SECTION ONE

The International Environment

CHAPTER ONE

An Introduction to International Management

Chapter Learning Objectives

After completing this chapter, you should be able to:

- Define the concepts of international business and international management.
- Examine the dramatic growth and global impacts of international companies.
- Define and understand the strategic, marketing, and economic motives of firms seeking to expand internationally.
- Explain the strategic objectives and sources of competitive advantage for an international firm.

Opening Case: Trained Manpower and Low Cost Attract Global Giants

NEW DELHI: It has all the ingredients of a corporate blockbuster: a growing middle class, rising income levels and low production costs. That's the Indian market as seen by the global biggies from the world of car-making.

No wonder then that an increasing number of car manufacturers from across the world are making India—the second fastest growing car market in Asia after China—a hub for most of their manufacturing activities.

To name a few: Suzuki has decided to make India the only hub for making cost-effective small cars outside Japan. It is also Suzuki's R&D hub for developing new small cars.

The country is also the production and export base for Hyundai's Santro. Toyota is building a utility vehicle for the world market and India features in the small list of destinations where it will be produced. India has also been named the hub for Fiat's R&D activities.

Low production costs and a high number of trained manpower are the reasons behind this newfound fascination among global car makers. Also, the local laws in some European nations, like Italy and Greece, favor shipping cars from India over other Asian nations, with tax breaks.

This has helped South Korea's Hyundai Motor Corp. establish its Indian arm as the export hub for the compact car Santro. The made-in-India hatchback is today being sold in Greece, Germany and Italy, besides being sourced by DaimlerChrysler to be sold under its Dodge badge in Mexico.

"We have proved that India can become a cost-competitive base for producing technologically superior cars," said Hyundai Motor India (HMI) president BVR Subbu. Riding on this growing acceptance among global buyers, HMI drove home export earnings to the tune of Rs 1,000 crore (1,000 crore = 10 billion rupees) in the first eight months of 2004. That's not all. The firm

is now gearing up to become the largest exporter of manufactured goods this calendar year in non-metallurgy and non-refinery sectors in India with an export earning of around Rs 1,500 crore (15 billion rupees).

Independent surveys by leading consultants also pointed out that India is fast emerging as the most-preferred sourcing base for global auto majors. U.S. auto executives have even picked India over China as the most popular business process outsourcing (BPO) destination as far as automotive activities are concerned. Even Nissan has last week procured the government nod to set up a subsidiary in India that will explore opportunities for sourcing low-cost components besides locally building cars. Above all, there's a burgeoning local population of professionals that can be targeted with soft loans. The industry is hopeful of selling 1 million units in the domestic market this fiscal. It's this captive industry that's working as an added bait for the global players.

As Maruti Udyog Managing Director Jagdish Khattar said: "There are about 40 million Indians who ride two-wheelers. I want them to upgrade to cars and that's what we are trying to achieve with our finance and exchange schemes." A recent ICRA study had also pointed out that the overall car segment in India is poised to grow at a compounded annual growth rate of 8 percent from 2004–2008, with compact and mid-range cars leading the growth. With an eye on this potential market, Suzuki has announced plans to invest Rs 6,000 crore in India over the next few years for setting up a new car-making venture.

With the Indian car market maturing, manufacturers are also experimenting with new vehicle types and segments that appeal to the new-age buyer. If 2003 was the year when manufacturers rolled out one SUV after the other, 2004 became the year of premium hatchbacks with Hyundai Getz, Ford Fusion and Indigo Marina vying for buyer attention. "We want to play in the heart of volume segment and that's why we are looking at locally making a volume car here," said Aditya Vij, president, GM India.

They are also playing the 24x7 service card to pull customers to win over working couples. Car makers led by Maruti, Hyundai, GM and Fiat are also driving into the call centre market to offer a slew of support services like round-the-clock assistance in case of breakdowns and even for vehicle servicing. Hyundai has also announced an extended four-year warranty program on its big cars.

Source: Anand Byas, *Times of India,* November 21, 2004 (http://timesofindia.indiatimes.com/articleshow/930106.cms).

Discussion Questions

1. Why are foreign car companies making India a premium car market for car manufacturing?
2. Under what conditions will India serve as an export base for foreign cars made in India?
3. What are the competitive advantages of India in car manufacturing?

The International Management Setting

The world is becoming a smaller place. Look around you. The clothes you wear, the gadgets in the kitchen, the car you drive—all may be made in China, India, or Japan. Perhaps in your refrigerator you have Mexican tacos or Indian chicken curry. Now people can communicate with friends and business associates across the world through instant messaging simply by clicking the "send" button. Distance is measured not in miles or kilometers but in the time it takes to reach from one end of the world to another. Who is responsible for "shrinking" the world in which we live? This responsibility has been shouldered by the numerous small and large international companies, from different countries, that produce and market their wares worldwide.

Even though the world is becoming "smaller," significant political, legal, economic, and technological differences still distance us from our fellow inhabitants of Earth. In

their quest to reach markets and customers in foreign countries, international companies have to navigate across the often turbulent international environment.

Consider an American company with, among other business units, sales offices in Buenos Aires, Toronto, and New York City, wholly owned manufacturing subsidiaries in Jakarta and Taipei, an equity joint venture in Shanghai, a research and development facility in Tel Aviv, and call service centers in Bangalore and Manila. In recent times, the economic collapse of Argentina, the political implosion of Indonesia, and the severe acute respiratory syndrome (SARS) scares in China, Taiwan, and Canada have exerted increased pressures, risks, and costs for that firm. Furthermore, the ongoing conflicts in the Middle East and southern Asia as well as the threat of terrorism aimed at Western targets worldwide have further increased risk and the cost of managing that risk for this company.

The excitement and opportunities of the new millennium have been accompanied by many new risks and associated costs of doing business internationally. This book is about the challenge of managing these risks of such international activities of international companies within the various international environments. Also, this book is about understanding and managing the tremendous amount of new opportunities internationally. Thus it is about the unique opportunities and problems that confront managers in international companies as they navigate through the extremely complex and ever-changing economic, political, legal, technological, and cultural environments of a world of increasingly interdependent nation-states. The choices that international managers make—plant location, products and services marketed in different countries or regions of the world, the mode used to penetrate foreign markets, the hiring of personnel to manage foreign operations, and so on—must take into account the limits imposed on such choices by the external environment, as well as the imperative to simultaneously adapt to local conditions and function efficiently on a global scale.

