Key Terms

- **Social democracy:** a moderate political philosophy or ideology that aims to achieve socialistic goals within capitalist society, such as by means of a strong welfare state and regulation of private industry.
- **Regulation:** A law or administrative rule, issued by an organization, used to guide or prescribe the conduct of members of that organization.
- **Mixed economy:** A mixed economy is an economic system in which both the state and private sector direct the economy, reflecting characteristics of both market economies and planned economies.

Many pubs in Britain are suffering due to drinking and smoking regulations imposed by the government for the good of society. As a result, many question whether pubs have a future.

A mixed economy combines choices made by businesses and consumers with a role for government. Businesses can compete, respond to customers, and develop new products, while governments can provide services and infrastructure that benefit many people, such as schools and roads. Governments may also set rules to protect workers and consumers and provide support when people face hardship. The goal is to draw on the strengths of both markets and public action.

There is no single recipe for a mixed economy. Countries make different choices about what to regulate, which services to fund, and how much to tax. Those choices involve trade-offs: a policy may address one problem while creating costs for businesses or taxpayers. As you study the examples on this page, ask not just whether an economy grew, but which choices helped, who benefited, and who paid the costs. The United States is a mixed economy.

1. **Economic freedoms (the "private" side):** People and businesses have the freedom to own property and businesses, buy and sell, hire and fire, travel, communicate and advertise, form groups (businesses, unions, nonprofits), and peacefully protest or push for changes in the law.
2. **Public services and infrastructure (what government provides):** Government funds or runs things that businesses and people rely on but might not provide on their own, like roads, schools, libraries, water systems, energy, mail, and research. It also gives subsidies to support industries such as agriculture.
3. **Safety nets and required payments (how government moves money around):** People mostly control their own money, but some spending is required. Taxes fund programs like welfare and Social Security, and some insurance, such as car insurance, is mandatory.
4. **Rules and regulations (how government protects society):** Government sets rules to keep the economy fair and safe, including environmental protections, minimum wage and labor laws, product safety rules, antitrust laws that prevent monopolies, patents and copyrights, and tariffs on imports.

The big idea: In a mixed economy, the market drives most activity, and government fills gaps, protects people, and keeps competition fair.

Disadvantages of Social Democratic Policy In a Mixed Economy

While most modern forms of government are consistent with some form of mixed economy, given the broad range of economic systems that can be described by the term, the mixed economy is most commonly associated with social democratic parties or nations run by social democratic governments. In contemporary terms, "social democracy" usually refers to a social corporatist arrangement and a welfare state in developed capitalist economies.

Critics of contemporary social democracy argue that when social democracy abandoned Marxism, it also abandoned socialism and has become, in effect, a liberal capitalist movement. They argue that this has made social democrats similar to center-left, but pro-capitalist groups, such as the U.S. Democratic Party.

The Democratic Party in the United States is seen by some critics of contemporary social democracy (and mixed economies) as a watered-down, pro-capitalist movement.

Marxian socialists argue that because social democratic programs retain the capitalist mode of production, they also retain the fundamental issues of capitalism, including cyclical fluctuations, exploitation, and alienation. Social democratic programs intended to ameliorate capitalism, such as unemployment benefits or taxation on profits and the wealthy, create contradictions of their own through limiting the efficiency of the capitalist system by reducing incentives for capitalists to invest in production.

Others contrast social democracy with democratic socialism by defining the former as an attempt to strengthen the welfare state and the latter as an alternative socialist economic system to capitalism. The democratic socialist critique of social democracy states that capitalism could never be sufficiently "humanized" and any attempt to suppress the economic contradictions of capitalism would only cause them to emerge elsewhere. For example, attempts to reduce unemployment too much would result in inflation, and too much job security would erode labor discipline. In contrast to social democracy, democratic socialists advocate a post-capitalist economic system based either on market socialism combined with workers' self-management, or on some form of participatory economic planning.

Social democracy can also be contrasted with market socialism. While a common goal of both systems is to achieve greater social and economic equality, market socialism does so by changes in enterprise ownership and management, whereas social democracy attempts to do so by government-imposed taxes and subsidies on privately owned enterprises. Market socialists criticize social democracy for maintaining a property-owning capitalist class, which has an active interest in reversing social democratic policies and a disproportionate amount of power over society to influence governmental policy as a class.

Can there be too much regulation? Rules can protect workers, customers, and the environment, but rules that are unnecessarily complex, costly, or slow to administer can make it harder to start or expand a business. A small Northeast Wisconsin company, for example, may have fewer people available to handle permits and paperwork than a large corporation. If compliance takes too much time or money, the company may delay hiring, investment, or a new product. The goal in a mixed economy is not simply to have more rules or fewer rules; it is to design rules that achieve a clear public benefit without creating avoidable burdens.

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3.6: Free-Enterprise

A **free-enterprise system** is based on private ownership as the means of production.

Key Points

- Free-market systems operate in capitalist economies.
- There are multiple variants of capitalism depending on interpretation and practice.
- Economists emphasize the degree to which markets are free of government control (*laissez-faire*) in capitalism.
- Political economists focus on the presence of private property, as well as power, wage, and class relations.
- Mixed economies and state capitalism are systems that incorporate different amounts of planned and market-driven elements in the state's economic system.

Key Terms

- **Laissez-faire:** A policy of governmental non-interference in economic affairs.
- **Mixed economy:** A mixed economy is an economic system in which both the state and private sector direct the economy, reflecting characteristics of both market economies and planned economies. Most mixed economies can be described as market economies with strong regulatory oversight, in addition to having a variety of government-sponsored aspects.
- **State capitalism:** The term state capitalism has various meanings, but is usually described as commercial (profit-seeking) economic activity undertaken by the state with management of the productive forces in a capitalist manner, even if the state is nominally socialist. State capitalism is usually characterized by the dominance or existence of a significant number of state-owned business enterprises.

China is seen as the primary example of a successful state capitalist system. Political scientist Ian Bremmer describes China as the primary driver for the rise of state capitalism as a challenge to the free market economies of the developed world, particularly in the aftermath of the 2008 financial crisis. Bremmer states, "In this system, governments use various kinds of state-owned companies to manage the exploitation of resources that they consider the state's crown jewels and to create and maintain large numbers of jobs. They use select privately owned companies to dominate certain economic sectors. They use so-called sovereign wealth funds to invest their extra cash in ways that maximize the state's profits. In all three cases, the state is using markets to create wealth that can be directed as political officials see fit. And in all three cases, the ultimate motive is not economic (maximizing growth) but political (maximizing the state's power and the leadership's chances of survival). This is a form of capitalism but one in which the state acts as the dominant economic player and uses markets primarily for political gain."

Free-Enterprise Defined

The definition of free enterprise is a business governed by the laws of supply and demand, where the government has no involvement in its decisions or actions. This economic system is based solely on private ownership as the means of production.

It is a private system in which all means of production are privately owned and operated.

Did free markets become capitalism? Not quite. Free markets and capitalism developed together in many places, which is why people often use the words interchangeably. But they answer different questions: How are buying and selling decisions made? points us toward markets; Who owns businesses and invests in production? points us toward capitalism. A capitalist country can rely heavily on markets while still regulating businesses, funding public services, or setting trade policy. That is why "capitalist" does not necessarily mean "no government involvement."

Link to Capitalism

Free enterprise is an example of capitalism in which government policies generally target regulation and not the money.

Capitalism is generally considered to be an economic system that is based on private ownership of the means of production and the creation of goods or services for profit by privately-owned business enterprises.

Some have also used the term as a synonym for competitive markets, wage labor, capital accumulation, voluntary exchange, and personal finance. The designation is applied to a variety of historical cases, varying in time, geography, politics, and culture.

Variations of Capitalism

There are multiple variants of capitalism, including laissez-faire, mixed economy, and state capitalism. There is, however, a general agreement that capitalism became dominant in the Western world following the demise of feudalism.

Economists, political economists, and historians have taken different perspectives on the analysis of capitalism. Economists usually emphasize the degree to which government does not have control over markets (laissez-faire), as well as the importance of property rights.

Most political economists emphasize private property as well, in addition to power relations, wage labor, class, and the uniqueness of capitalism as a historical formation.

The extent to which different markets are free, as well as the rules defining private property, is a matter of politics and policy. Many states have what are termed mixed economies, referring to the varying degree of planned and market-driven elements in a state's economic system.

A number of political ideologies have emerged in support of various types of capitalism, the most prominent being economic liberalism.

Capitalism gradually spread throughout the Western world in the 19th and 20th centuries.

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3.7: Capitalism in the US

Democratic capitalism is a political, economic, and social system with a market-based economy that is largely based on a democratic political system.

Key Points

- The United States is often seen as having a democratic capitalist political-economic system.
- The three pillars of democratic capitalism include economic incentives through free markets, fiscal responsibility, and a liberal moral-cultural system that encourages pluralism.
- Some commentators argue that, although economic growth under capitalism has led to democratization in the past, it may not do so in the future; for example, authoritarian regimes have been able to manage economic growth without making concessions to greater political freedom.
- Proponents of capitalism have argued that indices of economic freedom correlate strongly with higher income, life expectancy, and standards of living.
- Democratic Peace Theory states that capitalist democracies rarely make war with each other, and have little internal conflict. However, critics argue that this may have nothing to do with the capitalist nature of the states, and more to do with the democratic nature instead.

Key Terms

- **Capitalism:** A socio-economic system based on the abstraction of resources into the form of privately-owned money, wealth, and goods, with economic decisions made largely through the operation of a market unregulated by the state
- **Tripartite:** In three parts.
- **Polity:** An organizational structure of the government of a state, church, etc.
- **Pluralism:** A social system based on mutual respect for each other's cultures among various groups that make up a society, wherein subordinate groups do not have to forsake their lifestyle and traditions, but, rather, can express their culture and participate in the larger society free of prejudice.

Singapore's de facto one-party system has been described as an example of an authoritarian capitalist system that other authoritarian governments may follow. However, polls have recently suggested that the ruling PAP party is suffering declines in popularity, suggesting that increasing material gains may not make up for a lack of political freedoms. The Singaporean government has introduced limited political concessions, suggesting that authoritarian capitalist systems may transition to democracy in time.

Democratic Capitalism and the US

The United States is often seen as having a democratic capitalist political-economic system. Democratic capitalism, also known as capitalist democracy, is a political, economic, and social system and ideology based on a tripartite arrangement of a market-based economy that is based predominantly on a democratic polity. The three pillars include economic incentives through free markets, fiscal responsibility, and a liberal moral-cultural system, which encourages pluralism.

In the United States, both the Democratic and Republican Parties subscribe to this (little "d" and "r") democratic-republican philosophy. Most liberals and conservatives generally support some form of democratic capitalism in their economic practices. The ideology of "democratic capitalism" has been in existence since medieval times. It is based firmly on the principles of liberalism, which include liberty and equality. Some of its earliest promoters include many of the American founding fathers and subsequent Jeffersonians.

This economic system supports a capitalist, free-market economy subject to control by a democratic political system that is supported by the majority. It stands in contrast to authoritarian capitalism by limiting the influence of special interest groups, including corporate lobbyists, on politics. Some argue that the United States has become more authoritarian in recent decades.

The Relationship between Democracy and Capitalism

The relationship between democracy and capitalism is a contentious area in theory and among popular political movements. The extension of universal adult male suffrage in 19th-century Britain occurred alongside the development of industrial capitalism. Since democracy became widespread at the same time as capitalism, many theorists have been led to posit a causal relationship between them. In the 20th century, however, according to some authors, capitalism also accompanied a variety of political formations quite distinct from liberal democracies, including fascist regimes, absolute monarchies, and single-party states.

While some argue that capitalist development leads to the emergence of democracy, others dispute this claim. Some commentators argue that, although economic growth under capitalism has led to democratization in the past, it may not do so in the future. For example, authoritarian regimes have been able to manage economic growth without making concessions to greater political freedom. States that have highly capitalistic economic systems have thrived under authoritarian or oppressive political systems. Examples include:

- Singapore, which maintains a highly open market economy and attracts lots of foreign investment, does not protect civil liberties such as freedom of speech and expression.
- The private (capitalist) sector in the People's Republic of China has grown exponentially and thrived since its inception, despite having an authoritarian government.
- Augusto Pinochet's rule in Chile led to economic growth by using authoritarian means to create a safe environment for investment and capitalism.

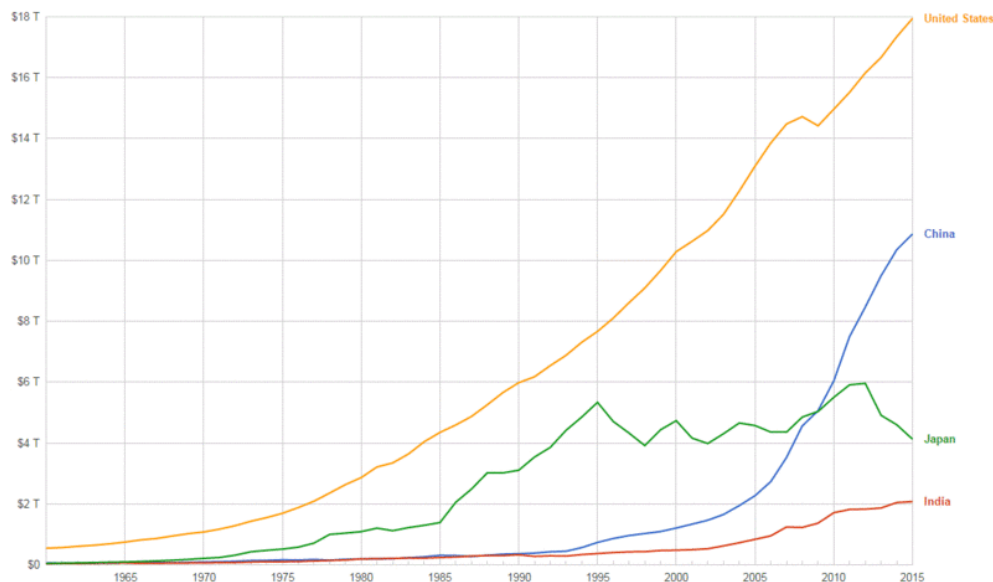


Figure 3.7.1: Peoples' Republic of China's Nominal Gross Domestic Product (GDP) Between 1952 and 2005. Scatter graph of the People's Republic of China's GDP between years 1952 to 2005, based on publicly available nominal GDP data published by the People's Republic of China and compiled by Hitotsubashi University (Japan) and confirmed by economic indicator statistics from the World Bank. (Image of Scatter Plot PRC GDP. **Authored by:** Intsokzen.CC-BY-SA, [Wikipedia](#))

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3.8: Socialism and Planned Economies

Socialism is characterized by social ownership of the means of production.

Key Points

- A planned economy is a type of economy consisting of a mixture of public ownership of the means of production and the coordination of production and distribution through state planning.
- Socialism has many variations, depending on the level of planning versus market power, the organization of management, and the role of the state.
- In a socialist system, production is geared towards satisfying economic demands and human needs. Distribution of this output is based on individual contribution.
- Socialists distinguish between a planned economy, such as that of the former Soviet Union, and socialist economies. They often compare the former to a top-down bureaucratic capitalist firm.

Key Terms

- **Socialism:** Any of various economic and political philosophies that support social equality, collective decision-making, distribution of income based on contribution and public ownership of productive capital and natural resources, as advocated by socialists.
- **Planned economy:** An economic system in which government directly manages supply and demand for goods and services by controlling production, prices, and distribution in accordance with a long-term design and schedule of objectives.

There are few clear examples of purely socialist economies; nonetheless, many of the industrialized countries of Western Europe experimented with one form of social democratic mixed economies or another during the twentieth century, including Britain, France, Sweden, and Norway. They can be regarded as social democratic experiments, because they universally retained a wage-based economy and private ownership and control of the decisive means of production. Variations range from social democratic welfare states, such as in Sweden, to mixed economies where a major percentage of GDP comes from the state sector, such as in Norway, which ranks among the highest countries in quality of life and equality of opportunity for its citizens.

Planned Economy

A planned economy is a type of economy consisting of a mixture of public ownership of the means of production and the coordination of production and distribution through state planning.

Planned Socialist Economy

Economic planning in socialism takes a different form than economic planning in capitalist mixed economies. In socialism, *planning* refers to the production of use-value directly (planning of production), while in capitalist mixed economies, *planning* refers to the design of capital accumulation in order to stabilize or increase the efficiency of its process. While many socialists advocate for economic planning as an eventual substitute for the market for factors of production, others define economic planning as being based on worker self-management, with production being carried out to directly satisfy human needs. Enrico Barone provided a comprehensive theoretical framework for a planned socialist economy. In his model, assuming perfect computation techniques, simultaneous equations relating inputs and outputs to ratios of equivalence would provide appropriate valuations in order to balance supply and demand.

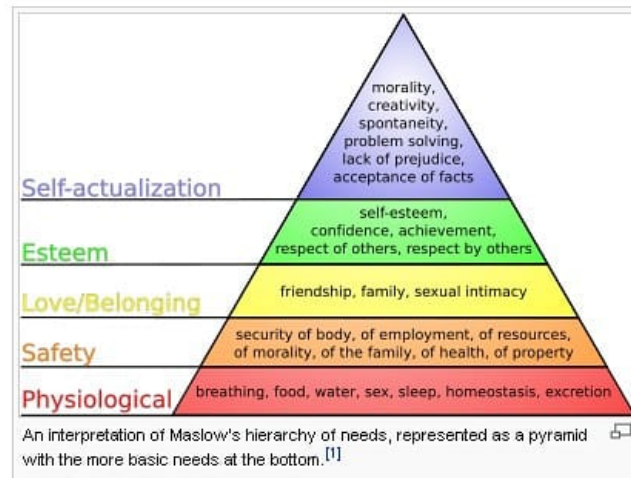


Figure 3.8.1: Hierarchy of Needs. Worker self-management and production to satisfy human needs are key. (Flickr, CC BY: Attribution)

The command economy is distinguished from economic planning. Most notably, a command economy is associated with bureaucratic collectivism, state capitalism, or state socialism.

Socialism

Socialism is an economic system characterized by social ownership, control of the means of production, and cooperative management of the economy. A socialist economic system would consist of an organization of production to directly satisfy economic demands and human needs, so that goods and services would be produced directly for use instead of for private profit driven by the accumulation of capital. Accounting would be based on physical quantities, a common physical magnitude, or a direct measure of labor-time. Distribution of output would be based on the principle of individual contribution.

There are many variations of socialism, and as such there is no single definition encapsulating all of socialism. They differ in:

- The type of social ownership they advocate;
- The degree to which they rely on markets versus planning;
- How management is to be organized within economic enterprises; and
- The role of the state in constructing socialism.

How Economies Can Benefit From Socialism

Socialism has a number of theoretical benefits, based on the idea of social equality and justice.

Key Points

- Advantages of socialism relating to social equality include a focus on reducing wealth disparities, unemployment, and inflation (through price controls).
- Advantages of socialism related to economic planning include an ability to make good use of land, labor and resources, as well as avoiding excess or insufficient production.
- Additional benefits of Socialism: Nationalization of key industries, redistribution of wealth, social security schemes, minimum wages, employment protection, and trade union recognition rights.

Key Terms

- **Public Benefit:** A payment made in accordance with an insurance policy or a public assistance scheme.
- **Redistribution:** The act of changing the distribution of resources

Socialist economics entails the following:

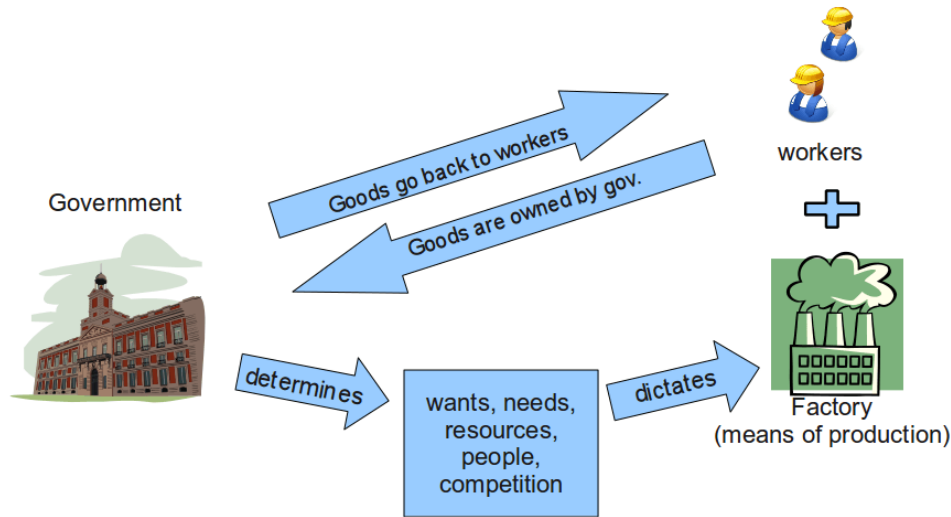


Figure 3.8.2: Socialism. A graphical illustration of socialism. (Image of Socialism in Pictures. By Rcragun. [Wikimedia](#), CC-BY)

1. Nationalization of key industries, such as mining, oil, steel, energy, and transportation. A common model includes a sector being taken over by the state, followed by one or more publicly owned corporations arranging its day-to-day running. Advantages of nationalization include: the ability of the state to direct investment in key industries, distribute state profits from nationalized industries for the overall national good, direct producers to social rather than market goals, and better control the industries both by and for the workers. Additionally, nationalization enables the benefits and burdens of publicly funded research and development to be extended to the wider populace.
2. Redistribution of wealth, through tax and spending policies that aim to reduce economic inequalities. Social democracies typically employ various forms of progressive taxation regarding wage and business income, wealth, inheritance, capital gains and property. On the spending side, a set of social policies typically provides free access to public services such as education, health care and child care. Additionally, subsidized access to housing, food, pharmaceutical goods, water supply, waste management and electricity is common.
3. Social security schemes in which workers contribute to a mandatory public insurance program. The insurance typically includes monetary provisions for retirement pensions and survivor benefits, permanent and temporary disabilities, unemployment, and parental leave. Unlike private insurance, governmental schemes are based on public statutes rather than contracts; therefore, contributions and benefits may change over time and are based on solidarity among participants. Its funding is done on an ongoing basis, without direct relationship to future liabilities.
4. Minimum wages, employment protection and trade union recognition rights for the benefit of workers. These policies aim to guarantee living wages and help produce full employment. While a number of different models of trade union protection have evolved throughout the world over time, they all guarantee the right of workers to form unions, negotiate benefits and participate in strikes. Germany, for instance, appointed union representatives at high levels in all corporations, and as a result, endured much less industrial strife than the UK, whose laws encouraged strikes rather than negotiation.

The benefits of socialism also include the following:

- In theory, based on public benefits, socialism has the greatest goal of common wealth;
- Since the government controls almost all of society's functions, it can make better use of resources, labor, and land;
- Socialism reduces disparity in wealth, not only in different areas, but also in all societal ranks and classes. Those who suffer from illnesses or are too old to work are still provided for and valued by the government, assuming that the government is more compassionate than the individual's family;

- Excess or insufficient production can be avoided;
- Prices can be controlled to a proper extent;
- Socialism can tackle unemployment to a great extent.

Austrian school economists, such as Friedrich Hayek and Ludwig Von Mises, have argued that the elimination of private ownership of the means of production would inevitably create worse economic conditions for the general populace than those that would be found in market economies. Without the price signals of the market, they state that it is impossible to calculate rationally how to allocate resources.

The Disadvantages of Socialism

Despite the theoretical benefits of socialist economic systems, there are also disadvantages that may arise in application.

Key Points

- Disadvantages of socialism include slow economic growth, less entrepreneurial opportunity and competition, and a potential lack of motivation by individuals due to lower rewards.
- Critics of socialism claim that it creates distorted or absent price signals, results in reduced incentives, causes reduced prosperity, has low feasibility, and has negative social and political effects.
- Economic liberals and pro-capitalist libertarians see private ownership of the means of production and the market exchange as natural entities or moral rights, which are central to their conceptions of freedom and liberty.

Key Terms

- **Economy:** The system of production, distribution, and consumption. The overall measure of a currency system.
- **Socialism:** Any of various economic and political philosophies that support social equality, collective decision-making, distribution of income based on contribution and public ownership of productive capital and natural resources, as advocated by socialists.

Economic liberals and pro-capitalist libertarians see private ownership of the means of production and the market exchange as natural entities or moral rights which are central to their conceptions of freedom and liberty. They, therefore, perceive public ownership of the means of production, cooperatives, and economic planning as infringements upon liberty. Some of the primary criticisms of socialism are claims that it creates distorted or absent price signals, results in reduced incentives, causes reduced prosperity, has low feasibility, and has negative social and political effects.

Critics from the neoclassical school of economics criticize state ownership and centralization of capital on the grounds that there is a lack of incentive in state institutions to act on information as efficiently as capitalist firms because they lack hard budget constraints, resulting in reduced overall economic welfare for society. Economists of the Austrian school argue that socialist systems based on economic planning are unfeasible because they lack the information to perform economic calculations in the first place, due to a lack of price signals and a free-price system, which they argue are required for rational economic calculation.

Thus, Socialism can have several disadvantages:



Figure 3.8.3: Red Flag Waving (By Wereon, [Wikipedia](#), CC0 - Public Domain)

Some of the primary criticisms of socialism are claims that it creates distorted or absent price signals, results in reduced incentives, causes reduced prosperity, has low feasibility, and has negative social and political effects.

- The national economy develops relatively slowly;
- There is an inability to obtain the utmost profit from the use of resources, labor, and land;
- Places that have a geographical advantage lose chances to develop better, and people who have intelligence and wealth lose chances to make their businesses become bigger and more powerful;
- People lose initiative to work and enthusiasm to study as doing more isn't rewarded.

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3.9: The Communist Economic System

The **communist economic system** is one where class distinctions are eliminated, and the community as a whole owns the means of production.

Key Points

- Karl Marx and Friedrich Engels wrote the Communist Manifesto in 1848, in response to poor working conditions for workers across Europe. The goal was to establish a system where class distinctions were eliminated, and the means of production were owned by the masses.
- Recent attempts at creating political-economic systems have led to state-driven authoritarian economies with unaccountable political elites, further driving power away from the hands of the masses.
- A Command Economy is characterized by collective ownership of capital: property is owned by the State, production levels are determined by the State via advanced planning mechanisms rather than supply and demand, and prices are regulated and controlled.

Key Terms

- **Proletariat:** The proletariat (from Latin proletarius, a citizen of the lowest class) is a term used to identify a lower social class, usually the working class; a member of such a class is proletarian. Originally, it was identified as those people who had no wealth other than their children.
- **Bourgeoisie:** In sociology and political science, bourgeoisie (Fr.: [buʁ.ʒwa'zi] | Eng.: /bʊrʒwɑːzi/) and the adjective bourgeois are terms that describe a historical range of socio-economic classes. Since the late 18th century in the Western world, the bourgeoisie describes a social class that is characterized by its ownership of capital and its related culture. In contemporary academic theories, the term bourgeoisie usually refers to the ruling class in capitalist societies. In Marxist theory, the abiding characteristics of this class are its ownership of the means of production.
- **Command economy:** Most of the economy is planned by a central government authority and organized along a top-down administration where decisions regarding production output requirements and investments are decided by planners from the top, or near the top, of the chain of command.

The former USSR (or Soviet Union) is the typical example of a communist, command economy. It was formed in 1922 by the Bolshevik party of the former Russian Empire. In 1928, Joseph Stalin achieved party leadership and introduced the first Five-Year Plan, ending the limited level of capitalism that still existed. In 1991, under Mikhail Gorbachev, the Soviet Union was dissolved.

A modern-day example is China, particularly in the 1970s, 80s, and 90s. Today, China is seen to be more of an authoritarian capitalist rather than communistic command economy.

The Communist Economic System

A communist economic system is an economic system where, in theory, economic decisions are made by the community as a whole. In reality, however, attempts to establish communism have ended up creating state-driven authoritarian economies and regimes which benefit a single-party political elite who are not accountable to the people or community.

Communist theory was developed by a German philosopher in the 1800s named Karl Marx. He thought that the only way to have a harmonious society was to put workers in control. This idea was established during the Industrial Revolution when many workers were treated unfairly in France, Germany, and England.

Marx did not want there to be a difference in economic classes, and he wanted class struggle to be eliminated. His main goal was to abolish capitalism (an economic system ruled by private ownership). Marx abhorred capitalism because the proletariat was exploited and unfairly represented in politics, and because capitalism allows the bourgeoisie to control a disproportionate amount of power. Therefore, he thought that if everything was shared and owned by everyone, a worker's paradise or Utopia could be achieved.

Together with Friedrich Engels, a German economist, Marx wrote a pamphlet called the Communist Manifesto. This was published in 1848, and it expressed Marx's ideas on communism. However, it was later realized that communism did not work. Most interpretations or attempts to establish communism have ended up creating state-driven authoritarian economies and regimes which benefit a single-party political elite who are not accountable to the people at all.

Command Planned Economy

An economy characterized by Command Planning is notable for several distinguishing features:

1. Collective or state ownership of capital: capital resources such as money, property and other physical assets are owned by the State. There is no (or very little) private ownership.
2. Inputs and outputs are determined by the State: the State has an elaborate planning mechanism in place that determines the level and proportions of inputs to be devoted to producing goods and services. Local planning authorities are handed 1-year, 5-year, 10-year or, in the case of China, up to 25-year plans. The local authorities then implement these plans by meeting with State-Owned Enterprises, whereby further plans are developed specific to the business. Inputs are allocated according to the plans and output targets are set.
3. Labor is allocated according to state plans: in a command planning economy, there is no choice of profession; when a child is in school (from a very early age), a streaming system allocates people into designated industries.
4. Private ownership is not possible: under a command planning system, an individual cannot own shares, real estate, or any other form of physical or non-physical asset. People are allocated residences by the State.
5. Prices and paying for goods and services: prices are regulated entirely by the State with little regard for the actual costs of production. Often a currency does not exist in a command planning economy, and when it does, its main purpose is for accounting. Instead of paying for goods and services when you need to buy them, you are allocated goods and services. This is often also called rationing.

In Western democratic and capitalist societies, the price mechanism is a fundamental operator in allocating resources. The laws of demand and supply interact; the price of goods (and services) sends signals to producers and consumers alike to determine what goods and quantities are produced, and helps determine what the future demands and quantities will be.

The law of demand states that the higher the price of a good or service, the less the amount of that good or service will be consumed. In other words, the quantity of a good or service demanded rises when the price falls and falls when the price increases.

In theory, Communism seems to have some very desirable characteristics. In practice, however, it has many drawbacks, and historically it seems that only the most corrupt members of Communist governments have gained advancement within systems. When a system depends on an entire community but is controlled by a few corrupt bureaucrats, it cannot be successful.

However, this is not to say that state-run enterprises in certain areas are a bad idea. Publicly-owned utilities such as water, electricity, and postal services have proven to be beneficial in countries, even when no communist system exists.

The Benefits of Communism

Communism ideology supports widespread universal social welfare, including improvements in public health and education.

Key Points

- The theoretical advantages of communism are built around equality and strong social communities.
- Communist ideology advocates universal education with a focus on developing the proletariat with knowledge, class consciousness, and historical understanding.
- Communism supports the emancipation of women and the ending of their exploitation.
- Communist ideology emphasizes the development of a “New Man”—a class-conscious, knowledgeable, heroic, proletarian person devoted to work and social cohesion, as opposed to the antithetic “bourgeois individualist” associated with cultural backwardness and social atomization.

Key Terms

- **Communism:** A political philosophy or ideology advocating holding the production of resources collectively
- **Antithetic:** Diametrically opposed.
- **Bourgeois:** Of or relating to capitalist exploitation of the proletariat.
- **Proletariat:** The working class or lower class.

Theoretically, there are many benefits that can be achieved through a communist society. Communist ideology supports widespread universal social welfare. Improvements in public health and education, provision of child care, provision of state-directed social services, and provision of social benefits will, theoretically, help to raise labor productivity and advance a society in its development. Communist ideology advocates universal education with a focus on developing the proletariat with knowledge, class consciousness, and historical understanding. Communism supports the emancipation of women and the ending of their exploitation. Both cultural and educational policy in communist states have emphasized the development of a “New Man”—a class-conscious, knowledgeable, heroic, proletarian person devoted to work and social cohesion, as opposed to the antithetical “bourgeois individualist” associated with cultural backwardness and social atomization.

Other theoretically beneficial ideas characteristic of communist societies include:

1. *People are equal.* In a communist regime, people are treated equally in the eyes of the government regardless of education, financial standing, et cetera. Economic boundaries don't separate or categorize people, which can help mitigate crime and violence.
2. *Every citizen can keep a job.* In a communist system, people are entitled to jobs. Because the government owns all means of production, the government can provide jobs for at least a majority of the people. Everyone in a communist country is given enough work opportunities to live and survive. Every citizen, however, must do his or her part for the economy to receive pay and other work benefits.
3. *There is an internally stable economic system.* In communism, the government dictates economic structure; therefore, economic instability is out of the question. Every citizen is required to work in order to receive benefits, and those who don't have corresponding sanctions. This creates an incentive to participate and to encourage economic growth.
4. *Strong social communities are established.* In communism, there are certain laws and goals which determine resource and responsibility allocation. If the citizens abide by these laws, this leads to a harmonious spirit of sharing one goal. Consequently, this builds stronger social communities and an even stronger economy.
5. *Competition doesn't exist.* In communist societies, everyone can work harmoniously without stepping on each other's toes. Work, responsibility, and rewards are shared equally among the citizens. If people have no sense of envy, jealousy, or ambitions that counter the goals of the state, then harmonious economic development can be maintained.
6. *Efficient distribution of resources.* In a communist society, the sense of cooperation allows for efficiency in resource distribution. This is very important, especially in times of need and in emergency situations.

Disadvantages of Communism

Businesses under a Communist system have very strict limitations as to what they can and cannot do, which can hamper productivity and innovation.

Key Points

- In a Communist system, the central authority dictates the means and quantity of production, and places strict rules on businesses.
- Since there is no competition amongst firms, each is given the same amount of money and each worker is paid the same, with the same expectations of each.
- All businesses are ultimately owned by the government.
- Populations tend to be treated homogeneously, meaning that common goals or sets of rules will not apply to different segments of the population and community.
- Without a price mechanism, supply and demand are difficult to balance perfectly over time.

Key Term

Price mechanism: An economic term that refers to the buyers and sellers who negotiate prices of goods or services depending on demand and supply. A price mechanism or market-based mechanism refers to a wide variety of ways to match up buyers and sellers through price rationing.

Ho Chi Minh raised a guerrilla army in Vietnam, promising them a Utopian communist future of rule by the people and a communal country. However, what transpired was a nation ruled by corrupt Party officials, with no rights or civil liberty. The theory peddled by Ho Chi Minh was far removed from the practice of Communism once he was successfully elected. There are many other examples of how Communism has failed the people of a country. Whether this is down simply to corrupt leaders, or to a deeper flaw in the nature of Communism, is a subject debated by many scholars.

The economic and political system of Communism effectively dictates what can and cannot be done in the realm of business. There are defined limitations for the amount a business can produce and how much money it can earn.

In addition to directly controlling the means of production, Communism places strict rules as to how businesses operate in such a way that a classless society is born. No matter what field a business specializes in, the same amount of funds will be allocated to each, and each worker will receive the same amount of money. This can cause emotional unrest between workers who wish to be specially recognized for their work. It can serve to create uncomfortable conditions for workers in a society without rank or varying specialty. Finally, it can be stifling to entrepreneurial spirit, which is key to a country's economic growth and development. The U.S., a capitalistic nation, has greatly benefited from that small business and entrepreneurial atmosphere, a backdrop for the American dream.

More specifically, in Communism:

- The government owns all the businesses and properties (the means of production).
- There is no freedom of speech.
- Large or geographically broad populations tend to be diverse, making it difficult to maintain a common goal or set of rules for shared effort and resources.
- Central planning is difficult to achieve.
- Consumers' needs are not taken into consideration.
- Productivity and efficiency are difficult to achieve without a profit motive for the workers.
- It is difficult to achieve internal balances between supply and demand without a price mechanism.



Figure 3.9.1: The Kremlin. Only the government has a say in production planning under a Communist system. (Image of the Kremlin, by Valerii Tkachenko, [Wikimedia](#), CC-BY)

Sources & References

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3.10: Global Business in Action

Global Business in Action: Food-Processing Equipment Company

When "The People" Shape Trade Policy

A government promises to put ordinary people ahead of powerful elites. For a global business, what happens next depends on whom the government sees as “the people,” whom it considers “the elite,” and which policies it chooses. That promise is often called *populism*, but populism is an approach to politics—not a complete political or economic system. It can be paired with progressive or conservative goals.

Consider a fictional Wisconsin company that makes food-processing equipment. It buys components from several countries and sells finished machines abroad. After an election in one of its export markets, the new government says that previous leaders favored wealthy insiders over local workers. The company now has to decide whether to expand there, change suppliers, or wait for clearer rules. The answer cannot come from the word *populist* alone: the company needs to examine the government’s actual trade, labor, tax, and investment policies.

Two versions, different priorities

Both progressive and conservative populists commonly argue that an establishment has ignored ordinary people. They tend to differ in how they describe the problem and what they want government to do about it. These are broad tendencies, not rules that describe every party or leader.

Table 3.10.1: Comparison of Views

Problem	Progressive or left-wing populism	Conservative or right-wing populism
Common concern	Economic inequality and the influence of wealthy individuals or large corporations	National identity, sovereignty, immigration, or decisions made by distant political institutions
Possible policy priorities	Stronger worker protections, redistribution, or greater state involvement in parts of the economy	Tighter immigration rules, preference for domestic producers, or less influence from international institutions
Potential appeal	People who feel excluded from economic gains may gain a stronger voice	People who feel their communities or national priorities have been overlooked may gain a stronger voice
Potential business challenge	Changes to taxes, labor costs, or regulation may alter an investment’s expected returns	Changes to trade rules, access to foreign workers, or relationships with trading partners may disrupt operations

These distinctions reflect common patterns identified by researchers; neither side has a single fixed policy package.

Advantages and Disadvantages

Populist movements can draw attention to genuine grievances that established parties have failed to address. A government that responds to workers’ concerns or neglected communities may improve political participation and prompt businesses to reconsider whose needs they serve. Whether a particular policy delivers those benefits, however, depends on its design and results—not on its populist label.

There are risks on either side of the political spectrum. If leaders claim that only they represent the “real people,” they may dismiss opponents as illegitimate. If they weaken courts, oversight bodies, or independent media, businesses and citizens alike may find it harder to rely on stable, fairly enforced rules. Progressive populism can face this risk, as can conservative populism; exclusionary definitions of who belongs to “the people” pose an additional concern for political equality.

For the Wisconsin company, the practical lesson is to look beyond campaign language. It should ask which proposals could become law, how those rules would affect its workers and supply chain, and whether institutions will apply them predictably. Populism helps explain a government's political appeal; specific policies and institutions reveal what operating in that market may be like.

Questions for Discussion

1. Why is populism better described as an approach to politics than as a political or economic system?
2. How might a progressive populist government and a conservative populist government each change the Wisconsin company's costs or sales opportunities?
3. Identify one potential advantage and one potential disadvantage of each approach for workers, consumers, and businesses. Whose interests might differ?
4. Could a policy favor local workers while making it harder for a local company to compete globally? Explain using the company in the article.
5. What evidence should the company gather before deciding whether to expand in the export market?
6. At what point does a promise to represent "the people" become a threat to democratic checks and balances? Does your answer change depending on whether the movement is progressive or conservative?

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4: CULTURE

- 4.1: What is Culture?
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4.1: What is Culture?

Culture is a system of values and norms shared among a group of people that directs and justifies how members operate, live, and behave. Culture has many layers and ways in which it manifests itself within a group, business, geographical location, etc. The core basis is still the same if we share a system of norms and values within a group; no matter how large or small, we are part of a culture. In a sense, business could be considered a culture, the shared value being to generate profits through investment, improved efficiencies, and capitalizing on opportunity cost. The shared norm and value is centered on finding the specific opportunity cost for your business and making the most out of that opportunity. Some companies may find the most significant opportunity in finding ways to create jobs, thus elevating the financial status of the society in which they operate. Others may find it through improved efficiencies, using innovation to get more done in a shorter time with less waste. In the non-profit world, the culture is to maximize the positive impact of their initiative.

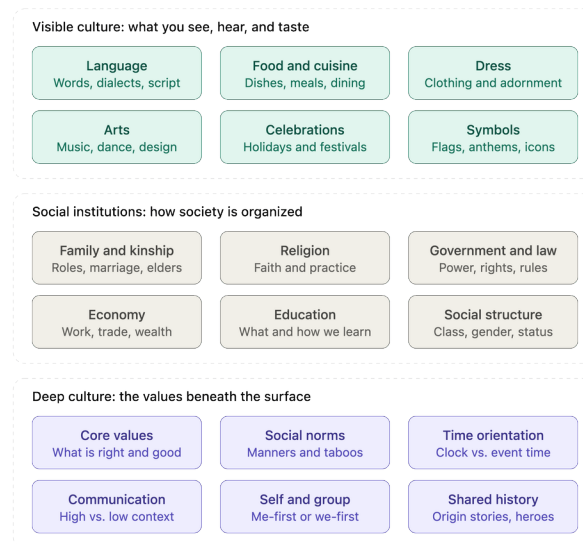


Figure 4.1.1: Elements of Culture—Visible Expressions, Social Institutions, and Deep Values

Elements of Culture

Culture is the shared system of values, beliefs, norms, and practices that influences how people understand the world and interact with one another. Although culture is often recognized through visible features such as language, food, clothing, music, celebrations, and national symbols, these outward expressions represent only part of a culture.

The graphic organizes culture into three connected layers. **Visible culture** includes the aspects people can easily observe, such as cuisine, dress, arts, celebrations, language, and symbols. **Social institutions** show how a society is organized through family relationships, religion, government, economic activity, education, and social structure. **Deep culture** includes the underlying values and assumptions that guide behavior, including beliefs about what is right or good, acceptable manners and taboos, communication styles, attitudes toward time, individual versus group responsibility, and shared historical experiences.