The need for international management arises with a firm's initial involvement in international operations by way of exports of its products, technology, or services to foreign markets. This need becomes even more critical when a company becomes involved in foreign direct investment. **Foreign direct investment (FDI)** is a long-term equity investment in a foreign affiliate or subsidiary; it gives the parent company (the investor) varying degrees of managerial control over the foreign operation, depending on the percentage of ownership by the parent company.[1] The more FDI that a company makes in a foreign affiliate, the greater the managerial control that it has over that foreign affiliate. FDI involves the establishment of facilities, buildings, plants, and equipment for the production of goods and/or services in a foreign country. And FDI is accompanied by the need to manage, market, and finance the foreign production. People manage enterprise functions like marketing, production, and finance. Managing the various enterprise functions abroad requires that managers in the parent company, as well as in every foreign affiliate, have the necessary skills and experience to manage the affairs of affiliates in countries whose political, cultural, economic, and financial environments may be very different from one another. It therefore follows that the greater a company's FDI, the greater will be its need for skilled international managers.

Figure 1.1 represents the multilevel focus of this text. We discuss international management from a variety of perspectives. In Section 1, we paint a picture of the various macro-level environments where managers must effectively manage. Section 2 elaborates on strategic management issues. That is, what are the firm-level strategic considerations necessary to consider when expanding overseas? In Section 3, we focus on the manager level and the need to effectively communicate, motivate, lead, and

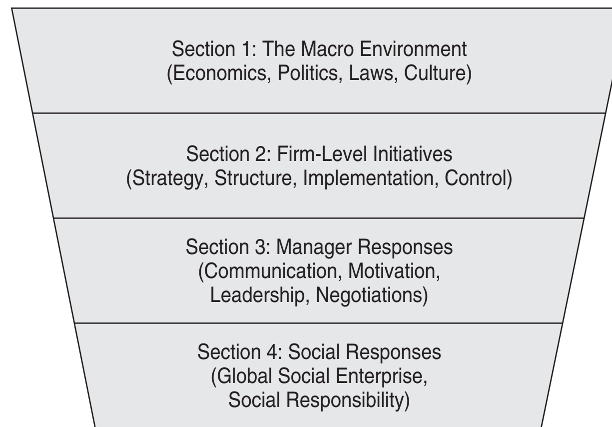


FIGURE 1.1
Managing in the International Environment

negotiate in order to manage internationally. Finally, Section 4 integrates serving the world's poor profitably and corporate social responsibility initiatives.

International management activities in a firm begin either when the firm's managers initiate the establishment of a foreign affiliate from the ground up, which is called a greenfield investment, or when it acquires an existing host-country firm. Furthermore, they continue as long as the parent company owns one or more functioning foreign affiliates.

What Is International Business?

Besides their involvement in foreign acquisition and greenfield investments, international companies may be simultaneously involved in several other international business activities such as export, import, countertrade, licensing, and strategic alliances. Before delving into the distinctions of these various forms of international involvement, we should first understand what international business is. Several definitions of international business have been advanced through the years. The most basic definition is "all business transactions that involve two or more countries."[2] These business transactions or relationships may be conducted by private, nonprofit, or government organizations, as well as through a combination of the various organizations. In the case of private firms the transactions are for profit. Government-sponsored activities in international business may or may not have a profit orientation, and a nonprofit firm may be competing in an industry that has firms with profit motives.

Other definitions suggest that an international business is "a business whose activities involve the crossing of national boundaries"[3] or is "any commercial, industrial or professional endeavor involving two or more nations."[4] To Charles W. L. Hill, "an international business is any firm that engages in international trade and investment . . . all the firm has to do is export or import products from other countries."[5] Kolde and Hill say that "one cannot ignore the contrasts between domestic and international business, or in a more general phrase between uninational and multinational business. The primary distinction between the two lies in the environmental framework and the organizational and behavioral responses that flow from that framework."[6]

Taking the foregoing definitions of international business into account, we define **international business** as those business activities of private or public enterprises that involve the movement of resources across national boundaries. The resources that may be involved in the cross-national transfers include raw materials, semifinished and

finished goods, services, capital, people, and technology. Specific services transferred may include functions such as accounting, consulting, legal counsel, and banking activities. Technology transferred may range from simple managerial and marketing know-how to higher level managerial and technical skills to ultimately high-end technological advancements.

What Is International Management?

The noted international management theorist and scholar Jean J. Boddewyn argues that a definition of international management must include an interpretation and "elaboration of the key terms *international* and *management* as well as of their *interaction.*"[7] We also agree with him that the term international means "crossing borders and [applies] to processes intersected by national borders."[8] In very general terms, international management is the management of a firm's activities on an international scale. But before we define international management in specific terms, let us define management.

Management is defined in numerous ways. We would define management as the process aimed at accomplishing organizational objectives by (1) effectively coordinating the procurement, allocation, and utilization of the human, financial, intellectual, and physical resources of the organization and (2) maintaining the organization in a state of satisfactory, dynamic equilibrium within the environment—that is, the firm's strategies and operational plans are responsive to the demands and constraints embedded in the economic, political, legal, cultural, political, and competitive environment.

This definition of management has two basic premises. First, management is needed to coordinate the human, financial, intellectual, and physical resources and to integrate them into a unified whole. Without such coordination the resources would remain unrelated and disorganized and therefore inefficiently used. The second premise in the definition is that an organization lives in a dynamic environment that constantly affects its operations. To further complicate the manager's job, the various environments have different degrees of dynamism. "The multinational setting is more dynamic than the uninational (domestic) setting. This is due partly to the different rates of speed at which the various environmental parameters are changing in the different countries and in part to the nature of the parameters themselves."[9] For instance, some of the environmental factors, such as the distinct national cultures, evolve and converge over time. Others, like the political environments, have the ability to be radically changed through elections and revolutions. Furthermore, the financial environment, especially when one considers foreign exchange rates, is continually in a state of change. Note that "for domestic businesses, the external factors are relatively constant and homogeneous. Any changes that occur are gradual and generally do not lead to any sudden differentiation among the opportunities and constraints among different industries or types of enterprises."[10] However, with expansion abroad of a firm's operation, the environmental setting can no longer be called constant. Thus one managerial task is to effectively forecast the varying environmental forces that are likely to have a significant impact on the firm in the immediate and distant future and to determine the probable impact. Also, managers must respond to the environmental forecasts by designing appropriate strategies to ensure the survival and growth of the organization as it interacts with its dynamic environment.

On the basis of the preceding meaning of the term *international* and definition of *management,* we can now define **international management** as a process of accomplishing the global objectives of a firm by (1) effectively coordinating across national boundaries the procurement, allocation, and utilization of the human, financial, intellectual, and physical resources of the firm and (2) effectively charting the path toward

the desired organizational goals by navigating the firm through a global environment that is not only dynamic but often very hostile to the firm's very survival. Note that our definition is focused on the *business firm* as the primary level and unit of analysis of international management, and it excludes the management of all international organizations such as the World Trade Organization, the International Labor Organization, and the United Nations. Focusing on the international business firm as an organization allows us to define the international management domain in terms of two central themes:

1. Why, when, and how does a business firm (as an organization) decide to "go international," including the expansion and reduction of such internalization?
2. Why, when, and how is its organizational behavior—a broad term covering mission, objectives, strategies, structures, staff, and processes [particularly decision making], internal and external transactions and relations, performance, impact, etc.—altered by internationalization?[11]

International Companies and Entry Modes

International Companies

All firms, regardless of size, are affected by international competition. Specifically, any firm that has one or more foreign affiliates is involved in international management; it does not have to be a billion-dollar corporation. Even small and medium-sized firms can and do have international operations in several countries. Many international companies do not qualify for the exclusive list of the Fortune 500 or the BusinessWeek Global 1000 list of the largest international corporations. Even though they do not come close to Microsoft, Toyota, Wal-Mart, or Deutsche Bank in terms of total sales, gross profits, total assets, and similar measures of company size, they are still multinational companies. Many firms in Europe and Japan have also developed a multinational structure; and in the last 10 years or so, we have seen many government-owned enterprises that have become privatized and subsequently multinational. The 1960s laid the foundations for the massive growth of international companies. The growth of that decade far exceeded any achieved earlier by the United States or the other industrialized countries of the world. Since then, the growth in international business activities has been exponential, culminating during the last 10 years with the significant increase in privatization and deregulation in many industries and countries.

Although international enterprises are dissimilar in many respects—size of sales and profits, markets served, and location of affiliates abroad—they all have some common features. To begin, an **international company** is an enterprise that has operations in two or more countries. If it has operations in several countries, then it may have a network of wholly or partially (jointly with one or more foreign partners) owned producing and marketing foreign affiliates or subsidiaries. The foreign affiliates may be linked with the parent company and with each other by ties of common ownership and by a common global strategy to which each affiliate is responsive and committed. The parent company may control the foreign affiliates via resources that it allocates to each affiliate—capital, technology, trademarks, patents, and workforce—and through the right to approve each affiliate's long- and short-range plans and budgets.[12]

As pointed out earlier, there are many small- and medium-sized multinational companies. However, generally we are talking about a large corporation whose revenues, profits, and assets typically run into hundreds of millions of dollars. For example, the most profitable international company in 2007 was ExxonMobil with profits of $39.51 billion. In 2007, Wal-Mart Stores ranked number one in the world on the basis of

sales, which approached $351 billion. In the same year, 30 companies accrued global revenues in excess of $100 billion. Table 1.1 lists the 15 largest international companies in terms of 2007 sales.

The top 100 international companies hold almost $5 trillion of assets outside their home countries. The economic power of these companies is evident in the fact that they are estimated to account for more than one-third of the combined outward FDI of their home countries. Because the largest international companies control such a large pool of assets, they exercise considerable influence over the home and host countries' output, economic policies, trade and technology flows, employment, and labor practices.

In 2005, the world's largest global (the terms *global* and *transnational* are used interchangeably) companies held 54.5 percent of their total assets in foreign countries and generated 56.5 percent of total sales from foreign countries. The foreign affiliates of these companies employed 8 million personnel, which amounted to 53.1 percent of their total employment. Global foreign direct investment in 2006 reached $1,306 billion, of which $857 billion flowed into the developed countries, as opposed to $379 billion to developing countries. This goes to show that the rich countries are getting the infusion of capital, technology, and knowledge that usually accompanies foreign direct investment, whereas the poorer countries do not enjoy such benefits from foreign direct investment. The world's gross domestic product (GDP) in 2006 amounted to almost $48.29 trillion, of which almost $4.8 trillion, or 11.5 percent, was accounted for by the production of foreign affiliates. The total world exports in 2006 amounted to $13.9 trillion, of which $4.7 trillion, or almost 34 percent, was generated by exports of foreign affiliates. In that same year, the total sales of foreign affiliates amounted to $25.2 trillion. Therefore, sales of goods and services produced by foreign affiliates are five times greater than their own exports and, not counting affiliates' exports, almost twice as large as total world exports. One could interpret this data to mean that local production by foreign affiliates to serve local markets has replaced exports to those markets.[13]

International companies have been growing in size at rates exceeding those of the economies of many countries. The size of the large international companies is often compared with that of countries' economies as an indicator of the power and influence

TABLE 1.1
Largest International Companies, by Sales

Source: Fortune Global 500, July 23, 2007.