Together, these elements shape everyday expectations and decision-making. For example, a culture's view of time may affect whether punctuality is treated as essential, while its communication norms may influence whether people speak directly or rely more on context and nonverbal cues. Recognizing both visible and deep cultural differences is important for building respectful relationships and working effectively in global business settings.

Culture and Religion

Religion is tied to culture, followed by having different faiths and beliefs. This connection means that the impact of religious beliefs has a definite effect on international business and culture. After all, religious beliefs are a guide for which people gauge

the morality of their actions in all aspects of their lives. Moreover, while it's clear that ethics are not religion, values based on religious teachings have influenced our understanding of ethical behavior.

Spotlight on Principles a Society Believes to be Good, Right, and Desirable

In the United States of America, culture holds individual respect and ethical treatment of others without regard to physical characteristics. So much so that we have laws in place to protect minorities of protected classes. Title VII of the Civil Rights Act defines these protected classes as Pregnancy, Age, Ethnicity, National Origin, Sex, Religion, and Race. We also value personal freedom and the belief that all Americans have equal opportunity to achieve success. Different countries have different customs related to their culture; for example, in European countries, it is appropriate to greet others with a kiss on each cheek. Conversely, in the United States of America, this would not be considered appropriate. While it is not a written rule or law, it is most certainly a social rule for each culture.

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4.2: Social and Cultural Environment

Most people hear about culture and business and immediately think about protocol—a list of dos and don'ts by country. For example, don't show the sole of your foot in Saudi Arabia; know how to bow in Japan. While these practices are certainly useful to know, they are just the tip of the iceberg. We often underestimate how critical local culture, values, and customs can be in the business environment. We assume, usually incorrectly, that business is the same everywhere. Culture does matter, and more and more people are realizing its impact on their business interactions.

Culture, in the broadest sense, refers to how and why we think and function. It encompasses all sorts of things—how we eat, play, dress, work, think, interact, and communicate. Everything we do, in essence, has been shaped by the cultures in which we are raised. Similarly, a person in another country is also shaped by his or her cultural influences. These cultural influences impact how we think and communicate.

Culture, a society's "programming of the mind," has both a pervasive and changing influence on each national market environment. Global marketers must recognize the influence of culture and be prepared to either respond to it or change it. Human behavior is a function of a person's own unique personality and that person's interaction with the collective forces of the particular society and culture in which he or she has lived. In particular, attitudes, values, and beliefs can vary significantly from country to country.

Also, differences pertaining to religion, aesthetics, dietary customs, and language and communication can affect local reaction to brands or products as well as the ability of company personnel to function effectively in different cultures. A number of concepts and theoretical frameworks provide insights into these and other cultural issues.

Cultures can be classified as high- or low-context; communication and negotiation styles can differ from country to country. **Hofstede's social value typology** sheds light on national cultures in terms of power distance, individualism vs. collectivism, masculinity vs. femininity, uncertainty avoidance, and long-versus short-term orientation. By understanding the self-reference criterion, global marketers can overcome the unconscious tendency for perceptual blockage and distortion.

Sources & References

The above note was adapted from the course note from the 'Global Marketing' course published online by Centre for Teaching and Learning (CTL) of Universiti Teknologi Malaysia (UTM) ('Social and Cultural Environments' is Copyright (c) by Dr. Inda Sukati and made available under a Attribution-Noncommercial-Share Alike 3.0 license.), and under a Creative Commons Attribution-NonCommercial-ShareAlike 3.0 License without attribution as requested by the work's original creator or licensor.

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4.3: Hofstede's Framework

Hofstede's Framework

Hofstede's cultural dimensions are a framework intended to aid in cross-cultural communication. Geert Hofstede developed the framework to describe the effects of culture on a society's values and how these values impact the behaviors of its members.

Key Terms

Power Distance: Power Distance is the level at which less powerful members of a culture accept and expect power to be distributed unequally.

Individualism vs. Collectivism: Individualism defined is that people are expected to care for themselves and their families with little interaction or help from society. Collectivism cultures focus more on society being close-knit, expecting that relatives or a specific group will look after them in exchange for loyalty.

Masculinity vs. Femininity: A masculine-dominated culture focuses on societal achievement, heroism, assertiveness, and material rewards for success. Whereas femininity is more rooted in cooperation, modesty, caring for others, and improving quality of life.

Uncertainty Avoidance: The degree of comfort a society has with uncertainty and ambiguity.

Long-Term vs. Short-Term Orientation: A low score in long-term orientation comes from a culture with strong ties to the past and maintenance of long-standing traditions and cultural norms. A high score would be given to a culture that is more pragmatic, accepting modern education and thrift.

Indulgence vs. Restraint: Indulgence is a society that allows free gratification of basic and natural human drives toward enjoying life and having fun. Restraint maintains strict social norms based on suppressing gratification.

Description

Geert Hofstede's model of national culture is a framework for comparing broad cultural tendencies across countries. It describes six dimensions: **power distance**, or acceptance of unequal authority; **individualism**, or the emphasis on personal independence rather than group ties; **masculinity**, the model's term for an emphasis on competition and achievement rather than cooperation and quality of life; **uncertainty avoidance**, or discomfort with ambiguity; **long-term orientation**, or the emphasis on adapting and preparing for the future; and **indulgence**, or the freedom people feel to enjoy life rather than restrain their desires. The dimensions are expressed as relative scores, roughly from 0 to 100. They describe national-level patterns, not the beliefs or behavior of every person in a country. (Geert Hofstede, n.d.)

Country Comparison

The table uses the commonly published six-dimension Hofstede scores. A higher number means more of the trait named in the first column; it does **not** mean a culture is better.

Table 4.3.1: Comparisons using Hofstede's Framework of cultures.

Dimension	United States	Japan	Mexico
Power distance	40	54	81
Individualism	91	46	30
Masculinity	62	95	69

Dimension	United States	Japan	Mexico
Uncertainty avoidance	46	92	82
Long-term orientation	26	88	24
Indulgence	68	42	97

The United States stands out for individualism: the model places more emphasis there on personal independence than in either Japan or Mexico. Japan stands out for achievement orientation, uncertainty avoidance, and long-term orientation. Mexico scores much higher than the United States on power distance and uncertainty avoidance, while both countries score low on long-term orientation. All three score above the midpoint on the dimension Hofstede called “masculinity,” though Japan scores highest. (Geert Hofstede, n.d.)

For example, the scores suggest that someone comparing workplace expectations might *explore* whether an American team expects more individual autonomy, a Japanese team prefers more preparation before an uncertain decision, or a Mexican team places more weight on formal authority. Those are questions to investigate—not rules for predicting how a particular colleague will act. Hofstede’s own site likens national patterns to rough cultural “climate maps” and notes substantial variation within countries.

Note on scores: Other online comparison tools may show different numbers, especially for individualism and long-term orientation, because they use different underlying data. The table above keeps one published score set consistent rather than mixing versions.

Sources & References

Geert Hofstede. (n.d.). *The 6D model of national culture*.

4.4: Culture and What Comprises Culture

There are 5.8 billion people globally who identify with a religious group; they represent 84% of the 2010 worldwide population. (Harper, 2012) This large percentage means the impact of religious beliefs have a definite impact on international business and culture. Religious beliefs are a guide for which people gauge the morality of their actions in all aspects of their lives. It is safe to say that differences in religious beliefs are impacting our economy and business dealings just as they have for millennia.

Ethics do not equal religion. Values based on religious teachings influence our understanding of ethical behavior. Western thought and philosophies over the past few centuries have impacted global business. Global business has been heavily impacted by the mode of thinking that began with the Reformation and post-Enlightenment values, which placed focus on equality and individual rights.

Political Philosophy

The term **political philosophy** doesn't have a specific definition, so we must examine each word individually. Political or politics is based on assumptions or principles rooted in what is perceived to be the commonly accepted governance over a city, state, or country. Philosophy is the study of a theory of specific knowledge or thought process.

In some places, democracy is the prevailing form of politics, where the votes of the people steer the direction of political policies. Other cultures fall under monarchies and/or dictatorships. A monarchy is a type of political philosophy where the governance of a people is represented by a family of power. Most modern monarchies do have a democratic political process in place, where the voice of the people is taken into consideration; some use voting to determine the will of the people. A dictatorship, on the other hand, is a political entity in which an individual or group of individuals thinks they know what is best for their society, then, in turn, create a philosophy based on their beliefs.

Economic Philosophy

Economics is defined as the science that deals with the production, distribution, and consumption of commodities. (Dictionary.com, n.d.) Philosophy is a study or particular way of thinking. Across cultures, economic philosophy differs significantly; in China, for example, they follow a Marxist philosophy.

BEIJING, Nov. 24 (Xinhua) — Chinese President Xi Jinping has called for new advances in Marxist economic philosophy by turning practices and experiences in China's economic development into economic theories. Xi Jinping stated the need to uphold and improve the basic socialist economic system. He stressed that people should consolidate and develop the public sector while encouraging, supporting the non-public sector to develop. "The mainstay status of the public ownership and the leading role of the state-owned economy must not waver," he said, adding that these could ensure that people from all ethnic groups share the fruit of development, and they are guarantees for solidifying CPC's ruling status and adherence to the socialist system. ([Huaxia](#))

India follows a different economic philosophy, developing into a more open-market economy. They do still hold on to the cast system where social mobility is limited based on birth.



Figure 4.4.1: India's caste system.

Communication (Verbal and Non-Verbal)

The way in which we communicate verbally and non-verbally also varies considerably by culture. Effective communication is essential for a successful business encounter.

In Arab culture, for example, it is an insult to show the bottom of your shoe to another. This behavior would be a form of non-verbal communication. Used to great effect by Muntadhar al-Zaidi when he threw his shoe at President George W. Bush during a speech. The video went viral due in part to its comedic effect in the United States, which points out the cultural difference between the two societies. Make no mistake, the shoe-throwing incident was intended as an insult.

Verbal communication and not understanding the culture in which you're communicating can have implications as well. As an example, the qualities appreciated by Spaniards are character and modesty. They do not emphasize professional experience or business success, as do other Western European countries. It is essential to be patient, listen, pay attention, and display some personal pride and honor to prove yourself and gain the respect of your associates. Another valued characteristic is the ability to be amusing and entertaining, as humor plays an important role, even in business encounters. Sarcasm might offend your Spanish counterparts or undermine their respect and trust, although it is difficult to cause real offense without being directly insulting. You should avoid making disrespectful remarks about Spanish traditions or practices and, under no circumstances, should you comment on national or regional stereotypes that Spaniards may find insulting. (businessculture.org)

Culture and Values, Norms, Folkways, and Mores

There are many categories of cultural values and norms.

Principles a Society Believes to be Good, Right, and Desirable

American culture holds individual respect and ethical treatment of others without regard to physical characteristics in high regard. So much so that we have laws in place to protect minorities of protected classes. Title VII of the Civil Rights Act defines these protected classes as Pregnancy, Age, Ethnicity, National Origin, Sex, Religion, and Race. We also value personal freedom and the belief that all Americans have equal opportunity to achieve success. These principles are a stark contrast to the cast system of India.

Social Rules and Guidelines that Prescribe Appropriate Behaviors

Appropriate behavior is another aspect of culture that we need to be aware of. In some European countries, it is appropriate to greet others with a kiss on each cheek. Conversely, in America, this would not be considered appropriate. While it is not a written

rule or law is most certainly a social rule for each culture. Another example would be in America, it is appropriate for men to hold the door open for women and allow them to pass through first. In Arab countries, it is considered rude for a man to allow or suggest a woman go first. The reason being it places the man in a position to ogle her from behind, which would offend her modesty. ([Parker](#))

Sub-Set of Norms: Routine Conventions of Everyday Life

Early American sociologist William Graham Sumner is credited with being the first to write about folkways. (See *Folkways: A Study of the Sociological Importance of Usages, Manners, Customs, Mores, and Morals* (1906).) Sumner created the framework for how sociologists understand this term today. Folkways are norms that stem from and organize casual interaction; They emerge out of repetition and routines. We engage in them to satisfy our daily needs. They are most often unconscious in operation, though quite useful to the ordered functioning of society. For example, the practice of waiting in line in many societies is an example of a folkway. ([Understanding Folkways](#))

Sub-Set of Norms: Seen as Central to the Functioning of Society

Mores are more strict than folkways. They determine what is considered the moral and ethical behavior in a society. Mores structure the difference between right and wrong. People feel strongly about mores. Violating mores typically results in disapproval or ostracism. As such, mores exert a more coercive force in shaping our values, beliefs, behavior, and interactions than do folkways.

Religious doctrines are an example of mores that govern social behavior. For example, many religions have prohibitions on cohabitating with a romantic partner before marriage. ([Understanding Folkways](#))

Culture and High vs. Low Context

In high context culture, it is more important to “paint the picture” than to get straight to the point.

High context cultures include:

- Value traditions.
- Foster long-lasting relationships.
- Rely on non-verbal signs such as tone of voice, facial expressions, body language, and so on.
- Tend to be non-confrontational and more indirect. Rejection is to be interpreted from non-explicit communication.
- Require little explanation.
- Are more collectivistic. The identity lies with the group.
- Value group harmony.
- Have stronger boundaries, i.e., one belongs to a certain group.
- Are slow to change.

Low context cultures include:

- Tend to make many shallower, short-term relationships.
- Require explicit communication since they lack additional context.
- Communication is more direct and confrontational.
- Are more individualistic. Identity lies with the individual.
- Value individual needs.
- Require all the information in the message.
- Can change quickly. ([Frost](#))

4.5: Culture in the Workplace

Ethnocentric

Ethnocentric: Someone who believes that his or her ethnic group or culture is superior to those of others.

Ethnocentric Approach: A company that fills all key management positions with parent-company nationals.

Pros of Ethnocentric Workplaces

- Fill skills gaps in the host country.
- Can help transfer core competencies to the host country.
- Helps maintain a unified corporate culture.

Cons of Ethnocentric Workplaces

- Produces resentment in the host country.
- Can lead to cultural myopia.

It is important for businesses to find the proper balance between an ethnocentric approach and adapting to the culture of the market they are serving. In the example of Duncan Doughnuts and Baskin-Robbins, adapting flavors that took into consideration local tastes was the difference between success and failure. The same is true for Jollibee vs. McDonald's in Manila. The ethnocentric approach McDonald's took by keeping their standard menu failed; in comparison, Jollibee adjusted for the local tastes and thrived.

Culture Shock

Culture shock is defined as confusion and uncertainty experienced by someone suddenly subjected to an unfamiliar culture, a way of life, or set of attitudes. One example would be when we fostered a boy from Mexico. Upon his 18th birthday, he was a man based on his culture. However, in our culture, age does not determine adulthood as much as experience and ability to be self-sufficient. This scenario created a culture shock on both sides; he didn't understand the need to respect the rules of our home or the foster care system. Feeling he should be able to come and go as he pleased with no communication. We, on the other hand, expected rules such as curfew, being home on time, and open communication of what, where, and with whom would be observed. When we expect others to act in a way that aligns with our culture and ideals, but that goes against their culture and ideals, we have opened the door to culture shock.

Steps to Mitigate its Effects

Though we may not think so consciously, we expect others to be like us; not exactly, of course, but generally speaking we expect others to conform to basic cultural expectations. When this doesn't happen—when someone doesn't conform to what we feel is a basic cultural truth—then a cultural divide occurs. When this happens, it's natural that we should respond emotionally. Maybe we become confused or a little unsettled. We may feel disrespect for the person. We can even become angry and violent. Feeling these things is natural and doesn't make us a bad person; how we respond may. We can choose one of two directions: we can create false attributions to their behavior, speculating that they do what they do because they're "dirty," "uncivilized," "backward," or "stupid," then disengage, or we can take another, more positive path. In this path, we first become aware of our feelings and reflect on what may have caused them. This approach allows the more vitriolic emotions to subside and make room for lucid considerations. We then seek to learn the roots of the foreign cultural behavior, so we can better understand why this group does what it does. We can then develop culturally appropriate expectations around the behaviors, so it no longer throws us off our game.



Figure 4.5.1: Flowchart of cultural expectations and reactions.

4.6: Examples in the US and Wisconsin

When we study culture, it can be easier to notice customs in another country than to recognize our own. Yet culture is all around us. It appears in what we eat, how we celebrate, the stories we tell, the sports we follow, and the ways we expect people to behave at school and work. The United States does not have one uniform culture: people's experiences differ across regions, communities, generations, and families.

American Culture in Everyday Life

Baseball and football are more than games for many Americans. They can be family traditions, school events, community gatherings, and sources of local pride. Movies and television produced in Hollywood, along with musical traditions such as country music, are other recognizable parts of American popular culture. "Americana" often refers to familiar images and traditions associated with life in the United States, such as roadside diners, county fairs, small-town parades, and classic cars. None of these examples represents every American, but each gives us a way to ask how people create a sense of belonging.

Culture also appears in less visible expectations. How important is it to arrive exactly on time? Is it acceptable to disagree openly with a supervisor? Should employees put individual accomplishments forward, or emphasize the team? The answers can vary even within the same country—and within the same organization.

Regional Cultures

The West, East, South, and North or Midwest are useful starting points for discussing U.S. culture, but they are broad labels, not fixed sets of traits. Regional differences can appear in food, speech, music, recreation, and social customs. A person's community, family history, and identity may matter as much as the region where they live.

Table 4.6.1: Examples of Regional Culture

Region	Examples to explore
East	Large-city and small-town traditions, local foods, and the histories of long-established communities and newer arrivals.
South	Regional foodways, storytelling, music, and the many communities that have shaped them.
West	Cultures influenced by varied landscapes, migration, Indigenous nations, and urban and rural life.
North/Midwest	Seasonal activities, local festivals, agriculture and industry, and traditions that vary from community to community.

These examples are conversation starters, not descriptions of what everyone in a region believes or does. Can you think of two communities you are familiar with and how the culture in those communities may differ.



Wisconsin Culture

Wisconsin offers a close-to-home example of culture's many layers: Friday fish fries, supper clubs, dairy products, local festivals, outdoor recreation, or enthusiasm for the Green Bay Packers. A supper club, for example, can be more than a place to eat: it can also be a setting for conversation, celebrations, and community gatherings.

Wisconsin's culture is not limited to its best-known images. Indigenous nations have distinct histories, languages, governments, and living traditions in the state. Immigration and the continuing contributions of newer communities also shape Wisconsin's neighborhoods, businesses, food, and festivals. These histories remind us that "Wisconsin culture" includes many cultures, not a single experience shared by every resident.

Education as an Example of Culture

Think about a typical school day. Who decides what students learn? When is it appropriate to question a teacher? How are students expected to show what they know? The answers reflect not only educational policy but also cultural expectations about authority, independence, cooperation, and success.

In the United States, education is largely a state and local responsibility. As a result, school requirements and student experiences can differ across states and communities, including within Wisconsin. Students may also encounter different educational cultures as they move from high school to a technical college, university, or workplace training program.

Education systems elsewhere in the world are varied, too; there is no single "international" approach. One useful comparison is how students prepare for work. In Germany, apprenticeships are a prominent pathway that combines learning at a vocational school with training at a company. This does not mean that every German student follows that path, or that U.S. students cannot learn through work. It shows how countries can organize the relationship between education and employment differently.

Think About It

What is one school routine you consider "normal"—such as raising your hand, working in groups, taking exams, or addressing an instructor by name? How might that routine surprise a student whose previous school worked differently?

Culture at Work

Every workplace develops its own culture. One organization may expect formal communication and decisions from managers; another may encourage employees to use first names, ask questions, and make decisions together. A business operating across U.S. regions—or hiring people with different backgrounds—cannot assume that everyone interprets friendliness, professionalism, punctuality, or teamwork in exactly the same way. Learning to ask rather than assume is a practical intercultural skill.

Think About It

Choose one Wisconsin tradition or one American sport, song, movie, or celebration. What can an outsider see or hear? What less visible values or expectations might be connected to it? Whose experience might be missing if we treat that example as representative of everyone?

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4.7: Global Business in Action

Global Business in Action: Fincantieri Marinette Marine

Fincantieri Marinette Marine

Fincantieri Marinette Marine illustrates how global business connects international ownership with a local Wisconsin workplace. The shipyard was founded in Marinette in 1942 and is now part of Fincantieri, an Italian shipbuilding company. Its work brings together people, technical knowledge, and organizational practices across national borders.

Cross-border collaboration involves more than translating words. Business-culture guides describe many Italian workplaces as placing considerable value on personal trust, discussion, and respect for senior decision-makers. Communication may be animated and conversational, while a meeting may serve to explore an issue rather than produce an immediate final decision. These are useful possibilities to consider—not rules that describe every Italian colleague or the specific practices of Fincantieri.

Such differences can affect everyday work. A Wisconsin-based team might interpret a lively debate as disagreement, while colleagues might see it as a productive exchange of ideas. A request that appears ready for approval may still require discussion with a senior leader. Clear communication helps both sides: teams can identify who has decision-making authority, make room for questions, confirm what was agreed upon, and put deadlines and responsibilities in writing. These practices reduce the risk of mistaking a difference in working style for a lack of cooperation.

Fincantieri's connection with Wisconsin extends to professional development. Through a University of Wisconsin–Madison program, engineering interns have worked with Fincantieri engineers in Trieste, Italy. The program offers an example of how a Wisconsin organization's international connections can create opportunities to exchange technical knowledge and experience another workplace culture firsthand.

Discussion Questions

1. How does Fincantieri Marinette Marine illustrate the relationship between a local Wisconsin workplace and a global business?
2. If colleagues in Marinette and Italy have different expectations about how decisions are made, what should they clarify before beginning a project?
3. A meeting ends after an energetic discussion, but no decision is announced. How might team members interpret the meeting differently? What could they do to confirm the next steps?
4. Why can trust and professional relationships matter when teams work across national borders? How can colleagues build trust without assuming that everyone from the same country works in the same way?
5. What information should a cross-border team put in writing after a meeting? Which parts of a working relationship may require conversation rather than a written procedure?
6. How might an international internship help an engineering organization beyond developing technical skills?
7. What are the risks of using general descriptions of “American” or “Italian” business culture to predict how a particular coworker will behave?

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5: ETHICS

- 5.1: Ethics and International Business
- 5.2: Ethics and Profitability
- 5.3: Multiple vs Single Ethical Standards
- 5.4: Common Ethical Dilemmas
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5.1: Ethics and International Business

Business ethics, also called corporate ethics, is a form of applied ethics or professional ethics that examines the ethical and moral principles and problems that arise in a business environment. It can also be defined as the written and unwritten codes of principles and values, determined by an organization's culture, that govern decisions and actions within that organization. It applies to all aspects of business conduct on behalf of both individuals and the entire company. In the most basic terms, a definition for business ethics boils down to knowing the difference between right and wrong and choosing to do what is right.

The importance of international business ethics has been rising steadily along with the growth of international business. Technologies like the Internet have made international business more viable, and many companies can only find the desirable growth and profit they seek by expanding into new markets. This means that just as business ethics domestically have grown in importance along with the power and significance of major businesses, so must international business ethics take center stage as a major concern of the modern era. It may be acceptable to discriminate in certain cultures, even if the people in that society know that it is not right or fair. In global business ethics, people try to understand what the ethical action is and what the normal practice might be. If these are not consistent, the focus is placed on how to encourage ethical actions.

5.2: Ethics and Profitability

Learning Objectives

By the end of this section, you will be able to:

- Differentiate between short-term and long-term perspectives
- Differentiate between *stockholders* and *stakeholders*
- Discuss the relationship among ethical behavior, goodwill, and profit
- Explain the concept of corporate social responsibility

Few directives in business can override the core mission of maximizing shareholder wealth, and today that particularly means increasing quarterly profits. Such an intense focus on one variable over a short time (i.e., a **short-term perspective**) leads to a short-sighted view of what constitutes business success.

Measuring true profitability, however, requires taking a long-term perspective. We cannot accurately measure success within a quarter of a year; a longer time is often required for a product or service to find its market and gain traction against competitors, or for the effects of a new business policy to be felt. Satisfying consumers' demands, going green, being socially responsible, and acting above and beyond the basic requirements all take time and money. However, the extra cost and effort will result in profits in the long run. If we measure success from this longer perspective, we are more likely to understand the positive effect ethical behavior has on all who are associated with a business.

Profitability and Success: Thinking Long Term

Decades ago, some management theorists argued that a conscientious manager in a for-profit setting acts ethically by emphasizing the maximization of earnings solely. Today, most commentators contend that ethical business leadership is grounded in doing right by all stakeholders directly affected by a firm's operations, including, but not limited to, **stockholders**, or those who own shares of the company's stock. That is, business leaders do right when they give thought to what is best for *all* who have a stake in their companies. Not only that, firms actually reap greater material success when they take such an approach, especially over the long run.

Nobel Prize-winning economist Milton Friedman stated in a now-famous *New York Times Magazine* article in 1970 that the only "social responsibility of a business is to increase its profits."² This concept took hold in business and even in business school education. However, although it is certainly permissible and even desirable for a company to pursue profitability as a goal, managers must also have an understanding of the context within which their business operates and of how the wealth they create can add positive value to the world. The context within which they act is society, which permits and facilitates a firm's existence.

Thus, a company enters a **social contract** with society as a whole, an implicit agreement among all members to cooperate for social benefits. Even as a company pursues the maximization of stockholder profit, it must also acknowledge that all of society will be affected to some extent by its operations. In return for society's permission to incorporate and engage in business, a company owes a reciprocal obligation to do what is best for as many of society's members as possible, regardless of whether they are stockholders. Therefore, when applied specifically to a business, the social contract implies that a company gives back to the society that permits it to exist, benefiting the community at the same time it enriches itself.

In addition to taking this more nuanced view of profits, managers must also use a different time frame for obtaining them. Wall Street's focus on periodic (i.e., quarterly and annual) earnings has led many managers to adopt a short-term perspective, which fails to take into account effects that require a longer time to develop. For example, charitable donations in the form of corporate assets or employees' volunteered time may not show a return on investment until a sustained effort has been maintained for years. A **long-term perspective** is a more balanced view of profit maximization that recognizes that the impacts of a business decision may not manifest for a longer time.

As an example, consider the business practices of Toyota when it first introduced its vehicles for sale in the United States in 1957. For many years, Toyota was content to sell its cars at a slight loss because it was accomplishing two business purposes: It was establishing a long-term relationship of trust with those who eventually would become its loyal U.S. customers, and it

was attempting to disabuse U.S. consumers of their belief that items made in Japan were cheap and unreliable. The company accomplished both goals by patiently playing its long game, a key aspect of its operational philosophy, “The Toyota Way,” which includes a specific emphasis on long-term business goals, even at the expense of short-term profit.⁴

What contributes to a corporation’s positive image over the long term? Many factors contribute, including a reputation for treating customers and employees fairly and for engaging in business honestly. Companies that act in this way may emerge from any industry or country. Examples include Fluor, the large U.S. engineering and design firm; illycaffè, the Italian food and beverage purveyor; Marriott, the giant U.S. hotelier; and Nokia, the Finnish telecommunications retailer. The upshot is that when consumers are looking for an industry leader to patronize and would-be employees are seeking a firm to join, companies committed to ethical business practices are often the first to come to mind.

Why should stakeholders care about a company acting above and beyond the ethical and legal standards set by society? Simply put, being ethical is good business. A business is profitable for many reasons, including expert management teams, focused and happy employees, and worthwhile products and services that meet consumer demand. One more and very important reason is that they maintain a company philosophy and mission to do good for others.

Year after year, the nation’s most admired companies are also among those that had the highest profit margins. Going green, funding charities, and taking a personal interest in employee happiness levels add to the bottom line! Consumers want to use companies that care for others and our environment. During the years 2008 and 2009, many unethical companies went bankrupt. However, those companies that avoided the “quick buck,” risky and unethical investments, and other unethical business practices often flourished. If nothing else, consumer feedback on social media sites such as Yelp and Facebook can damage an unethical company’s prospects.

Cases From the Real World

Competition and the Markers of Business Success

Perhaps you are still thinking about how you would define success in your career. For our purposes here, let us say that success consists simply of achieving our goals. We each have the ability to choose the goals we hope to accomplish in business, of course, and, if we have chosen them with integrity, our goals and the actions we take to achieve them will be in keeping with our character.

Warren Buffet (Figure 5.2.1), whom many consider the most successful investor of all time, is an exemplar of business excellence as well as a good potential role model for professionals of integrity and the art of thinking long term. He had the following to say: “Ultimately, there’s one investment that supersedes all others: Invest in yourself. Nobody can take away what you’ve got in yourself, and everybody has potential they haven’t used yet. . . . You’ll have a much more rewarding life not only in terms of how much money you make, but how much fun you have out of life; you’ll make more friends the more interesting person you are, so go to it, invest in yourself.”⁵



Figure 5.2.1: Warren Buffett, shown here with President Barack Obama in June 2010, is an investor and philanthropist who was born in 1930 in Omaha, Nebraska. Through his leadership of Berkshire Hathaway, he has become one of the most successful investors in the world and one of the wealthiest people in the United States, with an estimated total net worth of almost \$80 billion. (credit: "President Barack Obama and Warren Buffett in the Oval Office" by Pete Souza/Wikimedia Commons, Public Domain)

The primary principle under which Buffett instructs managers to operate is: "Do nothing you would not be happy to have an unfriendly but intelligent reporter write about on the front page of a newspaper."⁶ This is a very simple and practical guide to encouraging ethical business behavior on a personal level. Buffett offers another, equally wise, principle: "Lose money for the firm, even a lot of money, and I will be understanding; lose reputation for the firm, even a shred of reputation, and I will be ruthless."⁷ As we saw in the example of Toyota, the importance of establishing and maintaining trust in the long term cannot be underestimated.

Stockholders, Stakeholders, and Goodwill

We explained that stakeholders are all the individuals and groups affected by a business's decisions. Among these stakeholders are stockholders (or **shareholders**), individuals and institutions that own stock (or shares) in a corporation. Understanding the impact of a business decision on the stockholders and various other stakeholders is critical to the ethical conduct of business. Indeed, prioritizing the claims of various stakeholders in the company is one of the most challenging tasks business professionals face. Considering only stockholders can often result in unethical decisions; the impact on all stakeholders must be considered and rationally assessed.

Managers do sometimes focus predominantly on stockholders, especially those holding the largest number of shares, because these powerful individuals and groups can influence whether managers keep their jobs or are dismissed (e.g., when they are held accountable for the company's missing projected profit goals). And many believe the sole purpose of a business is, in fact, to maximize stockholders' short-term profits. However, considering only stockholders and short-term impacts on them is one of the most common errors business managers make. It is often in the long-term interests of a business *not* to accommodate stockowners alone but rather to take into account a broad array of stakeholders and the long-term and short-term consequences for a course of action.

Here is a simple strategy for considering all your stakeholders in practice. Divide your screen or page into three columns; in the first column, list all stakeholders in order of perceived priority (Figure 5.2.2). Some individuals and groups play more than one role. For instance, some employees may be stockholders, some members of the community may be suppliers, and the government may be a customer of the firm. In the second column, list what you think each stakeholder group's interests and goals are. For those that play more than one role, choose the interests most directly affected by your actions. In the third column, put the likely impact of your business decision on each stakeholder. This basic spreadsheet should help you identify all your stakeholders and evaluate your decision's impact on their interests. If you would like to add a human dimension to your analysis, try assigning some of your colleagues to the role of stakeholders and reexamine your analysis.

Considering Stakeholder Impact		
Stakeholders (in order of perceived priority)	Interests and Goals of Stakeholder	Impact of Action/Decision on Stakeholder

Figure 5.2.2: Imagine you are the CEO of a mid-sized firm—about five hundred employees—and your company is publicly traded. To understand what matters most to all your stakeholders, complete the preceding exercise to evaluate the impact of a particular action or decision. (CC BY 4.0; Rice University & OpenStax)

The positive feeling stakeholders have for any particular company is called **goodwill**, which is an important component of almost any business entity, even though it is not directly attributable to the company's assets and liabilities. Among other intangible assets, goodwill might include the worth of a business's reputation, the value of its brand name, the intellectual capital and attitude of its workforce, and the loyalty of its established customer base. Even being socially responsible generates goodwill. The ethical behavior of managers will have a positive influence on the value of each of those components. Goodwill cannot be earned or created in a short time, but it can be the key to success and profitability.

A company's name, its corporate logo, and its trademark will necessarily increase in value as stakeholders view that company in a more favorable light. A good reputation is essential for success in the modern business world, and with information about the company and its actions readily available via mass media and the Internet (e.g., on public rating sites such as Yelp), management's values are always subject to scrutiny and open debate. These values affect the environment outside and inside the company. The **corporate culture**, for instance, consists of shared beliefs, values, and behaviors that create the internal or organizational context within which managers and employees interact. Practicing ethical behavior at all levels—from CEO to upper and middle management to general employees—helps cultivate an ethical corporate culture and ethical employee relations.

What Would You Do?

Which Corporate Culture Do You Value?

Imagine that upon graduation you have the good fortune to be offered two job opportunities. The first is with a corporation known to cultivate a hard-nosed, no-nonsense business culture in which keeping long hours and working intensely are highly valued. At the end of each year, the company donates to numerous social and environmental causes. The second job opportunity is with a nonprofit recognized for a very different culture based on its compassionate approach to employee work-life balance. It also offers the chance to pursue your own professional interests or volunteerism during a portion of every workday. The first job offer pays 20 percent more per year.

Critical Thinking

- Which of these opportunities would you pursue and why?
- How important an attribute is salary, and at what point would a higher salary override for you the non-monetary benefits of the lower-paid position?

Positive goodwill generated by ethical business practices, in turn, generates long-term business success. As recent studies have shown, the most ethical and enlightened companies in the United States consistently outperform their competitors.⁸ Thus, viewed from the proper long-term perspective, conducting business ethically is a wise business decision that generates goodwill for the

company among stakeholders, contributes to a positive corporate culture, and ultimately supports profitability.

You can test the validity of this claim yourself. When you choose a company with which to do business, what factors influence your choice? Let us say you are looking for a financial advisor for your investments and retirement planning, and you have found several candidates whose credentials, experience, and fees are approximately the same. Yet one of these firms stands above the others because it has a reputation, which you discover is well earned, for telling clients the truth and recommending investments that seem centered on the clients' benefit and not on potential profit for the firm. Wouldn't this be the one you would trust with your investments?

Or suppose one group of financial advisors has a long track record of giving back to the community of which it is part. It donates to charitable organizations in local neighborhoods, and its members volunteer service hours toward worthy projects in town. Would this group not strike you as the one worthy of your investments? That it appears to be committed to building up the local community might be enough to persuade you to give it your business. This is exactly how a long-term investment in community goodwill can produce a long pipeline of potential clients and customers.

Cases from the Real World

The Equifax Data Breach

In 2017, from mid-May to July, hackers gained unauthorized access to servers used by Equifax, a major credit reporting agency, and accessed the personal information of nearly one-half the U.S. population.⁹ Equifax executives sold off nearly \$2 million of company stock they owned after finding out about the hack in late July, weeks before it was publicly announced on September 7, 2017, in potential violation of insider trading rules. The company's shares fell nearly 14 percent after the announcement, but few expect Equifax managers to be held liable for their mistakes, face any regulatory discipline, or pay any penalties for profiting from their actions. To make amends to customers and clients in the aftermath of the hack, the company offered free credit monitoring and identity-theft protection. On September 15, 2017, the company's chief information officer and chief of security retired. On September 26, 2017, the CEO resigned, days before he was to testify before Congress about the breach. To date, numerous government investigations and hundreds of private lawsuits have been filed as a result of the hack.

Critical Thinking

- Which elements of this case might involve issues of legal compliance? Which elements illustrate acting legally but not ethically? What would acting ethically and with personal integrity in this situation look like?
- How do you think this breach will affect Equifax's position relative to those of its competitors? How might it affect the future success of the company?
- Was it sufficient for Equifax to offer online privacy protection to those whose personal information was hacked? What else might it have done?

A Brief Introduction to Corporate Social Responsibility

If you truly appreciate the positions of your various stakeholders, you will be well on your way to understanding the concept of **corporate social responsibility (CSR)**. CSR is the practice by which a business views itself within a broader context, as a member of society with certain implicit social obligations and environmental responsibilities. As previously stated, there is a distinct difference between legal compliance and ethical responsibility, and the law does not fully address all ethical dilemmas that businesses face. CSR ensures that a company is engaging in sound ethical practices and policies in accordance with the company's culture and mission, above and beyond any mandatory legal standards. A business that practices CSR cannot have maximizing shareholder wealth as its sole purpose, because this goal would necessarily infringe on the rights of other stakeholders in the broader society. For instance, a mining company that disregards its corporate social responsibility may infringe on the right of its local community to clean air and water if it pursues only profit. In contrast, CSR places all stakeholders within a proper contextual framework.

An additional perspective to take concerning CSR is that ethical business leaders opt to do *good* at the same time that they do *well*. This is a simplistic summation, but it speaks to how CSR plays out within any corporate setting. The idea is that a corporation is entitled to make money, but it should not only make money. It should also be a good civic neighbor and commit itself to the general prospering of society as a whole. It ought to make the communities of which it is part better at the same time it pursues legitimate profit goals. These ends are not mutually exclusive, and it is possible—indeed, praiseworthy—to strive for both. When a

company approaches business in this fashion, it is engaging in a commitment to corporate social responsibility.

Link to Learning

U.S. entrepreneur [Blake Mycoskie](#) has created a unique business model combining both for-profit and nonprofit philosophies in an innovative demonstration of corporate social responsibility. The company he founded, TOMS Shoes, donates one pair of shoes to a child in need for every pair sold. As of May 2018, the company has provided more than 75 million pairs of shoes to children in seventy countries.¹⁰

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5.3: Multiple vs Single Ethical Standards

Learning Objectives

By the end of this section, you will be able to:

- Analyze ethical norms and values as they relate to business standards
- Explain the doctrine of ethical relativism and why it is problematic
- Evaluate the claim that having a single ethical standard makes behaving consistently easier

Business people sometimes apply different ethical standards in different contexts, especially if they are working in a culture different from the one in which they were raised or with coworkers from other traditions. If we look outside ourselves for ethical guidance, relying on the context in which we find ourselves, we can grow confused about what is ethical business behavior. Stakeholders then observe that the messages we send via our conduct lack a consistent ethical core, which can harm our reputation and that of the business. To avoid falling back on **ethical relativism**, a philosophy according to which there is no right or wrong and what is ethical depends solely on the context, we must choose a coherent standard we can apply to all our interactions with others.

Some people who adopt multiple ethical standards may choose to exhibit the highest standards with their families, because these are the people they most revere. In a business setting, however, this same person may choose to be an unethical actor whose sole goal is the ruthless accumulation of wealth by any means. Because work and family are not the only two settings in which we live our lives, such a person may behave according to yet another standard to competitors in a sporting event, to strangers on the street, or to those in his or her religious community.

Although the ethical standard we adopt is always a choice, certain life experiences can have more profound effects on our choice than others. Among the most formative experiences are family upbringing and cultural traditions, broadly defined here to include religious and ethnic norms, the standard patterns of behavior within the context in which we live. Culture and family also influence each other because the family exists in and responds to its cultural context, as well as providing us with the bedrock for our deepest values. Regardless of this initial coding, however, we can choose the ethical standards we apply in the business context.

Why should we choose a single ethical code for all the contexts in which we live? The Greek philosophers and later proponents of the normative ethical theories we discussed earlier would say that if you apply your reason to determine how to behave, it makes rational sense to abide by a single ethical code for all interactions with all persons in all contexts. By doing so, you maximize your ethical behavior no matter who the other party is. Furthermore, you have an internally consistent behavior for all family, friends, customers, clients, and anyone else with whom you interact. Thus, we need not choose different values in different contexts, and when people see us in different situations, they are more likely to trust us because they see we uphold the same values regardless of the context.

Indeed, proponents of all the normative ethical theories would insist that the only rational choice is to have a single ethical standard. A deontologist would argue that you should adhere to particular duties in performing your actions, regardless of the parties with whom you interact. A utilitarian would say that any act you take should result in the greatest good for the greatest number. A virtue ethicist would state that you cannot be virtuous if you lack integrity in your behavior toward all.

Adopting a consistent ethical standard is both selfless and in the manager's self-interest. That is, would-be customers and clients are more likely to seek out a business that treats all with whom it interacts with honesty and fairness, believing that they themselves will be treated likewise by that firm. Similarly, business leaders who treat everyone in a trustworthy manner need never worry that they might not have impressed a potential customer, because they always engage in honorable commercial practices. A single standard of business behavior that emphasizes respect and good service appeals to all.

Normative ethics is about discovering right and delineating it from wrong; it is a way to develop the rules and norms we use to guide meaningful decision-making. The ethics in our single code are not relative to the time, person, or place. In this world, we all wear different hats as we go about our daily lives as employees, parents, leaders, and students. Being a truly ethical person requires that no matter what hat we wear, we exhibit a single ethical code and that it includes, among others, such universal principles of behavior as honesty, integrity, loyalty, fairness, respect for law, and respect for others.

Yet another reason to adopt a universal ethical standard is the transparent character it nurtures in us. If a company's leadership insists that it stands for honest business transactions at every turn, it cannot prosecute those who defraud the company and look the other way when its own officers do the same. Stakeholders recognize such hypocrisy and rightly hold it against the business's leaders.

Business leaders are not limited to only one of the normative ethical theories we have described, however. Virtue theory, utilitarianism, and deontology all have advantages to recommend them. Still, what should not change is a corporate commitment to not make exceptions in its practices when those favor the company at the expense of customers, clients, or other stakeholders.

Moving from theory to daily life, we can also look at the way our reputation is established by the implicit and explicit messages we send to others. If we adopt ethical relativism, friends, family, and coworkers will notice that we use different standards for different contexts. This lack of consistency and integrity can alter their perception of us and likely damage our reputation.