Global Rank	Company	2007 Revenues ($ millions)
1	Wal-Mart Stores	$361,139.0
2	ExxonMobil	347,250.00
3	Royal Dutch Shell	318,845.0
4	BP	274,316.0
5	General Motors	207,349.0
6	Toyota Motor	204,746.4
7	Chevron	200,567.0
8	DaimlerChrysler	190,191.4
9	Conoco Phillips	172,451
10	Total	168,356.7
11	General Electric	168,307.0
12	Ford Motor	160,126.0
13	ING Group	158,274.3
14	Citigroup	146,777.0
15	AXA	139,738.1

of international companies in the world economy. Table 1.2 shows a comparison of the 100 largest country economies and global companies ranked by their GDP and total revenue respectively. This is a crude comparison as the domestic sales of foreign affiliates get included in the computation of a nation's GDP. Nevertheless, it is quite interesting to notice that Wal-Mart Stores (number 24), ExxonMobil (number 25), and Royal Dutch Shell (number 26) are "bigger" than 29 countries in the list. And of the 100 countries and companies in Table 1.2, there are 48 global companies.

Foreign Market Entry Modes

A company can achieve its international business aims through different forms of foreign market entry modes, such as:

- Exporting.
- Countertrade.
- Contract manufacturing.
- Licensing.
- Franchising.
- Turnkey projects.
- Nonequity strategic alliances.
- Equity-based ventures such as wholly owned subsidiaries and equity joint ventures.

We examine these entry modes in detail in later chapters

Why Firms Seek to Engage in International Business

An international company may have several motivations for establishing various types of foreign operations. Let us examine some of the motivations for foreign operations that are illustrated in Figure 1.2 and grouped into three categories: market-seeking motives, cost-reduction motives, and strategic motives.

Market-Seeking Motives

Historically, companies have initially looked to overseas markets when their home market became saturated. In his landmark *product life cycle theory,* Vernon theorizes that firms will search foreign markets for product that has been standardized and has reached the maturity stage in its life cycle.[14] Because of social and regulatory pressures

FIGURE 1.2
Motives to Go International

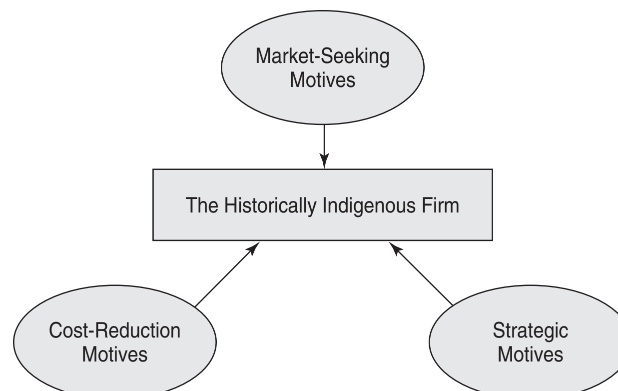


TABLE 1.2 How Large Are Global Companies in Comparison with Countries of the World?

Source: Fortune Global 500, *Fortune,* July 23, 2007, and 2007 CIA *World Factbook.*

Rank	Country/Company	GDP/Revenue ($ millions)	Rank	Country/Company	GDP/Revenue ($ millions)	Rank	Country/Company	GDP/Revenue ($ millions)
1	World	46,660,000	34	Greece	222,500	67	American International Group	113,194
2	European Union	13,620,000	35	Argentina	210,000	68	Hungary	113,100
3	United States	13,220,000	36	General Motors	207,349	69	United Arab Emirates	110,600
4	Japan	4,911,000	37	Toyota Motor	204,746	70	China National Petroleum	110,520
5	Germany	2,858,000	38	Ireland	202,900	71	BNP Paribas	109,214
6	China	2,512,000	39	Chevron	200,567	72	ENI	109,014
7	United Kingdom	2,341,000	40	South Africa	200,500	73	UBS	107,835
8	France	2,154,000	41	Thailand	196,600	74	Siemens	107,342
9	Italy	1,780,000	42	Finland	196,200	75	State Grid	107,186
10	Canada	1,089,000	43	Iran	194,800	76	Colombia	105,500
11	Spain	1,081,000	44	DaimlerChrysler	190,191	77	Assicurazioni Generali	101,811
12	India	796,100	45	Hong Kong	187,100	78	Chile	100,300
13	Korea, South	768,500	46	Portugal	176,600	79	J.P. Morgan Chase & Co.	99,973
14	Mexico	741,500	47	ConocoPhillips	172,451	80	Carrefour	99,015
15	Russia	733,000	48	Total	168,357	81	New Zealand	98,770
16	Australia	645,300	49	General Electric	168,307	82	Berkshire Hathaway	98,539
17	Brazil	620,700	50	Ford Motor	160,126	83	Philippines	98,480
18	Netherlands	612,700	51	ING Group	158,274	84	Pemex	97,469
19	Switzerland	386,800	52	Venezuela	147,900	85	Deutsche Bank	96,152
20	Sweden	371,500	53	Citigroup	146,777	86	Dexia Group	95,847
21	Belgium	367,800	54	AXA	139,738	87	Honda Motor	94,791
22	Turkey	358,200	55	Volkswagen	132,323	88	McKesson	93,574
23	Taiwan	353,900	56	Malaysia	131,800	89	Verizon Communications	93,221
24	Wal-Mart Stores	351,139	57	Sinopec	131,636	90	Algeria	92,220
25	ExxonMobil	347,254	58	Crédit Agricole	128,481	91	Nippon Telegraph Telephone	91,998
26	Royal Dutch Shell	318,845	59	Allianz	125,346	92	Hewlett-Packard	91,658
27	Austria	309,300	60	Pakistan	124,000	93	International Business Machines	91,424
28	Saudi Arabia	286,200	61	Israel	121,600	94	Valero Energy	91,051
29	BP	274,316	62	Singapore	121,500	95	Home Depot	90,837
30	Poland	265,400	63	Fortis	121,202	96	Nissan Motor	89,502
31	Indonesia	264,400	64	Czech Republic	118,900	97	Samsung Electronics	89,476
32	Norway	261,700	65	Bank of America Corp.	117,017	98	Credit Suisse	89,354
33	Denmark	256,300	66	HSBC Holdings	115,361	99	Hitachi	87,615
						100	Egypt	84,510

in the United States that leveled off a once-growing market, the U.S. cigarette industry firms had to look to the foreign markets of eastern Europe and Asia to maintain sales volumes. Similarly, as revenue growth declined and the fast-food industry edged toward maturity in the United States, various fast-food firms like McDonald's and Pizza Hut expanded overseas to countries such as Russia, Japan, China, and India. Today, product life cycles in many industries have become very short because of next-generation technologies, so firms are seeking to penetrate overseas markets simultaneously with their respective home markets in order to recoup costs and make a profit before the next generation of technology comes to market.

Once firms have internationally expanded, many try to protect and maintain a market position abroad by establishing production facilities in foreign markets that had been served through exports. In this way companies bypass the threat of trade barriers such as the imposition of high tariffs or quotas. For instance, the so-called voluntary restrictions in 1980 on the export of Japanese automobiles to the United States was one factor that prompted Japanese auto companies like Toyota and Nissan to build car manufacturing plants in the United States. Toyota, Honda, and Nissan have established significant shares in the U.S. automobile market. Similarly, many U.S. and Japanese companies established plants in the 15-country European Union (EU) to circumvent potential trade barriers raised by the member countries against imports from non-EU countries. Over the years, through the efforts of the World Trade Organization (WTO), tariffs and quotas have been reduced dramatically. We elaborate on the practical and strategic implications of the EU, other trade blocs, and the WTO in Chapter 2.

The expectation of immense business opportunities in an integrated and unified market of the 27-nation European Union has brought an upsurge of both Japanese and American direct investment in Europe. As an example, for the past decade, Japanese banks and companies in the manufacturing sector have been continually investing, buying European companies, setting up manufacturing subsidiaries, and boosting sales forces throughout Europe. Japan's business activities in Europe intensified in 1990 when Japanese companies decided Europe was serious about market unification after 1992. The Japanese companies wanted a foothold in Europe before protectionism possibly kept them out. Japanese companies have responded by building new manufacturing plants and buying existing manufacturing capacity inside what could become a European fortress.

Historically, U.S. firms in many industries have been able to gain cost efficiencies and needed experience in their home market before venturing overseas. However, when a company's home market is not large enough to gain necessary cost efficiencies, that firm must look to international markets. The small size of the domestic market is the reason given by European companies that have developed international presences. Pharmaceuticals companies Hoffman–La Roche and Novartis (in 1996, in one of the largest corporate mergers in history, Ciba-Geigy and Sandoz merged to form Novartis), based in Switzerland—a nation whose population is less than 8 million—could not have survived in their industry had they limited their business horizons to the Swiss market. These companies, and others like them in other European countries with small populations like Holland and Belgium, were forced to seek markets abroad, which eventually led to the creation of foreign manufacturing facilities in their major markets.

Cost-Reduction Motives

Companies venture overseas to lower factor costs. Intense competitive pressures and the resulting fall in profit margins serve as a powerful inducement for affected companies to seek cost-reduction measures. Firms therefore seek countries with low wages to shift manufacturing operations.[15]

Comparatively cheap labor is often the strongest incentive for companies to establish foreign operations.[16] For example, over the past two decades more than 2,000 maquiladoras have sprung up near the United States–Mexico border. These plants take advantage of cheap labor to assemble American-made components for reexport to the United States. Further inside Mexico, Japanese, German, and American automotive firms all have assembly facilities that ship final products to the United States and global markets. The economics of assembly in Mexico are favorable because jobs that are higher priced in the United States and fully "burdened" with benefits, Social Security, and so on, can be had in Mexico for a fraction of the cost.

In the 1950s and 1960s, many American companies had established not just assembly plants but fully integrated manufacturing plants in newly industrializing countries such as Taiwan and Singapore and the crown colony of Hong Kong. Even more foreign investment in manufacturing operations has flowed into Asia since then. Research indicates that "the high-wage differential between West Europe and Asia has been the most significant contribution to the restructuring of U.S. foreign direct investment (FDI) during 1981–2000."[17] As wages in Taiwan, Singapore, and Hong Kong rose in comparison to lesser developed Southeast Asian countries, the companies shifted their investment sights and moved to Malaysia, Thailand, and Indonesia. Most recently, even lower cost labor has been found in locales like southern China and Vietnam. During the 1990s and into the twenty-first century, Black & Decker, the U.S. power tools manufacturer, aggressively expanded production facilities for power drills throughout China, not to serve the Chinese market but rather to export to Europe. Automobile companies have engaged in several contracts with Indian suppliers for the supply of parts and components.

Another reason companies set up foreign plants is to eliminate or reduce high transportation costs, particularly if the ratio of the per-unit transportation expenditures to the per-unit selling price of the product is very high. For instance, if the product costs $10 to ship but it can be marketed for no more than $25 in the foreign market, all other things being nearly equal, the company may decide to produce it in the market to improve its competitiveness and profit margin. The trade-off for the company is giving up the economy-of-scale efficiencies of long production runs in one country in order to reduce transportation costs.

Costs can also be reduced for a firm through favorable host-government incentives and inducements. Local production often allows the company to take advantage of incentives that the host government may be offering to foreign companies that make direct investments in the country.[18] These incentives include reduced taxes for several years, free land, low-interest loans, and a guarantee of no labor strife. This was a principal motive for Intel to establish manufacturing operations in Costa Rica and for Mercedes, the German luxury car company, to build a manufacturing plant in Alabama.

Firms in industries with relatively high allocation of funds to research also look to overseas markets. Companies in pharmaceutical and high-technology industries that must spend large sums of money on research and development for new products and processes are compelled to look for ways to improve their sales volume in order to support their laboratories. If the domestic sales volume and exports do not raise the necessary cash flow, then strategically located manufacturing and sales affiliates are established abroad with the objective of attaining higher levels of sales volume and cash flow to support future research endeavors.

A factor that companies take into account in locating production plants is the comparative production costs in their major country markets. For example, a company that has major market positions in Japan, Germany, and the United States would be concerned about how costs are affected by the cross-exchange rates between the Japanese yen,

the euro, and the U.S. dollar. If the yen were to rise significantly in value against the U.S. dollar and the euro, then exports to the United States and Germany of the company's Japanese-produced products could become relatively noncompetitive because of the rise of the yen-denominated Japanese wage rates and exports, especially if labor costs added significantly to the total product value. In such an event, the economics of production and distribution permitting, the company would gain if it could shift its production to either the United States or Germany. In fact, during the 1990s, when the yen appreciated against the U.S. dollar, Japanese auto companies used their U.S. plants to ship cars to Europe and even back to Japan! BMW and Mercedes, two of the major luxury carmakers of Germany, decided to commence manufacture of some models in the United States because of the highly noncompetitive labor rates in Germany largely due to the high value of the German mark. Global companies invest in favor of operational flexibility and in the ability to shift the sourcing of products and components from country to country. Global companies are therefore motivated to make major investments in operations and supply sites in their major country markets.