What Would You Do?

Taking Advantage of an Employee Discount

Suppose you work in retail sales for an international clothing company. A perk of the job is an employee discount of 25 percent on all merchandise you purchase for personal use. Your cousin, who is always looking for a bargain, approaches you in the store one day and implores you to give him your employee discount on a \$100 purchase of clothes for himself.

Critical Thinking

- How would you handle this situation and why?
- Would it matter if the relative were someone closer to you, perhaps a brother or sister?
- If so, why?

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5.4: Common Ethical Dilemmas

Common Ethical Issues in Int'l Business

- Employment practices
- Human rights
- Environmental concerns
- Corruption
- Moral obligations



Figure 5.4.1: Categories of ethical issues in business.

Ethical behavior also refers to behavior that is generally accepted within a specific culture. Some behaviors are universally accepted—for example, people shouldn't physically hurt other people. Other actions are less clear, such as discrimination based on age, race, gender, or ethnicity.

Culture impacts how local values influence global business ethics. There are differences in how much importance cultures place on specific ethical behaviors. For example, bribery remains widespread in many countries, and while people may not approve of it, they accept it as a necessity of daily life. Each professional is influenced by the values, social programming, and experiences encountered from childhood on. These collective factors impact how a person perceives an issue and the related correct or incorrect behaviors. Even within a specific culture, individuals have different ideas of what constitutes ethical or unethical behavior.

Employment Practices

The role of ethics in management practices, particularly those practices involving human resources and employment, differs from culture to culture. Local culture impacts the way people view the employee-employer relationship. In many cultures, there are no clear social rules preventing discrimination against people based on age, race, gender, sexual preference, handicap, and so on. Even when there are formal rules or laws against discrimination, they may not be enforced, as normal practice may allow people and companies to act in accordance with local cultural and social practices.

In theory, most global firms have clear guidelines articulating anti-discrimination policies. Companies often determine whether a person—based on their gender, ethnicity, or race—can be effective in a specific culture based on the prevailing values in that culture. The largest and most respected global companies, typically the *Fortune* Global 500, can often make management and employment decisions regardless of local practices.

Human Rights

The United Nations Office of the High Commissioner defines human rights as rights which are inherent to all human beings, whatever our nationality, place of residence, sex, national or ethnic origin, color, religion, language, or any other status. These rights reflect the basic requirements to which each human being is entitled in order to sustain and exist with dignity. As governments around the globe exercise control over the communities they represent, international law and standards are critical in the protection of human rights.

Environmental Concerns



As the world economy relies heavily on global trade, one of the greater considerations with international business is the effects such operations have on the environment. The physical and cultural boundaries on our planet are dynamic, as they have expanded and contracted throughout history. Only one element within our planet remains static, and that is its size. As humans become more closely connected through international commerce and consumption, the need to protect our natural resources becomes all the more important.

The by-product of increased demand on these resources is concerning, as the extraction of Earth's material has more than tripled in the past forty years. According to the Worldwatch Institute's Living Planet Index, which measures the health of our forests, oceans, freshwater and other natural systems, the decline of the Earth's ecological health has decreased by 35% since 1970. Sound, ethical decisions made on behalf of growing industries are key in slowing the debilitating degradation of our natural resources.

Corruption

Our modern understanding of business ethics notes that following culturally accepted norms is not always the ethical choice. What may be acceptable at certain points in history, such as racism or sexism, became unacceptable with the further development of society's mindset. What happens when cultures change but business practices don't? Does that behavior become unethical, and is the person engaged in the behavior unethical? In some cultures, there may be conflicts with global business practices, such as in the area of gift giving, which has evolved into bribery—a form of corruption.

Paying bribes is relatively common in many countries, and bribes often take the form of *grease payments*, which are small inducements intended to expedite decisions and transactions. In India and Mexico, for example, a grease payment may help get your phones installed faster—at home or at work. Transparency International tracks illicit behavior, such as bribery and embezzlement, in the public sector in 180 countries by surveying international business executives. It assigns a CPI (Corruption Perceptions Index) rating to each country. New Zealand, Denmark, Singapore, and Sweden have the lowest levels of corruption, while the highest levels of corruption are seen in most African nations, Russia, Myanmar, and Afghanistan.

Moral Obligations

A moral obligation is a duty which is owed and ought to be performed, yet is not one that is legally bound to be fulfilled. These obligations are founded on the principle of another human's natural rights and subsist in morality and conscience. As cultures vary greatly in their value systems, moral obligations can be subjective. In the consideration of natural rights, whether it be shelter, clean air and water, or to be treated with dignity, businesses hold accountability in upholding those rights, regardless of where they exist.

There are many corporations operating without governmental oversight, and the effects of doing so can cause loss and suffering. The Tata group (a multi-billion-dollar global enterprise headquartered in India) employs over one million laborers on tea plantations within India. In a gesture of good corporate responsibility, the Tata group worked with a World Bank investment firm (the International Finance Corporation or IFC) in creating a separate company allowing oversight in the management of plantation workers. Although the intention of improving the conditions for the laborers and their families was good, a study by the International Monetary Fund found that the most basic human needs and rights had been withheld.

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5.5: Examples in the US and Wisconsin

Ethical Procedures in Wisconsin: Kohler

Kohler Co. is a Wisconsin company whose business involves suppliers and operations across national borders. Working internationally creates an ethical question that extends beyond a company's own facilities: how can it set expectations for the businesses that provide its materials, components, and services? Kohler addresses this question through a Supplier Code of Conduct and a Global Human Rights Policy that apply standards across its operations and supply chain.

Kohler's Supplier Code of Conduct prohibits suppliers from making or receiving improper payments and calls for compliance with applicable anti-bribery laws. It also sets expectations concerning gifts, conflicts of interest, forced labor, child labor, workplace safety, and environmental practices. Suppliers are expected to communicate these requirements to workers and monitor compliance within their own supply chains, including subcontractors.

A written standard is only one part of an ethical procedure. Kohler states that it assesses suppliers for human-rights and forced-labor risks when they register. Depending on the risk, further review may include supplier self-assessments or on-site audits. Its supplier code also permits announced or unannounced factory audits and requires suppliers to address noncompliance through corrective action. Workers at supplier facilities must have a way to report grievances anonymously without retaliation.

Kohler's policies illustrate the difference between declaring an ethical value and building a process around it: set requirements, assess risks, provide reporting channels, check compliance, and require corrective action when problems arise. Published policies describe the company's expectations and procedures; they do not, on their own, establish that every supplier always meets them.



Figure 5.5.1: "Kohler Enameled Plumbing Ware" (Don O'Brien Flickr CC BY 2.0, Kohler Ad in the January 1929 Issue of Country Life)

Discussion Questions

1. Why might a company hold its suppliers and their subcontractors to ethical standards, rather than applying those standards only to its own employees?
2. What risks could arise if a supplier charges migrant workers recruitment fees or holds their passports?
3. Why does Kohler's supplier code address gifts and entertainment as well as direct bribes?
4. What might an audit reveal that a supplier's written promise to comply would not?
5. If an audit finds a violation, when might corrective action be more useful than immediately ending the supplier relationship?

Sources

Kohler Co. "[Supplier Code of Conduct](#)."

Kohler Co. "[Global Human Rights Policy](#)."

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5.6: Global Business in Action

Global Business in Action

Ethical Challenges Across Borders

Global companies work across different legal systems, markets, and business customs. That complexity can create opportunities, but it can also make misconduct harder to detect. An improper payment may pass through an intermediary; a misleading product claim may reach customers in several countries; and weak financial controls may allow harmful transactions to cross borders. The following cases show that ethical failures remain a practical concern for businesses and the people who depend on them.

Siemens: Bribery and business contracts (2008). German engineering company Siemens and three subsidiaries pleaded guilty to charges related to the U.S. Foreign Corrupt Practices Act. The cases concerned improper payments and failures in company records and controls involving business in multiple countries. Resolutions with U.S. and German authorities totaled more than \$1.6 billion. The case illustrates why a company must understand how contracts are obtained—not merely whether those contracts are profitable.

Volkswagen: Emissions deception (2017). Volkswagen agreed to plead guilty to U.S. criminal charges after using software to make certain diesel vehicles perform differently during emissions tests than during normal driving. The U.S. resolution included \$4.3 billion in criminal and civil penalties. This was an ethical failure involving more than regulatory paperwork: customers and regulators relied on claims about the vehicles' environmental performance.

Goldman Sachs and 1MDB: Bribery in international finance (2020). Goldman Sachs and its Malaysian subsidiary admitted to a conspiracy involving bribes to officials connected to bond deals for 1Malaysia Development Berhad, a Malaysian state-owned fund. Goldman Sachs agreed to pay more than \$2.9 billion in a resolution coordinated with authorities in several countries. The case shows how misconduct involving financial institutions can affect the handling of money intended for public purposes.

Glencore: Bribery and market manipulation (2022). Two Glencore companies pleaded guilty in U.S. cases involving foreign bribery and a separate commodity-price manipulation scheme. They agreed to pay more than \$1.1 billion to resolve the U.S. investigations. The bribery case involved payments routed through intermediaries, highlighting a recurring risk in global business: using a third party does not remove a company's responsibility to examine how that party conducts business.

Binance: Anti-money-laundering and sanctions violations (2023). Cryptocurrency exchange Binance pleaded guilty to federal charges involving failures under U.S. anti-money-laundering requirements and violations of sanctions law. It agreed to pay approximately \$4.3 billion in criminal penalties and forfeiture. Unlike a traditional product company, a digital platform can operate across borders at great speed; effective controls must keep pace with that reach.

These cases differ in industry and conduct, but they raise a common question: what happens when growth, revenue, or competitive pressure is allowed to outweigh honesty and accountability? Laws and penalties matter, yet ethical business also depends on accurate records, meaningful oversight, and employees who can raise concerns before misconduct becomes an accepted way of working.

Discussion Questions

1. Which of these cases involved misleading customers or regulators, and which involved improper payments or inadequate financial controls? Where do the categories overlap?
2. How can operating in multiple countries make it harder for a company to identify unethical conduct?
3. In the Siemens and Glencore cases, what risks arise when companies rely on intermediaries to obtain business?
4. Volkswagen's software helped vehicles pass an official test. Why is passing a test not enough if the result misrepresents a product's real-world performance?
5. What responsibility should a financial institution have when arranging transactions for a public development fund?
6. How might a fast-growing digital business design controls that remain effective as it enters new markets?
7. Financial penalties appeared in every case. What else would a company need to change to rebuild trust?

Sources

U.S. Department of Justice. "[Siemens AG and Three Subsidiaries Plead Guilty to Foreign Corrupt Practices Act Violations.](#)" December 15, 2008.

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U.S. Department of Justice. "[Goldman Sachs Charged in Foreign Bribery Case and Agrees to Pay Over \\$2.9 Billion.](#)" October 22, 2020.

U.S. Department of Justice. "[Glencore Entered Guilty Pleas to Foreign Bribery and Market Manipulation Schemes.](#)" May 24, 2022.

U.S. Department of Justice. "[Binance and CEO Plead Guilty to Federal Charges in \\$4 Billion Resolution.](#)" November 21, 2023.

6: REGIONAL ECONOMIC INTEGRATION

6.1: Economic Cooperation Among Nations

6.2: International Trade Barriers

6.3: Common Markets

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6.1: Economic Cooperation Among Nations

Learning Objectives

By the end of this section, you will be able to:

- Understand the global trading system.
- Explain how and why the GATT was created and what its historical role in international trade is.
- Know what the WTO is and what its current impact on international trade is.

In the post-World War II environment, countries came to realize that a major component of achieving any level of global peace was global cooperation—politically, economically, and socially. The intent was to level the trade playing field and reduce economic areas of disagreement, since inequality in these areas could lead to more serious conflicts. Among the initiatives, nations agreed to work together to promote free trade, entering into bilateral and multilateral agreements. The General Agreement on Tariffs and Trade (GATT) resulted from these agreements. In this section, you'll review GATT—why it was created and what its historical successes and challenges are. You'll then look at the World Trade Organization (WTO), which replaced GATT in 1995, and study the impact of both these organizations on international trade. While GATT started as a set of rules between countries, the WTO has become an institution overseeing international trade.

General Agreement on Tariffs and Trade (GATT)

The General Agreement on Tariffs and Trade (GATT) is a series of rules governing trade that were first created in 1947 by twenty-three countries. By the time it was replaced with the WTO, there were 125 member nations. GATT has been credited with substantially expanding global trade, primarily through the reduction of tariffs.

The basic underlying principle of GATT was that trade should be free and equal. In other words, countries should open their markets equally to member nations, and there should be neither discrimination nor preferential treatment. One of GATT's key provisions was the most-favored-nation clause (MFN). It required that once a benefit, usually a tariff reduction, was agreed on between two or more countries, it was automatically extended to all other member countries. GATT's initial focus was on tariffs, which are taxes placed on imports or exports.

Did You Know?

Most Favored Nation (MFN) Is Everywhere

As a concept, MFN can be seen in many aspects of business; it's an important provision. Companies require MFN of their trading partners for pricing, access, and other provisions. Corporate or government customers require it of the company from which they purchase goods or services. Venture capitalists (VCs) require it of the companies in which they invest. For example, a VC wants to make sure that it has negotiated the best price for equity and will ask for this provision in case another financier negotiates a cheaper purchase price for the equity. The idea behind the concept of MFN is that the country, company, or entity that has MFN status shouldn't be disadvantaged in comparison with others in similar roles as a trading partner, buyer, or investor. In practice, the result is that the signing party given MFN status benefits from better negotiation and receives the cheaper price point or better terms. This terminology is also used in sales contracts or other business legal agreements.

Gradually, the GATT member countries turned their attention to other non-tariff trade barriers. These included government procurement and bidding, industrial standards, subsidies, duties and customs, taxes, and licensing. GATT countries agreed to limit or remove trade barriers in these areas. The only agreed-on export subsidies were for agricultural products. Countries agreed to permit a wider range of imported products to enter their home markets by simplifying licensing guidelines and developing consistent product standards between imports and domestically produced goods. Duties had to result from uniform and consistent procedures for the same foreign and domestically produced items.

The initial successes in these categories led some countries to get more creative with developing barriers to trade as well as entering into bilateral agreements and providing more creative subsidies for select industries. The challenge for the member countries of GATT was enforcement. Other than complaining and retaliating, there was little else that a country could do to register disapproval of another country's actions and trade barriers.

Gradually, trade became more complex, leading to the Uruguay Round beginning in 1986 and ending in 1994. These trade meetings were called rounds in reference to the series of meetings among global peers held at a "roundtable." Prior to a round, each series of trade discussions began in one country. The round of discussions was then named after that country. It sometimes took several years to conclude the topic discussions for a round. The Uruguay Round took eight years and actually resulted in the end of GATT and the creation of the World Trade Organization (WTO). The current Doha Development Round began in 2001 and is actually considered part of the WTO.

World Trade Organization (WTO)

Brief History and Purpose

The World Trade Organization (WTO) developed as a result of the Uruguay Round of GATT. Formed officially on January 1, 1995, the concept of the WTO had been in development for several years. When the WTO replaced GATT, it absorbed all of GATT's standing agreements. In contrast to GATT, which was a series of agreements, the WTO was designed to be an actual institution charged with the mission of promoting free and fair trade. As explained on its website, the WTO "is the only global international organization dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments. The goal is to help producers of goods and services, exporters, and importers conduct their business."

The global focus on multilateral trade agreements and cooperation has expanded trade exponentially. "The past 50 years have seen an exceptional growth in world trade. Merchandise exports grew on average by 6 percent annually. Total trade in 2000 was 22-times the level of 1950. GATT and the WTO have helped to create a strong and prosperous trading system contributing to unprecedented growth." (*The Multilateral Trading System—Past, Present and Future*, "World Trade Organization").

The WTO's primary purpose is to serve as a negotiating forum for member nations to dispute, discuss, and debate trade-related matters. More than just a series of trade agreements, as it was under GATT, the WTO undertakes discussions on issues related to globalization and its impact on people and the environment, as well as trade-specific matters. It doesn't necessarily establish formal agreements in all of these areas but does provide a forum to discuss how global trade impacts other aspects of the world.

Headquartered in Geneva, Switzerland, the current round is called the Doha Round and began in 2001. With 153 member nations, the WTO is the largest global trade organization. Thirty nations have observer status, and many of these are seeking membership. With so many member nations, the concept of MFN has been eased into a new principle of normal trade relations (NTR). Advocates say that no nation really has a favored nation status; rather, all interact with each other as a normal part of global trade.

The biggest change from GATT to the WTO is the provision for the settlement of disputes. If a country finds another country's trade practices unfair or discriminatory, it may bring the charges to the WTO, which will hear from both countries and mediate a solution.

The WTO has also undertaken the effort to focus on services rather than just goods. Resulting from the Uruguay Round, the General Agreement on Trade in Services (GATS) seeks to reduce the barriers to trade in services. Following the GATT commitment to nondiscrimination, GATS requires member nations to treat foreign service companies as they would domestic ones. For example, if a country requires banks to maintain 10 percent of deposits as reserves, then this percentage should be the same for foreign and domestic banks. Services have proven to be more complex to both define and regulate, and the member nations are continuing the discussions.

Similar to GATS is the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). Intellectual property refers to just about anything that a person or entity creates with the mind. It includes inventions, music, art, and writing, as well as words, phrases, sayings, and graphics—to name a few. The basic premise of intellectual property rights (IPR) law is that the creator of the property has the right to financially benefit from his or her creation. This is particularly important for protecting the development for the creation, known as the research and development (R&D) costs. Companies can also own the intellectual property that their employees generate. This section focuses on the protection that countries agree to give to intellectual property

created in another country.

Over the past few decades, companies have become increasingly diligent in protecting their intellectual property and pursuing abusers. Whether it's the knock-off designer handbag from China that lands on the sidewalks of New York or the writer protecting her thoughts in the written words of a book (commonly understood as content), or the global software company combating piracy of its technical know-how, IPR is now formally a part of the WTO agreements and ongoing dialogue.

Current Challenges and Opportunities

Agriculture and textiles are two key sectors in which the WTO faces challenges. Trade in agriculture has been impacted by export-country subsidies, import-country tariffs and restrictions, and nontariff barriers. Whether the United States provides low-cost loans and subsidies to its farmers or Japan restricts beef imports, agriculture trade barriers are an ongoing challenge for the WTO. Global companies and trade groups that support private-sector firms seek to have their governments raise critical trade issues on their behalf through the WTO.

For example, Japan's ban on beef imports in response to mad cow disease had a heavy impact on the US beef industry during the first decade of the 21st century. Japan was the largest foreign buyer of U.S. beef before it banned all imports when the first case of the brain-wasting disease, also known as bovine spongiform encephalopathy [i.e., mad cow disease], was discovered in the U.S.

Japanese restrictions on U.S. beef created distance between Japan and the U.S. Japan Agriculture Minister Hirotaka Akamatsu told reporters in 2010 after meeting [US Agriculture Secretary Tom] Vilsack in Tokyo. "For us, food safety based on Japan's scientific standards is the priority. The OIE standards are different from the Japanese scientific ones." During the beef export ban, the U.S. beef industry lost about \$1 billion a year in sales because of the restrictions, according to the National Cattlemen's Beef Association, [a trade group supporting the interests of American beef producers].

The ban was eased in 2005 to allow meat from cattle aged 20 months or less, which scientists say are less likely to have contracted the fatal illness. ... Japan was the third-largest destination for U.S. beef [in 2009], with trade totaling \$470 million, up from \$383 million in 2008, according to the U.S. Meat Export Federation. That compares with \$1.39 billion in 2003. Mexico and Canada were the biggest buyers of U.S. beef [in 2009] ([Japan, U.S. to Continue Dialogue on Beef Import Curbs \(Update 1\)](#)).

The role of the WTO is to facilitate agreements in difficult bilateral and multilateral trade disputes, but this certainly isn't easy. Japan's reluctance to accept American beef may have appeared to be the result of mad cow disease, but business observers note Japan's historical cultural preference for Japanese goods, which the country often claims are superior. A similar trade conflict was triggered in the 1980s when Japan discouraged the import of rice from other countries. The prevailing Japanese thought was that its local rice was easier for the Japanese to digest. After extensive discussions in the Uruguay Round of trade talks, on "December 14, 1993, the Japanese government accepted a limited opening of the rice market under the GATT plan" ([Japan Rice Trade](#)).

Antidumping is another area on which the WTO has focused its attention. Dumping occurs when a company exports to a foreign market at a price that is either lower than the domestic prices in that country or less than the cost of production. Antidumping charges can be harder to settle, as the charge is against a company and not a country. One example is in India, which has, in the past, accused Japan and Thailand of dumping acetone, a chemical used in drugs and explosives, in the Indian market. In an effort to protect domestic manufacturers, India has raised the issue with the WTO. In fact, India was second only to Argentina among the G-20 (or Group of Twenty) nations in initiating antidumping investigations during 2009, according to a WTO report.

Future Outlook

The future for the WTO and any related organizations remains strong. With companies and countries facing a broader array of trade issues than ever before, the WTO plays a critical role in promoting and ensuring free and fair trade. Many observers expect that the WTO will have to emphasize the impact of the Internet on trade. In most cases, the WTO provides companies and countries with the best options to dispute, discuss, and settle unfair business and trade practices.

Key Takeaways

- The General Agreement on Tariffs and Trade (GATT) is a series of rules governing trade that were first created in 1947 by twenty-three countries. It remained in force until 1995, when it was replaced by the WTO.
- The World Trade Organization (WTO) is the only global, international organization dealing with the rules of trade between nations. The WTO agreements that have been negotiated and signed by the organization's 153 member nations and ratified in their parliaments are the heart of the organization. Its goal is to help the producers, exporters, and importers of goods and services conduct business. The latest round of the WTO trade negotiations is called the Doha Round.

Exercise 6.1.1

(AACSB: Reflective Thinking, Analytical Skills)

1. Define GATT and discuss the importance of the successive rounds. Do you think that GATT was essential to promoting world trade or would we be in the same place today without it? Why or why not?
2. Define WTO. In what ways do you think the WTO is still essential to global trade? Discuss how a private-sector firm would use the WTO to protect its business interests.
3. Read the following excerpt from a 2010 *Wall Street Journal* article about the WTO:

The World Trade Organization formally condemned European subsidies to civil-aircraft maker Airbus, concluding the first half of the most expensive trade dispute in WTO history. Its main finding was that more than \$20 billion in low-interest government loans used to develop six models of passenger jet constituted prohibited export subsidies.

The ruling could force the parent company of Airbus, European Aeronautic Defence & Space Co., to repay some aid money or risk giving the U.S. the right to raise import tariffs in retaliation on goods imported from Europe, such as cars, wines and cheese. ([WTO Condemns Airbus Subsidies](#)).

Do you agree with the WTO's assessment? Is it fair for the United States to retaliate against the airplane manufacturer with tariffs on other imported products? How might US consumers react to additional taxes imposed on popular imported products such as cars, wine, and cheese?

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6.2: International Trade Barriers

Trade barriers are government-induced restrictions on international trade, which generally decrease overall economic efficiency.

Key Points

- Trade barriers cause a limited choice of products and, therefore, would force customers to pay higher prices and accept inferior quality.
- Trade barriers generally favor rich countries because these countries tend to set international trade policies and standards.
- Economists generally agree that trade barriers are detrimental and decrease overall economic efficiency, which can be explained by the theory of comparative advantage.

Key Terms

- **Tariff:** A system of government-imposed duties levied on imported or exported goods; a list of such duties, or the duties themselves.
- **Quota:** A restriction on the import of something to a specific quantity.

Trade barriers are government-induced restrictions on international trade. Man-made trade barriers come in several forms, including:

- Tariffs
- Non-tariff barriers to trade
- Import licenses
- Export licenses
- Import quotas
- Subsidies
- Voluntary Export Restraints
- Local content requirements
- Embargo
- Currency devaluation
- Trade restriction

Most trade barriers work on the same principle—the imposition of some sort of cost on trade that raises the price of the traded products. If two or more nations repeatedly use trade barriers against each other, then a trade war results.

Economists generally agree that trade barriers are detrimental and decrease overall economic efficiency. This can be explained by the theory of comparative advantage. In theory, free trade involves the removal of all such barriers, except perhaps those considered necessary for health or national security. In practice, however, even those countries promoting free trade heavily subsidize certain industries, such as agriculture and steel. Trade barriers are often criticized for the effect they have on the developing world. Because rich-country players set trade policies, goods such as agricultural products that developing countries are best at producing face high barriers. Trade barriers, such as taxes on food imports or subsidies for farmers in developed economies, lead to overproduction and dumping on world markets, thus lowering prices and hurting poor-country farmers. Tariffs also tend to be anti-poor, with low rates for raw commodities and high rates for labor-intensive processed goods. The Commitment to Development Index measures the effect that rich country trade policies actually have on the developing world. Another negative aspect of trade barriers is that they would cause a limited choice of products and, therefore, would force customers to pay higher prices and accept inferior quality.

In general, for a given level of protection, quota-like restrictions carry a greater potential for reducing welfare than do tariffs. Tariffs, quotas, and non-tariff barriers lead to too few of the economy's resources being used to produce tradeable goods. An export subsidy can also be used to give an advantage to a domestic producer over a foreign producer. Export subsidies tend to have a particularly strong negative effect because, in addition to distorting resource allocation, they reduce the economy's

terms of trade. In contrast to tariffs, export subsidies lead to an over-allocation of the economy's resources to the production of tradeable goods.



Figure 6.2.1: Singapore Port. The Port of Singapore is one of the busiest in the world because Singapore must import most of its foodstuffs and consumer goods. (By Lukacs, [Wikipedia](#), [CC BY-SA: Attribution-ShareAlike](#))

International trade barriers can take many forms for any number of reasons. Generally, governments impose barriers to protect domestic industry or to “punish” a trading partner.

Watch this video to learn the types of tools used for restricting trade and the effects of trade restrictions.

YouTube Video

This interactive element is not available in this format. Visit the link or scan the QR code to access it online.

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[Watch this video on YouTube to view the transcript.](#)

Sources & References

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6.3: Common Markets

A **common market** is the first stage towards a single market and may be limited initially to a free trade area.

Key Points

- A common market is the first stage towards a single market and may be limited initially to a free trade area, with relatively free movement of capital and of services. However, it is not yet at a stage where the remaining trade barriers have been eliminated.
- The European Economic Community (EEC) (also known as the Common Market in the English-speaking world and sometimes referred to as the European Community even before it was renamed as such in 1993) was an international organization created by the 1957 Treaty of Rome.
- The main aim of the EEC, as stated in its preamble, was to “preserve peace and liberty and to lay the foundations of an ever closer union among the peoples of Europe.”

Key Term

Free trade: International trade free from government interference, especially trade free from tariffs or duties on imports.

European Economic Community

The European Economic Community was the first example of both a common and single market, but it was an economic union since it had a customs union additionally. The European Economic Community (EEC) was an international organization created by the 1957 Treaty of Rome. Its aim was to bring about economic integration, including a common market, among its six founding members: Belgium, France, Germany, Italy, Luxembourg and the Netherlands. Upon the entry into force of the Maastricht Treaty in 1993, the EEC was renamed the European Community (EC) to reflect that it covered a wider range of policy. This was also when the three European Communities, including the EC, were collectively made to constitute the first of the three pillars of the European Union (EU). For the customs union, the treaty provided for a 10% reduction in customs duties and up to 20% of global import quotas. Progress on the customs union proceeded much faster than the twelve years planned.

A common market is a first stage towards a single market and may be limited initially to a free trade area with relatively free movement of capital and of services, but not so advanced in the reduction of the rest of the trade barriers.

The European Economic Community (EEC) (also known as the Common Market in the English-speaking world and sometimes referred to as the European Community even before it was renamed as such in 1993) was an international organization created by the 1957 Treaty of Rome. Its aim was to bring about economic integration, including a common market, among its six founding members: Belgium, France, Germany, Italy, Luxembourg, and the Netherlands.

It gained a common set of institutions along with the European Coal and Steel Community (ECSC) and the European Atomic Energy Community (EURATOM) as one of the European Communities under the 1965 Merger Treaty (Treaty of Brussels).

Upon the entry into force of the Maastricht Treaty in 1993, the EEC was renamed the European Community (EC) to reflect that it covered a wider range of policy. This was also when the three European Communities, including the EC, were collectively made to constitute the first of the three pillars of the European Union (EU), which the treaty also founded. The EC existed in this form until it was abolished by the 2009 Treaty of Lisbon, which merged the EU's former pillars and provided that the EU would “replace and succeed the European Community.” The main aim of the EEC, as stated in its preamble, was to “preserve peace and liberty and to lay the foundations of an ever closer union among the peoples of Europe.” Calling for balanced economic growth, this was to be accomplished through:

- The establishment of a customs union with a common external tariff
- Common policies for agriculture, transport, and trade
- Enlargement of the EEC to the rest of Europe

For the customs union, the treaty provided for a 10% reduction in customs duties and up to 20% of global import quotas. Progress on the customs union proceeded much faster than the 12 years planned. However, France faced some setbacks due to its war with Algeria.

The six states that founded the EEC and the other two communities were known as the “inner six” (the “outer seven” were those countries that formed the European Free Trade Association). The six were France, West Germany, Italy, and the three Benelux countries: Belgium, the Netherlands, and Luxembourg. The first enlargement was in 1973, with the accession of Denmark, Ireland, and the United Kingdom. Greece, Spain, and Portugal joined in the 1980s. Following the creation of the EU in 1993, it has enlarged to include an additional 15 countries by 2007.

There were three political institutions that held the executive and legislative power of the EEC, plus one judicial institution and a fifth body created in 1975. These institutions (except for the auditors) were created in 1957 by the EEC, but from 1967 on, they applied to all three communities. The Council represents governments, the Parliament represents citizens, and the Commission represents the European interest.

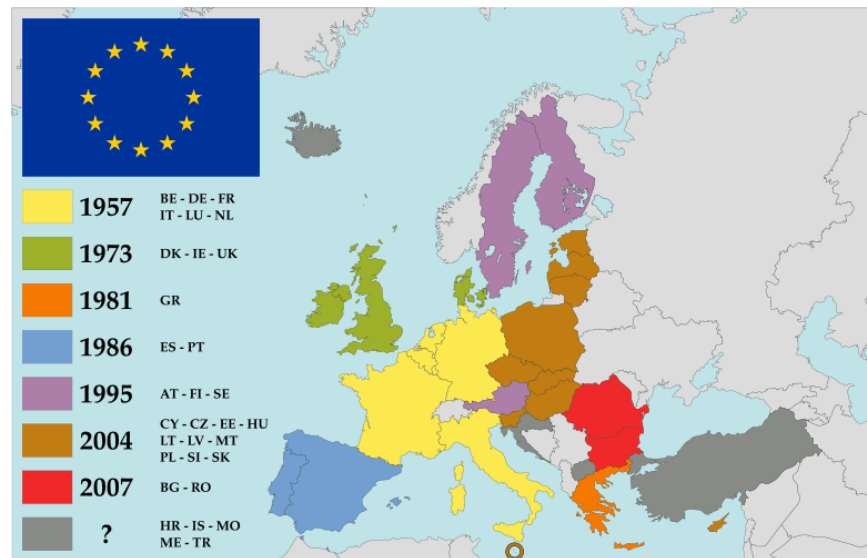


Figure 6.3.1: European Economic Community Original member states (yellow) and later members (green). The UK has exited the community ([Wikimedia](#), CC-BY-SA).

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6.4: USMCA

The **United States–Mexico–Canada Agreement (USMCA)** is a trade agreement among Canada, Mexico, and the United States. It replaced the **North American Free Trade Agreement (NAFTA)** on July 1, 2020, while preserving much of NAFTA's framework for duty-free trade across North America. The USMCA also updated the agreement in areas such as digital trade, intellectual property, labor, environmental standards, rules of origin, and the automotive industry.

Key Points

- NAFTA took effect on January 1, 1994, creating a trilateral trade framework among Canada, Mexico, and the United States. It replaced the earlier Canada–United States Free Trade Agreement.
- The United States–Mexico–Canada Agreement (USMCA) replaced NAFTA on July 1, 2020. Like NAFTA, the USMCA maintains duty-free treatment for most goods traded among the three member countries, subject to the agreement's rules of origin and other requirements.
- The USMCA includes updated provisions on digital trade, intellectual property, labor, the environment, and the automotive sector.
- The agreement seeks to reduce tariff and non-tariff barriers, provide more predictable trade rules, and support economic integration among Canada, Mexico, and the United States.

Key Terms

- **Trade bloc:** A trade bloc is a type of intergovernmental agreement, often part of a regional intergovernmental organization, where regional barriers to trade (tariffs and non-tariff barriers) are reduced or eliminated among the participating states.
- **Free trade:** International trade free from government interference, especially trade free from tariffs or duties on imports.
- **Tariff:** A system of government-imposed duties levied on imported or exported goods; a list of such duties, or the duties themselves.

The United States–Mexico–Canada Agreement (USMCA)

The **United States–Mexico–Canada Agreement (USMCA)** is the trade agreement among Canada, Mexico, and the United States. It entered into force on July 1, 2020, replacing the North American Free Trade Agreement (NAFTA), which had been in effect since January 1, 1994. NAFTA had replaced the earlier Canada–United States Free Trade Agreement.

Like NAFTA, the USMCA provides a framework for trade and investment among the three North American countries. It preserves duty-free treatment for most qualifying goods traded within the region while establishing rules of origin and other requirements that determine whether products qualify for preferential tariff treatment. The agreement seeks to reduce trade barriers, promote more predictable commercial rules, and support economic integration across North America.

The USMCA updates NAFTA in several important areas:

- **Digital trade:** It includes provisions intended to support cross-border data flows, electronic commerce, and the digital economy.
- **Automotive rules of origin:** It raises regional-content requirements for vehicles and certain auto parts and includes labor-value-content requirements for qualifying vehicles.
- **Labor and environmental standards:** It incorporates labor and environmental obligations into the core agreement and provides mechanisms for addressing alleged violations.
- **Intellectual property:** It includes commitments related to trademarks, copyrights, trade secrets, and enforcement of intellectual-property rights.
- **Agriculture:** It generally maintains duty-free trade for agricultural goods among the three countries, while expanding selected access to Canada's dairy market.
- **Review process:** The agreement includes a “sunset” review mechanism under which the parties periodically review the

agreement and may extend it beyond its initial 16-year term.

NAFTA was significant because it phased out most tariffs on goods traded among Canada, Mexico, and the United States and helped deepen North American supply chains. The USMCA retains much of that foundation while adding provisions designed for contemporary trade, including digital commerce, updated labor and environmental commitments, and revised rules for the automotive industry.



Figure 6.4.1: USMCA member countries. (By Heraldry, [Wikipedia](#), CC-BY-SA 3.0)

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6.5: European Union

The **European Union** (EU) is an economic and political union made up of 27 member states that are located primarily in Europe.

Key Points

- Members of the EU include Austria, Belgium, Bulgaria, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, and Sweden.
- The EU operates through a system of supranational independent institutions and intergovernmental negotiated decisions by the member states.
- Within the Schengen Area, which includes EU and non-EU countries, routine passport checks at internal borders have generally been abolished, although countries may temporarily reintroduce them under certain conditions.
- The creation of a single currency became an official objective of the European Economic Community (EEC) in 1969. On January 1, 2002, euro notes and coins were issued, and participating countries began phasing out their national currencies.
- The European Central Bank (ECB) is the central bank for the euro area. It sets monetary policy with the primary objective of maintaining price stability. The ECB is part of the European System of Central Banks, which includes the national central banks of all EU member states. The ECB's Governing Council—comprising its Executive Board and the central bank governors of the countries that use the euro—is its main monetary-policy decision-making body.
- The United Kingdom voted to leave the EU on June 23, 2016, and formally left on January 31, 2020. Its withdrawal is commonly referred to as Brexit.

Key Terms

- **Euro:** The currency unit of the European Monetary Union. Symbol: €
- **Transparency:** Open, public; having the property that theories and practices are publicly visible, thereby reducing the chance of corruption.
- **European Union:** A supranational organization created in the 1950s to bring the nations of Europe into closer economic and political connection. It formally became an economic and political union formally established in 1993. As of 2026, its 27 member countries are Austria, Belgium, Bulgaria, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, and Sweden.

The euro is designed to help build a single market by easing travel of citizens and goods, eliminating exchange rate problems, providing price transparency, creating a single financial market, stabilizing prices, maintaining low interest rates, and providing a currency used internationally and protected against shocks by the large amount of internal trade within the eurozone. It is also intended as a political symbol of integration.

The European Union

The European Union (EU) is an economic and political union of 27 member states located in Europe, including Austria, Belgium, Bulgaria, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, and Sweden. Croatia joined the EU in 2013, and the United Kingdom left in 2020. Brexit is discussed on the next page.

The EU operates through a system of supranational institutions and decisions negotiated by its member states. Important institutions include the European Commission, the Council of the European Union, the European Council, the Court of Justice of the European Union, and the European Central Bank. The European Parliament is elected every five years by EU citizens. The EU has developed a single market through common rules that apply across its member states. Within the Schengen Area, which includes both EU and non-EU countries, routine passport controls at internal borders have generally been abolished, although countries may temporarily reintroduce them under certain conditions. EU policies aim to ensure the free movement of people,

goods, services, and capital, and include common approaches to trade, agriculture, fisheries, and regional development.elections.

A monetary union, the euro area, was established in 1999 and, as of 2026, comprises 21 of the EU's 27 member states. Through the Common Foreign and Security Policy, the EU also has a role in external relations and security, although member states retain important responsibilities in these areas. The EU maintains diplomatic missions around the world. It has observer status at the United Nations, is a member of the World Trade Organization, and participates in the G7 and G20.

The Euro

The creation of a single European currency became an official objective of the European Economic Community in 1969. However, it was with the Maastricht Treaty, which took effect in 1993, that member states committed to the process of monetary union. In 1999, the euro was launched by eleven EU member states. At first, it was used for accounting and electronic payments rather than as cash. Euro notes and coins were introduced on 1 January 2002, when the euro area consisted of twelve countries. The euro area—made up of EU member states that have adopted the euro—has since grown to 21 countries. The most recent is Bulgaria, which joined on 1 January 2026. Other EU member states are expected to adopt the euro once they meet the required economic and legal *convergence criteria*, with one exception: Denmark has a treaty-based exemption. Sweden has not adopted the euro and does not currently meet all the criteria for joining.

The euro is designed to help build a single market by making travel and cross-border business easier, eliminating exchange-rate changes between participating countries, and making prices easier to compare. It also serves as a symbol of European integration and is used internationally. The European Central Bank (ECB) is the central bank for the euro area and sets its monetary policy, with the primary objective of maintaining price stability. Its main monetary-policy decision-making body is the **Governing Council**, made up of the ECB's Executive Board and the governors of the national central banks of euro-area countries. The ECB is also part of the European System of Central Banks, which includes the national central banks of all EU member states, whether or not they use the euro. The sovereign-debt crisis that began around 2009 tested the monetary union, particularly in countries such as Greece. The euro area remained intact and expanded afterward, but it has faced further challenges, including a sharp rise in inflation in 2022.

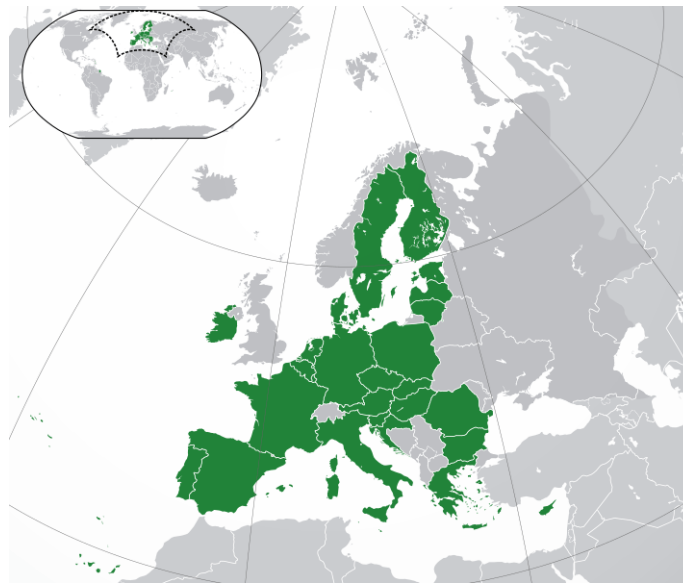


Figure 6.5.1: European Union member countries. (By Hayden120 and NuclearVacuum, [Wikimedia](#), CC-BY-SA)

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6.6: Video- How Did Brexit Happen?

Brexit means the United Kingdom's withdrawal from the European Union (EU). In a June 2016 referendum, 51.9% voted to leave. The UK formally left on January 31, 2020, and a transition period ended on December 31, 2020.

Why it happened

People voted for different reasons, so there is no single explanation for the result. A central argument for leaving was that the UK should have more control over its laws, borders, and decisions about trade. Others favored remaining because EU membership made it easier to trade, travel, live, and work across member countries. Concerns about immigration, the economy, and whether people felt represented also shaped the debate.

Why it matters

- **Trade:** The UK left the EU's single market and customs union. A UK-EU trade agreement allows qualifying goods to move without tariffs or quotas, but businesses still face some new rules and paperwork.
- **Government decisions:** The UK can make more decisions independently, while no longer participating in EU institutions as a member. How valuable that independence is compared with the benefits of close integration remains a matter of debate.
- **People and borders:** Brexit changed arrangements for citizens and raised a particularly difficult question in Northern Ireland: how to avoid a hard border with Ireland, an EU member, while managing trade between the UK and EU.

In neutral terms, Brexit is important because it changed the balance between **national independence and regional cooperation**. It is a useful example of how economic integration affects not just trade, but laws, borders, and people's daily lives.

Watch this video to learn more about the history of Brexit.

YouTube Video

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[Watch the video on YouTube to view the transcript.](#)

Sources & References

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6.7: APEC

The **Asia-Pacific Economic Cooperation** (APEC) is a forum for 21 Pacific Rim countries that seeks to promote free trade and economic cooperation.