Firms have been known to move their operations to ecologically and environmentally friendly countries in order to reduce costs of adherence, both from the operations perspective and from the political perspective. Companies have been alleged to have moved their environmentally harmful operations to countries in Africa, Asia, and Latin America whose laws for environmental protection are less strict than those in the United States and therefore are considered ecologically and environmentally friendly to businesses. But companies do not have to migrate to developing countries to avoid environmental risks. A case in point is Germany's BASF, which moved its biotechnology research laboratory focusing on cancer and immune-system research from Germany—where it faced legal and political challenges from the environmentally conscious Green movement—to Cambridge, Massachusetts, which, according to BASF's director of biotechnology research, had more or less settled any controversies involving safety, animal rights, and the environment.[19] These and other types of social responsibility issues that confront the international company are expanded upon in Chapter 14.

Strategic Motives

Firms venture overseas for many long-term strategic reasons. Strategic decisions are those that are made to maintain or enhance the competitive position of a company in an industry or market. According to Hymer, who was the first to offer an explanation of why firms start production abroad, firms use foreign production as a means of transferring and taking advantage of the host country's specialized assets, knowledge, and capabilities, both tangible and intangible.[20] Firms also engage in foreign operations in several countries to diversify their strategic risk.[21] Both Caves and Dunning explain foreign production by firms as a means of taking advantage of their assets, knowledge, and capabilities that are superior to firms in the foreign markets.[22] A firm can accrue many distinct strategic advantages by producing a product in a foreign market. These include the ability to meet the demand for the product quickly, good public relations with customers and the host government, and improved service.

A firm may simply follow its major customers abroad. When the Japanese automakers Honda, Toyota, Nissan, Mazda, Subaru, and Isuzu established car manufacturing plants in the United States, their Japanese suppliers followed and set up their own plants in the United States. There are today more than 300 Japanese-owned parts suppliers in the United States, representing an investment in excess of $7 billion and employing more than 30,000 workers. Most of these supplier firms provide glass, brake systems, seats, air conditioners, heaters, filters, fuel pumps, and other components directly to

the production plants. This pattern has been seen in the service industries as well. As major American corporations were expanding worldwide, they demanded better and more reliable services, including telecommunications services. Consequently, AT&T began the international expansion initiative of its communications line of business in the latter half of the 1980s, setting up overseas operations in five countries. AT&T now has major subsidiary locations in more than 50 countries.

The hardware line of business of AT&T, which was eventually spun off into a separate entity named Lucent, also made a big push overseas, mainly to satisfy the telecommunications needs of its large global customers, which had made their own push into overseas markets. Fearing that its major customers—the global companies—would turn to rival companies such as France's Alcatel, Italy's Italtel, IBM, and Japan's NEC if it did not operate advanced voice and data networks around the world, the company formed several joint ventures and strategic alliances around the globe.[23] Combined employment abroad for AT&T and Lucent jumped from a mere 50 people in 1983 to more than 50,000 today. Like AT&T, Federal Express followed the lead of its customers who increasingly wanted packages sent to Asia and Europe. Accordingly, with the aim of "keeping it purple"—the color of FedEx's planes and vans—the company set out to duplicate its business abroad.

Besides following their important customers, firms exhibit a *bandwagon effect,* venturing abroad to follow their major competitors.[24] This is especially true in an industry that is characterized by an oligopolistic rivalry. A competitor's inroads in certain foreign markets may translate to losing business in other markets. Years ago, fearing that they would eventually lose some of their U.S. business with Ford and General Motors if European tire manufacturers were able to sell to those auto manufacturers in Europe, U.S. tire manufacturers followed each and established plants in Europe to better service their major accounts. Similarly, Japanese tire manufacturers like Bridgestone have established manufacturing plants in the United States to serve Japanese carmakers. More recently, from the telecommunications service perspective, MCI followed AT&T to many overseas markets.

The competitive perspective is another strategically based motive for international expansion. If a company's competitor can make unencumbered profits in a specific host country, that competitor can use a portion of those profits to attack the firm in the firm's major markets. This is called *cross-subsidization,* that is, using profits generated in one market to compete in another market. Firms strategically look overseas to gain cross-subsidization possibilities as well as to block competitors from that advantage.[25]

Rapid expansion of a foreign market for the company's product and the desire to obtain a large market share in it before a major competitor can get in are other strong driving forces for companies to engage in foreign production. By being first into a new market, a firm may be able to obtain favorable deals with customers and suppliers. Furthermore, the firm may be able to secure the most efficient distribution channels and set both the strategic and technological agendas for the industry in that host country. This is an important reason for American and European companies wanting to enter the market in China.

The need for vertical integration is another strategic reason often responsible for the international expansion of operations. Companies are pushed into making direct investment abroad so that they can capture a source of supply or new markets for their products. For example, a company in the oil exploration and drilling business may integrate "downstream" by acquiring or building an oil refinery in a foreign country that has a market for its refined products. Conversely, a company that has strong distribution channels (e.g., gas stations) in a country but needs a steady source of supply

of gasoline at predictable prices may integrate "upstream" and acquire an oil producer and refiner in another country.

Numerous companies have established operations abroad to exploit the strong brand name of their products. Realizing that they could not fully exploit their advantage by way of exports, they have set up plants in their major foreign markets. Examples of companies that have used this strategy are Coca-Cola, Pepsi-Cola, Budweiser, and Heineken. Scotch whiskey is now produced in India, replacing exports from abroad.