Key Points

- APEC was established in 1989 in response to the growing interdependence of Asia-Pacific economies and the advent of regional economic blocs.
- APEC has 21 member economies: Australia, Brunei Darussalam, Canada, Chile, the People's Republic of China, Hong Kong, China, Indonesia, Japan, the Republic of Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, the Philippines, the Russian Federation, Singapore, Chinese Taipei, Thailand, the United States, and Viet Nam.
- During the 1994 meeting in Bogor, Indonesia, APEC leaders adopted the Bogor Goals, which called for free and open trade and investment in the Asia-Pacific by 2010 for industrialized economies and by 2020 for developing economies. Although these target dates have passed, the goals continue to serve as an important benchmark for APEC's work on regional economic integration.

Key Term

Bloc: A group of countries acting together for political or economic goals, an alliance (e.g., the eastern bloc, the western bloc, a trading bloc).

The Asia-Pacific Economic Cooperation (APEC) is a regional economic forum of 21 Pacific Rim **member economies** that promotes free and open trade and investment, inclusive and sustainable economic growth, and economic and technical cooperation throughout the Asia-Pacific region. Established in 1989 in response to the growing interdependence of Asia-Pacific economies and the emergence of regional economic blocs in other parts of the world, APEC works to improve living standards, support economic integration, and strengthen cooperation among its member economies.

APEC's member economies are Australia, Brunei Darussalam, Canada, Chile, the People's Republic of China, Hong Kong, China, Indonesia, Japan, the Republic of Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, the Philippines, the Russian Federation, Singapore, Chinese Taipei, Thailand, the United States, and Viet Nam. APEC uses the term *member economies* rather than *member countries* because its participants include distinct customs territories and economies.

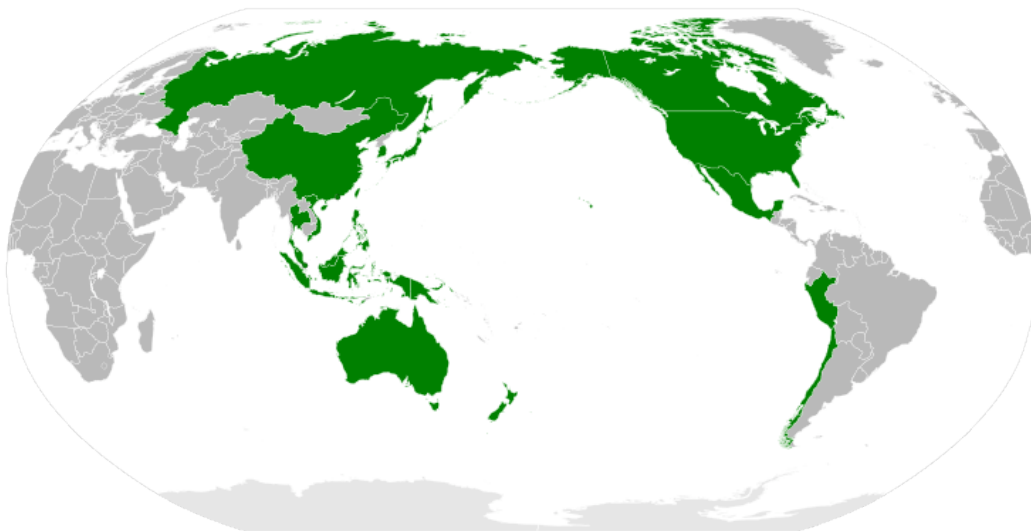


Figure 6.7.1: APEC member countries as of 2009. (By Cflm001, [Wikimedia](#), CC0)

During the 1994 APEC Economic Leaders' Meeting in Bogor, Indonesia, leaders adopted the **Bogor Goals**, which called for free and open trade and investment in the Asia-Pacific by 2010 for industrialized economies and by 2020 for developing economies. Although these target dates have passed, the goals remain an important benchmark for APEC's work on regional economic integration and open trade and investment.

In 1995, APEC established the APEC Business Advisory Council (ABAC), which consists of up to three senior business representatives appointed by each member economy. ABAC provides business-sector perspectives and recommendations directly to APEC leaders and ministers.

To advance its objectives, APEC's work is commonly organized around three main areas:

- Trade and investment liberalization
- Business facilitation
- Economic and technical cooperation

APEC continues to support a possible Free Trade Area of the Asia-Pacific (FTAAP), envisioned as a comprehensive regional trade arrangement among APEC's member economies. Rather than negotiating the FTAAP as a stand-alone agreement, APEC has pursued it through broader Asia-Pacific regional integration efforts and high-quality regional trade agreements. This approach aims to reduce the complexity created by overlapping trade agreements—sometimes called the “spaghetti bowl” effect—and encourage more coherent regional trade rules.

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6.8: Global Business in Action

Wisconsin Businesses, USMCA, and Tariffs

Trade agreements and tariffs shape business decisions far beyond national capitals. In Wisconsin, companies that produce dairy products, manufacture equipment, fabricate metal parts, package goods, or sell lumber-related products may depend on trade with Canada and Mexico. The United States–Mexico–Canada Agreement (USMCA) generally supports duty-free trade for qualifying goods among the three countries, but tariffs and other trade restrictions can still affect the cost of imported materials, the competitiveness of exports, and the stability of cross-border supply chains.

Wisconsin's connection to North American trade is substantial. In 2025, Canada was Wisconsin's largest market for agricultural, forestry, and food exports, purchasing about \$1.38 billion in products. Mexico was the state's second-largest agricultural export market, with approximately \$535 million in purchases. Wisconsin exported \$468 million in dairy products worldwide in 2025.

Case 1: Wisconsin Dairy and USMCA

Wisconsin's dairy industry illustrates how a regional trade agreement can create both opportunities and limitations. The state is a major producer of cheese, whey, milk ingredients, and other dairy products. Canada and Mexico are important nearby markets because transportation costs and delivery times may be lower than for more distant export destinations.

Under the USMCA, many agricultural products can move among Canada, Mexico, and the United States with low or zero tariffs when they meet the agreement's requirements. This can help Wisconsin dairy processors and farmers reach customers beyond the U.S. market. USMCA also preserved much of the market access created under NAFTA and expanded limited access for U.S. dairy products in Canada.

However, trade agreements do not eliminate every barrier. Canada maintains a supply-management system for dairy that uses tariff-rate quotas: limited quantities of certain dairy products may enter at lower tariff rates, while imports above those quantities can face much higher tariffs. U.S. dairy producers and policymakers have argued that Canadian implementation of some USMCA dairy commitments has restricted the access that U.S. exporters expected to receive. In 2025, Wisconsin Senator Tammy Baldwin and other senators called on the U.S. government to address continued barriers facing American dairy exports to Canada.

Discussion Questions

1. How can the USMCA benefit a Wisconsin cheese or whey producer seeking to sell in Canada or Mexico?
2. Why might a trade agreement reduce barriers without creating completely unrestricted trade?
3. How could high Canadian tariffs on dairy imports above quota levels affect a Wisconsin dairy processor's export strategy?
4. What business decisions might a dairy company make if access to one export market becomes less predictable?

Case 2: Tariffs and Wisconsin Manufacturers

Tariffs can affect manufacturers even when a company does not directly import finished products. Many manufacturers purchase imported inputs, such as steel, aluminum, electronic components, machinery parts, packaging materials, and lumber. A tariff raises the landed cost of an imported good, which may force the business to absorb the added expense, increase prices, change suppliers, redesign products, or reduce its profit margin.

This issue is especially relevant in Wisconsin, where manufacturing is a major part of the state economy. In 2025, Wisconsin manufacturers reported concern that higher steel and aluminum tariffs would increase material costs. One industry estimate reported that the tariffs could raise equipment-production costs for Wisconsin manufacturers by approximately 7 to 9 percent, depending on the company's material mix and ability to obtain alternative supplies.

A Milwaukee metal fabricator described the practical challenge of relying on Canadian aluminum. The firm reported sharp increases in aluminum, stainless-steel, and cold-rolled-steel costs after tariff-related changes. When materials become more expensive, manufacturers may pass some costs to customers, but doing so can reduce demand or make the company less competitive against rivals.

The effects can also move through a regional supply chain. For example, a Northeast Wisconsin manufacturer that makes machinery, trailers, cabinets, food-processing equipment, paper-converting equipment, or metal components may face higher costs if it uses imported steel or aluminum. Its customers may then encounter higher prices for the finished equipment or may delay purchases while they wait for prices and trade rules to stabilize.

Discussion Questions

1. Why can a tariff on imported steel or aluminum affect a Wisconsin manufacturer that sells only in the United States?
2. What choices does a manufacturer have when the price of a key imported input rises?
3. Who may ultimately bear the cost of a tariff: the foreign producer, the importing business, the manufacturer, the customer, or some combination of these groups?
4. How can tariff uncertainty affect decisions about hiring, inventory, pricing, and long-term investment?

Connecting the Cases

The dairy and manufacturing examples show that international trade creates both opportunities and risks for Wisconsin businesses.

Table 6.8.1: Trade Policy Opportunities and Changes

Trade-policy issue	Potential opportunity	Potential challenge
USMCA and regional trade	Lower tariffs and clearer rules can help qualifying Wisconsin products reach Canadian and Mexican customers.	Rules of origin, quotas, customs procedures, and differing national regulations can still limit or complicate trade.
Dairy trade	Wisconsin firms can sell cheese, whey, and other dairy products in nearby export markets.	Canadian dairy quota rules and retaliatory tariffs can restrict access or reduce the profitability of exports.
Tariffs on industrial inputs	Tariffs may help some domestic producers compete with imported products.	Higher input costs can reduce margins and raise prices for downstream manufacturers and their customers.
Cross-border supply chains	Regional integration can help companies source materials and serve customers efficiently across North America.	Sudden tariff changes can disrupt supplier relationships, contracts, inventory plans, and investment decisions.

Key Takeaway

Regional trade agreements such as the USMCA can make cross-border business easier by lowering tariffs and creating common rules for trade. At the same time, tariffs, quota systems, rules of origin, and policy uncertainty can materially affect Wisconsin businesses. For a dairy exporter, the central question may be access to Canadian markets; for a manufacturer, it may be the cost and availability of steel, aluminum, or other imported inputs. Wisconsin firms therefore must treat trade policy as a practical business issue—not simply a government or international-relations topic.

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7: FOREIGN EXCHANGE MARKET

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7.1: Overview

Learning Objectives

After you complete this section, you will be able to:

- Explain how the foreign exchange market operates
- Differentiate among the different exchange rates
- Explain how business can overcome the risks and challenges of the foreign exchange markets

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7.2: Video- Exchange Rates

Exchange rates determine how much one country's currency is worth relative to another country's currency. They affect the cost of travel, imported products, overseas investments, and the ability of businesses to buy from or sell to customers in foreign markets.

In this video, you will learn how exchange rates are determined in the foreign exchange market and why currency values rise and fall. The video also examines why governments may try to influence the value of their currencies—for example, to make exports more competitive, manage inflation, or support broader economic goals. As you watch, consider how a stronger or weaker U.S. dollar could affect a Wisconsin business that imports materials or sells products in international markets.

YouTube Video

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Sources & References

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7.3: The Foreign Exchange Market

The **foreign-exchange market**, often called the FX or forex market, is the global market in which participants buy and sell currencies. Its participants include commercial and investment banks, businesses that buy or sell internationally, central banks, investment funds, brokers, and individual investors. The foreign-exchange market enables currency conversion for international trade, travel, investment, and financial transactions.

An **exchange rate** is the price of one currency expressed in terms of another currency. For example, if one U.S. dollar buys more euros than it did previously, the dollar has appreciated against the euro. If it buys fewer euros, the dollar has depreciated against the euro. Currency values change in response to supply and demand, interest rates, inflation expectations, economic conditions, trade flows, investor expectations, and central-bank actions.

Strong vs. Weak Currency

A stronger U.S. dollar can make foreign goods and services less expensive for U.S. consumers and businesses, because each dollar can buy more foreign currency. This may benefit U.S. importers and travelers. At the same time, a stronger dollar can make U.S.-made goods more expensive for foreign buyers, which may reduce the price competitiveness of U.S. exporters.

A weaker U.S. dollar can have the opposite effect. It may make U.S. exports relatively less expensive for foreign buyers and support export sales. However, it can raise the U.S.-dollar cost of imported consumer goods, raw materials, components, and energy. The overall effect depends on the firm, its supply chain, its customers, its pricing strategy, and whether it uses contracts or financial instruments to manage exchange-rate risk.

Law of One Price

The **law of one price** is the economic idea that identical tradable goods should sell for the same price in different markets after prices are converted into a common currency. In practice, the law may not hold exactly because transportation costs, tariffs, taxes, product differences, local regulations, market power, and other transaction costs can cause prices to differ across countries. (Investopedia 2015)

Purchasing Power Parity

Purchasing power parity (PPP) is a method for comparing the purchasing power of currencies across countries. Rather than using the market exchange rate alone, PPP compares the prices of a broad and standardized basket of goods and services. PPP is particularly useful when comparing countries' standards of living, gross domestic product, or real income levels.

Market exchange rates and PPP serve different purposes. Market rates determine the actual currency conversion rate used in trade, travel, and financial transactions. PPP estimates how much a currency can buy within a country and is therefore useful for comparing real purchasing power across economies.

Why It Matters



Figure 7.3.1: Foreign Currency Image, Philip Brewer, licensed as CC BY 2.0

Exchange rates can influence the prices businesses pay for imported materials and components, the competitiveness of exported goods and services, the cost of international travel, and the value of overseas investments. They can also affect consumer prices indirectly, particularly for products that rely heavily on imports or internationally traded commodities. However, exchange rates are only one factor among many; supply conditions, taxes, wages, commodity prices, competition, and business pricing decisions also shape the prices consumers and businesses pay.

Wisconsin Business Example

A Wisconsin manufacturer that imports specialized parts, aluminum, or electronic components may face higher costs if the U.S. dollar depreciates against the currencies used to purchase those inputs. Conversely, a Green Bay-area manufacturer that exports machinery, food-processing equipment, paper products, or agricultural products may find its goods more price-competitive abroad when the dollar weakens. Neither outcome is automatic, but the example helps students see why exchange rates matter to local businesses.

The Big Mac Index is explained as a way to measure “PPP” or Purchasing Power Parity across the globe.

What is the “Big Mac” Index?

One suggested method of predicting exchange rate movements is that the rate between two currencies should naturally adjust so that a sample basket of goods and services should cost the same in both currencies: purchasing power parity.

The **Big Mac Index** is an informal way to illustrate purchasing power parity (PPP). Created by *The Economist* in 1986, it compares the price of a McDonald’s Big Mac across countries to estimate an implied exchange rate. The implied rate is then compared with the actual market exchange rate to suggest whether a currency appears relatively undervalued or overvalued against the U.S. dollar.

Exercise 7.4.1

Explore current data: Visit *The Economist’s* [Big Mac Index interactive](#) to compare current burger prices, implied PPP exchange rates, and currency valuation estimates across countries. The display is updated periodically, so the figures students see may differ from examples in this textbook. You will need to sign up for free access. Use your student email.

Try it: Choose Canada, Mexico, Japan, or another country available in the current Big Mac Index. Record the local Big Mac price, the implied PPP exchange rate, and the actual market exchange rate. Does the index suggest that the country’s currency is under- or overvalued relative to the U.S. dollar? Identify two reasons why the result may differ from the currency’s market value.

In the Big Mac Index, the basket in question is a single Big Mac burger as sold by the McDonald’s fast food restaurant chain. The Big Mac was chosen because it is available to a common specification in many countries around the world, as local McDonald’s franchisees, at least in theory, have significant responsibility for negotiating input prices. For these reasons, the index enables a comparison between many countries’ currencies.

The Big Mac PPP exchange rate between two countries is obtained by dividing the price of a Big Mac in one country (in its currency) by the price of a Big Mac in another country (in its currency). This value is then compared with the actual exchange rate; if it is lower, then the first currency is under-valued (according to PPP theory) compared with the second, and conversely, if it is higher, then the first currency is over-valued.

Example 7.4.1

The basic calculation is:

Implied PPP exchange rate = Local price of a Big Mac / U.S. price of a Big Mac

For example, if a Big Mac costs 300 Mexican pesos in Mexico and \$6.00 in the United States, the implied PPP exchange rate is:

Solution

300 Pesos / 6.00 dollars = 50 pesos per US Dollar

If the actual market exchange rate is 18 pesos per U.S. dollar, the peso would appear overvalued by this simplified burger-based comparison. The result does **not** prove that the currency is mispriced; it simply shows how prices for this one standardized product differ across markets.

YouTube Video

This interactive element is not available in this format. Visit the link or scan the QR code to access it online.

[View this YouTube Video online](#)



[Watch the video on YouTube to view the transcript.](#)

Why It Is Useful

The index gives you a concrete way to connect exchange rates, consumer prices, and purchasing power. A Big Mac is produced and sold in many countries, but its price reflects local wages, rent, ingredients, taxes, transportation costs, competition, and McDonald's pricing decisions. The Big Mac Index therefore makes the abstract concept of PPP more accessible.

Important limitations

The Big Mac Index is a teaching tool, not a complete measure of a currency's fair value or a country's cost of living.

- It compares one product rather than a broad basket of goods and services.
- Big Macs may vary across markets because of local ingredients, taxes, wages, rents, regulations, and business strategies.
- McDonald's does not operate in every country, so the index cannot provide worldwide coverage.
- PPP may help explain long-run currency tendencies, but it provides limited guidance about short-run exchange-rate movements.
- The Economist also publishes a GDP-adjusted version because burger prices tend to be lower in countries with lower average incomes and labor costs.

Sources & References

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7.5: What is the International Monetary System?

Learning Objectives

By the end of this section, you will be able to:

- Understand the role and purpose of the international monetary system.
- Describe the purpose of the gold standard and why it collapsed.
- Describe the Bretton Woods Agreement and why it collapsed.
- Understand today's current monetary system, which developed after the Bretton Woods Agreement collapse.

Why do Economies Need Money?

This section defines *money* as a unit of account that is used as a medium of exchange in transactions. Without money, individuals and businesses would have a harder time obtaining (purchasing) or exchanging (selling) what they need, want, or make. Money provides us with a universally accepted medium of exchange.

Before the current monetary system can be fully appreciated, it's helpful to look back at history and see how money and systems governing the use of money have evolved. Thousands of years ago, people had to barter if they wanted to get something. That worked well if the two people each wanted what the other had. Even today, bartering exists.

History shows that ancient Egypt and Mesopotamia—which encompasses the land between the Euphrates and Tigris Rivers and is modern-day Iraq, parts of eastern Syria, southwest Iran, and southeast Turkey—began to use a system based on the highly coveted coins of gold and silver, also known as bullion, which is the purest form of the precious metal. However, bartering remained the most common form of exchange and trade.

Gold and silver coins gradually emerged in the use of trading, although the level of pure gold and silver content impacted the coin's value. Only coins that consist of the pure precious metal are bullion; all other coins are referred to simply as *coins*. It is interesting to note that gold and silver lasted many centuries as the basis of economic measure and even into relatively recent history of the gold standard, which we'll cover in the next section. Fast-forward two thousand years, and bartering has long been replaced by a currency-based system. Even so, there have been evolutions in the past century alone in how—globally—the monetary system has evolved from using gold and silver to represent national wealth and economic exchange to the current system.

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7.6: Dominant Currencies in History

Throughout history, some types of money have gained widespread circulation outside of the nations that issued them. Whenever a country or empire has regional or global control of trade, its currency becomes the dominant currency for trade and governs the monetary system of that time. In the middle of a period that relies on one major currency, it's easy to forget that, throughout history, there have been other primary currencies—a historical cycle. Generally, the best currency to use is the most liquid one, the one issued by the nation with the biggest economy as well as usually the largest import-export markets. Rarely has a single currency been the exclusive medium of world trade, but a few have come close. Here's a quick look at some of the most powerful currencies in history:

- **Persian daric:** The daric was a gold coin used in Persia between 522 BC and 330 BC.
- **Roman currency:** Currencies such as the aureus (gold), the denarius (silver), the sestertius (bronze), the dupondius (bronze), and the as (copper) were used during the Roman Empire from around 250 BC to AD 250.
- **Thaler:** From about 1486 to 1908, the thaler and its variations were used in Europe as the standard against which the various states' currencies could be valued.
- **Spanish American pesos:** Around 1500 to the early nineteenth century, this contemporary of the thaler was widely used in Europe, the Americas, and the Far East; it became the first world currency by the late eighteenth century.
- **British pound:** The pound's origins date as early as around AD 800, but its influence grew in the 1600s as the unofficial gold standard; from 1816 to around 1939, the pound was the global reserve currency until the collapse of the gold standard.
- **US dollar:** The Coinage Act of 1792 established the dollar as the basis for a monetary account, and it went into circulation two years later as a silver coin. Its strength as a global reserve currency expanded in the 1800s and continues today.
- **Euro:** Officially in circulation on January 1, 1999, the euro continues to serve as currency in many European countries today.

Let's take a look at the last century of the international monetary system evolution. The international monetary system refers to the system and rules that govern the use and exchange of money around the world and between countries. Each country has its own currency as money, and the international monetary system governs the rules for valuing and exchanging these currencies.

Until the nineteenth century, the major global economies were regionally focused in Europe, the Americas, China, and India. These were loosely linked, and there was no formal monetary system governing their interactions. The rest of this section reviews the distinct chronological periods over the past 150 years leading to the development of the modern global financial system. Keep in mind that the system continues to evolve and each crisis impacts it. There is not likely to be a final international monetary system, simply one that reflects the current economic and political realities. This is one main reason why understanding the historical context is so critical. As the debate about the pros and cons of the current monetary system continues, some economists are tempted to advocate a return to systems from the past. Businesses need to be mindful of these arguments and the resulting changes, as they will be impacted by new rules, regulations, and structures.

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7.7: Pre World War 1- Gold Standard

Ancient societies started using gold as a means of economic exchange. Gradually, more countries adopted gold, usually in the form of coins or bullion, and this international monetary system became known as the gold standard. This system emerged gradually, without the structural process in more recent systems. The **gold standard**, in essence, created a fixed exchange rate system. An exchange rate is the price of one currency in terms of a second currency. In the gold standard system, each country sets the price of its currency to gold, specifically to one ounce of gold. A fixed exchange rate stabilizes the value of one currency vis-à-vis another and makes trade and investment easier.

Our modern monetary system has its roots in the early 1800s. The defeat of Napoleon in 1815, when France was beaten at the Battle of Waterloo, made Britain the strongest nation in the world, a position it held for about one hundred years. In Africa, British rule extended at one time from the Cape of Good Hope to Cairo. British dominance and influence also stretched to the Indian subcontinent, the Malaysian peninsula, Australia, New Zealand—which attracted British settlers—and Canada. Under the banner of the British government, British companies advanced globally and were the largest companies in many of the colonies, controlling trade and commerce. Throughout history, strong countries, as measured mainly in terms of military might, were able to advance the interests of companies from their countries—a fact that has continued to modern times, as seen in the global prowess of American companies. Global firms in turn have always paid close attention to the political, military, and economic policies of their and other governments.

In 1821, the United Kingdom, the predominant global economy through the reaches of its colonial empire, adopted the gold standard and committed to fixing the value of the British pound. The major trading countries, including Russia, Austria-Hungary, Germany, France, and the United States, also followed and fixed the price of their currencies to an ounce of gold.

The United Kingdom officially set the price of its currency by agreeing to buy or sell an ounce of gold for the price of 4.247 pounds sterling. At that time, the United States agreed to buy or sell an ounce of gold for \$20.67. This enabled the two currencies to be freely exchanged in terms of an ounce of gold. In essence,

$$£4.247 = 1 \text{ ounce of gold} = \$20.67.$$

The exchange rate between the US dollar and the British pound was then calculated by

$$\$20.67 / £4.247 = \$4.867 \text{ to } £1.$$

The Advantages of the Gold Standard

The gold standard dramatically reduced the risk in exchange rates because it established fixed exchange rates between currencies. Any fluctuations were relatively small. This made it easier for global companies to manage costs and pricing. International trade grew throughout the world, although economists are not always in agreement as to whether the gold standard was an essential part of that trend.

The second advantage is that countries were forced to observe strict monetary policies. They could not just print money to combat economic downturns. One of the key features of the gold standard was that a currency had to actually have in reserve enough gold to convert all of the currency being held by anyone into gold. Therefore, the volume of paper currency could not exceed the gold reserves.

The third major advantage was that the gold standard would help a country correct its trade imbalance. For example, if a country was importing more than it was exporting (called a trade deficit), then under the gold standard the country had to pay for the imports with gold. The government of the country would have to reduce the amount of paper currency, because there could not be more currency in circulation than its gold reserves. With less money floating around, people would have less money to spend (thus causing a decrease in demand), and prices would also eventually decrease. As a result, with cheaper goods and services to offer, companies from the country could export more, changing the international trade balance gradually back to being in balance. For these three primary reasons, and as a result of the 2008 global financial crisis, some modern economists are calling for the return of the gold standard or a similar system.

Collapse of the Gold Standard

If it was so good, what happened? The gold standard eventually collapsed from the impact of World War I. During the war, nations on both sides had to finance their huge military expenses and did so by printing more paper currency. As the currency in circulation exceeded each country's gold reserves, many countries were forced to abandon the gold standard. In the 1920s, most countries, including the United Kingdom, the United States, Russia, and France, returned to the gold standard at the same price level, despite the political instability, high unemployment, and inflation that were spread throughout Europe.

However, the revival of the gold standard was short-lived due to the Great Depression, which began in the late 1920s. The Great Depression was a worldwide phenomenon. By 1928, Germany, Brazil, and the economies of Southeast Asia were depressed. By early 1929, the economies of Poland, Argentina, and Canada were contracting, and the United States economy followed in the middle of 1929. Some economists have suggested that the larger factor tying these countries together was the international gold standard, which they believe prolonged the Great Depression. The gold standard limited the flexibility of the monetary policy of each country's central banks by limiting their ability to expand the money supply. Under the gold standard, countries could not expand their money supply beyond what was allowed by the gold reserves held in their vaults.

Too much money had been created during World War I to allow a return to the gold standard without either large **currency devaluations** or price deflations. In addition, the U.S. gold stock had doubled to about 40 percent of the world's monetary gold. There simply was not enough monetary gold in the rest of the world to support the countries' currencies at the existing exchange rates.

By 1931, the United Kingdom had to officially abandon its commitment to maintain the value of the British pound. The currency was allowed to float, which meant that its value would increase or decrease based on demand and supply. The U.S. dollar and the French franc were the next strongest currencies, and nations sought to peg the value of their currencies to either the dollar or franc. However, in 1934, the United States devalued its currency from \$20.67 per ounce of gold to \$35 per ounce. With a cheaper U.S. dollar, U.S. firms were able to export more as the price of their goods and services was cheaper vis-à-vis other nations. Other countries devalued their currencies in retaliation for the lower U.S. dollar. Many of these countries used arbitrary par values rather than a price relative to their gold reserves. Each country hoped to make its exports cheaper to other countries and reduce expensive imports. However, with so many countries simultaneously devaluing their currencies, the impact on prices was canceled out. Many countries also imposed tariffs and other trade restrictions in an effort to protect domestic industries and jobs. By 1939, the gold standard was dead; it was no longer an accurate indicator of a currency's real value.

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7.8: Post World War 2- Bretton Woods

The demise of the gold standard and the rise of the Bretton Woods system pegged to the U.S. dollar was also a changing reflection of global history and politics. The British Empire's influence was dwindling. In the early 1800s, with the strength of both their currency and trading might, the United Kingdom had expanded its empire. At the end of World War I, the British Empire spanned more than a quarter of the world; the general sentiment was that "the sun would never set on the British Empire." British maps and globes of the time showed the empire's expanse proudly painted in red. However, shortly after World War II, many of the colonies fought for and achieved independence. By then, the United States had clearly replaced the United Kingdom as the dominant global economic center and as the political and military superpower as well.

U.S. Companies Going Global

As the United States emerged from World War II as a major political and economic power, large U.S. companies also prepared to expand internationally. Firms such as General Motors, Ford, Kellogg's, and Amoco viewed postwar reconstruction and growing international trade as opportunities to enter new markets.

General Motors created a postwar planning group in 1942 to assess the likely global business environment after the war. The group anticipated political uncertainty, including growing tension between Western countries and the Soviet Union, but also concluded that the United States would be economically stronger than it had been after World War I. GM therefore planned to expand cautiously while continuing to seek overseas markets and investments.

This example illustrates an important connection to the Bretton Woods era: the postwar international economic system, including more stable exchange-rate arrangements and new institutions such as the International Monetary Fund and World Bank, was designed to support economic recovery and international trade. U.S. multinational companies sought to take advantage of the expanding opportunities created by that more connected global economy.

Bretton Woods

In the early 1940s, the United States and the United Kingdom began discussions to formulate a new international monetary system. John Maynard Keynes, a highly influential British economic thinker, and Harry Dexter White, a U.S. Treasury official, paved the way to create a new monetary system. In July 1944, representatives from forty-four countries met in Bretton Woods, New Hampshire, to establish a new international monetary system.

"The challenge," wrote Ngaire Woods in his book *The Globalizers: The IMF, the World Bank, and Their Borrowers*, "was to gain agreement among states about how to finance postwar reconstruction, stabilize exchange rates, foster trade, and prevent balance of payments crises from unraveling the system." Source: Ngaire Woods, *Globalizers: The IMF, the World Bank, and Their Borrowers* (Ithaca, NY: Cornell University Press, 2006), 16.

Outcomes of Bretton Woods

Throughout history, political, military, and economic discussions between nations have always occurred simultaneously in an effort to create synergies between policies and efforts. A key focus of the 1940s efforts for a new global monetary system was to stabilize war-torn Europe.

In the decade following the war, the administrations of both Harry Truman and Dwight Eisenhower looked to the private sector to assist in the recovery of western Europe, both through increased trade and direct foreign investments. In fact, the \$13 billion Marshall Plan, which became the engine of European recovery between 1948 and 1952, was predicated on a close working relationship between the public and private sectors. Similarly, Eisenhower intended to bring about world economic recovery through liberalized world commerce and private investment abroad rather than through foreign aid. Over the course of his two administrations (1953–1961), the president modified his policy of "trade not aid" to one of "trade and aid" and changed his focus from Western Europe to the developing economies, which he felt was most threatened by communist expansion. In particular, he was concerned by what he termed a "Soviet economic offensive" in the Middle East, that is, Soviet loans and economic assistance to such countries as Egypt and Syria. But even then he intended that international commerce and direct foreign investments would play a major role in achieving global economic growth and prosperity.

The resulting Bretton Woods Agreement created a new dollar-based monetary system, which incorporated some of the disciplinary advantages of the gold system while giving countries the flexibility they needed to manage temporary economic setbacks, which had led to the fall of the gold standard. The Bretton Woods Agreement lasted until 1971 and established several key features.

Fixed Exchange Rates

Fixed exchange rates are also sometimes called pegged rates. One of the critical factors that led to the fall of the gold standard was that after the United Kingdom abandoned its commitment to maintaining the value of the British pound, countries sought to peg their currencies to the US dollar. With the strength of the U.S. economy, the gold supply in the United States increased, while many countries had less gold in reserve than they did currency in circulation. The Bretton Woods system worked to fix this by tying the value of the U.S. dollar to gold but also by tying all of the other countries to the U.S. dollar rather than directly to gold. The par value of the U.S. dollar was fixed at \$35 to one ounce of gold. All other countries then set the value of their currencies to the U.S. dollar. In reflection of the changing times, the British pound had undergone a substantial loss in value, and by that point, its value was \$2.40 to £1. Member countries had to maintain the value of their currencies within 1 percent of the fixed exchange rate. Lastly, the agreement established that only governments, rather than anyone who demanded it, could convert their U.S. dollar holdings into gold—a major improvement over the gold standard. In fact, most businesspeople eventually ignored the technicality of pegging the U.S. dollar to gold and simply utilized the actual exchange rates between countries (e.g., the pound to the dollar) as an economic measure for doing business.

National Flexibility

To enable countries to manage temporary but serious downturns, the Bretton Woods Agreement provided for a devaluation of a currency—more than 10 percent if needed. Countries could not use this tool to competitively manipulate imports and exports. Rather, the tool was intended to prevent the large-scale economic downturn that took place in the 1930s.

Creation of the International Monetary Fund and the World Bank

“What Is the Role of the IMF and the World Bank?” looks at the International Monetary Fund and the World Bank more closely, as they have survived the collapse of the Bretton Woods Agreement. In essence, the IMF’s initial primary purpose was to help manage the fixed rate exchange system; it eventually evolved to help governments correct temporary trade imbalances (typically deficits) with loans. The World Bank’s purpose was to help with post-World War II European reconstruction. Both institutions continue to serve these roles but have evolved into broader institutions that serve essential global purposes, even though the system that created them is long gone. “What Is the Role of the IMF and the World Bank?” explores them in greater detail and addresses the history, purpose, evolution, and current opportunities and challenges of both institutions.

Collapse of Bretton Woods

Despite a fixed exchange rate based on the US dollar and more national flexibility, the Bretton Woods Agreement ran into challenges in the early 1970s. The U.S. trade balance had turned to a deficit as Americans were importing more than they were exporting. Throughout the 1950s and 1960s, countries had substantially increased their holdings of U.S. dollars, which was the only currency pegged to gold. By the late 1960s, many of these countries expressed concern that the U.S. did not have enough gold reserves to exchange all of the U.S. dollars in global circulation. This became known as the **Triffin Paradox**, named after the economist Robert Triffin, who identified this problem. He noted that the more dollars foreign countries held, the less faith they had in the ability of the U.S. government to convert those dollars. Like banks, though, countries do not keep enough gold or cash on hand to honor all of their liabilities. They maintain a percentage, called a reserve. The U.S. reserve requirements for many transaction accounts were reduced to 0 percent in 2020. Some countries state their reserve ratios openly, and most seek to actively manage their ratios daily with open-market monetary policies—that is, buying and selling government securities and other financial instruments, which indirectly control the total money supply in circulation, which in turn impacts supply and demand for the currency.

The expense of the Vietnam War and an increase in domestic spending worsened the Triffin Paradox; the US government began to run huge budget deficits, which further weakened global confidence in the U.S. dollar. When nations began demanding gold in exchange for their dollars, there was a huge global sell-off of the U.S. dollar, resulting in the Nixon Shock in 1971.

The Nixon Shock

By the late 1960s and early 1970s, the Bretton Woods system was under growing pressure. The United States had issued more dollars abroad than it could comfortably support with its gold reserves. Foreign governments and central banks could exchange their dollars for U.S. gold at the official rate of \$35 per ounce, raising concern that U.S. gold reserves would be depleted. Inflation and U.S. trade deficits also weakened confidence in the dollar.

On August 15, 1971, President Richard Nixon announced a group of economic actions that became known as the **Nixon Shock**. Most importantly, he ended the ability of foreign governments and central banks to exchange U.S. dollars for gold at the fixed rate. This decision effectively ended the gold-convertibility feature at the center of the Bretton Woods system. Nixon also introduced temporary wage and price controls and other measures intended to address inflation and economic pressures in the United States.

Later in 1971, several countries attempted to preserve the system through the **Smithsonian Agreement**. The agreement reduced the dollar's official value in gold from \$35 to \$38 per ounce. In other words, it took more U.S. dollars to equal one ounce of gold, so the dollar was devalued. The agreement also allowed exchange rates to move within a wider range—up to 2.25 percent above or below their official values—rather than the earlier 1 percent limit.

The Smithsonian Agreement did not solve the underlying problems. It still depended on confidence in the U.S. dollar, while inflation, trade imbalances, and currency speculation continued. One by one, major economies—including Germany, the United Kingdom, and Switzerland—began allowing their currencies to move more freely against the dollar. By 1973, the major industrial economies had largely shifted to **floating exchange rates**, in which currency values are determined mainly by market supply and demand rather than being fixed to the dollar or gold.

Why Bretton Woods Mattered

The Bretton Woods system was important because it created an organized international framework for managing exchange rates after World War II. Under the system, countries agreed to maintain relatively stable exchange rates, while the U.S. dollar served as the central reserve currency and was linked to gold. This arrangement reduced exchange-rate uncertainty and made it easier for businesses to plan international purchases, sales, investments, and financing.

The fixed exchange-rate system ended in the early 1970s, but the institutions established at Bretton Woods—the **International Monetary Fund (IMF)** and the **World Bank**—continue to play major roles in the global economy. Today's system is not a return to Bretton Woods: most major currencies float, and governments use a variety of exchange-rate arrangements. However, the Bretton Woods legacy remains important because it showed how international rules and institutions can support cooperation and stability in global trade and finance.

Institutions created at Bretton Woods, like the IMF and the World Bank did not collapse and remain major international institutions.

Contemporary Developments: Digital Money and Cross-Border Payments

The Bretton Woods system ended, but the international monetary system remains strongly influenced by the U.S. dollar. The dollar continues to be the world's preeminent reserve currency and is widely used in international trade, finance, borrowing, and foreign-exchange markets. At the same time, some countries are seeking ways to make cross-border payments faster, less expensive, and less dependent on dollar-based payment channels.

One area of innovation involves **central bank digital currencies (CBDCs)**. A CBDC is a digital form of a country's official currency issued by, or representing a claim on, its central bank. Central banks are studying or piloting CBDCs for domestic payments and for cross-border transactions. Potential benefits include faster settlement, lower transaction costs, and improved payment access. However, CBDCs also raise important questions about privacy, cybersecurity, financial stability, international coordination, and the role of commercial banks.

Countries within the BRICS grouping and other governments have discussed using their own national currencies more often in trade and developing payment systems that can connect national financial infrastructures. These efforts are sometimes described as “de-dollarization.” However, they should not be described as the creation of a new global currency. As of 2026, BRICS has not adopted a common currency; its more immediate focus has been local-currency settlement and interoperability among payment

and messaging systems.

Bitcoin is different from a CBDC. Bitcoin is a decentralized cryptoasset that is not issued or guaranteed by a government or central bank. Its price can fluctuate substantially, which limits its usefulness as a stable unit of account or widely used medium of exchange for international trade. While cryptoassets may be used for investment or some payments, they have not replaced national currencies or the U.S. dollar in the mainstream international monetary system.

Stablecoins are another development to watch. A stablecoin is a digital token designed to maintain a relatively stable value by referencing an asset, often the U.S. dollar. Stablecoins may support faster digital transfers, including cross-border payments, but they can present regulatory, reserve-management, consumer-protection, and financial-integrity concerns. More than 99 percent of stablecoins are denominated in U.S. dollars, meaning their growth may, in some cases, extend rather than displace the dollar's international role.

Table 7.8.1: Comparison of Forms of Money or Systems

Form of money or system	Issuer or backing	Main purpose	Relevance to global business
National currency	National government and central bank	Domestic payments, saving, pricing, and taxation	Used for most trade, investment, and financial transactions
U.S. dollar	U.S. government and Federal Reserve	U.S. currency and leading international reserve currency	Widely used to invoice trade, hold reserves, borrow, and settle cross-border transactions
CBDC	Central bank	Digital form of official national money	Could improve domestic or cross-border payment efficiency, subject to policy and technical design
Bitcoin	No government or central-bank issuer	Decentralized crypto asset	Used primarily as a speculative or investment asset; volatility limits its role in routine trade settlement
Stablecoin	Private issuer; typically linked to a reserve asset or currency	Digital payments and transfers	May support faster transfers but depends on credible reserves, regulation, and user trust

The post-Bretton Woods system is evolving rather than being replaced. The U.S. dollar remains central to global finance, but digital payment technologies, CBDC experiments, stablecoins, and increased use of local currencies in cross-border trade may gradually change how international payments are made.

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7.9: Post Bretton Woods System

From Bretton Woods to Today's System

After the Bretton Woods fixed exchange-rate system ended in the early 1970s, countries adopted a variety of exchange-rate arrangements. Many major economies—including the United States, the euro area, Japan, the United Kingdom, Canada, and Australia—allow their currencies to float. In a floating exchange-rate system, currency values are determined largely by supply and demand in foreign-exchange markets.

Other countries manage their exchange rates more closely. They may allow limited movement within a target range, peg their currency to another currency or basket of currencies, operate a currency board, or use another country's currency. As a result, there is no single post-Bretton Woods system. Instead, the modern international monetary system combines market-determined exchange rates, government intervention, international institutions, and regional monetary arrangements

Jamaica Agreement

In 1976, IMF member countries reached the **Jamaica Agreement**, which formally recognized the end of the Bretton Woods system of fixed exchange rates tied to gold. The agreement removed gold from its former central role in the international monetary system and allowed countries to choose their own exchange-rate arrangements.

The agreement also confirmed the IMF's continuing role in monitoring members' exchange-rate policies and assisting countries facing balance-of-payments difficulties. The IMF's role evolved from supporting a fixed-rate system to promoting international monetary cooperation, financial stability, and orderly exchange-rate arrangements in a more diverse global system.

International Economic Coordination

Countries continue to coordinate economic policy through several international forums. The **Group of Seven (G7)** brings together Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States, along with the European Union. It discusses economic policy, financial stability, security, and other shared concerns.

The **Group of Twenty (G20)** was established in 1999 to bring major advanced and emerging economies into international economic discussions. Its members include 19 countries, the European Union, and the African Union. The G20 gained greater prominence during the 2008 global financial crisis, when national leaders used it to coordinate responses to severe global economic disruption.

These groups do not govern the global economy or set binding exchange rates. Instead, they provide forums for finance ministers, central-bank governors, and national leaders to discuss shared challenges such as inflation, debt, financial crises, trade, climate-related finance, and cross-border payment systems.

G20 Countries	
Argentina	Japan
Australia	Mexico
Brazil	Russia
Canada	Saudia Arabia
China	South Africa
France	South Korea
Germany	Turkey
India	United Kingdom
Indonesia	United States
Italy	European Union

Figure 7.9.1: List of G20 Countries

Today's Exchange Rate System

Most major currencies now operate under floating or managed-floating exchange-rate arrangements. Exchange rates can change daily in response to interest rates, inflation expectations, economic growth, trade flows, investment decisions, political events, and central-bank actions.

The U.S. dollar remains the world's most widely used reserve currency and plays a major role in international trade, global borrowing, commodity pricing, and foreign-exchange transactions. The euro, Japanese yen, British pound, Swiss franc, Chinese renminbi, and other currencies also play important international roles. However, no currency or institution has replaced the U.S. dollar as the central currency in global finance.

For businesses, this system creates both flexibility and risk. Floating exchange rates can help economies adjust to changing conditions, such as shifts in energy prices or economic growth. At the same time, exchange-rate changes can affect the cost of imported materials, the competitiveness of exports, the value of overseas revenue, and international investment decisions.

Digital Currencies and Cross-Border Payments

Countries, central banks, and private firms are exploring new ways to move money across borders. These include central bank digital currencies, faster-payment networks, tokenized bank deposits, and stablecoins. These developments may eventually reduce transaction costs and improve the speed of international payments.

They have not, however, created a replacement for the international monetary system or the U.S. dollar. Bitcoin is a decentralized cryptoasset rather than a national currency, and its price volatility limits its use for routine business pricing and trade settlement. Central bank digital currencies are official digital forms of national money, but most remain in research, pilot, or limited-use stages

Ethics in Action

The *Wall Street Journal*'s July 30, 2010, edition noted how gangsters are helping provide stability in the euro zone. The highest denomination of a euro is a €500 bill, in contrast to the United States, where the largest bill is a \$100 bill.

The high-value bills are increasingly "making the euro the currency of choice for underground and black economies, and for all those who value anonymity in their financial transactions and investments," wrote Willem Buiter, the chief economist at Citigroup.... When euro notes and coins went into circulation in January 2002, the value of €500 notes outstanding was

€30.8 billion (\$40 billion), according to the ECB [European Central Bank]. Today some €285 billion worth of such euro notes are in existence, an annual growth rate of 32 percent. By value, 35 percent of euro notes in circulation are in the highest denomination, the €500 bill that few people ever see. In 1998, then-U.S. Treasury official Gary Gensler worried publicly about the competition to the \$100 bill, the biggest U.S. bank note, posed by the big euro notes and their likely use by criminals. He pointed out that \$1 million in \$100 bills weighs 22 pounds; in hypothetical \$500 bills, it would weigh just 4.4 pounds.

Police forces have found the big euro notes in cereal boxes, tires and in hidden compartments in trucks, says Soren Pedersen, spokesman for Europol, the European police agency based in The Hague. “Needless to say, this cash is often linked to the illegal drugs trade, which explains the similarity in methods of concealment that are used.” ([How Gangsters Are Saving Euro Zone](#)).

While you might think that the ECB should just stop issuing the larger denominations, it turns out that the ECB and the member governments of the euro zone actually benefit from this demand.

The profit a central bank gains from issuing currency—as well as from other privileges of a central bank, such as being able to demand no-cost or low-cost deposits from banks—is known as seigniorage. It normally accrues to national treasuries once the central banks account for their own costs. The ECB's gains from seigniorage are becoming increasingly important, with profits from issuing new paper currency upwards of €50 billion annually.

Some smaller nations have chosen to voluntarily set exchange rates against the dollar, while other countries have selected the euro. Usually, a country makes the decision between the dollar and the euro by reviewing its largest trading partners. By choosing the euro or the dollar, countries seek currency stability and a reduction in inflation, among other perceived benefits. Many countries in Latin America once dollarized to provide currency stability for their economy. Today, this is changing, as individual economies have strengthened and countries are now seeking to de-dollarize.

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7.10: Spotlight on Dollarizing and Dedollarizing in Latin America

Introduction

Countries sometimes rely on a foreign currency—most often the U.S. dollar—to improve confidence in prices, savings, and financial contracts. This practice is called **dollarization**. It may occur officially, when a government adopts the U.S. dollar as legal tender, or unofficially, when households and businesses voluntarily use dollars for savings, loans, prices, or contracts even though the country retains its own currency.

Dollarization may help countries that have experienced high inflation, rapid currency depreciation, banking instability, or low public confidence in the national currency. When people trust the U.S. dollar more than the local currency, they may prefer to save, borrow, or set prices in dollars.

However, dollarization also involves important tradeoffs. A country that officially adopts the U.S. dollar gives up control over its own monetary policy. It cannot issue its own currency, set an independent policy interest rate, or devalue its currency to support exports during an economic downturn. In addition, the country must obtain enough dollars through exports, tourism, foreign investment, remittances, borrowing, or reserves to support its economy.

This section compares two different experiences. Ecuador adopted the U.S. dollar as its official currency after a major financial crisis. Peru retained its national currency, the sol, but worked to reduce the economy's dependence on U.S. dollars. Together, the two cases show the difference between **official dollarization** and **financial de-dollarization**.

Key Terms

- **Official dollarization:** Adoption of the U.S. dollar as legal tender in place of a national currency.
- **Financial dollarization:** Extensive use of a foreign currency for deposits, loans, pricing, or contracts while the national currency remains legal tender.
- **De-dollarization:** Policies and market changes that reduce reliance on a foreign currency and increase the use of the national currency.
- **Monetary policy:** Actions by a central bank to influence interest rates, the money supply, inflation, and financial conditions.
- **Exchange-rate risk:** The possibility that a change in exchange rates will affect the value of a payment, loan, investment, purchase, or sale.

Ecuador: Official Dollarization

Ecuador adopted the U.S. dollar as legal tender in 2000 after a severe economic and financial crisis. The country faced high inflation, a sharp depreciation of the sucre, banking-sector problems, and a loss of public confidence in the national currency. Replacing the sucre with the U.S. dollar was intended to stabilize prices, restore confidence, and reduce the risk that the domestic currency would continue to lose value.

Dollarization helped Ecuador reduce inflation and removed exchange-rate risk between Ecuador and the United States. For households and businesses, prices, savings, and contracts could be denominated in a currency that was widely trusted and internationally accepted. Companies that imported goods or borrowed in dollars no longer faced the risk that a depreciating Ecuadorian currency would suddenly make their dollar obligations much more expensive.

However, Ecuador also gave up important policy tools. Because it does not issue its own currency, Ecuador cannot independently adjust interest rates, expand the money supply, or devalue its currency when economic conditions weaken. The country's economy is therefore strongly affected by the availability of U.S. dollars, the value of the dollar in world markets, export earnings, remittances, tourism, and international financing.

For example, if the U.S. dollar strengthens against other currencies, Ecuadorian exports may become more expensive for foreign buyers. Ecuador cannot reduce the value of its currency to make its exports more competitive because its currency is the U.S. dollar. Businesses must instead respond through productivity improvements, cost management, product quality, pricing, or new markets.

Argentina: A Continuing Dollarization Debate

Argentina has experienced recurring inflation and periods of low confidence in the peso. As a result, many Argentines use U.S. dollars for savings, real-estate transactions, and some larger purchases. During the 2023 presidential campaign, Javier Milei proposed official dollarization as a way to end inflation and restore confidence. Argentina has not adopted the U.S. dollar as legal tender and continues to use the peso, but the debate illustrates how currency instability can lead businesses and households to rely more heavily on a foreign currency.

Peru: Financial Dollarization and De-Dollarization

Peru offers a different example. Peru has retained the **sol** as its national currency, but periods of high inflation and economic instability led many households and businesses to use U.S. dollars for deposits, loans, real-estate transactions, and long-term contracts. This is known as financial dollarization.

Financial dollarization can create risk for borrowers. For example, a Peruvian company may earn revenue in soles but borrow money in U.S. dollars because dollar loans offer lower interest rates. If the sol loses value against the dollar, the company must use more soles to make the same dollar-denominated loan payment. A business that does not earn dollars may therefore face a sharp increase in its debt burden even if the amount owed in dollars has not changed.

Over time, Peru worked to reduce this risk by strengthening confidence in the sol and encouraging lending and saving in local currency. Policies included maintaining relatively low and stable inflation, improving the credibility of monetary policy, developing financial markets in soles, and using banking regulations that made foreign-currency lending less attractive when borrowers did not earn income in dollars.

Peru's experience shows that de-dollarization is usually gradual. It depends on public confidence that the national currency will hold its value and that the financial system can provide reliable ways to save, borrow, and invest in local currency. Even when a country successfully reduces dollar use, U.S. dollars may remain important for international trade, foreign investment, tourism, and some long-term financial contracts.

Comparing Ecuador and Peru

Table 7.10.1: *International Comparisons*

Issue	Ecuador	Peru
Currency arrangement	Officially uses the U.S. dollar	Uses the Peruvian sol
Type of dollarization	Official dollarization	Financial dollarization
Exchange-rate risk within the country	No exchange-rate risk between the U.S. dollar and a local currency	Businesses and borrowers may face risk when dollar debts are paid with sol-denominated income
Monetary-policy independence	Limited; Ecuador cannot set an independent monetary policy or issue its own currency	Retained; Peru's central bank can use interest rates and other tools to support price stability
Ability to devalue	None; the country uses the U.S. dollar	Possible; the sol can rise or fall in value
Main challenge	Adjusting to economic shocks without its own currency	Building trust in the sol and limiting currency mismatches in the financial system

Business Implications

Dollarization and de-dollarization affect everyday business decisions.

- **Pricing:** A business that prices goods in U.S. dollars may protect itself from local-currency inflation, but customers paid in local currency may face higher prices when the local currency depreciates.
- **Borrowing:** A dollar-denominated loan can be risky when a borrower earns revenue in local currency. A depreciation of the local currency raises the local-currency cost of repaying the loan.
- **Imports and exports:** Dollarization can reduce currency-conversion costs and uncertainty in trade with the United States. However, a stronger U.S. dollar can make a dollarized country's exports less competitive in world markets.
- **Investment:** Foreign investors may view a stable currency arrangement as reducing currency risk. At the same time, investors may be concerned that a dollarized government has fewer tools to respond to recession, banking stress, or falling export revenue.
- **Financial planning:** Businesses operating across borders need to match the currency of their costs, revenue, and debt whenever possible. A company that earns revenue in soles but owes debt in dollars faces a currency mismatch that can become costly when the sol depreciates.

Key Takeaways

- Dollarization means using a foreign currency—usually the U.S. dollar—in place of, or alongside, a national currency.
- **Official dollarization** occurs when a country adopts the U.S. dollar as legal tender; Ecuador is an example.
- **Financial dollarization** occurs when people and businesses use dollars widely while the country retains its own currency; Peru has experienced this form of dollar use.
- Dollarization may reduce inflation and exchange-rate uncertainty, but it limits a country's ability to conduct independent monetary policy.
- De-dollarization is a gradual effort to increase the use of the national currency by building public confidence, maintaining low inflation, and reducing foreign-currency borrowing.
- For businesses, the most important issue is currency mismatch: borrowing or paying costs in one currency while earning revenue in another can create substantial financial risk.

Discussion Questions

1. Why might people in a country with high inflation prefer to save or borrow in U.S. dollars?
2. What benefits did Ecuador gain by adopting the U.S. dollar, and what policy tools did it give up?
3. Why can a dollar-denominated loan be risky for a Peruvian business that earns revenue in soles?
4. How might a stronger U.S. dollar affect Ecuadorian exporters?
5. If you managed a business in Peru, what steps could you take to reduce currency-mismatch risk?

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7.11: Global Business in Action

Key Terms

Federal budget deficit: The amount by which federal spending exceeds federal revenue in one fiscal year

Federal budget surplus: The amount by which federal revenue exceeds federal spending in one fiscal year

National debt: The total accumulated amount the federal government has borrowed over time to finance past deficits, minus any budget surpluses used to repay debt.

Trade deficit: The amount by which the value of imports exceeds the value of exports; it is not the same as the federal budget deficit.

U.S. Budget Deficits, Debt, and the International Role of the Dollar

The United States government has not always run large, persistent budget deficits. In some years, especially following wars or during periods of strong economic growth and higher tax revenue, the federal government has recorded budget surpluses. For example, the federal budget recorded surpluses from fiscal years 1998 through 2001. More recently, however, the United States has run annual deficits for many consecutive years. In fiscal year 2025, the federal budget deficit was approximately \$1.8 trillion, equal to 5.8 percent of gross domestic product (GDP).

A federal **budget deficit** occurs when the government spends more in a fiscal year than it collects in taxes and other revenue. To cover the difference, the U.S. Treasury borrows by issuing securities such as Treasury bills, notes, and bonds. The accumulation of past borrowing is the **national debt**.

Government deficits do not result from the actions of a president alone. Congress passes tax and spending legislation, presidents propose budgets and sign or veto legislation, and economic conditions affect both revenue and spending. Recessions often reduce tax collections and increase spending on unemployment benefits and other support programs. Wars, public-health emergencies, tax cuts, infrastructure spending, Social Security and Medicare obligations, and rising interest payments can also increase deficits.



Figure 7.11.1: Federal Debt Over Time

A Changing Fiscal Pattern

U.S. deficits have varied widely across history. Large deficits occurred during the Civil War, World War I, World War II, the Great

Depression, the 2008–2009 financial crisis, and the COVID-19 pandemic. In contrast, the United States recorded smaller deficits or surpluses during some peacetime periods.

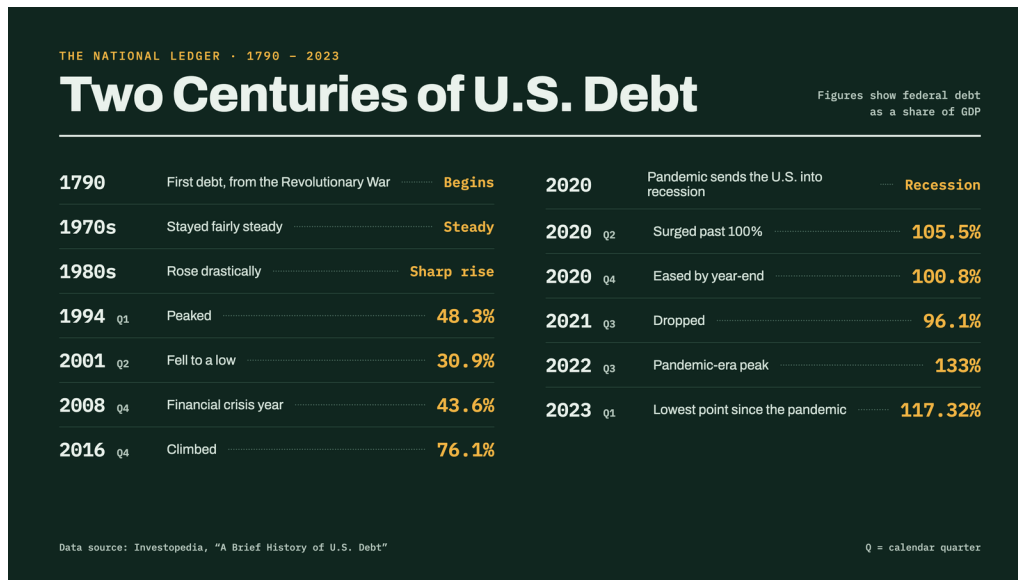


Figure 7.11.2: Two Centuries of U.S. Debt

Implications:

- **Wars and national emergencies** often produce large, temporary increases in borrowing.
- **Recessions** reduce tax revenue and increase government spending on economic support.
- **Tax and spending policies** can create or reduce deficits depending on whether revenues and outlays change by similar amounts.
- **Interest costs** rise as the national debt grows and as interest rates increase.
- **Population aging and health-care costs** place ongoing pressure on federal spending through programs such as Social Security and Medicare.

The federal government ended fiscal year 2025 with a deficit of about \$1.8 trillion. The Congressional Budget Office projected a deficit of approximately \$1.9 trillion for fiscal year 2026 and projected that federal debt held by the public would rise to 120 percent of GDP by 2036 under its baseline assumptions.cbo+1

Did the Gold Standard Prevent Deficits?

No. The United States ran budget deficits and accumulated debt during periods when the dollar was linked to gold. For example, large federal borrowing occurred during the Civil War, World War I, the Great Depression, and World War II. A gold standard did not require balanced federal budgets.

However, the gold standard created tighter constraints on monetary policy and international payments. Under a gold-based system, governments and central banks needed to maintain confidence that currency could be exchanged for gold at the stated rate. Large deficits could become more difficult to finance if they contributed to gold outflows, inflation, or reduced confidence in the currency's convertibility.

The United States moved away from the domestic gold standard during the Great Depression and ended the dollar's convertibility into gold for foreign governments in 1971. After the end of Bretton Woods, the United States operated under a fiat-money system, meaning that the dollar is not convertible into gold at a fixed price. This gave policymakers greater flexibility to respond to recessions and financial crises, but it did not eliminate the economic costs or policy tradeoffs associated with persistent deficits.richmondfed+1

Why the U.S. Can Borrow in Dollars

The U.S. dollar plays a central role in the global financial system. Foreign governments, central banks, banks, investment funds, businesses, and individuals hold U.S. Treasury securities because they are widely traded, highly liquid, and denominated in the world's leading reserve currency.

This international demand can make it easier and less costly for the U.S. government to borrow than it would be for a smaller country with a less widely used currency. The United States can borrow largely in its own currency, whereas many countries must borrow in foreign currencies such as U.S. dollars or euros. A country that borrows in a foreign currency faces additional risk: if its own currency depreciates, its debt becomes more expensive to repay.

The dollar's international role does not mean that deficits are costless or unlimited. Persistent deficits add to the national debt, and higher debt can increase federal interest costs, affect private investment, limit future fiscal choices, and create risks if investors demand higher returns to hold Treasury securities.

How Could the Federal Deficit be Reduced?

Reducing the federal budget deficit generally requires some combination of increasing federal revenue, slowing the growth of spending, and supporting long-run economic growth. Revenue options include changing tax rates, broadening the tax base by limiting deductions or credits, improving tax compliance, or creating new taxes. Spending options include changes to health-care programs, Social Security, defense, discretionary spending, and other programs. Current tax spending categories are listed below.

Table 7.11.1: Categories of US Government Spending

Broad category	Included programs	Approximate share
Social services	Social Security; income-security programs such as unemployment compensation, food assistance, housing assistance, and related support; veterans' benefits and services	34%
Healthcare	Medicare; Medicaid; Affordable Care Act subsidies; other federal health programs	29%
Miscellaneous government services	Education, transportation, scientific research, law enforcement, courts, environmental programs, diplomacy, and routine government operations	11%
Military	National defense, including military personnel, equipment, operations, and national security	13%
Interest	Net interest payments on the national debt	13%
Total		100%

Source: U.S. Department of the Treasury, *Fiscal Data: Federal Spending*, accessed October 2026.

Policies that raise productivity, labor-force participation, and economic growth can also increase tax revenue over time, but growth alone is unlikely to fully close a large structural deficit. Each option involves trade-offs involving household costs, economic incentives, equity, public services, and political feasibility. It isn't easy, and there isn't one solution that will fix it all. There needs to be a combination of reduced services, increased taxes, and reduced spending.

Business Implications

Federal deficits and government borrowing influence businesses through interest rates, inflation expectations, exchange rates, investor confidence, and the availability of credit.

For example, a Northeast Wisconsin manufacturer planning to purchase equipment may be affected if interest rates rise, increasing the cost of business loans. A Wisconsin exporter may be affected if changes in interest rates influence the value of the U.S. dollar. A stronger dollar can make U.S. exports more expensive for foreign customers, while a weaker dollar can raise the cost of imported materials and components.

Businesses do not control federal fiscal policy, but they must plan for its potential effects. They may manage interest-rate risk, review borrowing needs, diversify suppliers, adjust export prices, or use financial contracts to reduce exchange-rate uncertainty.

Key Takeaways

- A **budget deficit** is an annual shortfall between federal spending and revenue; the **national debt** is the accumulated result of past borrowing.
- A **trade deficit** is different from a federal budget deficit and should not be treated as the same measure.
- The United States has experienced both deficits and surpluses throughout its history.
- The gold standard did not prevent federal deficits, but it limited monetary-policy flexibility and created pressure to preserve confidence in gold convertibility.
- Since the end of Bretton Woods, the United States has borrowed in a fiat currency that it controls.
- The U.S. dollar's international role supports demand for Treasury securities, but persistent deficits still create long-term economic and policy tradeoffs.
- Government borrowing can affect businesses through interest rates, inflation, exchange rates, investment decisions, and access to credit.

Discussion Questions

1. What is the difference between a federal budget deficit, national debt, and trade deficit?
2. Why is it inaccurate to attribute all changes in the federal deficit to one president?
3. Why did the gold standard constrain government policy without eliminating budget deficits?
4. How does the dollar's international role affect the U.S. government's ability to borrow?
5. How could higher federal borrowing costs affect a Wisconsin manufacturer, exporter, or small business?
6. If Congress wanted to reduce the federal budget deficit over the next decade, what balanced combination of revenue changes, spending changes, and growth-oriented policies would you recommend? Explain the likely benefits, costs, and effects on households and businesses.

8: INTERNATIONAL MONETARY SYSTEMS

8.1: Overview

8.2: International Monetary Systems

8.3: Importance of Currency Management

8.4: Exchange Rates

8.5: Video- The IMF and the World Bank

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8.8: Global Business in Action

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8.1: Overview

Both the IMF and the World Bank act as global outreach partners to assist both developed and developing countries in areas that range from Economic Management to Rule of Law to Human Development. Although controversial at times, these two organizations and their over 180 members have touched almost every country on the globe, either directly or indirectly. In this section, we will examine the difference between the two organizations and look at some of the projects they have undertaken.

Learning Objectives

After you complete this section, you will be able to:

- Illustrate the history of the WTO and its contribution to international business
- Identify ways that the World Bank and IMF provide support to global business ventures
- Identify the impact global organizations have on business decisions to trade internationally

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8.2: International Monetary Systems

The **international monetary system** refers to a system that forms rules and standards for facilitating international trade among nations and helps in relocating capital and investment from one nation to another. Moreover, it's the worldwide network of governments and financial institutions that determine the exchange rate of each currency. It is amazing how the monetary system has evolved from centuries ago, when gold coins were used as a form of currency, and where people had to barter products or goods to receive something in exchange.

The international monetary system aids countries by lending them money so they can overcome poverty and debts. Some countries struggle with inflation, which means that there is too much product and no demand for it.

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8.3: Importance of Currency Management

It is important to understand currency management because companies need to know that volatility in exchange rates can significantly affect their bottom line.

Why do Economies Need Money?

We define *money* as a unit of account that is used as a medium of exchange in transactions. Without money, individuals and businesses would have a harder time obtaining (purchasing) or exchanging (selling) what they want, need, or make. Money provides us with a universally accepted medium of exchange.

Whenever a country or empire has regional or global control of trade, its currency becomes the dominant currency for trade and governs the monetary system of that time.

With the growing complexity in international trade and financial markets, the international monetary system is necessary to assign a standard value of the international currencies. The rules and regulations set by the international monetary system to regulate and control the exchange value of the currencies are agreed upon by the respective governments of the nations. Thus, the government's stand may affect the decision-making of the international monetary system. For example, a change in the trade policy of a government may affect the international trade of goods and services.

The aim of the new international monetary system is to create a stabilized international currency system and ensure monetary stability for all the nations.

The central banks of nations were given the task of maintaining fixed exchange rates with respect to the dollar for each currency.

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8.4: Exchange Rates



Currency	Buying Rate	Selling Rate
USD	29.75	30.55
GBP	47.85	49.27
EUR	42.21	43.18
CNY	4.28	4.88
JPY	37.45	38.94
MYR	9.21	10.28
AUD	31.68	32.85
HKD	3.77	4.00
KOR	0.022	0.033
PHP	0.47	0.76

Figure 8.4.1: International exchange rates list.

An **exchange rate** is the ratio at which one currency is converted into another currency:

- **Fixed Exchange Rate:** The government manipulates the value of a country's currency.
- **Floating Exchange Rate:** The value of a country's currency changes based on market forces.
- Most countries operate under a freely floating exchange rate system.

A flexible exchange rate, which is the same as the floating exchange rate system, is a system wherein the value of a currency changes with market demands. When the demand for a particular currency is high, the value of that currency goes up. When demand is low, the value goes down.

The opposite of this is a fixed exchange rate, wherein a currency has a fixed value relative to another currency or commodity. Market demand has no influence on the value of the currency.

8.5: Video- The IMF and the World Bank

This video explains the origins and modern roles of the IMF and World Bank. Created at the Bretton Woods Conference in 1944, these institutions were designed to support international monetary stability, postwar recovery, and economic development. Today, the IMF helps countries facing financial and balance-of-payments problems, while the World Bank finances longer-term development projects. The video also raises questions about the benefits and controversies of international lending, including debt, loan conditions, and the influence of wealthier member countries.

YouTube Video

This interactive element is not available in this format. Visit the link or scan the QR code to access it online.

[View this YouTube Video online](#)



[Watch the video on YouTube to view the transcript.](#)

Sources & References

- World Bank and the IMF. **Authored by:** ITM Trading, Inc. **Provided by:** YouTube. **Located at:** <https://youtu.be/E920L4R9GXE>. **License:** All Rights Reserved. **License Terms:** Standard YouTube License

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8.6: International Monetary Fund

The **International Monetary Fund (IMF)** is an international organization that promotes monetary cooperation, financial stability, sustainable economic growth, and international trade. It was created in 1944 at the Bretton Woods Conference and is headquartered in Washington, D.C. The IMF has **191 member countries**.

The IMF helps support the international monetary system—the network of exchange rates, international payments, financial institutions, and economic policies that allows countries, businesses, and individuals to trade and invest across borders. Its work is especially important when a country faces a sharp loss of foreign currency, difficulty paying for imports or external debt, banking stress, high inflation, or a broader financial crisis.

Historical Note

The IMF was established under the Bretton Woods system, when many countries maintained fixed exchange rates tied indirectly to the U.S. dollar and gold. After the United States ended dollar convertibility into gold in 1971 and exchange rates became more flexible, the IMF's role evolved. Today, it focuses less on maintaining fixed exchange rates and more on surveillance, financial assistance, policy advice, and institutional capacity development

The IMF's Three Core Functions

The IMF's work is generally grouped into three main activities:

- **Surveillance:** The IMF monitors economic and financial developments in member countries and in the global economy. It evaluates issues such as inflation, government debt, exchange rates, financial-sector risks, trade flows, and external borrowing. The IMF then provides policy advice intended to help countries reduce vulnerabilities and strengthen economic stability.
- **Lending:** The IMF provides financial assistance to member countries experiencing balance-of-payments problems or other external-financing pressures. IMF lending is intended to give a country time to restore economic stability, rebuild foreign-exchange reserves, and regain access to private financing. Loans are usually temporary and are commonly linked to an agreed policy program.
- **Capacity development:** The IMF provides technical assistance and training to central banks, finance ministries, tax authorities, statistical agencies, and financial-sector regulators. This assistance can help countries improve tax collection, public-finance management, monetary and exchange-rate policy, banking supervision, economic data, and financial governance.[imf.org](https://www.imf.org)

IMF Lending and Conditions

IMF loans are generally not grants. Countries are expected to repay the IMF, and lending programs often include **policy conditions**, sometimes called conditionality. These conditions may involve steps to strengthen public finances, improve central-bank policy, address financial-sector weaknesses, improve governance, or reduce external imbalances.

Supporters argue that these conditions can help address the economic problems that led to the crisis and increase the likelihood that the country can repay its loan. Critics argue that conditions can be too demanding, may reduce a government's policy flexibility, and can impose hardship when they require rapid spending cuts, tax increases, or other reforms during an economic downturn.

Governance and Voting Power

Each IMF member has a quota, or financial commitment, that helps determine its financial contribution to the institution, access to IMF resources, and voting power. Quotas broadly reflect a country's relative size and role in the world economy. Because larger and wealthier economies generally have larger quotas, they also have greater influence in IMF decisions. This structure has prompted continuing debate about whether representation and voting power adequately reflect the current global economy.

Why the IMF Matters to Global Business

The IMF affects the global business environment because financial crises, currency instability, inflation, and restrictions on international payments can disrupt trade and investment. When an IMF-supported program helps stabilize an economy, it may restore confidence, reduce uncertainty, and improve a country's ability to participate in global markets. At the same time, policy changes associated with IMF programs can affect taxes, government spending, interest rates, exchange rates, imports, consumer demand, and business conditions.

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8.7: The World Bank

The **World Bank Group** is an international development institution created in 1944 at the Bretton Woods Conference. Its mission is to reduce poverty, promote shared prosperity, and support sustainable development. The World Bank Group works with governments, private businesses, nonprofit organizations, and other development partners to finance projects, provide policy advice, share research, and strengthen public institutions.

Although the World Bank Group and the International Monetary Fund (IMF) were both created at Bretton Woods, they have different primary roles. The IMF focuses on international monetary cooperation, macroeconomic stability, and assistance to countries facing balance-of-payments or financial crises. The World Bank Group focuses on longer-term development challenges, including poverty, infrastructure, education, health, energy, agriculture, climate resilience, public administration, and private-sector growth.

The Five World Bank Group Institutions

The World Bank Group consists of five related institutions:

Table 8.7.1: World Bank Institutions

Institution	Main purpose
International Bank for Reconstruction and Development (IBRD)	Provides loans, guarantees, risk-management products, and advisory services to middle-income and creditworthy lower-income countries.
International Development Association (IDA)	Provides concessional loans and grants to the world's lowest-income countries.
International Finance Corporation (IFC)	Invests in and advises private-sector businesses and financial institutions in developing economies.
Multilateral Investment Guarantee Agency (MIGA)	Offers political-risk insurance and credit enhancement to encourage foreign direct investment in developing economies.
International Centre for Settlement of Investment Disputes (ICSID)	Provides arbitration and conciliation services for certain disputes between investors and governments.

The term **World Bank** specifically refers to the IBRD and IDA. The broader term **World Bank Group** includes all five institutions.

How the World Bank Group Supports Development

The World Bank Group provides more than project financing. Its support can include:

- Loans, credits, grants, and guarantees for public-development projects.
- Technical assistance to improve public institutions, data systems, tax administration, health systems, education systems, and infrastructure planning.
- Research and data that help governments identify development priorities and evaluate results.
- Private-sector financing and advisory services through the IFC.
- Political-risk guarantees through MIGA to help encourage cross-border investment.

Projects can support roads and ports, clean water and sanitation, schools, hospitals, renewable energy, agricultural productivity, digital access, disaster preparedness, and social-protection programs. The World Bank Group's objective is not simply to provide money; it is to help countries build the institutions and infrastructure needed for lasting economic development.

Benefits and Debates

World Bank Group financing can help countries undertake projects that would otherwise be difficult to fund because of high upfront costs, limited domestic savings, weak credit access, or investor concerns about political risk. Successful projects may improve public health, access to education, infrastructure, productivity, employment, and participation in international trade.

However, the World Bank Group is also debated and criticized. Critics have raised concerns about the environmental effects of large infrastructure projects, displacement of local communities, the burden of debt, the influence of wealthier shareholder countries, and whether policy requirements attached to assistance always fit local circumstances. Supporters argue that the institution can provide financing, expertise, safeguards, and coordination that are difficult for individual countries to obtain on their own.

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8.8: Global Business in Action

Greece's debt crisis shows how quickly fiscal problems can become a broader international financial crisis when a government loses access to private borrowing, banks hold risky government debt, and economic adjustments must occur within a shared currency system.

Case Study: Greece

Greece's Sovereign-Debt Crisis

In 2009–2010, Greece faced a severe sovereign-debt and financial crisis. The government had accumulated high public debt and large budget deficits, while the global financial crisis made investors less willing to lend to governments viewed as risky. As concern grew about Greece's ability to repay its debt, the interest rates investors demanded on Greek government bonds rose sharply. Greece eventually lost access to private borrowing at sustainable interest rates and requested international financial assistance in April 2010.

A major challenge for Greece was that it used the **euro**. Because Greece did not control its own national currency, it could not devalue a separate Greek currency to make exports less expensive or use an independent central bank to create money and lower domestic interest rates. Instead, restoring confidence required a combination of outside financing, budget changes, banking-sector support, and structural reforms.

International Assistance Programs

Greece received three major economic-adjustment programs between 2010 and 2018:

Table 8.8.1: Greece's Economic Adjustment Programs

Program	Period	Main institutions	Financial commitment
First program	2010–2012	Euro-area countries and IMF	€110 billion, including about €30 billion from the IMF
Second program	2012–2015	European Financial Stability Facility and IMF	€172.6 billion in committed financing; the IMF committed €19.8 billion
Third program	2015–2018	European Stability Mechanism	Up to €86 billion; €61.9 billion was ultimately received

The first program was designed to cover Greece's financing needs, support its banking system, and prevent the crisis from spreading to other euro-area economies. The IMF, European Commission, and European Central Bank—often referred to informally as the **"troika"**—worked with Greek authorities on the first two programs. The third program was financed through the European Stability Mechanism and concluded in August 2018.

Policy Conditions and Reform

Financial assistance came with conditions. Greece agreed to measures intended to improve public finances, strengthen the banking sector, and make the economy more competitive. These measures included:

- Reducing budget deficits through tax increases and reductions in government spending.
- Reforming pensions and public-sector compensation.
- Improving tax administration and efforts to collect unpaid taxes.
- Privatizing some state-owned assets.
- Reforming labor, product, and service markets.
- Restructuring and recapitalizing parts of the banking system.
- Reforming the judicial system and public administration.

In March 2012, Greece also restructured debt held by private investors. This **private-sector involvement**, often described as a debt “haircut,” reduced the value of certain Greek bonds held mainly by private banks and institutional investors. The restructuring was meant to reduce Greece’s debt burden, though it did not by itself restore sustainable market access.

Why This Case Matters

Greece shows how an international monetary crisis affects more than government budgets. A loss of investor confidence can raise borrowing costs, weaken banks, reduce consumer and business spending, increase unemployment, and disrupt trade and investment. It also illustrates the difficult tradeoff in international crisis lending:

- **Potential benefit:** External financial assistance can prevent an immediate default, provide time for reform, stabilize banks, and limit international contagion.
- **Potential cost:** The policy changes required to obtain assistance can reduce incomes and public services in the short run, especially when they occur during a deep recession.

The case also demonstrates why the roles of the IMF and World Bank Group should not be confused. The IMF participated in Greece because of the country’s macroeconomic, fiscal, and external-financing crisis. The World Bank Group’s involvement in Greece was more limited and focused on technical assistance, institutional reform, and selected private-sector investment rather than the central sovereign-rescue packages.

Economic and Social Effects

The programs helped Greece avoid an immediate disorderly default, remain in the euro area, and receive financing when private markets were largely closed to it. They also helped contain risks that the crisis could spread more broadly through Europe’s financial system. The IMF’s later evaluation found that the first program achieved substantial fiscal consolidation and helped keep Greece in the euro area.

However, the adjustment was extremely difficult. The recession was deeper and more prolonged than many policymakers initially expected. Unemployment reached **27.5% in July 2013**, and the IMF later noted that Greece’s GDP per capita was still 22% below its pre-crisis level nearly a decade after the crisis began. Critics argue that austerity measures—especially rapid spending reductions and tax increases during a recession—intensified hardship and weakened demand. The IMF’s own evaluation concluded that the first program did not restore market confidence, debt sustainability, competitiveness, or broad reform implementation as expected, and that the burden of adjustment was not sufficiently shared across society.

This interactive element is not available in this format. Visit the link or scan the QR code to access it online.

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Discussion Questions

1. Why did Greece lose access to affordable private borrowing, and why did this create a crisis for its government, banks, businesses, and households?
2. How did membership in the euro area limit Greece’s available policy choices?
3. Which goals of the assistance programs were most important: preventing default, protecting the euro area, reducing debt, reforming the economy, or reducing hardship for Greek households?
4. Were the conditions attached to financial assistance necessary to restore confidence, or were they too severe during a recession? Support your answer with evidence from the case.
5. What are the advantages and disadvantages of a debt restructuring, such as the 2012 reduction in privately held Greek debt?
6. How does the Greece case illustrate the difference between the IMF’s crisis-management role and the World Bank Group’s development role?

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9: GLOBAL BUSINESS STRATEGY AND EXPANDING TO NEW MARKETS

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9.1: Overview

In this section, we will explore the various ways that businesses can enter foreign markets – and there are a variety from which to choose. Each strategy has its advantages and disadvantages, and sometimes it works, but other times ... well, not so much! Oftentimes it is not the product or service that is a failure, but the ability to replicate success on an international scale has eluded some VERY big names ... Walmart, Coke, McDonald's. So, now we will see what options are available to businesses and take a look at what works and what doesn't work.

Learning Objectives

After you complete this section, you will be able to:

- Identify the various strategies of international business and the strategic ways to enter a foreign market
- Compare and contrast strategies for entering world markets
- Determine the most appropriate strategy for entering a specific market or specific product

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9.2: Global Business Strategy

International business strategy refers to plans that guide commercial transactions taking place between entities in different countries. Typically, it refers to the plans of action or policies designed to achieve an overall goal of private companies rather than governments; as such, one goal may be increased profits. One reason for making investments in international markets would be to generate higher returns than firms would achieve on investments made in their domestic markets.



Figure 9.2.1: Capital Investment (Pixabay)

Global Strategies

Multidomestic strategy is a set of strategies used by companies that operate in more than one country at a time. Or simply defined as a business that uses a different approach in each of the markets it operates in.

This strategy can maximize local responsiveness by distributing the decision-making authority to local business groups in each country. Therefore, they can create products and services better developed to their local markets. It also allows firms to compete more effectively in the local market to increase their share in that market. One disadvantage of a multi-domestic strategy, however, is that the firm faces more uncertainty because of the tailored strategies in different countries. Also, because the firm is pursuing different strategies in different locations, it cannot take advantage of economies of scale that could help decrease costs for the firm overall.

For example: “YUM! Brands (KFC, Pizza Hut, Taco Bell, A&W, and Long John Silver’s). They have a strong incentive to compete internationally with their restaurant concepts. They pursue a multi-domestic strategy by trying to localize as much as possible. The firm doesn’t open restaurants using only the US model.”(Williams, 2018)

Global Strategy is when an organization treats the world as one market and one source of supply with little local variation, which they believe maximizes global efficiency. Using this strategy, products are more likely to be standardized rather than tailored to local markets. Although pursuing a global strategy decreases risk for the firm, the firm may not be able to gain as high a market share in local markets because the global strategy isn’t as responsive to local markets.

Transnational Strategy is when a business seeks a middle ground between a multi-domestic strategy and a global strategy. A business tries to balance the desire for efficiency with the need to adjust to local preferences within the various countries they operate. One disadvantage is that it is difficult to simultaneously execute the dual goals of flexibility and coordination.

According to Beardsley (2012) “ Large fast-food chains such as McDonald’s and Kentucky Fried Chicken (KFC) rely on the same brand names and the same core menu items around the world. These firms make some concessions to local tastes too. In France, for example, wine can be purchased at McDonald’s. This approach makes sense for McDonald’s because wine is a central element of French diets.”

Why It Matters

There are four primary benefits of using international strategies:

1. Increased market size
2. Greater returns on major capital investments or investments in new products and processes
3. Greater economies of scale, scope, or learning
4. A competitive advantage through location (for example, access to low-cost labor or critical resources)

By choosing appropriate global strategies, a business firm can locate its different operations given the consumer market, low-cost labor supply, and availability of raw materials and other productive resources. For example, a country like India may choose to count on software and R &D work because of easy availability of highly skilled techno-geeks for relatively lower salaries.

Finally, by entering the global marketplace, a business can learn how to compete against foreign companies and even learn to battle them for market share on their own territory.

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9.3: Multinational Firms

With the advent of improved communication and technology, corporations have been able to expand into multiple countries.

Key Points

- Multinational corporations (MCNs) operate in multiple countries.
- MNCs have considerable bargaining power and may negotiate business or trade policies successfully.
- A corporation may choose to locate in a special economic zone, a geographical region that has economic and other laws that are more free-market-oriented than a country's typical or national laws.

Key Term

Multinational corporation (MCN): A corporation or enterprise that operates in multiple countries.

McDonald's operates in over 119 different countries, making it a fairly large MNC by any standard. Ford is a MNC with operations throughout the world.

A multinational corporation (MNC) or **multinational enterprise** (MNE) is a corporation registered in more than one country or has operations in more than one country. It is a large corporation that both produces and sells goods or services in various countries. It can also be referred to as an international corporation. The first multinational corporation was the Dutch East India Company, founded on March 20, 1602.

Corporations may make a **foreign direct investment**. Foreign direct investment is direct investment into one country by a company located in another country. Investors buy a company in the country or expand operations of an existing business in the country.

A corporation may choose to locate in a special economic zone, a geographical region with economic and other laws that are more free-market-oriented than a country's typical or national laws.

Multinational corporations are important factors in the processes of globalization. National and local governments often compete against one another to attract MNC facilities, with the expectation of increased tax revenue, employment, and economic activity. To compete, political powers push toward greater autonomy for corporations. MNCs play an important role in developing economies of developing countries.

Many economists argue that in countries with comparatively low labor costs and weak environmental and social protection, multinationals actually bring about a "race to the top." While multinationals will see a low tax burden or low labor costs as an element of comparative advantage, MNC profits are tied to operational efficiency, which includes a high degree of standardization. Thus, MNCs are likely to adapt production processes in many of their operations to conform to the standards of the most rigorous jurisdiction in which they operate.

As for labor costs, while MNCs pay workers in developing countries far below levels in countries where labor productivity is high (and accordingly, will adopt more labor-intensive production processes), they also tend to pay a premium over local labor rates of 10% to 100%.

Finally, depending on the nature of the MNC, investment in any country reflects a desire for a medium- to long-term return, as establishing a plant, training workers and so on can be costly. Therefore, once established in a jurisdiction, MNCs are potentially vulnerable to arbitrary government intervention like expropriation, sudden contract renegotiation and the arbitrary withdrawal or compulsory purchase of licenses. Thus both the negotiating power of MNCs and the "race to the bottom" critique may be overstated while understating the benefits (besides tax revenue) of MNCs becoming established in a jurisdiction.