A global company may decide to locate its manufacturing plant in a country that is of strategic importance for the company's exports to a third country. For instance, Japanese companies have strictly observed the Arab boycott of Israel and therefore cannot export to Israel directly from Japan. However, Japanese plants in the United States can export their U.S.-made products to Israel, and this is exactly what Honda is doing. It is exporting Honda Civic sedans to Israel from its plant in Ohio. In the same vein, Northern Telecom Ltd. (Nortel), the Canadian telecommunications giant, has moved many of its manufacturing operations to the United States to gain the competitive edge that an American company can obtain in securing Japanese contracts. Nortel made this strategic move to the United States knowing that the Japanese would favor U.S. companies because of Japan's huge trade surplus with the United States.

As organizational knowledge is becoming a key competitive weapon, firms have recognized that scientific talent and brainpower are not the monopoly of any one country or group of countries. Thus international companies are establishing technological research and development centers around the world. Companies like IBM and Microsoft have established such centers in Japan and India respectively to tap into the "innovation culture" of those countries. Several global companies in a variety of knowledge-based industries such as biotechnology, pharmaceuticals, and electronics have set up such centers in the countries of the so-called Triad of Europe, the Pacific Basin (including Japan), and the United States. This strategy has paid rich dividends for Xerox, which has introduced 80 different office copier models in the United States that were engineered and built by its Japanese joint venture, Fuji-Xerox Company. Another example is Bangalore, India, which has become the global center for software development for major computer and software companies. The number-one global carmaker, General Motors, plans to invest $60 million in a technology center in Bangalore, India's technology hub. General Motors plans to hire 260 engineers, who will collaborate with the company's American and European research center through high-speed communication links. Most planes flying between Mumbai (Bombay), the major international gateway to India, and Bangalore are filled with U.S. technology executives looking to source business in this emerging Silicon Valley.[26] Similarly, firms in Malaysia have proactively marketed themselves to North American and European companies as the appropriate places to outsource their technology needs.

Paralleling financial planning thinking, firms have strategically ventured overseas to diversify their operations and, in effect, to hedge against the many environmental risks of doing business in one country. This strategy ranges from simply distribution and sales in multiple countries to rationalization of production across key countries. Regarding distribution and sales, firms relying solely on the Japanese market have been hurt due to the long-lasting recession in Japan. Firms with a portfolio of country businesses have somewhat hedged against such a recession. Likewise, firms try to balance the efficiencies of long production runs with the flexibility of being able to switch production should trouble arise in a certain country. For instance, auto parts are produced in many countries, including the United States, Japan, Argentina, Mexico, India, and Indonesia. Although the comparative costs in Argentina, Mexico, India, and Indonesia are lower than in the United States and Japan, the former countries are less

stable than the latter. Mexico had a financial problem in the mid-1990s. From the late 1990s until today, Indonesia saw a combination of financial and political upheaval that put many foreign investments at risk. And most recently, Argentina's financial problems have bubbled over into increased instability of the market and workforce. Thus producing all of a firm's components in any one of these countries would have proved catastrophic to a firm.

In this section, we have introduced some of the many reasons why a firm may choose to "go international." However, it is important to remember that each company's decision should be based on a careful assessment of its own distinctive strengths (and weaknesses) and the potential for it to strengthen its overall competitive position by making the international move. In the next section, we look at one proposed framework for assessing such potential benefits.

Strategic Objectives and Sources of Competitive Advantage

Sumantra Ghoshal, in his seminal article "Global Strategy: An Organizing Framework,"[27] offered an excellent framework that explains the broad categories of objectives of a global firm and the sources for developing an international/global firm's competitive advantage. The framework is presented in Exhibit 1.1.

As seen in Exhibit 1.1, in its **global strategy,** a global firm pursues three categories of objectives: (1) achieving efficiency, (2) managing risks, and (3) innovating, learning, and adapting. The key is to create a firm's competitive advantage by developing and implementing strategies that optimize the firm's achievement of these three categories of objectives. This may require trade-offs to be made between the objectives because on occasion they may conflict. For example, the objective of achieving efficiency through economies of scale in production may conflict with the objective of minimizing risks emanating from economic or political conditions in a country where the plant is located.

Ghoshal identifies three sources through which a global firm may derive its competitive advantage: (1) national differences, (2) scale economies, and (3) scope economies. According to Ghoshal, the strategic task of managing globally is to use all three sources of competitive advantage to optimize efficiency, risk, and learning simultaneously in a

EXHIBIT 1.1 Global Strategy: An Organizing Framework

Source: From Sumantra Ghoshal, "Global Strategy: An Organizing Framework," *Strategic Management Journal,* Vol. 8. Copyright © 1987 John Wiley & Sons Limited. Reproduced with permission.

	Sources of Competitive Advantage		
Strategic Objectives	**National Differences**	**Scale Economies**	**Scope Economies**
Achieving efficiency in current operations	Benefiting from differences in factor costs (wages and cost of capital)	Expanding and exploiting potential scale economies in each activity	Sharing investments and costs across products, markets, and businesses
Managing risks	Managing different kinds of risks arising from market- or policy-induced changes in comparative advantage of different countries	Balancing scale with strategic and operational flexibility	Portfolio diversification of risks and creation of options and side-bets
Innovation, learning, and adapting	Learning from societal differences in organizational and managerial processes and systems	Benefiting from experience, cost reduction, and innovation	Sharing learning across organizational components in different products, markets, or businesses

worldwide business. The key to a successful global strategy is to manage the interactions between these different goals and means.[28]

Achieving Efficiency

If a firm is viewed as an input–output system, its overall efficiency is defined as a ratio of the value of all its outputs to the costs of all its inputs. A firm obtains the surplus resources needed to grow and prosper by maximizing this ratio. It may enhance the value of its products or services (outputs) by making them of higher quality than those of its competitors, and at the same time it may lower the costs of inputs by obtaining low-cost factors of production such as labor and raw materials.[29] Different business functions—production, research and development, marketing, and so on—have different factor intensities. A firm could exploit *national differences* by locating a function in a country that has a comparative advantage in providing the factors required to perform it. Thus it could locate labor-intensive production in low-wage countries like Malaysia or Mexico and locate R & D activities in countries that have capable scientists who can do the work but who do not have to be paid high salaries. As an example, many American companies—Microsoft, Oracle, Hewlett-Packard, Novell, Motorola, and Texas Instruments—established centers for software development work in India, where personnel qualified to write innovative software are plentiful and can be employed for as little as $300 a month. Similarly, many U.S.-based companies have established service centers outside America in order to gain added cost efficiencies. For instance, when talking with a Compaq computer service representative, a customer is actually talking with a technical adviser in Ottawa, Canada. Service centers for various firms have been established in countries like Ireland, India, and the Philippines as well during the first part of the twenty-first century.