Sources & References

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9.4: 6 Modes of Entry

Six Modes of Entry

Exporting

Exporting is the selling of products produced in one country to customers in another country. Without exporting, we wouldn't have the access we have currently to things like metals, computers, and electronics. Without exporting, you wouldn't even dream of taking a road trip. The price of oil and gasoline would be out of your budget.

Pros: Avoids costs associated with setting up manufacturing facilities in another country. Less expensive way of gaining experience in a foreign market (reducing pioneering costs).

Cons: May miss out on efficiencies and economies of scale. High transport costs. Trade barriers such as tariffs.

Turnkey Projects



Figure 9.4.1: 7-Eleven franchise store (This file is licensed under the [Creative Commons Attribution 3.0 Unported](https://creativecommons.org/licenses/by/3.0/) license.)

Turnkey projects allow places like 7-Eleven to pop up almost everywhere. They make it easier to open up franchises, no matter your background. They give you all of the tools you need to successfully start a franchise, even if you're lacking the knowledge and experience. A turnkey project is when a firm agrees to set up a plant for a foreign client and hand over the key when the plant is fully operational.

Pros: The contractor has the know-how necessary to set up a plant in the country.

Cons: The firm building the plant has little long-term commitment to the country. It may inadvertently create a competitor if the building firm sways

Licensing

Licensing is a business arrangement in which one company gives another company permission to manufacture its product for a specified payment. Licensing generally involves allowing another company to use patents, trademarks, copyrights, designs, and other intellectual property in exchange for a percentage of revenue or a fee. An international licensing agreement allows foreign firms, either exclusively or non-exclusively, to manufacture a proprietor's product for a fixed term in a specific market. Licensing

means that now that Disney has rights to Star Wars and Marvel, you're getting a whole new addition to Disneyland. With Disney as the licensor, they gain more publicity than they would without. Disney has proven to be successful with their marketing strategies.

Pros: The licensee puts up most of the operating capital, so it's an inexpensive way for a licensor to enter the market. Can allow the licensor to avoid trade barriers.

Cons: The licensor loses tight control over manufacturing, marketing, and strategy. Complicates the flow of money when investing in other countries.

Franchising

Franchising is purchasing the rights to use a trade mark, business model, and processes. The purchaser does business under the franchiser's name and has the benefit of operating as a company that has already developed a relationship with the public.

Pros: Similar to those of licensing: low cost for the franchisor and avoiding trade barriers.

Cons: Challenges in maintaining quality standards (exacerbated by physical distances). Must follow the franchisor's dress code and values. May inhibit the ability to take funds out of one country to enter another.

Joint Ventures

A joint venture is a business agreement in which parties agree to develop a new entity and new assets by contributing equity. They exercise control over the Enterprise and consequently share revenues, expenses, and assets. A consortium JV (also known as a cooperative agreement) is formed when one party seeks technological expertise, franchise and brand-use agreements, management contracts, and rental agreements for one-time contracts. The JV is dissolved when that goal is reached. Some major joint ventures include Dow Corning, MillerCoors, Sony Ericsson, Penske Truck Leasing, Norampac, and Owens-Corning.

Pros: Benefit from a local partner's knowledge and expertise. Share costs and risks. Politically preferable in many countries.

Cons: May have to give up control of competitive advantage and technology to a partner. Lack of tight control over the newly-created company.

Wholly-Owned Subsidiaries

Lastly, wholly owned subsidiaries are when a firm owns 100 percent of the stock of a foreign entity by way of FDI, both greenfield and brownfield. Companies like Google and eBay are perfect examples. Google is one of the most common search engines everyone uses, so without this, how would you search for the answers to all of your questions?

Pros: Tight control of a firm's competitive advantage and technology. Tight control over operations (quality, strategy, use of profits, etc.). Allows a firm to take advantage of economies of scale, comparative advantage, and other efficiencies.

Cons: The costliest option. Entails a great deal of risk.

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9.5: Contract Manufacturing

In **contract manufacturing**, a hiring firm makes an agreement with the contract manufacturer to produce and ship the hiring firm's goods.

Key Points

- A hiring firm may enter a contract with a contract manufacturer (CM) to produce components or final products on behalf of the hiring firm for some agreed-upon price.
- There are many benefits to contract manufacturing, and companies are finding many reasons why they should be outsourcing their production to other companies.
- Production outside of the company does come with many risks attached. Companies must first identify their core competencies before deciding about contract manufacturing.

Key Term

Contract manufacturing: Business model in which a firm hires a contract manufacturer to produce components or final products based on the hiring firm's design. A business model where a firm hires another firm to produce components or products.

A contract manufacturer ("CM") is a manufacturer that enters into a contract with a firm to produce components or products for that firm. It is a form of outsourcing. In a contract manufacturing business model, the hiring firm approaches the contract manufacturer with a design or formula. The contract manufacturer will quote the parts based on processes, labor, tooling, and material costs. Typically, a hiring firm will request quotes from multiple CMs. After the bidding process is complete, the hiring firm will select a source, and then, for the agreed-upon price, the CM acts as the hiring firm's factory, producing and shipping units of the design on behalf of the hiring firm.

Benefits

Contract manufacturing offers a number of benefits:

- **Cost Savings:** Companies save on their capital costs because they do not have to pay for a facility and the equipment needed for production. They can also save on labor costs such as wages, training, and benefits. Some companies may look to contract manufacture in low-cost countries, such as China, to benefit from the low cost of labor.
- **Mutual Benefit to Contract Site:** A contract between the manufacturer and the company it is producing for may last several years. The manufacturer will know that it will have a steady flow of business at least until that contract expires.
- **Advanced Skills:** Companies can take advantage of skills that they may not possess, but the contract manufacturer does. The contract manufacturer is likely to have relationships formed with raw material suppliers or methods of efficiency within their production.
- **Quality:** Contract Manufacturers are likely to have their own methods of quality control in place that help them to detect counterfeit or damaged materials early.
- **Focus:** Companies can focus on their core competencies better if they can hand off base production to an outside company.
- **Economies of Scale:** Contract Manufacturers have multiple customers that they produce for. Because they are servicing multiple customers, they can offer reduced costs in acquiring raw materials by benefiting from economies of scale. The more units there are in one shipment, the less expensive the price per unit will be.

Risks

Balanced against the above benefits of contract manufacturing are a number of risks:

- **Lack of Control:** When a company signs the contract allowing another company to produce their product, they lose a

significant amount of control over that product. They can only suggest strategies to the contract manufacturer; they cannot force them to implement those strategies.

- **Relationships:** It is imperative that the company forms a good relationship with its contract manufacturer. The company must keep in mind that the manufacturer has other customers. They cannot force them to produce their product before a competitor's. Most companies mitigate this risk by working cohesively with the manufacturer and rewarding good performance with additional business.
- **Quality:** When entering into a contract, companies must make sure that the manufacturer's standards are congruent with their own. They should evaluate the methods in which they test products to make sure they are of good quality. The company has to ensure the contract manufacturer has suppliers that also meet these standards.
- **Intellectual Property Loss:** When entering into a contract, a company is divulging its formulas or technologies. This is why it is important that a company not give out any of its core competencies to contract manufacturers. It is very easy for an employee to download such information from a computer and steal it. The recent increase in intellectual property loss has corporate and government officials struggling to improve security. Usually, it comes down to the integrity of the employees.
- **Outsourcing Risks:** Although outsourcing to low-cost countries has become very popular, it does bring along risks such as language barriers, cultural differences, and long lead times. This could make the management of contract manufacturers more difficult, expensive, and time-consuming.
- **Capacity Constraints:** If a company does not make up a large portion of the contract manufacturer's business, they may find that they are de-prioritized over other companies during high production periods. Thus, they may not obtain the product they need when they need it.
- **Loss of Flexibility and Responsiveness:** Without direct control over the manufacturing facility, the company will lose some of its ability to respond to disruptions in the supply chain. It may also hurt its ability to respond to demand fluctuations, risking its customer service levels.

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9.6: Exporting and Importing

Exporting is the sale of products and services in foreign countries that are sourced or made in the home country.

Importing is the buying of goods and services from foreign sources and bringing them back into the home country. Importing is also known as global sourcing.

Exporting, Importing, and the Business Opportunity

Exporting and importing are low-cost, low-risk strategies for entering a foreign market. These are good strategies for small to midsize companies that are unable to make large financial investments in international markets. Companies can buy from and sell into a foreign country either through a local distributor or through their own salespeople. The internet has also provided a more efficient way for foreign companies to find local distributors and enter into commercial transactions.

Distributors are export intermediaries who represent the company in the foreign market. Often, distributors represent many companies, selling products, providing customer service, and receiving payments. Another option is an export management company (EMC), which is an independent company that performs the duties that a firm's own export department would execute. The EMC handles the necessary documentation, finds buyers for the export, and takes title of the goods for direct export. In return, the EMC charges a fee or commission for its services.

Even with so many ways for a company to receive help and guidelines for exporting and importing. Mistakes can be made, including waiting until after a competing company has fully saturated local markets before thinking of entering, waiting until the world comes to you rather than proactively developing foreign markets, and a lack of experience combined with attempting to export alone.

Exporting and Importing and the Risks and Challenges

Exporting and importing do have some drawbacks like Not being in the market to see who your competition is gives local businesses the chance to swoop in. There can be transport delays or damage to goods in transit. Suppliers may change, or you may be unable to supply. Currency fluctuations can be rather frustrating, along with political or economic instability in the country you are doing business with. These risks are important to address because, in the long run, if an exporter or importer isn't prepared, the loss of payment or especially the damaging of goods could destroy the trust built with your distributor and your business. It's very difficult for exporters to trust one another because in many cases they have never met. Trust is also difficult to develop because the importer and exporter live in different countries, speak different languages, may abide by different legal systems, and it can be very difficult to track them down if a default occurs.

Why It Matters

Exports are an important part of Utah's economy, and the good news is they are growing. In 2015, Utah exported \$13.3 billion worth of goods, an 8 percent increase from the previous year. While primary metals make up a large portion of Utah's exports, the state has been working to diversify and grow exports in other areas as well. Some of Utah's top export products include computer and electronic products, chemicals, food and kindred products, and transportation equipment.

The private and public sectors put international business as a top state priority a decade ago with the creation of World Trade Center Utah—and it has paid off. Utah is one of the few states in the nation with a trade surplus of \$4 billion, and it ranks ninth for export growth in the United States. This is an impressive feat for a small, landlocked state.

So, what does this all mean for Utah? According to a policy brief produced by the Kem C. Gardner Policy Institute at the University of Utah, the state's 2014 international goods exports generated \$4.1 billion in earnings, supported more than 95,000 jobs and contributed almost \$7.6 billion to the state's gross domestic product. These impacts represented 4.8 percent of total earnings in the state, 5.3 percent of total employment and 5.4 percent of total GDP. It is hard to argue with those economic benefits.

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9.7: Foreign Direct Investment

Direct Investment is a production in a country by a company located in a different country, either by buying a company in the target country or by expanding operations of an existing business in that country.

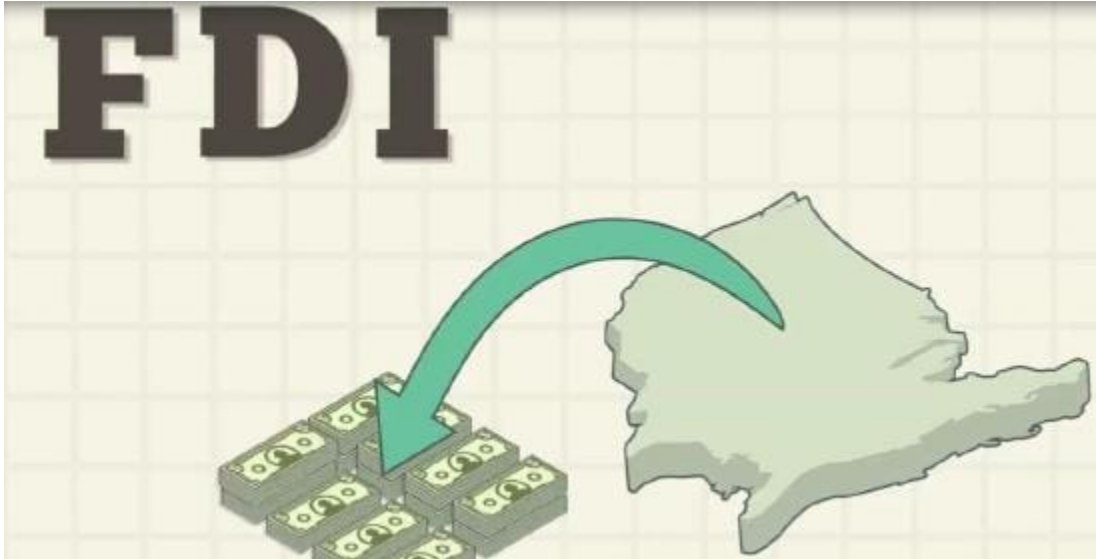


Figure 9.7.1: Foreign Direct Investment. ([Investopedia](#))

Foreign Direct Investment and Radical View

The radical view sees the Multinational Enterprise as an imperialist tool for exploiting host countries. According to this view, no country should allow FDI. Due to the collapse of communism, the radical view was in retreat everywhere by the end of the 1990s.

Foreign Direct Investment and Pragmatic Nationalistic View

Pragmatic nationalism views FDI as having both benefits and costs. Countries adopting a pragmatic stance pursue policies designed to maximize the benefits and minimize the costs of FDI.

Foreign Direct Investment and Inflow and Outflow

FDI consists of the acquisition or creation of assets (e.g., firm equity, land, houses, oil-drilling rigs) undertaken by foreigners. If these are enterprises, they are not alone but act together with local firms and/or governments as “joint ventures”. Moreover, a country's outflows of FDI mean that it is exporting money to buy or build foreign productive capacity whose ownership will remain in the first country's hands, and for a country attracting an inflow of FDI strengthen the connection to world trade networks and finances its development path.

Foreign Direct Investment and Stock of FDI

Stocks measure the total level of direct investment at a given point in time, usually the end of a quarter or year. The outward FDI stock is the value of the resident investors' equity in and net loans to enterprises in foreign economies. The inward FDI stock is the value of foreign investors' equity in and net loans to enterprises resident in the reporting economy. FDI stocks are measured in USD and as a share of GDP. FDI creates stable and long-lasting links between economies.

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9.8: Global Business in Action

Global Spotlight on Strategy: Schreiber Foods

Schreiber Foods

Pick up a package of cheese or yogurt at a grocery store. The name on the label might not tell you who made it. That's the idea behind the strategy of Schreiber Foods, a company founded in Green Bay, Wisconsin, in 1945. Rather than relying chiefly on a famous consumer brand of its own, Schreiber focuses on making dairy products for retailers, restaurants, distributors, and food manufacturers. It calls this a *customer-brand* approach.

A company doesn't have to put its own name on every package to build a global business. Green Bay-founded Schreiber Foods specializes in *customer-brand* dairy products: it partners with retailers, restaurants, distributors, and food manufacturers rather than relying primarily on a consumer brand of its own. Today, Schreiber reports more than 10,000 employees and a presence on five continents.

Its international growth was not simply a matter of shipping more cheese from Wisconsin. Schreiber's company history shows several ways to enter and grow in other markets: it formed a joint venture in Europe in 1992, opened a plant in Mexico that year, developed a licensing agreement in India in 1996, and later acquired yogurt plants in Europe. These are different strategic choices, each involving different levels of investment, control, and local knowledge.

Schreiber also competes through services that customers may never see on a label. It studies food trends, helps customers manage exposure to changing dairy costs, and provides export expertise. For a restaurant chain or retailer operating in multiple countries, a dependable partner may be valuable not just for the food it makes, but for its ability to help deliver the right product, at a workable cost, where customers need it.

Read and Investigate

Explore Schreiber Foods' [customer services](#) website. As you read, look for evidence that Schreiber competes on more than its dairy products. Which capability would be hardest for a new competitor to copy—and why?

Discussion Questions

1. What strengths would a customer-brand strategy need in order to work across different countries?
2. What risks might Schreiber face if it depends on other companies' brands?
3. Schreiber has used a joint venture, licensing, new plants, and acquisitions in its international growth. Why might a company choose different approaches in different countries?
4. Schreiber offers consumer insights, risk management, and export services alongside its products. Which of these could create the most value for a customer expanding internationally? Defend your choice with an example from the reading.

Source

Schreiber Foods. (n.d.). [Services](#). Retrieved October 2, 2026.

10: GLOBAL PRODUCTION, OUTSOURCING AND LOGISTICS

10.1: Overview

10.2: Global Production and Supply Chain

10.3: Made in India Video Clip

10.4: Using Logistics to Go Global

10.5: Business of Offshoring

10.6: Global Business in Action

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10.1: Overview

Outsourcing your business has great benefits since it costs less, and you can get better quality, plus you can save on infrastructure. Moreover, you no longer need to invest in recruiting and training expensive resources for your business because the foreign country will be well established to deliver the product. However, exporting has a dark side: if you merely export to a country, the distributor or buyer might switch to, or at least threaten to switch to, a cheaper supplier to get a better price.



Figure 10.1.1: Outsourcing worldwide.

Why Should We Care?

We all probably understand outsourcing better than we think, and in part that is thanks to the UPS commercials where they boil down logistics to its foundation: getting things where they need to be, when they need to be there, at a cost that is acceptable to both the seller and buyer. Outsourcing has been a prominent business practice among businesses worldwide. Business owners who are looking for practical methods to enhance the efficiency of their processes find relief in outsourcing. Outsourcing refers to the business practice of contracting an external organization to handle specific tasks. External companies that deal with these tasks are commonly known as Business Process Outsourcing (BPO) providers. Tasks that BPO firms handle are non-core or functions that are essential but not the most critical part of business operations. (Muñiz, 2018)

Global Production, Outsourcing, and Logistics and Benefits

There are many benefits of outsourcing your business processes to destinations around the world. Some of them are –

1. **Cost advantages:** The most obvious and visible benefit relates to the cost savings that outsourcing brings about. You can get your job done at a lower cost and at better quality as well. Due to the difference in wages between Western countries and Asia, the same kind of work that is done over there can be done in India at a fraction of the cost. There is a cost savings of around 60% by outsourcing your work to India. Plus, the quality of the services provided is high, thereby ensuring that low-cost does not mean low-quality.
2. **Increased efficiency:** When you outsource, this can bring years of experience in business practices and expertise in delivering complex outsourcing projects. Thus, they can do the job better with their knowledge and understanding of the domain. This leads to an increase in productivity and efficiency in the process, thereby contributing to the bottom line of your company.
3. **Focus on core areas:** Outsourcing your business processes would free your energies and enable you to focus on building your brand, invest in research and development, and move on to providing higher value-added services.
4. **Save on infrastructure and technology:** Outsourcing eliminates the need for investment in infrastructure, as the

outsourcing partner takes responsibility for the business processes and hence develops infrastructure for the same.

5. **Access to skilled resources:** You no longer need to invest in recruiting and training expensive resources for your business.
6. **Time zone advantage:** Apart from the cost advantage, the other much touted benefit has to do with the time zone differential between your country and the location you are outsourcing to. Get your job done while you are closed for the day and wake up to your service being delivered the next morning. This unique advantage gives you the benefit of round-the-clock business operations
7. **Faster and better services:** Make your service offerings better with high-quality deliverables and decrease the lead time it takes for your product to reach the marketplace. Thus, you would be faster in getting your ideas converted into products and better at delivering the value-added proposition. (Flatworld, 2018)

Risks of Exporting

There are risks in relying on the export option. If you merely export to a country, the distributor or buyer might switch to or at least threaten to switch to a cheaper supplier in order to get a better price. Or someone might start making the product locally and take the market from you. Also, local buyers sometimes believe that a company which only exports to them isn't very committed to providing long-term service and support once a sale is complete. Thus, they may prefer to buy from someone who's producing directly within the country. At this point, many companies begin to reconsider having a local presence, which moves them toward one of the other entry options.

Global Production, Outsourcing, and Logistics and Factors to Consider

- **Cultural and linguistic differences.** These affect all relationships and interactions inside the company, with customers, and with the government. Understanding the local business culture is critical to success.
- **Quality and training of local contacts and/or employees.** Evaluating skill sets and then determining if the local staff is qualified is a key factor for success.
- **Political and economic issues.** Policy can change frequently, and companies need to determine what level of investment they're willing to make, what's required to make this investment, and how much of their earnings they can repatriate.
- **Experience of the partner company.** Assessing the experience of the partner company in the market—with the product and in dealing with foreign companies—is essential in selecting the right local partner.
- **Low Fixed Costs.** Serve the world market out of one single location to maximize economies of scale.
- **High Fixed Costs.** Operate locally out of multiple locations to be more responsive to local market needs and be less dependent on any one market or facility.

Global Production, Outsourcing, and Logistics and Minimum Efficiency Scale

The point at which economies of scale are exhausted and the unit price cannot be pushed any lower. This is when a firm's minimum efficient scale (MES) is the lowest scale necessary for it to achieve the economies of scale required to operate efficiently and competitively in its industry. No further significant economies of scale can be achieved beyond this scale. Minimum efficient scale affects the number of firms that can operate in a market, and the structure of markets.

When Minimum efficient scale is low, relative to the size of the whole industry, a large number of firms can operate efficiently, as in the case of most retail businesses, like corner shops and restaurants. However, if minimum efficient scale can only be achieved at very high levels of output relative to the whole industry, the number of firms in the industry will be small. This is the case with natural monopolies, such as water, gas, and electricity supply. (Economics Online, 2018)

Global Production, Outsourcing, and Logistics and Outsourcing Pros and Cons

Over the course of the past couple of decades, outsourcing has become one of the most hotly debated topics in American politics. Nobody likes to see jobs go overseas, and lawmakers love to use a firm stance against the threat of outsourcing as a rallying point for their wider business agendas.

But in the realm of small business, outsourcing doesn't necessarily mean taking work overseas. When small business owners talk about outsourcing, they're usually thinking of farming out content work to freelance writers, hiring an accountancy firm to take on the bookkeeping, or relying on an employment agency to track down and deploy hired help.

In the right context and deployed shrewdly, outsourcing can be a fantastic way for small business owners to improve efficiencies

and bolster their company's bottom line. But that doesn't mean the practice isn't without its own disadvantages, too. Outsourcing isn't right for every situation, and so you've got to think long and hard before investing time and energy in farming out work. (Riggins,2017)

Benefits of Outsourcing

Companies are able to enjoy the following benefits through outsourcing:

- A decrease in operational expenses
- Increased reach
- Cost and efficiency savings
- Operation control
- Focus on tasks that can help yield more earnings
- Access to quality talents that are experts in handling non-core tasks
- Enhance the efficiency of business processes
- Enjoy a boost in sales given the mature process of attaining customer satisfaction that a BPO company has

Disadvantages of Outsourcing

Outsourcing is the right approach for some companies – particularly those that take the time to properly structure an agreement that drives cost reduction, takes advantage of the outsource provider's best practices, clearly defines scope and service levels that meet the company's needs, and allows the company to focus on its core competencies. When well planned and executed, outsourcing relationships provide substantial benefits to an organization.

A variety of factors are driving some companies to revisit the outsource / in-house service delivery equation. Whether your company's outsourcing agreement is well functioning or in a tenuous state, it behooves all customers to retain visibility, understanding, and flexibility in their finances and service delivery solutions. (Savitz, 2013)

- Lack of customer focus
- Failure to meet expectations
- Marketplace Pressures
- Financial Segmentation
- Synchronizing the deliverables
- Lack of Flexibility
- Confidentiality and security

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10.2: Global Production and Supply Chain

Learning Objectives

By the end of this section, you will be able to:

- Understand the differences between outsourcing and offshoring.
- Explain three strategies for locating production operations.
- Know the value of supply-chain management.

Strategic Choices: Export, Local Assembly, and Local Production

When deciding where and how to produce products for international markets, companies typically have a choice of three strategies. The strategies vary in terms of levels of risk, cost, exposure to exchange-rate fluctuations, and leveraging of local capabilities. Companies need to tailor their strategy to fit their product and the country.

Manufacture in the United States and Then Export

The lowest-investment production strategy is to make the product at the company's existing manufacturing locations and then export it to the new market. Companies use this solution in situations where the total opportunity in the new market doesn't justify opening a plant. For example, EMC supplies its Asia-Pacific customers from plants in the United States and Ireland. This strategy does have several downsides. Specifically, the company faces higher shipping costs, importation delays, local import duties, risks due to exchange-rate fluctuations, and isolation from local knowledge.

Global Components with Local Assembly

The next level of strategy uses out-of-country suppliers but local assembly. Dell Latin America uses this approach. It buys high-tech computer components globally but performs customized assembly in Brazil. Being closer to the market improves Dell's sales, service, and customer knowledge.

Another example is Iams. Iams makes its proprietary pet food in the United States and ships it to other countries for packaging. This strategy lets Iams do some local customization and offer better customer response, while gaining tax or tariff incentives from local assembly.

Along with these advantages come increased supplier-coordination issues and concerns about supplier quality. In some cases, local assembly can harm the product, which leads back to the country-of-origin effect associated with standardized vs. customized products. For example, some markets like Colombia don't want to buy Colombian-made goods. In those cases, local assembly can harm product sales.

Local Production

Finally, a company can go completely local, sourcing materials in the foreign country and manufacturing the product there. Nokia used this strategy in India. This strategy takes the greatest advantage of lower-cost labor, regional suppliers, and local knowledge. However, it involves high investment and depends heavily on the quality of local resources. It also exposes the company to political risks. However, going 100 percent local may work well in BRIC countries (i.e., Brazil, Russia, India, and China) for labor-intensive, low-value products. These types of products can tolerate the potentially lower levels of quality associated with local suppliers.

Companies that decide to build a local plant have to decide in which country to locate the plant. The criteria to consider are

- Political stability,
- Statutory/legal environments,

- Infrastructure quality,
- Foreign-investment incentives,
- Local telecommunications and utility infrastructure,
- Workforce quality,
- Security and privacy,
- Compensation costs,
- Tax and regulatory costs, and
- Communication costs.

Government Incentives

Countries sometimes offer special incentives to attract companies to their area. Malaysia, for example, set up the Multimedia Super Corridor that offers tax breaks, desirable facilities, and excellent infrastructure to foreign companies. Similarly, China has special economic zones (SEZs) that promote international high-quality standards in Hainan Province, Shenzhen, Shantou, and elsewhere. While one component is a government initiative to set up SEZs or corridors that boast excellent communications infrastructure, other factors, such as uninterrupted power supply and connections to transportation infrastructure, play an important role as well. Even though the economic or political picture of a country may appear appealing, companies also need to understand public policy and the regulatory environment of the specific state or municipality in which they plan to set up operations, because laws on a local level may be different and may create roadblocks for new company operations.

Infrastructure Issues

Emerging-market countries are investing in new infrastructure to varying degrees. China is working hard to grow rail, road, and port infrastructure. In other countries, investment may be lagging. And in some cases, companies have been caught in the middle of governmental problems arising from dealing with officials who turn out to be corrupt.

Locating a plant in China means having to ship products from China. If a company's primary market is in the United States, China is halfway around the world. The company may save on labor, but there are other added costs—extra shipping costs as well as hidden costs of uncertainty. If the company's products are en route and experience delays, for example, customers might experience a stock-out. A stock-out means that there is no more stock of the company's product. The product is unavailable to customers who want to buy it. To avoid stock-out situations, a company may decide to hold inventory close to its customers. Called safety stock, this inventory helps ensure that the company won't run out of products if there's a delay or crisis in a distant manufacturing region. The downsides of safety stock, however, include the increased costs of carrying that inventory, such as the investment in the products, taxes and insurance, and storage space. In addition, companies risk obsolescence of the products before they're sold.

It's important to note that China is far away only if the company's primary markets are outside Asia. The distance that truly matters is the distance to the company's markets. Companies that sell their products around the world may want to have production facilities around the world as well, so that their products are closer to customers—wherever those customers may be.

Did You Know?

Global Supply Chains Are Rerouting Around the Red Sea

A supply chain does not need a factory shutdown to be disrupted. Shipping routes themselves can become a major source of risk. Since late 2023, attacks on commercial vessels in the Red Sea have led many shipping companies to avoid the Suez Canal and reroute ships around the Cape of Good Hope at the southern tip of Africa.

This detour can add days or weeks to deliveries and increases fuel use, shipping costs, and uncertainty. UN Trade and Development (UNCTAD) reported that, by May 2025, cargo tonnage moving through the Suez Canal remained about **70 percent below 2023 levels**. Rerouting also pushed global shipping “ton-miles”—the distance goods travel multiplied by their weight—to a record **6 percent increase in 2024**, nearly three times faster than the growth in trade volume.

The disruption matters for businesses because many products depend on parts and materials that cross several countries before final assembly. Delayed shipments can create stock-outs, interrupt production, increase inventory costs, and raise prices for consumers. Industries that depend on intermediate imports from Asia, including automotive, machinery, construction, chemicals, and retail goods, can be particularly affected.

In response, companies may use strategies such as holding more safety stock, qualifying backup suppliers, choosing alternate shipping routes, locating production closer to customers, and using better supply-chain data to identify delays early. These choices can make a supply chain more resilient, but they may also increase operating costs. The lesson is that the lowest-cost supply chain is not always the most reliable one.

Source: UN Trade and Development (UNCTAD), *Review of Maritime Transport 2025*; UNCTAD, “Unprecedented Shipping Disruptions Raise Risk to Global Trade,” February 22, 2024.

Outsourcing and Offshoring

Offshoring means setting up operations in a low-cost country for the purpose of hiring local workers at lower labor rates. Offshoring differs from outsourcing in that the firm retains control of the operations and directly hires the employees. In outsourcing, by contrast, the company delegates an entire process (such as accounts payable) to the outsourcing vendor. The vendor takes control of the operations and runs the operations as they see fit. The company pays the outsource vendor for the end result; how the vendor achieves those end results is up to the vendor.

Companies that choose to offshore face the same location-criteria factors as companies that make production-operation decisions.

The advantages of outsourcing include the following:

- Efficient processes (the outsourcer typically specializes in a particular process or set of processes, giving them high levels of expertise with that process)
- Access to specialized equipment that may be too expensive for a company to invest in unless that process is their chief business

India has long been a favorite location for outsourcing services, such as call centers and software testing, because of its English-speaking, highly educated workforce. The labor-rate ratio has been five to one, meaning that a company based in the United Kingdom, for example, could hire five Indian college graduates for the price of hiring one UK college graduate. Given the high demand for their labor, however, Indian employees' wages have begun to rise. Offshoring companies are now faced with a new challenge. The firms hire and train Indian employees only to see them leave in a year for a higher salary elsewhere. This wage inflation and high turnover in India have led some companies, like ABN AMRO Bank, to consider whether they should move offshoring operations to China, where wages are still low. The downside is that graduates in China aren't as knowledgeable about the financial industry, and language problems may be greater.

Diageo, the world's largest purveyor of spirits, used the following criteria when choosing an offshoring-services location. Diageo analyzed nineteen locations in fourteen countries, ultimately choosing Budapest, Hungary, as the location of its offshore shared-services operations. The primary criteria Diageo used were

- A low-cost base, both in terms of start-up and ongoing running costs;
- A favorable general business environment;
- The availability of suitable staff—particularly with regard to language skills;
- A high level of local and international accessibility with good transport links;
- The attractiveness for international staff; and
- A robust regulatory framework.

Companies save on labor costs when offshoring, but the “hidden costs” can be significant. These hidden costs include the costs of additional facilities, telecommunications, and technological infrastructure. Delays or problems with internal project coordination and the need for redundancy can add even more costs.

Did You Know?

Standard Chartered Bank Mitigated Risk by Duplicating Operations in Chennai and Kuala Lumpur

As you can imagine, banks are very concerned about security because of the highly confidential customer information they possess. Some banks try to mitigate the risks by setting up mirror sites. Standard Chartered Bank, for instance, chose Chennai in South India as the hub for its Scope International operations, but some of the tasks are also done in Kuala Lumpur in Malaysia: “Because we run the operations of 52 countries, we have to satisfy information security and business continuity issues in all locations,” says Sreeram Iyer, Group Head, Global Shared Services Centers, Standard Chartered Scope International at the time of the decision. “Kuala Lumpur backs up the Chennai center and vice versa.” (*Banks: Captive to Third Party Move?*).

Supply-Chain Management

Supply-chain management encompasses the planning and management of all activities involved in sourcing and procurement, conversion, and logistics. Importantly, it also includes coordination and collaboration with channel partners, which can be suppliers, intermediaries, third-party service providers, and customers. In essence, supply-chain management integrates supply-and-demand management within and across companies.

Activities in the supply chain include:

- Demand management (e.g., forecasting, pricing, and customer segmentation),
- Procurement (e.g., purchasing, supplier selection, and supplier-base rationalization),
- Inventory management (e.g., raw materials and finished goods),
- Warehousing and material handling,
- Production planning and control (e.g., aggregate planning, workforce scheduling, and factory operations),
- Packaging (i.e., industrial and consumer),
- Transportation management,
- Order management,
- Distribution network design (e.g., facility location and distribution strategy), and
- Product-return management.

Cross-organizational teams across the supply chain can bring great perspective to the overall team process. Representatives from design, business, purchasing, manufacturing, equipment purchasing, planning, customer, logistics, information technology, and finance all bring their specialized knowledge to the benefit of the supply chain as a whole.

Spotlight on International Strategy and Entrepreneurship

Entrepreneurial Innovation at P&G

In 2002, Procter & Gamble (P&G) created a test factory, called the Garage, in Vietnam to experiment with low-cost diaper manufacturing for emerging markets. This factory was different from P&G's US-based factories because it didn't use high-tech, automation-intensive manufacturing processes. Rather, P&G wanted a low-cost, low-tech solution. The factory helped P&G devise a new, low-cost approach to manufacturing in emerging-market countries. The strategy required finding local suppliers, some of whom wouldn't have been acceptable for other P&G products but were suitable for this one. P&G formed a network of 150 low-cost machine builders who could supply manufacturing equipment to P&G's Vietnam factory. This manufacturing equipment was appropriate for emerging-market sites and emerging-market prices. The equipment was not on par to P&G's US-based manufacturing equipment, but P&G could use it in other countries and in other product lines. For example, P&G took the lessons and machine-building know-how it had learned from making low-cost diapers in Asia and applied it to reducing the costs of making feminine pads in Mexico. In transferring this know-how from one country to the next, P&G reduced the costs of its feminine pads in Mexico by 20 percent.

P&G has gone a step further and brought its results back home to the United States in two ways. First, thanks to the North American Free Trade Agreement (NAFTA), P&G can import its low-cost feminine pads from Mexico back into the United States. Second, P&G now sees an opportunity to give a second life to obsolete plants in the United States. The experience P&G has gained in emerging markets has taught the company that not every product in every market needs the latest and

greatest approaches to manufacturing in order to be successful. P&G's experience with its Vietnamese factory has given it a scalable approach, which has enabled P&G to make diapers and other similar personal-care products in many different emerging-market countries using widely available, low-cost manufacturing equipment.

Key Takeaways

- There are several strategic choices available to companies when they decide how to produce their products for international markets. First, companies can manufacture their products in their home countries and export them. This strategy involves the least amount of change but has the downsides of higher supply-chain costs, potential delays, exchange-rate risks, and isolation from local knowledge.
- Second, a company can build components in one country and do local assembly in another. This strategy offers advantages of tax or tariff incentives but increases coordination costs and may bring unfavorable country-of-origin effects.
- Finally, a company can opt for local production. This decision requires a careful evaluation of the risks and rewards of production operations in that country, including assessing political risks, the skills of the local workforce, and the quality of the infrastructure.
- Some companies also choose to outsource or offshore their processes, either giving control to the outsource vendor for the process and paying for the results (i.e., outsourcing) or retaining control of the process while taking advantage of lower labor rates (i.e., offshoring).
- Supply-chain management is the coordination of a host of activities that can give a company a distinct competitive advantage. Cross-organizational teams are the best way to take advantage of the perspectives of each supply-chain function for the benefit of all.

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10.3: Made in India Video Clip

Before You Watch

This clip from the film *Outsourced* captures a familiar tension in global business: consumers may worry about jobs moving overseas, yet they also value the lower prices that global production and sourcing can make possible. The clip focuses on goods made in China and jobs outsourced to India, but the underlying question remains relevant today: **Can consumers, businesses, and governments simultaneously demand low prices, reliable availability, and more domestic production without tradeoffs?**

In recent years, supply-chain disruptions, geopolitical tensions, tariffs, and concerns about access to critical products have encouraged businesses and governments to reconsider where goods are made. Some firms are reshoring production to the United States, moving production to nearby countries, or adding suppliers in multiple regions to reduce risk. These decisions may strengthen resilience and support domestic employment, but they can also increase labor, facility, inventory, and product costs.

As you watch, consider the competing priorities faced by a business deciding where to manufacture: cost, quality, speed, worker skills, supplier reliability, transportation, customer expectations, and risk. The film is comedic, but its central issue is real: global production creates benefits and costs that are shared unevenly among consumers, workers, businesses, and communities.

YouTube Video

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The clip suggests that people may want both low-cost imported products and more domestic manufacturing jobs. If you managed a U.S. company, how would you balance product price, domestic employment, supply-chain reliability, and profitability? Explain which factor you would prioritize and why.

Sources & References

- Made in China. **Authored by:** peacerebelgirl. **Located at:** <https://youtu.be/win-EzAX5Fc>. **License:** Other. **License Terms:** Standard YouTube license

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10.4: Using Logistics to Go Global

Before You Watch

Global business depends on more than making a product at a competitive cost. A company must also be able to move raw materials, components, and finished goods reliably across borders and deliver them to customers when and where they are needed. This process—known as **global logistics**—includes transportation, warehousing, inventory management, customs compliance, documentation, technology, and coordination among suppliers, carriers, and customers.

The video introduces the importance of logistics in an increasingly interconnected economy. It explains that firms may use multiple transportation modes, including ocean shipping, air freight, rail, trucking, and intermodal transportation, depending on the product, distance, time requirements, and cost. It also distinguishes logistics from the broader concept of supply-chain management: logistics focuses on managing the flow and storage of goods, while supply-chain management coordinates the flow of materials, information, and money from raw materials to the final customer.

As you watch, consider why companies such as Walmart, Amazon, and Apple view logistics as a source of competitive advantage. A well-managed logistics system can lower costs, reduce delays, improve customer service, and help a firm respond when supply routes, demand, or international regulations change. However, global logistics also requires firms to manage trade rules, customs requirements, carrier relationships, shipment tracking, inventory, and disruption risk.

The video makes five main points:

1. **Logistics makes modern commerce possible.** Products reach consumers because businesses coordinate transportation, storage, and delivery across increasingly complex supply networks. The video argues that logistics affects nearly every industry and every product people use.
2. **Global logistics is complex.** Firms may source components from several countries, assemble products in another location, and distribute them into multiple markets. This requires attention to customs regulations, freight contracts, shipping modes, documentation, and delivery schedules.
3. **Transportation choices depend on the product and business need.** The video gives examples of companies using ocean containers for international shipments; railcars and tank trucks for bulk materials; trucks for regional delivery; air freight for speed; and parcel carriers for small shipments.
4. **Technology improves visibility and efficiency.** Transportation-management systems, warehouse-management systems, cloud-based tools, and electronic tracking help firms monitor shipments, manage inventory, share information, and respond more quickly to disruptions. The video's examples predate many current tools, but its main point remains relevant: data and technology are essential to modern logistics.
5. **Logistics is a major career field.** The video identifies planning, transportation, purchasing, compliance, supplier relationships, customer service, data analysis, and performance measurement as important skills. It presents logistics and supply-chain management as functions that create value and competitive advantage, rather than simply back-office operational work.

YouTube Video

This interactive element is not available in this format. Visit the link or scan the QR code to access it online.

[View this YouTube Video online](#)



[Watch the video on YouTube to view the transcript.](#)

Suggested Viewing Questions 10.4.1

1. How does the video distinguish logistics from supply-chain management?
2. Why might a company use several transportation modes rather than rely on only one?
3. What tradeoffs occur when a company chooses a faster but more expensive shipping option?
4. How do technology and shipment visibility improve customer service and inventory management?
5. How could a disruption to shipping, customs clearance, or a key supplier affect a company's ability to compete globally?

Sources & References

- Use Global Logistics **Authored by:** Forsyth Tech **Located at:** <https://www.youtube.com/watch?v=UYAqObW13pc>. **License:** Other. **License Terms:** Standard YouTube license

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10.5: Business of Offshoring

Offshoring and Outsourcing

Businesses often look beyond their home country to lower costs, gain access to specialized skills, reach new customers, or make their supply chains more flexible. Two common strategies are **outsourcing** and **offshoring**. Although people sometimes use the terms interchangeably, they describe different business decisions.

Outsourcing means hiring an outside organization to perform a business activity that the company could otherwise perform internally. The outside provider may be located in the same country or in another country. For example, a U.S. retailer that hires a Wisconsin company to operate its customer-service center is outsourcing, but it is not offshoring.

Offshoring means moving a business activity to another country. The activity may be performed by the company itself in a foreign facility or by an outside supplier. For example, a U.S. manufacturer that opens and operates its own production plant in Mexico is offshoring, but it is not outsourcing because the company still performs the work itself.

When a company hires an independent company in another country to perform work, it is doing **both outsourcing and offshoring**. For example, a U.S. apparel company that contracts with an independently owned factory in Vietnam to make clothing is outsourcing production to a foreign supplier and offshoring that production.

The Difference at a Glance

Table 10.5.1: Comparison of Sourcing Methods

Business decision	Key question	Example
Outsourcing	Who does the work—our company or another company?	A manufacturer hires an outside firm to provide payroll, information-technology support, or packaging services.
Offshoring	Where is the work done—in the home country or another country?	A company moves assembly from the United States to a company-owned factory in Mexico.
Offshore outsourcing	Is the work done by an outside company located in another country?	A U.S. firm contracts with a software-development company in India.
Domestic outsourcing	Is the work done by an outside company in the same country?	A U.S. company hires a U.S. logistics provider to operate its warehouse.

Why Firms Offshore or Outsource

Companies may offshore or outsource to:

- Reduce labor, production, or administrative costs.
- Gain access to specialized technology, expertise, or production capacity.
- Operate closer to overseas customers or suppliers.
- Increase production capacity without building and managing new facilities.
- Focus internal resources on activities that create the most value, such as product development, branding, marketing, or customer relationships.
- Use suppliers in multiple regions to improve flexibility and reduce dependence on a single location.

A company's decision is rarely based on labor cost alone. Managers must consider transportation, tariffs, customs requirements, quality control, intellectual-property protection, political stability, currency risk, communication challenges, supplier reliability, and delivery time.

Benefits and Tradeoffs

Outsourcing and offshoring can reduce costs, speed up production, and give a firm access to global expertise. They may also help a company remain competitive when competitors use lower-cost or more specialized suppliers.

However, these strategies create risks. A company may lose direct control over quality, labor practices, data security, or delivery schedules. Long international supply chains may be disrupted by port delays, conflict, natural disasters, trade restrictions, or changes in currency values. Offshoring can also affect workers and communities when domestic jobs are relocated abroad.

For these reasons, many firms now evaluate **total cost** rather than simply comparing wages. Total cost includes transportation, inventory, tariffs, quality problems, delays, compliance, and the risk of disruptions. Some companies respond by bringing selected activities back to the United States (**reshoring**), moving them closer to home markets (**nearshoring**), or using multiple suppliers in different countries.

Example

Suppose a U.S. company sells small kitchen appliances:

- It hires a U.S. accounting firm to manage payroll: **domestic outsourcing**.
- It opens and manages its own assembly plant in Mexico: **offshoring**.
- It contracts with an independent electronics factory in Vietnam to produce circuit boards: **offshore outsourcing**.
- It moves circuit-board production from Vietnam to a supplier in Mexico to reduce shipping time and disruption risk: **nearshoring**.

The company must decide whether the lower unit cost from a distant supplier is worth the longer delivery time, higher inventory needs, and greater exposure to disruptions.

Questions to Consider

1. Can a company offshore work without outsourcing it? Explain using an example.
2. Can a company outsource work without offshoring it? Explain using an example.
3. Why might the lowest-wage supplier not be the lowest-cost choice overall?
4. What types of work should a company be least willing to outsource or offshore?
5. When might reshoring or nearshoring be a better strategic choice than offshoring?

Sources & References

- Gray, John V. "Business of Offshoring" [video lecture]. Fisher College of Business, The Ohio State University. Reproduced in *Business LibreTexts*, "10.5: Business of Offshoring." Accessed October 2, 2026.

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10.6: Global Business in Action

Global Business in Action: International Shipping

Sending Products Internationally

Imagine that a Wisconsin company manufactures insulated stainless-steel water bottles. After building a successful U.S. business, the company receives an order from a retailer in Germany. The retailer wants 2,000 bottles delivered to Hamburg. The company now faces a global-logistics challenge: it must move the products across borders legally, on time, at a cost that allows the sale to remain profitable.

International shipping requires more than putting products on a truck. The exporter must decide how the goods will travel, prepare required documents, determine who is responsible for shipping costs and risk, follow customs rules, and coordinate delivery after the goods arrive in the destination country.

Step 1: Confirm That the Product Can Be Exported

Before accepting an international order, the company should verify that it can legally export the product and that the buyer can legally import it. The firm may need to determine the product's customs classification, country of origin, labeling requirements, tariff rate, restricted-material rules, and any product-safety or packaging requirements in the destination market.

For some products, exporters may need licenses or additional documentation. Even for ordinary consumer goods, an error in classification, valuation, labeling, or documentation can delay a shipment at the border and create unexpected costs.

Step 2: Choose How to Ship

The exporter must choose a transportation method based on the product's weight, value, urgency, size, and destination.

Table 10.6.1: Shipping Methods

Shipping option	Best used when	Main advantage	Main limitation
Parcel carrier	Small packages, samples, and e-commerce orders	Simple tracking and door-to-door service	Expensive for heavy or high-volume shipments
Air freight	High-value, perishable, or urgent goods	Fastest international delivery	Usually the most expensive option
Ocean freight	Large, heavy, or less time-sensitive shipments	Lowest cost per unit for large volumes	Slow and vulnerable to port or route disruptions
Rail and truck	Moving products within North America or from ports to inland destinations	Flexible and useful for regional distribution	May require coordination with other modes
Intermodal shipping	Large shipments using more than one mode, such as truck-rail-ocean-truck	Can balance cost, capacity, and environmental impact	Requires more planning and coordination

For the water-bottle order, the company might send a small urgent order by air freight or use ocean freight for a larger order that can tolerate a longer delivery time. The company could use a truck to move the containers from Wisconsin to a port, an ocean carrier to cross the Atlantic, and a local carrier in Germany to complete delivery.

Step 3: Work With Logistics Specialists

Small businesses often hire a **freight forwarder** to organize international shipments. A freight forwarder does not necessarily move the goods itself. Instead, it helps the exporter compare transportation options, reserve cargo space, prepare documents, arrange cargo insurance, and coordinate carriers.

The exporter may also work with a **customs broker**. A customs broker helps prepare and submit import documentation, classify the goods under the correct tariff code, calculate duties and taxes, and communicate with customs authorities. In some cases, a freight forwarder and customs broker may be the same company or work closely together.

A logistics provider such as Schneider may assist with domestic trucking, intermodal transportation, warehousing, freight management, and the movement of containers to or from a U.S. port. The exporter remains responsible for understanding the overall transaction, even when outside specialists handle parts of the process.

Step 4: Agree on Responsibility and Risk

The buyer and seller should agree in writing on who arranges transportation, who pays each cost, where responsibility transfers from seller to buyer, and who purchases insurance. Businesses often use **Incoterms**, standardized international trade terms published by the International Chamber of Commerce, to clarify these responsibilities.

For example, the seller might agree to deliver the goods to a U.S. port, while the buyer arranges ocean transportation and import clearance. In another transaction, the seller might arrange transportation all the way to the buyer's location. The chosen term affects the price, paperwork, insurance, customer experience, and risk each party accepts.

Step 5: Prepare Documents and Clear Customs

Common documents in international shipping include:

- A commercial invoice describing the goods, value, buyer, seller, and payment terms.
- A packing list showing the contents, weight, and dimensions of each package or container.
- A bill of lading or air waybill, which serves as a transportation document and evidence that the carrier accepted the goods.
- A certificate of origin, when required, identifying where the product was made.
- Export and import declarations or other customs documents, depending on the countries and products involved.
- Insurance documents, if cargo insurance is purchased.

The accuracy of these documents matters. Customs authorities use them to determine whether goods may enter the country and what duties, taxes, or other requirements apply.

Step 6: Manage Cost, Time, and Disruption Risk

International transportation costs include more than the carrier's freight charge. The company must consider packaging, inland trucking, warehousing, handling, port fees, customs-broker fees, insurance, duties, taxes, currency conversion, and potential delays.

The company must also plan for risk. A port strike, severe weather event, conflict near a shipping route, customs inspection, carrier capacity shortage, or damaged shipment can interrupt delivery. To reduce these risks, firms may use multiple carriers, maintain extra inventory, purchase cargo insurance, use shipment-tracking technology, and build additional delivery time into customer promises.

Key Takeaway

Global logistics allows even relatively small businesses to sell beyond their home market. Success depends on coordinating the right partners and making clear decisions about transportation, documentation, cost, customer service, and risk. A firm does not need to perform every logistics activity itself, but it must understand how each activity affects the customer and the company's profitability.

Activity 10.6.1

Your role: You are the logistics manager for a Wisconsin company that sells water bottles to a retailer in Germany. The retailer has ordered 2,000 units and wants delivery in six weeks.

Your task: Recommend a shipping plan. Identify the transportation modes you would use, the outside specialists you would hire, the documents you would prepare, and the main risks you would manage. Explain how your choices balance cost, speed, reliability, and customer service

11: GLOBAL MARKETING

11.1: Overview

11.2: Importance of Culture on Markets

11.3: Introduction to Global Pricing

11.4: Currency Fluctuations and Global Pricing

11.5: Tariffs and Global Pricing

11.6: Changes in Promotion

11.7: Changes in Placement

11.8: Global Business in Action

11.1: Overview



Figure 11.1.1: Global Marketing.

For U.S. marketers, selling is relatively straightforward – but how do you market laundry detergent to people living in Norway? Not so simple! There have been hundreds of failed global marketing attempts, and not all companies recover what they lose. So, now we will look at the traditional components of the marketing mix but from a global perspective!

The Relationship Between Product and Promotion

With the emerging force of globalization, the distinction between marketing within an organization's home country and marketing in external markets is disappearing very quickly. Organizations are modifying marketing strategies to meet challenges of a global marketplace in addition to sustaining their competitiveness within home markets. An effective global marketing plan enables brands to tweak products for local markets while using the most effective promotional channels to reach consumers. The "Four P's" (product, price, placement, and promotion) of marketing are all affected as a company moves through different phases to become and maintain dominance as a global company. Promotion becomes particularly important for positioning the company in a way that a single product can be adjusted for different markets.

Promotion and Product

Before launching promotions, global companies must define their target markets. In addition to pinpointing which price point and distribution channels would best serve those country markets, global marketers must decide how to introduce products. Promotional tactics for global audiences can range from television commercials to social media marketing on Facebook, YouTube, Twitter, and other channels. Local languages, colors, and religious beliefs all impact how global marketers promote their products and services in different countries.

Changes in Promotion

Before a company decides to become global, it must consider factors unique to the international marketing environment. These factors are social, cultural, political, legal, competitive, economic, and even technological in nature. Ultimately, at the global marketing level, a company trying to speak with one voice is faced with many challenges when creating a worldwide marketing plan. Such as language, religious, and cultural barriers.

Smart companies will vary their marketing mix from country to country, depending on differences in national culture, economic development, product development, distribution channels, etc.

Sources & References

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11.2: Importance of Culture on Markets

Learning Objectives

After reading this section, students should be able to:

- Appreciate the importance of culture on markets

Because international marketing is closely correlated to the cultures in which a firm wishes to sell its product, culture itself must be analyzed to understand the best way to integrate into both existing and emerging foreign markets. There are five essential areas within which culture must be continually studied in order to achieve success in dealing with culture as it affects international marketing.

These are:

- Culture impacts on marketing (international versus domestic)
- Cross-cultural dimensions of marketing research
- Cross-cultural aspects of the marketing mix (products, price, promotion, and place)
- Cross-cultural marketing education and professional training
- Cross-cultural practice in electronic marketing (Tian, 2008)

Cross-cultural marketing occurs when a consumer's culture differs from that of the marketer's own culture.

Consumer behavior diverges across country lines with increased wealth, globalization, and technology; it does not converge (De Mooij, 2005).

Student Example

McDonald's has done a great job introducing its chain around the world and moving into numerous markets and cultures. One location that I think is a great example of cross-cultural marketing is McDonald's in France. The French have a very different culture than the United States. They live their life at a much slower pace, and their meals are more about socializing and enjoying the time with people rather than eating and getting out. McDonald's has created some new menu items for their French locations, such as an Alpine burger and the McBaguette. McDonald's also designed the French chains so that they are more spacious and decorated tastefully so that it does encourage the French to sit down and enjoy their meal at their own pace. There are also separate McCafe locations around France that are decorated with big comfortable chairs and couches to encourage socialization. In addition, the coffee is served in real coffee mugs and not in to-go cups.

Before entering the country, McDonald's surely did their research because they not only added French-like items to the menu, but they also incorporated a French-like atmosphere. I think this is a very good example of cross-cultural marketing because these locations really encourage a dine-in and more relaxed experience compared to the fast-paced take-out that Americans are used to. Many French people have actually commented on the fact that McDonald's in France does not feel like a fast-food restaurant at all. With this information, I think it is easy to say that their research and cross-cultural marketing plan for France has been a success. (Courtney Kent, Class of 2020)

This simple fact proves the importance of cultural knowledge in cross-cultural marketing endeavors. In fact, the importance of cross-cultural study has inspired a definition separate from that of international marketing. Cross-cultural marketing is defined as the strategic process of marketing among consumers whose culture differs from that of the marketer's own culture at least in one of the fundamental cultural aspects, such as language, religion, social norms and values, education, and the living style (Tian, 2008).

Sources & References

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11.3: Introduction to Global Pricing

Learning Objectives

After reading this section, students should be able to:

- Define pricing
- Apply the basics of pricing to global pricing decisions
- Appreciate the global marketer's view of price

Price is the value of a product offering that can be created through the different marketing mix elements, such as through product, distribution, and communication decisions. Therefore, global pricing decisions are related to other marketing mix variables.

At its basic level, pricing is the process of determining what a company will receive in exchange for its products. As one of the four “Ps” in the marketing mix, pricing is the only revenue-generating element. Several factors affect the global pricing of a product, e.g., manufacturing cost, marketplace, competition, market condition, quality of product, distribution channels, country factors and company factors (Alon and Jaffe 2013). According to Clarke and Wilson (2009), international pricing decisions also need to take account of tariffs, quotas, local taxes, subsidies, grants, currency exchange rates, local purchasing power, local business and consumer characteristics. Figure 11.3.1 shows the drivers of international pricing.

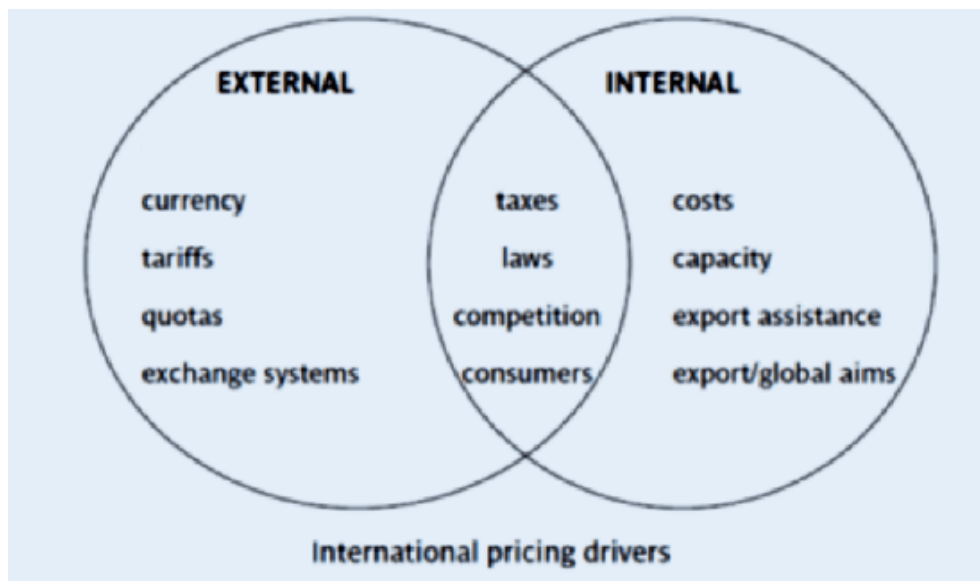


Figure 11.3.1: (Clarke and Wilson (2009))

Prices can be used both to set values and provide signals in international markets (Eden and Rodriguez 2004). From a customer's point of view, value is the sole justification for price. Many times customers lack an understanding of the cost of materials and other costs that go into the making of a product. But those customers can understand what that product does for them in the way of providing value. It is on this basis that customers make decisions about the purchase of a product.

Effective pricing meets the needs of consumers and facilitates the exchange process. It requires that marketers understand that not all buyers want to pay the same price for products, just as they do not all want the same product, the same distribution outlets, or the same promotional messages. Therefore, in order to effectively price products, marketers must distinguish among various market segments. The key to effective pricing is the same as the key to effective product, distribution, and promotion strategies. Marketers must understand buyers and price their products according to buyer needs if exchanges are to occur. However, one cannot overlook the fact that the price must be sufficient to support the plans of the organization, including satisfying stockholders. Price charged remains the primary source of revenue for most businesses.

Although making the global pricing decision is usually a marketing decision, making it correctly requires an understanding of

both the customer and society's view of price as well. In some respects, price setting is the most important decision made by a business. A price set too low may result in a deficiency in revenues and the demise of the business. A price set too high may result in poor response from customers and, unsurprisingly, the demise of the business. The consequences of a poor pricing decision, therefore, can be dire. We begin our discussion of pricing by considering the perspective of the customer.

The Customer's View of Price

A customer can be either the ultimate user of the finished product or a business that purchases components of the finished product. It is the customer that seeks to satisfy a need or set of needs through the purchase of a particular product or set of products. Consequently, the customer uses several criteria to determine how much they are willing to expend in order to satisfy these needs. Ideally, the customer would like to pay as little as possible to satisfy these needs. Therefore, for the business to increase value (i.e., create the competitive advantage), it can either increase the perceived benefits or reduce the perceived costs. Both of these elements should be considered elements of price. To a certain extent, perceived benefits are the mirror image of perceived costs. For example, paying a premium price (e.g., USD 650 for a piece of Lalique crystal) is compensated for by having this exquisite work of art displayed in one's home. Other possible perceived benefits directly related to the price-value equation are status, convenience, the deal, brand, quality, choice, and so forth. Many of these benefits tend to overlap. Thus, providing value-added elements to the product has become a popular strategic alternative. Computer manufacturers now compete on value-added components such as free delivery setup, training, a 24-hour help line, trade-in, and upgrades.

Student Example

A great example of this concept is Sherwin-Williams. Our contractor segment (residential painters) wants the best product to use on their projects, yet they want to pay as little as possible. There are cases when they will use higher quality products if their customers want the best finish possible; however, once more, everything comes down to cost.

When the sales representative sets prices for individual contractors, they are not always the lowest. Whether a contractor purchases a low-grade, mid-grade, or high-grade product, we (store employees) try to add value to their purchase by providing exceptional services. This can range from many things, such as carrying all of their paint out to their vehicles and loading it for them while having a small conversation; to reminding them about future sales; providing quick delivery services; and accepting orders by phone; or simply providing free coffee all day. Expressing our appreciation by having cook-outs every few months also helps the contractors feel more at home with us, which is great because it helps build loyalty to our brand, which is one of the main reasons why we have over 70% of the total paint and coatings market share in the world. (Silviano Espana Silva, Class of 2020)

Perceived costs include the actual dollar amount printed on the product, plus a host of additional factors. As noted, these perceived costs are the mirror-opposite of the benefits. When finding a gas station that is selling its highest grade for USD 0.06 less per gallon, the customer must consider the 16-mile (25.75-kilometer) drive to get there, the long line, the fact that the middle grade is not available, and heavy traffic. Therefore, inconvenience, limited choice, and poor service are possible perceived costs. Other common perceived costs include risk of making a mistake, related costs, lost opportunity, and unexpected consequences, to name but a few. A new cruise traveler discovers they really do not enjoy that venue for several reasons—e.g., they are given a bill for incidentals when they leave the ship, have used up their vacation time and money, and receive unwanted materials from this company for years to come. In the end, viewing price from the customer's perspective pays off in many ways. Most notably, it helps define value—the most important basis for creating a competitive advantage.

Price From a Societal Perspective

Price, at least in dollars and cents, has been the historical view of value. Derived from a bartering system (exchanging goods of equal value), the monetary system of each society provides a more convenient way to purchase goods and accumulate wealth. Price has also become a variable society employs to control its economic health. Price can be inclusive or exclusive. In many countries, such as Russia, China, and South Africa, high prices for products such as food, health care, housing, and automobiles mean that most of the population is excluded from purchase. In contrast, countries such as Denmark, Germany, and Great Britain charge little for health care and consequently make it available to all.

The Global Marketer's View of Price

Price is important to global marketing because it represents marketers' assessment of the value customers see in the product or service and are willing to pay for a product or service. A number of factors have changed the way marketers undertake the pricing of their products and services.

- Local competition puts pressure on the global firms' pricing strategies. Many local-made products are high in quality and compete in global markets on the basis of a lower price for good value.
- Local competitors often try to gain market share by reducing their prices. The price reduction is intended to increase demand from customers who are judged to be sensitive to changes in price.
- New products are far more prevalent today than in the past. Pricing a new product can represent a challenge, as there is often no historical basis for pricing new products. If a new product is priced incorrectly, the marketplace will react unfavorably, and the "wrong" price can do long-term damage to a product's chances for marketplace success.
- Technology has led to existing products having shorter marketplace lives. New products are introduced to the market more frequently, reducing the "shelf life" of existing products. As a result, marketers face pressures to price products to recover costs more quickly. Prices must be set for early successes, including fast sales growth, quick market penetration, and fast recovery of research and development costs.

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11.4: Currency Fluctuations and Global Pricing

Learning Objectives

After reading this section, students should be able to:

- Explain the role of currency fluctuations and global pricing
- Outline what happens when home currency is weak and strong

Currency values change continually. For companies that buy, sell, borrow, or operate across national borders, those movements can change the real value of a sale even when the product price does not change.

For example, a U.S. company may sell a product abroad for a fixed price in the customer's local currency. If that local currency loses value before the company receives payment, the company receives fewer U.S. dollars than expected. Its revenue and profit margin may fall even if it sells the same number of units. The reverse can also occur: if the foreign currency strengthens, the company may receive more in its home currency.

Because of this risk, global companies must regularly evaluate whether their prices still cover costs and provide an acceptable profit.

Why Companies May Adjust Prices

A company may need to adjust its international prices when exchange-rate changes materially affect its costs, revenue, or competitive position. Common reasons include:

- **Protecting profit margins.** If sales are priced in a weakening foreign currency while major costs are paid in the company's home currency, the company may need to raise the local selling price or find ways to reduce costs.
- **Responding to rising imported-input costs.** A local subsidiary may buy ingredients, packaging, equipment, or technology in a foreign currency. When its local currency weakens, those imports become more expensive and may force a price increase.
- **Remaining competitive.** A company whose home currency weakens may be able to lower its foreign-market price and still earn an acceptable amount when it converts revenue back into its home currency. However, lowering prices is a strategic choice, not an automatic response; the company may instead keep prices steady and retain a higher margin.
- **Managing inflation and regulation.** In countries with rapid inflation, exchange controls, or sudden official devaluations, a price set at the beginning of the year may no longer cover the cost of inventory or imported inputs a few months later.
- **Preserving customer relationships.** Frequent or dramatic price changes can frustrate customers and distributors. Firms therefore must balance financial protection with the need for price stability and trust.

How Currency Strength Can Affect a Business

Table 11.4.1: Effects of Currency Strength

If the company's home currency...	Possible effect on exports	Possible effect on imported inputs	Possible effect on foreign revenue when converted home	Common management response
Weakens	Exported products may become less expensive for foreign customers, which can improve price competitiveness	Imported materials, equipment, and ingredients may become more expensive	Foreign-currency sales may convert into more home-currency revenue	Maintain price to improve margin, lower the foreign-market price selectively, raise prices where imported costs increase, or hedge key imports

If the company's home currency...	Possible effect on exports	Possible effect on imported inputs	Possible effect on foreign revenue when converted home	Common management response
Strengthens	Exported products may become more expensive for foreign customers, which can reduce price competitiveness	Imported materials, equipment, and ingredients may become less expensive	Foreign-currency sales may convert into less home-currency revenue	Raise foreign-market price only if demand allows, absorb part of the change in margin, improve efficiency, source locally, or hedge expected foreign revenue

Adapted from: Keegan and Green (2011)

Example: PepsiCo in Venezuela

Venezuela illustrates how severe currency changes can affect a multinational company. In 2013, the Venezuelan government devalued the bolívar's official exchange rate from 4.3 to 6.3 bolívars per U.S. dollar. PepsiCo reported an **after-tax net charge of \$111 million** in the first quarter of that year related to remeasuring bolívar-denominated net monetary assets in its Venezuelan business. The company described the effect as a noncash foreign-exchange loss, but it still reduced reported earnings by approximately \$0.07 per share.

This example shows that currency risk is not limited to the price of a product sold to consumers. A large currency devaluation can reduce the reported value of cash, receivables, and other assets held in the local currency. PepsiCo had also recorded a **\$120 million one-time net charge** in 2010 after Venezuela's currency devaluation and a shift to hyperinflationary accounting for its Venezuelan operations.

How Companies Reduce Currency-Related Losses

Companies cannot control exchange rates, but they can reduce how much a currency movement harms their business.

- **Price in a stable or preferred currency.** An exporter may invoice customers in U.S. dollars, euros, or another relatively stable currency rather than the customer's local currency. This shifts some exchange-rate risk to the buyer, so it may reduce competitiveness in markets where customers expect local-currency pricing.
- **Use price-adjustment clauses.** Contracts can allow prices to change when exchange rates move beyond an agreed range. This is particularly useful for long-term supply agreements, large equipment sales, and projects with lengthy delivery periods.
- **Hedge currency exposure.** Firms can use forward contracts, options, and other financial instruments to lock in or limit the exchange rate used for an expected future payment. For example, a U.S. exporter expecting euro revenue in 90 days may use a forward contract to establish the dollar value it will receive.
- **Match revenue and costs in the same currency.** A company can create a natural hedge by earning revenue and paying more of its costs in the same currency. Local production, local sourcing, and borrowing in the local currency can reduce the mismatch between foreign-currency sales and home-currency costs.
- **Shorten payment terms.** Collecting payment more quickly reduces the time during which exchange rates can move against the seller. Companies may require deposits, invoice more frequently, or limit extended credit in volatile markets.
- **Limit cash balances in unstable currencies.** When a local currency is rapidly losing value, a company may seek to convert excess cash promptly, use it to pay local expenses, purchase inventory, or reinvest it in the local operation—subject to local law and foreign-exchange restrictions.
- **Review prices regularly.** In stable markets, a company might review international pricing quarterly or annually. In highly volatile or high-inflation markets, it may need to review prices monthly, weekly, or under a formula written into distributor agreements.

Key Takeaway

Exchange-rate movements can affect a company's revenue, expenses, assets, and competitiveness. Global pricing is therefore

not simply a matter of converting one currency into another. Companies must decide whether to absorb the effect in lower margins, pass some of it to customers through price changes, reduce exposure through sourcing and contract design, or hedge the financial risk. PepsiCo's reported \$111 million Venezuela-related charge in 2013 demonstrates how a sharp devaluation can affect a multinational's financial results even without a change in the number of products sold.

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- "What Do We Mean by Currency and Foreign Exchange?", section 7.1 from the book Challenges and Opportunities in International Business (v. 1.0). under a Creative Commons Attribution-NonCommercial-ShareAlike 3.0 License without attribution as requested by the work's original creator or licensor.

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11.5: Tariffs and Global Pricing

Learning Objectives

After reading this section, students should be able to:

- Explain the effects of a tariff on global prices

A tariff is any tax or fee collected by a government. Two of the price effects of a tariff are worthy of emphasis. First, although a tariff represents a tax placed solely on imported goods, the domestic price of both imported and domestically produced goods will rise. In other words, a tariff will cause local producers of the product to raise their prices. Why?

When the price of imported goods rises due to the tariff, consumers will shift their demand from foreign to domestic suppliers. The extra demand will allow domestic producers an opportunity to raise output and prices to clear the market. In so doing, they will also raise their profit. Thus, as long as domestic goods are substitutable for imports and as long as the domestic firms are profit seekers, the price of the domestically produced goods will rise along with the import price.

The average consumer may not recognize this rather obvious point. For example, suppose the United States places a tariff on imported automobiles. Consumers of U.S.-made automobiles may fail to realize that they are likely to be affected. After all, they might reason, the tax is placed only on imported automobiles. Surely this would raise the imports' prices and hurt consumers of foreign cars, but why would that affect the price of U.S. cars? The reason, of course, is that the import car market and the domestic car market are interconnected. Indeed, the only way U.S.-made car prices would not be affected by the tariff is if consumers were completely unwilling to substitute U.S. cars for imported cars or if U.S. automakers were unwilling to take advantage of a profit-raising possibility. These conditions are probably unlikely in most markets around the world.

The second interesting price effect arises because the importing country is large. When a large importing country places a tariff on an imported product, it will cause *the foreign price to fall*. The reason? The tariff will reduce imports into the domestic country, and since its imports represent a sizeable proportion of the world market, world demand for the product will fall. The reduction in demand will force profit-seeking firms in the rest of the world to lower output and price in order to clear the market.

The effect on the foreign price is sometimes called the terms of trade effect. The terms of trade is sometimes defined as the price of a country's *export goods* divided by the price of its *import goods*. Here, since the importing country's import goods will fall in price, the country's terms of trade will rise. Thus, a tariff implemented by a large country will cause an improvement in the country's terms of trade.

Sources & References

- The book "International Trade: Theory and Policy" v. 1.0 published by Saylor Academy under a Creative Commons Attribution-NonCommercial-ShareAlike 3.0 License without attribution as requested by the work's original creator or licensor.

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11.6: Changes in Promotion

Local languages, colors, and religious beliefs all impact how global marketers promote their products and services in different countries.

Key Points

- To successfully implement global marketing strategies, brands must ensure their promotional campaigns take into account how consumer behavior is shaped by internal conditions and external influences.
- Global companies must be nimble enough to adapt changing local market trends, tastes, and needs to their promotional mix.
- When launching global advertising, public relations, or sales campaigns, global companies test promotion ideas to provide results that are comparable across countries.
- Using measures can be particularly helpful for marketers since they are based on visual, not verbal, elements of the promotion.

Key Terms

- **Measure:** To ascertain the quantity of a unit of material via calculated comparison with respect to a standard.
- **Demographics:** The observable characteristics of a population, such as physical traits, economic traits, occupational traits, and more.

Changes in Promotion

Before a company decides to become global, it must consider a multitude of factors unique to the international marketing environment. These factors are social, cultural, political, legal, competitive, economic, and even technological in nature. Ultimately, at the global marketing level, a company trying to speak with one voice is faced with many challenges when creating a worldwide marketing plan. Unless a company holds the same position against its competition in all markets (market leader, low cost, etc.), it is impossible to launch identical marketing plans worldwide. Thus, global companies must be nimble enough to adapt to changing local market trends, tastes, and needs.



Figure 11.6.1: Global Promotion Language is usually one element that is customized in a global promotional mix. (Image of Potato Chips, by kevin dooley, [Flickr](#), CC BY)

Global Promotion Language is usually one element that is customized in a global promotional mix.

For global advertisers, there are four potentially competing business objectives that must be balanced when developing worldwide advertising: building a brand while speaking with one voice, developing economies of scale in the creative process, maximizing local effectiveness of advertisements, and increasing the company's speed of implementation. Global marketers can use the following approaches when executing global promotional programs: exporting executions, producing local executions, and importing ideas that travel.

Factors in Global Promotion

To successfully implement these approaches, brands must ensure their promotional campaigns take into account how consumer behavior is shaped by internal conditions (e.g., demographics, knowledge, attitude, beliefs) and external influences (e.g., culture, ethnicity, family, lifestyle) in local markets.

- **Language** – The importance of language differences is extremely crucial in global marketing, as there are almost 3,000 languages in the world. Language differences have caused many problems for marketers in designing advertising campaigns and product labels. Language becomes even more significant if a country's population speaks several languages.
- **Colors** – Colors also have different meanings in different cultures. For example, in Egypt, the country's national color of green is considered unacceptable for packaging because religious leaders once wore it. In Japan, black and white are colors of mourning and should not be used on a product's package. Similarly, purple is unacceptable in Hispanic nations because it is associated with death.
- **Values** – An individual's values arise from his or her moral or religious beliefs and are learned through experiences. For example, Americans place a very high value on material well-being and are much more likely to purchase status symbols than people in India. In India, the Hindu religion forbids the consumption of beef.
- **Business norms** – The norms of conducting business also vary from one country to the next. For example, in France, wholesalers do not like to promote products. They are mainly interested in supplying retailers with the products they need.
- **Religious beliefs** – A person's religious beliefs can affect shopping patterns and products purchased in addition to his or her values. In the United States and other Christian nations, Christmas time tends to be a major sales period. In other religions, significant religious holidays may or may not serve as popular times for purchasing products.

There are many other factors, including a country's political or legal environment, monetary circumstances, and technological environment, that can impact a brand's promotional mix. Companies have to be ready to quickly respond and adapt to these challenges as they evolve and fluctuate in the market of each country.

Changing the Global Promotional Mix

When launching global advertising, public relations, or sales campaigns, global companies test promotional ideas using marketing research systems that provide results comparable across countries. The ability to identify the elements or moments of an advertisement that contribute to the success of a product launch or expansion is how economies of scale are maximized in marketing communications. Market research measures such as flow of attention, flow of emotion, and branding moments provide insight into what is working in an advertisement in one or many countries. These measures can be particularly helpful for marketers since they are based on visual, not verbal, elements of the promotion.

Considering these measures along with conducting extensive market research is essential to determining the success of promotional tactics in any country or region. Once brands discover what works (and what does not) in their promotional mix, those ideas can be imported by any other market. Likewise, companies can use this intelligence to modify various elements in their promotional mix that are receiving minimal or unfavorable response from global audiences.

Adapting a promotional message helps a global company communicate effectively with local customers. However, effective communication alone does not ensure a sale. The product must also be available through distribution channels that match local shopping habits, infrastructure, regulations, and retail systems. The next section examines how companies adapt placement decisions in global markets.

Sources & References

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11.7: Changes in Placement

Successfully positioning products on a global scale requires marketers to determine the target market's preferred combination of attributes.

Key Points

- Placement in global marketing involves conducting extensive research to accurately define the market, as well as the attributes that define the product's potential environment.
- Regardless of its size or visibility, a global brand must adjust its country strategies to take into account placement and distribution in the marketing mix.
- In addition to where products are placed, global marketers must consider how these products will be distributed across the different shopping venues and communication channels unique to that particular country or market.

Key Terms

- **Positioning:** The act of positioning; placement. Positioning involves ascertaining how a product or a company is or should be perceived in the minds of consumers. Positioning is the underpinning of messages created to promote a product or company in order to generate positive perceptions in the minds of consumers.
- **Marketing mix:** A business tool used in marketing products; often crucial when determining a product or brand's unique selling point. Often synonymous with the four Ps: price, product, promotion, and place.
- **Dollar store:** A retail store selling inexpensive items, especially one in which all items have a price of one dollar.

Changes in Placement

The global marketing mix comprises four main elements: product, price, placement, and promotion. Although product development, promotional tactics and pricing mechanisms are the most visible during the marketing process, placement is just as important in determining how the product is distributed. Placement determines the various channels used to distribute a product across different countries, taking in factors such as competition and how similar brands are being offered to the target market.



Figure 11.7.1: Product Placement in Supermarket. Global brands attempt to place products in locations where consumers will be most receptive to their messaging. (Image of Product Placement, by Chiara Marra, [Flickr](#), CC-BY)

Product Placement in Supermarket Global brands attempt to place products in locations where consumers will be most receptive

to their messaging.

Global marketing presents more challenges compared to domestic or local marketing. Consequently, brands competing in the global marketplace often conduct extensive research to accurately define the market, as well as the attributes that define the product's potential environment. Successfully positioning products on a global scale also requires marketers to determine each product's current location in the product space, as well as the target market's preferred combination of attributes. These attributes span the range of the marketing mix, including price, promotion, distribution, packaging, and competition.

Regardless of its size or visibility, a global brand must adjust its country strategies to take into account placement and distribution in the marketing mix. For example, not all cultures use or have access to vending machines. In the United States, beverages are sold by the pallet via warehouse stores. However, in India, this is not an option.

Moreover, placement decisions must also consider the product's positioning in the marketplace. A global luxury brand would not want to be distributed via a "dollar store" in the United States. Conversely, low-end shoemakers would likely be ignored by shoppers browsing in an Italian boutique store.

In addition to where products are placed, global marketers must consider how these products will be distributed across the different shopping venues unique to that particular country or market. Customizing these placement strategies for national and local markets while retaining a strong and consistent brand image can help companies gain significant competitive advantages in the global market.

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11.8: Global Business in Action

Global Business in Action: Harley-Davidson

Harley-Davidson's Global Marketing Challenge

Harley-Davidson is one of Wisconsin's most recognizable global brands. Founded in Milwaukee in 1903, the company is known for motorcycles, accessories, apparel, and a distinct brand image associated with freedom, community, and the open road. While the company has a strong identity in the United States, international expansion presents a different set of challenges.

A motorcycle is not marketed globally in the same way as a T-shirt or a digital subscription. Customers must be able to afford the product, obtain a license, find a dealership, access repairs and replacement parts, purchase insurance, and ride safely on local roads. In addition, consumer preferences, traffic congestion, fuel costs, environmental regulations, import duties, and cultural perceptions of motorcycles vary widely among countries.

Harley-Davidson also operates in a changing market. Its traditional heavyweight motorcycles appeal strongly to some riders, but the company has faced pressure to attract younger and more diverse consumers while competing with manufacturers that offer smaller, less expensive, and more fuel-efficient motorcycles. Recent reporting has noted weaker earnings as some consumers move away from heavy, powerful motorcycles.

Motorcycles Around the World: One Product, Different Customer Needs

In the United States, Harley-Davidson is strongly associated with leisure riding, road trips, personal identity, and riding communities. In other parts of the world, motorcycles and scooters may serve a much more practical purpose: commuting to work or school, transporting family members, making deliveries, reaching areas with limited public transportation, and navigating congested city streets.

Across Southeast Asia, motorized two- and three-wheelers are a dominant form of transportation. More than 80% of households in Indonesia, Malaysia, Thailand, and Vietnam own motorcycles, and the six largest ASEAN economies recorded more than 13.7 million motorcycle and scooter sales in 2019.

For many consumers, the most useful vehicle is not a large touring motorcycle. Smaller scooters and motorcycles are more affordable, use less fuel, are easier to park, and can move through narrow streets and heavy traffic. In the major Southeast Asian markets studied by the International Council on Clean Transportation, 100–125 cc two-wheelers accounted for 62.9% of the market in 2020.

Vietnam offers a particularly clear example. More than 80% of the country's travel demand was met by approximately 65.2 million registered two-wheelers at the end of 2020. In the new two-wheeler fleet sold that year, 80.7% had engines between 50 and 125 cc, while only 2.3% had engines larger than 150 cc.



Figure 11.8.1: Motorcycles in Asia. (Photographed by Dennis Jarvis (2009) Flickr CC BY-SA 2.0)

In many Southeast Asian cities, small two-wheelers fit local conditions because they are:

- More affordable to buy and operate than cars or large motorcycles.
- Easier to maneuver on narrow or congested roads.
- Easier to park in dense urban areas.
- More fuel efficient for frequent short trips.
- Useful for small-business deliveries and gig-economy work.
- Often more practical where public transit coverage is incomplete.

Nearly 250 million motorcycles and other light motorized vehicles operate in Southeast Asia, where they account for around 80% of vehicles. Their affordability, availability, compact size, and ability to navigate heavy traffic and narrow roads help explain their central role in the region.

The result is an important global-marketing lesson: a company cannot assume that its successful U.S. product mix will fit another market. A large, high-priced motorcycle may appeal to a smaller group seeking recreation, premium design, status, or touring experiences. But it may not meet the practical needs of commuters, delivery workers, or price-sensitive consumers who depend on a small, fuel-efficient, easy-to-maneuver two-wheeler every day.

The International Marketing Challenge

Harley-Davidson wants to strengthen sales outside the United States while protecting its premium brand and dealer network. Company leaders must decide how to adapt their marketing strategy for different international markets.

They face the following questions:

- Should Harley-Davidson emphasize large touring motorcycles, smaller and more accessible motorcycles, electric models, or a mix of products?
- How much should Harley adapt its products to fit local road conditions, licensing rules, traffic patterns, fuel prices, and environmental standards?
- Should the company preserve a premium U.S.-heritage price, use financing or lower-priced entry models, or consider local assembly to reduce tariff and shipping costs?
- How should Harley market an American freedom-and-open-road brand in densely populated cities where many consumers use motorcycles mainly for commuting?
- Which channels are most important: traditional dealerships, online research and ordering, rider events, rental programs, training courses, or partnerships with local motorcycle communities?
- How should Harley respond when currency shifts, import duties, or local taxes suddenly increase the local price of an imported motorcycle?

Your Role

Assume you are an international marketing consultant hired by Harley-Davidson. Choose **one market type** for your recommendation:

- A dense, high-income European city.
- A rapidly growing Asian urban market.
- A middle-income Latin American market.
- A developed market with a strong outdoor-tourism and motorcycle-culture segment.

Do not assume every country needs the same strategy. Your recommendation should identify the consumer need Harley can serve and show how the company should adapt its product, price, promotion, and placement decisions.

Analysis Questions

1. Which type of motorcycle customer should Harley-Davidson target first in your selected market? Describe the target customer's likely transportation needs, lifestyle interests, income constraints, and riding conditions.
2. What product mix should Harley offer? Recommend a primary motorcycle category and at least one supporting product or service, such as apparel, parts, financing, rentals, training, rider events, or maintenance plans.
3. How should Harley handle price? Discuss the role of premium positioning, financing, local taxes, import costs, tariffs, and currency changes.
4. How should the company adapt its promotion while retaining its American heritage and recognizable brand identity?
5. What placement strategy is most realistic? Explain the role of dealerships, service centers, local riding communities, events, and digital channels.
6. Identify the greatest risk to your recommendation and propose one specific response.
7. In 200–300 words, write an executive recommendation explaining how Harley-Davidson should enter or strengthen its position in the market type you selected.

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12: HUMAN RESOURCES

12.1: Global Human Resource Management

12.2: Staffing

12.3: Recruiting and Hiring

12.4: Training and Motivating

12.5: Evaluating and Managing Performance

12.6: Compensating

12.7: Terminating and Repatriation

12.8: Global Business in Action

12.1: Global Human Resource Management

Learning Objectives

After you complete this section, you will be able to:

- Describe the roles of Human Resource Management in global business.

In a way, no matter where you do business, Human Resources (HR) is Human Resources. Human Resource Management (HRM) is the coordinated activities of several HR functions, including:

- **Staffing**
- **Recruiting and Hiring**
- **Training and Motivating**
- **Evaluating and Managing Performance**
- **Compensating**
- **Terminating and Repositioning**

Regardless of where you find yourself doing business, you will need to consider these HR functions to be successful. So in that way, HR is HR, in that it concerns itself with the same things no matter where you are. However, that is where the similarities end.

Every country and culture approaches these HR functions differently, and smart organizations work to understand these differences and work them into their HR policies and practices.

12.2: Staffing

When it comes to staffing a global organization, there are three main approaches companies can take, each with its own pros and cons. Let's have a look:

Ethnocentric Approach

An ethnocentric staffing approach fills key positions in foreign operations primarily with employees from the company's home country. Organizations may use this approach when they need to transfer specialized technical expertise, establish common operating practices, protect proprietary knowledge, or maintain close coordination during a new international expansion.

For example, a U.S.-based medical-device manufacturer opening its first production facility abroad might assign experienced home-country engineers and quality leaders for the start-up period. Their role would be to establish production processes, train local employees, and ensure that the new site meets global quality standards. Over time, the company may shift more leadership positions to qualified local employees as the operation becomes established.

An ethnocentric approach can support consistency and knowledge transfer, but it can also limit advancement opportunities for host-country employees, increase relocation costs, and reduce the organization's understanding of local business practices and stakeholder expectations.

Polycentric Approach

A polycentric staffing approach relies primarily on host-country nationals to manage operations in their own country. This approach recognizes that local managers often bring valuable knowledge of the market, language, labor laws, customer expectations, government relationships, and workplace culture.

For example, a global retailer entering the Brazilian market might hire Brazilian leaders for store operations, human resources, supply chain, and marketing. These managers can adapt company practices to local consumer preferences, employment regulations, and business customs while still operating within the organization's overall strategy.

A polycentric approach can improve local responsiveness and create meaningful career opportunities for host-country employees. However, organizations must intentionally create communication, development, and mobility opportunities so that country operations do not become isolated from regional or global decision-making.

Geocentric Approach

A geocentric staffing approach selects employees based on their qualifications and fit for the role, regardless of nationality. The organization treats international talent as a shared global resource and may recruit or transfer employees across countries to place the strongest available candidate in each position.

For example, a multinational technology company may appoint a product leader from India to manage a regional team in Germany because that individual has the strongest combination of technical knowledge, international experience, language ability, and leadership capability. The employee's nationality is less important than the skills needed for the role.

Moving employees across national borders requires careful planning. Employers may need to address work authorization and visa requirements, immigration quotas, tax residency, payroll arrangements, social-security obligations, labor-law protections, data and privacy requirements, relocation logistics, and family-member work authorization. In the United States, the H-1B visa is one example of a work-authorization pathway for certain specialty occupations, but international staffing requirements vary widely by country and by assignment type.

The geocentric approach can build a diverse global leadership pipeline and improve knowledge sharing across the organization. It can also be complex and expensive because employers must manage work authorization, immigration requirements, tax obligations, compensation differences, relocation support, and local labor laws.

Hybrid Approach

In practice, many multinational organizations use a hybrid staffing approach rather than relying entirely on one model. A company may hire local leaders for customer-facing and country-management roles, send technical specialists from another country for a short-term project, and fill regional leadership roles with candidates from anywhere in the organization. Staffing decisions often depend on the role, the availability of local talent, the organization's stage of international expansion, legal requirements, and the need for local market knowledge

Global Strategy and Staffing

The organization's international strategy influences its staffing decisions. An international strategy often relies more heavily on employees from the home country because the organization is transferring knowledge and practices developed at headquarters. A multi-domestic strategy usually places greater emphasis on host-country managers because local responsiveness is critical. A global standardization strategy may use centralized staffing and internationally mobile specialists to maintain consistent processes and achieve economies of scale.

Table 12.2.1: Comparison of Staffing Strategies

Global strategy	Primary strategic focus	Typical staffing emphasis	Why this fit makes sense	Example staffing pattern
International strategy	Transfer products, knowledge, and capabilities developed in the home country to foreign markets	Ethnocentric , especially during early expansion	Headquarters maintains substantial control and transfers its established practices, technology, and culture to foreign operations	A U.S. manufacturer sends experienced U.S. engineers and managers to open and standardize a new overseas facility.
Multi-domestic strategy	Adapt products, marketing, and operations to the needs of each local market	Polycentric	Host-country managers are usually best positioned to understand local customers, competitors, regulations, language, and cultural expectations	A global food company gives country managers broad authority to adapt products, advertising, packaging, and distribution for their local market.
Global standardization strategy	Achieve worldwide efficiency, cost reduction, scale, and consistent products or processes	Ethnocentric or a centrally coordinated geocentric approach	Firms need strong coordination across countries, common standards, and the ability to transfer specialized expertise quickly	A global electronics company assigns leaders with deep process expertise to ensure that factories in multiple countries follow the same quality and production systems.
Transnational strategy	Achieve global efficiency while also adapting to local markets and sharing knowledge across countries	Geocentric and hybrid staffing	A transnational firm needs the best talent regardless of nationality, while still relying on local leaders who understand each market	A multinational appoints local country leaders, forms cross-border product teams, rotates specialists among regions, and fills global roles with candidates from any country.

The organization's international strategy influences its staffing decisions. An international strategy often relies more heavily on employees from the home country because the organization is transferring knowledge and practices developed at headquarters. A multi-domestic strategy usually places greater emphasis on host-country managers because local responsiveness is critical.

A global standardization strategy may use centralized staffing and internationally mobile specialists to maintain consistent processes and achieve economies of scale.

A transnational strategy generally requires the most flexible staffing model. Transnational organizations seek global efficiency, local responsiveness, and knowledge sharing across borders at the same time. As a result, they often use a geocentric or hybrid approach: local leaders manage market-specific activities, global roles are filled based on capability rather than nationality, and employees move among countries or collaborate virtually to share expertise.

Example 12.2.1

Staffing a transnational organization

A multinational consumer-products company uses a transnational strategy. It wants to maintain global efficiency in sourcing, product development, and brand standards, but it also needs to adapt products and marketing to local customer preferences.

The company staffs its organization in several ways. Local nationals lead country operations because they understand consumers, regulations, retail partners, and labor markets. Regional supply-chain and product-development teams include employees from several countries so that knowledge can move across markets. Global leadership positions are filled based on qualifications, international experience, and the ability to work across cultures rather than on nationality alone. Short-term international assignments and virtual cross-border teams help employees share successful ideas from one market with another.

This staffing model supports the transnational strategy because it combines local expertise with global coordination and knowledge sharing.

Important Qualification: These relationships are general patterns rather than fixed rules. Many multinational organizations use a hybrid approach to staffing. For example, a company pursuing a global standardization strategy may still hire local leaders for customer-facing roles, while a multi-domestic company may use international assignments for technical, financial, or executive-development positions. Staffing decisions should reflect the requirements of the role, the organization's global strategy, local talent availability, legal requirements, and the need for coordination across locations.

Expatriates

An expatriate is an employee who works in a country other than their country of citizenship or usual residence. In global organizations, international assignments can take many forms. A long-term assignee may relocate with family for several years, while a short-term assignee may work abroad for a limited project. Other arrangements include international commuters, rotational assignments, virtual cross-border roles, and employees from foreign subsidiaries assigned to corporate headquarters.

Although long-term expatriate assignments remain important for some leadership and technical roles, organizations increasingly use a mix of in-person, short-term, regional, and virtual arrangements to share knowledge across borders

Supporting Successful International Assignments

International assignments can be valuable for developing global leaders, transferring knowledge, launching operations, and strengthening coordination across locations. However, an assignment may be unsuccessful if the employee or accompanying family members experience difficulties adapting to the new location or if the organization provides insufficient support.

Common challenges include:

- Adjusting to a different language, culture, workplace norms, and management style
- Finding appropriate housing, transportation, health care, and schooling or dependent-care arrangements
- Supporting an accompanying partner's career, professional identity, or work authorization
- Managing stress, isolation, safety concerns, and the loss of familiar social networks
- Understanding local laws, tax obligations, and workplace expectations

- Reintegrating into the home organization after the assignment ends

Organizations can improve assignment outcomes by offering cultural and language preparation, destination services, immigration and tax support, mentoring, career planning, mental-health resources, and support for partners and dependents. Preparation should begin before departure and continue throughout the assignment and repatriation process.

Cultural Training

Cultural training involves helping the manager develop an appreciation for the host country's culture, including its history, politics, economics, religion, and social business practices. Managers who develop an affinity and familiarity with the host country culture are likely to perform better and more easily relate to customers, employees, and business partners.

Language Training

English is often used as a shared working language in multinational organizations, particularly in global or regional teams. However, language expectations vary by country, job, industry, customer base, and workplace. Local-language ability may be essential for managing employees, serving customers, meeting safety requirements, building government or community relationships, and participating fully in workplace culture.

Employees working internationally should understand both the formal language requirements of the job and the informal communication practices that shape trust and collaboration in the host location.

Practical Training

Practical training involves helping expat families ease into day-to-day life in the host country by establishing routines, connecting with communities, and navigating life in this new country. It is important that businesses help both the manager and their family (spouse and children) adjust to life abroad.

Expatriate Compensation

Compensation for international assignments can be complex because employees may face differences in cost of living, taxes, health care, housing, transportation, education, social-security systems, and benefits. Organizations aim to create compensation packages that are fair, legally compliant, competitive in the relevant labor market, and appropriate for the purpose and length of the assignment.

Common international-assignment approaches include:

- **Balance-sheet approach:** The employer seeks to maintain an employee's approximate home-country purchasing power while providing allowances or support for assignment-related costs.
- **Host-based or going-rate approach:** The employee is paid primarily according to local market rates and benefits in the host country.
- **Local-plus approach:** The employee receives host-country compensation plus selected benefits or allowances, such as housing, relocation assistance, or periodic travel home.
- **Tax equalization or tax protection:** The employer may help ensure that a cross-border assignment does not create an unexpected tax burden for the employee.

The appropriate approach depends on the role, location, assignment duration, local legal requirements, labor-market conditions, and whether the employee is expected to return to the home country.

Balance Sheet Approach

Under a **balance sheet approach**, the company compensates its expatriate managers at a similar level as their domestic managers, possibly with cost-of-living adjustments.

"The balance sheet approach is the most widely used approach by organizations and its main idea is to maintain the expatriate's standard of living throughout the assignment at the same level as it was in his/her home country. In other

words, it is about ensuring the same purchasing power, which helps to maintain the home country lifestyle. Another important notion is that the balance sheet approach implies matching the expatriate's salary with home-country peers, not with the host-country colleagues." (IESE)

The main advantages and disadvantages of the balance sheet approach are:

Pros: Creates equity across expatriate assignments in different countries and between expatriate managers from the same home country. Easy to communicate to employees.

Cons: Can result in different pay for managers from different home countries in the same host country.

International Assignment Compensation

A product director who normally works in Seoul is assigned to lead a two-year product-launch project in Chicago. The company must decide whether to use a home-based balance-sheet approach, a host-based salary, or a local-plus package. In making that decision, it considers the employee's role and experience, Chicago market pay, housing costs, health-care coverage, taxes in both countries, relocation expenses, the needs of accompanying family members, and whether the employee is expected to return to Korea after the assignment.

Rather than assuming that compensation should be based solely on nationality, the company should use a consistent policy that considers job scope, local market conditions, legal compliance, assignment purpose, and the employee's individual circumstances.

Repatriation

Repatriation occurs when managers return to their home country after serving for a period in a host country position. Repatriated managers may find that they have acquired valuable skills by working abroad which qualify them for higher positions within the organization when they return. For example, they may have gained greater knowledge of the company's international operations or held broader managerial responsibilities in the host country, thereby preparing them for broader responsibilities in the headquarters operation.

On the other hand, repatriates may face several challenges upon returning to their home country. These include:

- Uncertainty about the position they will hold upon return. The supervisor who encouraged an employee to work abroad may have moved on, or managers who remain in the home country may be able to forge closer relationships with their supervisors, leaving them in better standing for promotion.
- Uncertainty about how and whether foreign experience will be valued by other managers in the company. Home country managers may view managerial actions taken in the host country as less consequential than actions taken at the company's headquarters, especially if they are ethnocentric in their worldview.
- Lower status within home country operations than in the foreign operation. A manager might be in charge of the entire operation in a host country, only to return home to a more limited managerial role.
- Difficulties faced by the manager's family. Spouses and children may have trouble adjusting to life back home, especially after extended periods abroad.

Key Takeaway

Global staffing requires organizations to balance the need for consistent global practices with the need for local knowledge and responsiveness. Ethnocentric, polycentric, and geocentric approaches provide a useful framework, but many organizations use a hybrid model that combines local hiring, international assignments, regional leadership, and virtual cross-border collaboration.

Successful international staffing depends on more than selecting a technically qualified employee. Organizations must also consider cultural preparation, family and partner support, immigration and tax compliance, fair compensation, employee well-being, language needs, career development, and repatriation planning

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12.3: Recruiting and Hiring

Global Recruiting and Hiring

Recruiting and hiring in a global business involves attracting, selecting, and retaining employees across countries while balancing organizational goals with local labor-market conditions, laws, culture, and talent availability. A staffing approach answers, “Who should fill positions across the organization?” Recruiting and hiring answer, “How will the organization find and select qualified people for those positions?”

Global recruiting and hiring decisions depend on the organization’s international strategy. A company pursuing cost efficiency may centralize some recruiting processes and use standardized selection criteria. A company competing through local responsiveness may give country managers more authority to recruit employees who understand local customers, language, regulations, and workplace norms. A transnational organization often combines global standards with local flexibility.

Effective global recruiting does not mean using the same process in every country. Organizations should maintain consistent standards for job-related qualifications, fairness, ethics, and nondiscrimination while adapting recruiting methods and selection processes to local legal requirements and cultural expectations.

Hiring Strategies Chart

Table 12.3.1: Comparison of Hiring Strategies

Hiring strategy	Main purpose	Best fit with global strategy	Typical recruiting and selection practices	Main advantage	Potential challenge
Centralized global hiring	Create consistency, strengthen headquarters control, and hire for shared global capabilities	International strategy or global standardization strategy	Global employer brand, common job descriptions, centralized applicant tracking, standardized interviews, global assessment criteria	Supports consistent quality standards and makes it easier to transfer employees across locations	May overlook local labor-market conditions or create processes that do not fit every country
Localized hiring	Build strong local-market knowledge and adapt to country-specific needs	Multi-domestic strategy	Country-specific job postings, local recruiting agencies, local-language interviews, locally appropriate benefits, selection by host-country managers	Improves understanding of local customers, regulations, culture, and talent networks	Can make it harder to maintain consistent standards or share talent across countries
Regional hiring	Coordinate talent across a group of nearby or economically connected countries	Regional strategy or a growing multinational organization	Regional talent pools, regional recruiters, shared leadership-development programs, cross-border hiring within a region	Balances efficiency with greater local relevance than a fully centralized approach	Differences in language, labor law, pay, and work authorization can still be substantial within a region

Hiring strategy	Main purpose	Best fit with global strategy	Typical recruiting and selection practices	Main advantage	Potential challenge
Geocentric or global-talent hiring	Select the best candidate regardless of nationality	Transnational strategy	International job postings, global internal mobility, cross-border interviews, standardized competency assessments, relocation or remote-work options	Expands the talent pool and supports global knowledge sharing	Immigration, taxation, payroll, relocation, and work-authorization requirements can be complex
Internal global mobility	Fill roles with current employees who already understand the company	International, global standardization, or transnational strategy	International assignments, transfers, rotational programs, expatriate and inpatriate assignments, global leadership pipelines	Transfers organizational knowledge and develops employees with global experience	Can be costly and may limit opportunities for local external candidates if overused
Local-plus-specialist hiring	Combine local market expertise with specialized knowledge from elsewhere	Transnational strategy, new-market entry, or technically complex operations	Local hiring for country leadership and market-facing roles; international specialists for start-up, engineering, compliance, or knowledge transfer	Combines local legitimacy with access to scarce expertise	Requires clear role design, collaboration, and equitable career opportunities for local employees
Remote cross-border hiring	Access talent without requiring a long-term relocation	Digital, knowledge-intensive, or distributed global operations	Remote interviewing, employer-of-record arrangements, international contractors where lawful, distributed teams, virtual onboarding	Broadens access to talent and may reduce relocation costs	Employers must manage employment law, taxes, data security, time zones, and team inclusion

Selection Considerations

Global organizations should use selection methods that are directly related to job requirements and appropriate for the country where hiring occurs. Common selection methods include résumé or application reviews, structured interviews, work samples, job simulations, skills assessments, reference checks, and background checks where permitted by law.

Selection practices should be reviewed for legal compliance, fairness, accessibility, and cultural relevance. For example, a test that is valid for a technical role in one country may require translation, local validation, or modification before it is used elsewhere. Organizations should avoid assuming that one country's preferred interview style, communication norms, educational credentials, or assessment practices apply universally.

Selection Practices in South Korea

Recruiting and selection practices are shaped by national education systems, labor markets, cultural expectations, and employer traditions. In South Korea, large employers have historically used highly competitive standardized examinations as one part of their hiring process. This approach reflects the importance that formal testing and educational achievement have held in parts of the country's employment system.

However, global organizations should not assume that a particular country follows one uniform hiring model. Employers should examine current local practices, legal requirements, candidate expectations, and the requirements of the specific job before designing a selection process.

Link strategy to hiring

Table 12.3.2: Links Between Strategies and Hiring Approaches

International strategy	Hiring priority	Likely hiring approach
International	Transfer home-country knowledge and established practices to foreign markets	Centralized global hiring, internal global mobility, and selected expatriate assignments
Multidomestic	Adapt products, services, and operations to local customers and institutions	Localized hiring led by host-country managers
Global standardization	Achieve efficiency, scale, and consistent global processes	Centralized hiring, common competencies, global recruiting systems, and mobile technical specialists
Transnational	Combine global efficiency, local responsiveness, and knowledge sharing	A hybrid model: local hiring for market-facing roles, global talent selection for key positions, regional recruiting, and cross-border project teams

Recruiting for a Transnational Strategy

A multinational consumer-products company sells standardized core products worldwide but adapts flavors, packaging, marketing, and distribution to local markets. Because it follows a transnational strategy, it uses more than one recruiting approach.

The company hires local marketing, sales, human-resources, and country-management employees because these roles require knowledge of consumers, language, labor regulations, retail partners, and cultural preferences. It recruits product-development, supply-chain, data-analytics, and senior leadership talent globally because these roles require specialized capabilities and benefit from knowledge sharing across countries. It also uses regional recruiting teams to build talent pools across markets with similar business conditions.

This approach allows the company to maintain global standards and share expertise while still responding to the needs of individual markets.

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12.4: Training and Motivating

Culture, Training, and Motivation

Training and motivation are not culturally neutral. Employees bring different expectations about leadership, communication, decision-making, rewards, and workplace relationships. A training method or motivational practice that is effective in one setting may be interpreted differently in another.

For example, a manager may use open discussion, group problem-solving, and participatory decision-making to encourage involvement. In some workplaces, employees may view this approach as respectful and empowering. In other workplaces—particularly where employees expect leaders to provide clear direction and make final decisions—employees may interpret a manager's repeated requests for group input as uncertainty, lack of expertise, or an unwillingness to take responsibility.

Effective global managers do not assume that one approach will work everywhere. Instead, they identify the cultural expectations that may affect how employees respond, adapt their methods when appropriate, and communicate clearly about why a particular training or leadership approach is being used.

Culture Connections

This chart connects culture connections to training, motivation and leadership. Cultural values and communication norms influence how employees interpret leadership behavior, feedback, training methods, teamwork, recognition, and rewards. Review the Culture chapter's discussion of power distance, individualism and collectivism, communication styles, and attitudes toward uncertainty when considering how to train and motivate employees in global organizations.

Table 12.4.1: Cultural Connections to Training, Motivation and Leadership

Cultural dimension or expectation	How it may affect training	How it may affect motivation and leadership	Managerial response
Power distance: Expectations about hierarchy and authority	Employees may expect the trainer or manager to be the recognized expert who gives clear direction. Openly challenging an instructor or supervisor may be uncomfortable.	Participative decision-making may be viewed as empowering in some settings but as weak or unclear leadership in others.	Explain roles and decision authority. Combine structured direction with carefully designed opportunities for input.
Individualism and collectivism: Emphasis on individual achievement versus group relationships	Individual exercises and public self-promotion may feel natural in some settings; team-based learning and peer support may be more comfortable in others.	Individual bonuses and recognition may motivate some employees, while team rewards, group pride, and relationship-based recognition may be more meaningful to others.	Use a mix of individual and team goals when appropriate. Consider whether recognition should be public, private, individual, or group-based.
Communication context: Direct versus indirect communication norms	Participants may not openly say that they are confused, disagree, or need help. Silence may represent reflection, respect, uncertainty, or disagreement.	Direct criticism can be seen as useful and efficient in some settings but embarrassing or relationship-damaging in others.	Use multiple ways to check understanding: anonymous questions, demonstrations, practice activities, one-on-one follow-up, and written feedback.
Uncertainty avoidance: Comfort with ambiguity, risk, and changing procedures	Employees may prefer detailed instructions, clear schedules, examples, and formal procedures when learning a new task.	Frequent change, unclear expectations, or loosely defined goals may reduce motivation or confidence.	Provide clear objectives, job aids, examples, timelines, and opportunities to practice before expecting independent performance.

Cultural dimension or expectation	How it may affect training	How it may affect motivation and leadership	Managerial response
Achievement and quality-of-life values: Emphasis on competition, advancement, and performance versus balance, relationships, and well-being	Competitive training exercises may appeal to some participants but discourage others.	Promotions, performance pay, status, meaningful work, security, work-life balance, and supportive relationships may carry different weight across employees and workplaces.	Ask employees what supports engagement. Avoid assuming that money, promotion, autonomy, or competition motivates everyone in the same way.
Time orientation: Focus on immediate results versus long-term relationships and future outcomes	Training may be evaluated differently depending on whether employees expect quick application or see development as a long-term investment.	Short-term incentives may be less persuasive when employees value stable employment, long-term development, and organizational loyalty.	Connect training and rewards to both immediate job performance and longer-term career growth.

Example 12.4.1

Collaboration does not always signal strong leadership.

A U.S.-based manager leads a team in a country where employees are accustomed to leaders making decisions and giving direct instructions. The manager wants to create an inclusive environment, so they ask the team to discuss every operational problem and reach a group recommendation before the manager acts.

Although the manager intends to show respect and encourage participation, some employees interpret the approach differently. They may believe the manager lacks the expertise or confidence to make decisions, or they may be reluctant to offer an opinion in front of a supervisor and coworkers. As a result, employees may participate less rather than more.

The manager can adapt without abandoning collaboration. For example, the manager can clearly state the decision that must be made, provide relevant information and a recommended direction, invite input through smaller groups or private conversations, and then make the final decision. This approach preserves leadership clarity while still using employee knowledge and participation.

Training Strategies for Global Teams

Global training is most effective when it uses consistent learning goals while allowing flexibility in how those goals are achieved. Organizations can adapt training by:

- Providing clear learning objectives, schedules, expectations, and examples.
- Using local language support, translated materials, and locally relevant examples when needed.
- Combining instructor-led explanation with demonstrations, practice, coaching, and written job aids.
- Giving participants several ways to ask questions or provide feedback, including anonymous or private options.
- Avoiding assumptions that silence means agreement, understanding, or disengagement.
- Preparing managers and employees for differences in communication, decision-making, feedback, and conflict management.
- Evaluating whether learning transferred to job performance rather than assuming attendance equals successful training.

Motivation Strategies for Global Teams

Motivation involves more than pay. Employees may value a combination of fair compensation, job security, meaningful work, advancement opportunities, autonomy, recognition, supportive leadership, workplace relationships, professional development, flexibility, and work-life balance.

Global organizations should create compensation and performance systems that are equitable and aligned with local laws and labor-market conditions. Managers should also learn what individual employees and teams value rather than relying on broad cultural stereotypes. For example, one team may respond well to public recognition and individual performance bonuses, while

another may prefer private recognition, development opportunities, team-based rewards, or greater stability and predictability.

Caution: Cultural frameworks help managers ask better questions; they should not be used to stereotype employees or assume that every person from a country will think, communicate, or respond to motivation in the same way.

12.5: Evaluating and Managing Performance

Evaluating and Managing Performance in Global Organizations

Performance management is the ongoing process of setting expectations, supporting employees, providing feedback, evaluating results, and making decisions about development, promotion, recognition, and compensation. In a global organization, this process must balance consistent organizational standards with differences in local laws, labor markets, language, communication norms, and cultural expectations about leadership and feedback.

A fair performance-management system uses job-related criteria that employees can understand. Employees should know what results, behaviors, skills, or standards will be evaluated; how performance information will be collected; who will provide feedback; and how ratings may affect development opportunities, promotion, compensation, or continued employment. Clear expectations and documented, job-related criteria reduce the risk that personal preference, stereotypes, or informal workplace relationships will determine important employment decisions.

Performance evaluation and promotion decisions should be free from discrimination. The International Labour Organization's Discrimination (Employment and Occupation) Convention calls on ratifying countries to promote equality of opportunity and treatment in employment and occupation and to eliminate discrimination in employment-related practices. This principle is relevant to performance management because ratings, development opportunities, promotions, and discipline can all affect an employee's access to opportunity (International Labour Organization, 1958).

Culture and Performance Feedback

Culture can influence how employees interpret performance feedback. In some workplaces, direct feedback and open discussion of weaknesses may be viewed as efficient and constructive. In other settings, public criticism may be perceived as embarrassing, disrespectful, or harmful to workplace relationships. Similarly, employees may differ in the extent to which they expect managers to give direct instructions, invite self-evaluations, or involve employees in goal setting.

Managers should not assume that one feedback style is effective everywhere. They should communicate expectations clearly, use examples of effective performance, invite questions, and provide employees with a respectful opportunity to explain context or respond to concerns. When possible, managers should use more than one source of information—such as work results, customer feedback, quality measures, self-assessment, and manager observation—rather than relying on a single supervisor's impression.

Fairness, Voice, and Accountability

Global organizations should provide employees with a meaningful way to raise concerns about performance ratings, promotion decisions, discrimination, harassment, retaliation, or inconsistent treatment. A review or appeal process can help correct errors and improve trust in the system. The United Nations Guiding Principles on Business and Human Rights emphasize that businesses should avoid causing or contributing to adverse human-rights impacts and should provide for or cooperate in remediation when harms occur (United Nations Office of the High Commissioner for Human Rights, 2011).

The OECD Guidelines for Multinational Enterprises on Responsible Business Conduct also encourage responsible employment practices, respect for worker rights, and engagement with workers and their representatives. For performance management, this means organizations should apply policies consistently, protect employees from retaliation for raising concerns, and review whether evaluation practices produce unequal outcomes across employee groups or locations (Organisation for Economic Co-operation and Development, 2023).

Applying the Framework

Evaluating a global team

A multinational company uses the same broad performance categories for managers in every country: business results, customer service, people leadership, compliance, and collaboration. However, it does not require every manager to use identical evidence or feedback methods. Local HR teams adapt examples, training, language support, and administrative procedures to comply with local law and workplace norms.

The company requires managers to explain ratings using job-related evidence, hold private feedback conversations, document development plans, and give employees a process for requesting review of a disputed rating. HR reviews rating patterns across departments and locations to identify possible inconsistency or discrimination. This approach maintains global standards while recognizing local context.

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12.6: Compensating

International Compensation

Compensation in a global organization includes more than salary. It may include wages or base pay, performance incentives, health and retirement benefits, paid leave, legally required social-insurance contributions, allowances, relocation support, and other forms of financial and non-financial reward.

Compensation levels and benefit structures vary among countries because labor markets, living costs, taxes, currency conditions, social-insurance systems, health-care systems, collective-bargaining arrangements, and legal requirements differ. A multinational organization must decide whether to pay employees primarily according to local market conditions, home-country conditions, global role requirements, or a combination of these approaches.

A sound international compensation plan should be competitive enough to attract and retain qualified employees, fair to employees performing comparable work, consistent with the organization's strategy, and compliant with the laws of every country in which the organization employs people.

Compensation Approaches

For local employees working permanently in one country, organizations commonly use a **host-country or local-market approach**. Pay, benefits, and required contributions are based primarily on the conditions of the local labor market and the country's employment laws. This approach is usually appropriate because employees live, work, and build their careers in that country.

For employees sent abroad on a temporary international assignment, organizations may use a **home-country or balance-sheet approach**. The goal is to help the employee maintain a similar standard of living to the one they had in the home country while the employer covers reasonable assignment-related costs. The package may include housing assistance, cost-of-living adjustments, education support for dependents, relocation expenses, tax assistance, and periodic travel home.

A **local-plus approach** combines host-country compensation with selected assignment benefits. For example, an employee transferring to another country may receive local salary and benefits, plus temporary housing, relocation assistance, tax support, or a mobility allowance. This approach is often used when the employee may remain in the host country for an extended period or transition to a local contract.

International Compensation Plans

Table 12.6.1: Comparison of Compensation Plans

Plan or approach	How it works	Best use	Advantages	Key concerns
Host-country or local-market pay	Employees are paid according to the compensation structure, wage levels, benefits, and legal requirements of the country where they work.	Local hires and employees on permanent local contracts	Supports local-market competitiveness and is generally easier to administer long term	Pay levels can differ substantially across countries; employees moving internationally may experience major changes in purchasing power or benefits

Plan or approach	How it works	Best use	Advantages	Key concerns
Home-country or balance-sheet approach	The employer aims to preserve an international assignee's approximate home-country purchasing power, then adjusts for assignment-related costs.	Traditional long-term international assignments when the employee is expected to return home	Reduces the chance that the assignment creates a financial loss; supports mobility and repatriation	Complex, expensive, and sometimes viewed as inequitable by host-country employees
Local-plus approach	Employees receive host-country salary and benefits plus selected assignment support, such as housing, relocation, tax assistance, or travel home.	Mid-term assignments, regional transfers, and employees building longer-term careers abroad	Often less expensive than a full balance-sheet package while still offering transition support	The level of support can be inconsistent unless policies are clear
Global salary bands	The organization uses broadly consistent pay ranges for comparable global roles, then adjusts for location, taxes, legal requirements, and local labor-market conditions.	Global leadership, technical, professional, and highly mobile roles	Promotes greater consistency and transparency across countries	Requires reliable market data and careful attention to local pay-equity and legal requirements
Project, hardship, or mobility allowances	Salary is supplemented with temporary payments for difficult locations, relocation, housing, education, security, or assignment-related travel.	Short-term or long-term assignments in costly, remote, or high-risk locations	Addresses real assignment costs and can make difficult postings feasible	Allowances must be reviewed regularly and should not become permanent, unclear, or inequitable
Remote cross-border compensation	An employee works from one country for an employer or team based in another country; pay is set through a location-based, role-based, or hybrid policy.	Distributed global teams and remote-first organizations	Expands access to talent without requiring relocation	Raises complex questions about payroll, tax residency, social insurance, labor law, benefits, data security, and pay differences by

Equity and Transparency

International compensation can create perceptions of unfairness if employees do not understand why different workers receive different pay or benefits. Differences should be based on legitimate, job-related factors such as role scope, experience, local labor-market conditions, legal requirements, cost of living, assignment length, and documented mobility needs—not simply on an employee's nationality.

Organizations should communicate how compensation decisions are made, review pay practices for unintended disparities, and ensure that managers understand local requirements. They should also review allowances and mobility benefits regularly because exchange rates, housing costs, tax rules, and business conditions can change.

Example 12.6.1

Selecting an International Compensation Plan

A company based in the United States transfers an experienced operations manager to lead a two-year manufacturing start-up in Mexico. Because the assignment is temporary and the manager is expected to return to the United States, the company uses a balance-sheet approach. The manager continues to receive home-country base compensation and receives support for relocation, temporary housing, tax preparation, and assignment-related travel.

In contrast, the company hires local production supervisors and human-resources specialists in Mexico using local-market salary ranges, statutory benefits, and locally competitive practices. This approach recognizes that the two groups have different employment arrangements while avoiding the assumption that nationality alone determines an employee's value

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12.7: Terminating and Repatriation

Termination in Global Organizations

Termination is the end of an employee's work relationship with an organization. It can occur because an employee resigns, retires, completes a fixed-term contract, is laid off during a restructuring, is dismissed for performance or misconduct, or leaves at the end of an international assignment.

Termination practices differ substantially across countries. Employment laws may address notice periods, probationary periods, severance pay, required documentation, acceptable reasons for dismissal, consultation with employee representatives, collective-bargaining agreements, unemployment protections, and procedures for challenging a dismissal. In some countries, employers have relatively broad discretion to end employment. In others, employers may need to demonstrate a legally recognized reason, follow formal procedures, consult with works councils or unions, or provide required notice and severance.

For this reason, multinational organizations should not assume that employment practices used at headquarters can be applied in every country. Before ending an employment relationship, organizations should consult qualified local human-resources professionals and legal counsel, follow applicable laws and collective agreements, document job-related reasons for the decision, and communicate with the employee respectfully.

Fair and Respectful Termination Practices

Even when a termination is legally permitted, the process can affect employee well-being, organizational reputation, employee trust, and relationships with labor representatives. A fair process generally includes clear expectations, documented performance concerns when appropriate, an opportunity for employees to respond, consistent treatment, and access to information about final pay, benefits, return of property, and next steps.

Managers should avoid making assumptions about what employees in another country expect from a termination process. Cultural norms can influence expectations about directness, privacy, hierarchy, face-saving, family involvement, and how feedback is communicated. However, cultural sensitivity does not replace legal compliance. Employers must follow local law and protect employees from discrimination, retaliation, harassment, or unfair treatment.

When organizations restructure or reduce their workforce, they should communicate honestly about the business reasons for the change, provide required notice and benefits, and consider available support such as career-transition services, skills training, references, or employee-assistance resources.

Labor Relations and Employee Voice

Labor unions, works councils, employee associations, and collective-bargaining agreements can play an important role in termination, restructuring, compensation, scheduling, health and safety, and grievance procedures. Their influence varies by country, industry, occupation, and workplace.

Some countries have high levels of union membership or strong traditions of collective bargaining. Others rely more heavily on individual employment contracts or employer-led policies. In many countries, employee representatives may have legal rights to receive information, be consulted, or bargain over issues related to layoffs, workplace changes, and working conditions.

Global managers should understand the role of employee representatives before making significant employment decisions. Consulting employee representatives early can help organizations identify legal obligations, reduce conflict, communicate more effectively, and manage change more responsibly.

Repatriation

Repatriation is the process of returning an employee to their home country or moving the employee into a new role after an international assignment. It is a critical part of global staffing because international assignments are more likely to succeed when

employees understand what will happen at the end of the assignment.

An employee returning home may experience reverse culture shock. The employee may have changed personally and professionally while working abroad, but the home office, workplace culture, and social network may also have changed. Returning employees may face practical challenges involving housing, schools, partner employment, taxes, health-care coverage, and reconnecting with family and friends. They may also be disappointed if the organization does not recognize the international skills they developed.

Organizations should begin repatriation planning before the employee leaves for the assignment. A written assignment agreement should identify the expected duration of the assignment, the anticipated return role or process for finding one, compensation and benefits during transition, relocation support, tax and immigration responsibilities, and expectations for sharing knowledge after the assignment ends.

Supporting Successful Repatriation

Organizations can improve repatriation outcomes by:

- Discussing career goals and possible post-assignment roles before the employee accepts the assignment.
- Maintaining regular contact between the assignee and leaders in the home organization.
- Offering return relocation support for the employee and accompanying family members.
- Reviewing compensation, benefits, payroll, taxes, and housing arrangements before the employee returns.
- Providing mentoring, career coaching, and opportunities to discuss reverse culture shock.
- Assigning a meaningful role that uses the employee's international experience.
- Creating structured opportunities for the returning employee to share market knowledge, customer insights, language skills, leadership practices, and lessons learned with colleagues.

Example 12.7.1

End-of-Assignment Planning

A U.S.-based company assigns a supply-chain manager to Singapore for a two-year assignment. Before the employee leaves, the company documents the assignment's purpose, relocation support, compensation, tax assistance, expected end date, and the process for identifying a return role.

During the assignment, the manager remains connected to a mentor and to leaders at the home office. Six months before the assignment ends, the company begins formal repatriation planning. The manager returns to a role that applies the international experience gained during the assignment and leads a project to improve supplier coordination across Asia and North America.

This approach treats repatriation as part of talent development rather than as an administrative task completed after the employee returns.

12.8: Global Business in Action

Global Business in Action: Rockwell Automation

Rockwell Automation

Rockwell Automation's international human-resources approach appears designed to support a large, geographically distributed industrial-technology workforce while maintaining compliance with country-specific immigration, tax, labor, and travel rules. Headquartered in Milwaukee, Rockwell operates in more than 100 countries and had approximately 26,000 employees at the end of fiscal 2025. More than half of its workforce is outside the United States, making international talent acquisition, employee mobility, local compensation, and cross-border compliance core HR needs rather than occasional activities.

The company's international HR plan can be understood as a combination of: recruiting and retaining talent in local markets; moving employees across borders when business needs require it; maintaining immigration and travel compliance; and providing support for employees and families during international transfers.



Figure 12.8.1: Rockwell International Small Plane. (Bill Larkins Flickr CC BY-SA 2.0)

Global Workforce Context

Rockwell's global operating structure drives the need for international HR coordination. Its fiscal 2025 workforce was approximately:

Table 12.8.1: Rockwell Automation's Staffing Levels By Location

Region	Approximate employees	Share of workforce
North America	9,000	35%
Europe, Middle East, and Africa	5,000	19%
Asia Pacific	7,000	27%
Latin America	5,000	19%
Total	26,000	100%

Rockwell reported major manufacturing operations in the United States, Mexico, Poland, India, Canada, and Singapore, along with sales and administrative locations at more than 200 sites in over 50 countries. Its largest employee populations are in the United States, Mexico, India, and Poland. This footprint requires HR policies that can be applied consistently at the corporate level while being adapted to local law, market pay, labor practices, and operational needs.

International HR Priorities

Global Recruitment and Local Talent

Rockwell's public reporting describes global business and global talent needs as important to its competitive position. Its workforce strategy therefore appears to prioritize finding technical, engineering, digital, manufacturing, sales, and service talent in the regions where it operates, rather than relying only on U.S.-based hiring. The company's compensation approach is intended to be competitive according to both the role and the employee's geographic location, which is consistent with a "local-market" compensation strategy used by multinational employers.

In practical terms, this means a Rockwell employee in India, Poland, Mexico, Singapore, or the United States may be covered by the same broad corporate principles, but pay, benefits, leave, payroll, and employment conditions will be set or adjusted according to the local labor market and legal requirements.

Immigration and Work Authorization

Rockwell has publicly advertised an *International Business Travel and Immigration Lead* role in Milwaukee. The listed responsibilities indicate that Rockwell maintains a formal immigration-compliance function rather than treating work authorization as an ad hoc recruiting issue. That function includes coordinating with employees and managers, partnering with external immigration counsel, preparing and managing immigration applications, developing procedures, monitoring business-travel and tax compliance, and conducting audits.

This suggests that immigration support is managed through a centralized process involving HR, employees, business leaders, legal counsel, and outside vendors. Visa decisions are likely based on the individual job, country of employment, candidate eligibility, business need, cost, and legal requirements.

Global Mobility and International Assignments

Rockwell also appears to operate a structured global-mobility program for employees who relocate or take international assignments. Publicly available role information from a Rockwell global-mobility specialist describes support for:

- Selecting an appropriate assignment or mobility-policy type based on business needs and assignment cost.
- Advising on immigration and tax implications of cross-border moves.
- Managing U.S. immigration, including PERM-based permanent-residence processes.
- Tracking tax-equalization obligations and payroll transfers.
- Coordinating vendors, invoices, policy exceptions, and employee support.
- Assisting with relocation logistics such as travel, expense reimbursement, household-goods shipments, destination support, and family transition.

This structure indicates that Rockwell's international-mobility plan is designed to make cross-border moves operationally workable for both the company and the employee. It also places strong emphasis on compliance because a transfer can create immigration, payroll, tax, social-security, employment-law, and permanent-establishment risks in both the home and host countries.

Policy Implications

Rockwell's international HR plan appears to balance business growth with risk management. It supports a workforce spread across major manufacturing and engineering hubs, while using centralized HR, immigration, and mobility processes to reduce legal and operational risk. The policy model is likely especially important for a company that has production, sales, service, engineering, and administrative operations across North America, Europe, Asia Pacific, and Latin America.

The practical takeaway is that international staffing should be planned early. Immigration eligibility, relocation cost, tax exposure, payroll setup, and family relocation needs can materially affect the timing and feasibility of a hire or assignment. Rockwell's visible use of global-mobility specialists and external immigration counsel suggests it treats those issues as part of the staffing decision itself, not merely as administrative steps after an employee has been selected.

Discussion Questions

1. How does Rockwell Automation's operation in more than 100 countries affect the HR policies it needs for recruitment, compensation, benefits, compliance, and employee support?
2. What factors should Rockwell consider when deciding whether to fill an opening through a local hire, an international employee transfer, or visa sponsorship?
3. Why should immigration, tax, payroll, and business-travel requirements be reviewed before an employee begins an international assignment?
4. How can relocation assistance, family-transition support, and clear communication about immigration status help Rockwell retain employees who move internationally?
5. How should Rockwell balance consistent company-wide HR standards with different labor laws, pay expectations, and workplace cultures in each country where it operates?

Sources

- Global workforce and international operations: (Rockwell Automation, 2025)
- Workforce distribution and multinational footprint: (Rockwell Automation, 2025; U.S. Securities and Exchange Commission, 2025)
- Global HR, compensation, and workforce-management strategy: (Rockwell Automation, Inc., 2025)
- Immigration, travel, and compliance functions: (Rockwell Automation, n.d.)
- International-assignment and mobility administration: (Taylor, n.d.)

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