A firm could enjoy the benefits of *scale economies* like lower costs and higher quality resulting from specialization by designating one plant to serve as the sole producer of a component for use in the final assembly of a product. For example, a plant in the Philippines may make transmissions, another in Malaysia the steering mechanisms, and one in Thailand the engines. Each country would then do the final assembly of the complete automobile. Toyota Motor Company is rapidly moving in this direction. Practical Insight 1.1 illustrates steps taken by Dell Computer to take advantage of scale economies and proximity to key markets to reduce transportation costs.

The concept of *scope economies* is based on the notion that savings and cost reductions will accrue when two or more products can share the same asset, such as a production plant, distribution channel, brand name, or staff services (legal, public relations, etc.). A global company like Coca-Cola enjoys a competitive advantage because it is in a position to produce two or more products in one plant rather than two separate plants, market its products through common distribution channels, and share its world-famous brand name across a wide range of products.

Managing Risks

A global company faces a number of different types of risk including economic, political, cultural, legal, and competitive. The nature and severity of such risks are not the same for all countries. A global company is in a position to manage such risks effectively by planning and implementing effective strategies aimed at diffusing risk.[30] For example, in a country that has high levels of unemployment, a global company could deflect restrictive and unfriendly governmental policies by sourcing products for world markets in that country, thus increasing much-needed employment opportunities for the local populace. An example of such a strategy is the transfer of significant amounts of car production to the United States by Japanese automakers like Toyota, Honda,

PRACTICAL INSIGHT 1.1

DELL COMPUTER'S SUPPLY CHAIN EXTENDS INTO CHINA

Dell Computer's competitive advantage lies in its manufacturing acumen, an upstream activity in the value chain. Dell has dispersed its manufacturing operations to large manufacturing plants strategically located in various parts of the globe primarily to take advantage of scale economies and proximity to key markets to reduce transportation costs. Now Dell is making a big push to lower costs and prices across the board—especially in the two largest markets, Japan and China. In the past, most of the Dell computers that ended up in Japan were built at the company's giant facility in Malaysia. Now Dell is making PCs for the Japanese market at a factory in the southeastern Chinese city of Xiamen. The switch means Dell saves a third off its manufacturing and shipping costs—savings Dell can pass on to customers. Dell's market share in Japan jumped from 3.8% in 2000 to 5.8% in 2001, according to Gartner Group Inc. consultants, a surge that Dell execs attribute to better management and lower prices.

Source: Reprinted from Bruce Einhorn, Andrew Park, and Irene M. Kunii, "Will Dell Click in Asia? The PC Maker Is Going All Out to Win a Bigger Piece of the Pie," April 22, 2002 issue of *BusinessWeek* by special permission. Copyright © 2002 by The McGraw-Hill Companies, Inc.

and Nissan. One of the principal motivations behind this strategy was to minimize the growing anti-Japanese sentiment in the United States due to the alleged job losses caused by Japanese imports.

The benefits of scale economies must be weighed against their risks. A plant located in a country because of its low wages could lose its locational advantage if the wage rates in the country rise significantly because of economic development or appreciation of the country's currency. Global companies manage such risks by distributing production in more than one country even at the expense of benefits derived from lower scale economies. Japanese car companies have managed currency and wage-rate risks caused by rising wage rates in Japan and the much stronger Japanese yen compared to the U.S. dollar by exporting cars made in U.S.-based plants back to Japan. The flexibility afforded to Japanese car companies by having plants in both the United States and Japan was responsible for their effective management of risk. Chapters 3 and 4 further delineate the various political, legal, economic, and cultural environments and associated risks.

Innovation and Learning

A global company has a distinct advantage over its purely domestic competitor because of the multiple environments in which the global company operates. A company that has operations in many countries is exposed to a diversity of experiences and stimuli. Being in many countries allows it to develop a variety of capabilities.[31] A global company has opportunities to learn skills and acquire knowledge of a country, which can be transferred and applied in many other countries where it has operations.[32] For example, a company that has operations in Japan can learn about the very best aspects of the Japanese management system and adapt and use those that are most useful in its American or European operations. General Electric is marketing in India an ultrasound unit designed by Indian engineers, using technology developed in GE's Japanese operations.

Hewlett-Packard has continued pouring resources into the Asian region, opening a laboratory in Japan and new manufacturing facilities in Japan and Malaysia, while simultaneously beefing up its engineering, project management, and design capacity in Singapore. Such investments provide not only increased sales in the region but also skills and expertise in how to improve the production process, something that it lacks in the United States. Hewlett-Packard has learned process improvement techniques

from its Asian operations and transferred the knowledge not only to its U.S. operations but also to operations worldwide.

Eli Lilly & Company, a global pharmaceutical corporation, and Ranbaxy Laboratories Limited, India's largest pharmaceutical company, have formed a path-breaking alliance to set up joint ventures in India and the United States. In the first phase, a state-of-the art research, development, and manufacturing facility is being set up in India to develop products for the U.S. market by undertaking chemical, pharmaceutical, and analytical research. Lilly's strategy apparently is to tap into the research capabilities of Indian scientists, and thereby to learn and develop innovative new products and processes. Moreover, the development of a new patented pharmaceutical product costs $800 million or more in the United States, but it may cost as little as $200 million in India.[33]

The framework we have discussed in this chapter is very useful in identifying possible sources of competitive advantage for an international company. However, the suggested strategies must be translated into operating decisions that can realize the broader goals. We explore this topic in depth in Chapter 6 and illustrate how an international firm establishes the optimum mix of functional and geographic integration to achieve its strategic objectives. But before we take up the issue of strategy, we turn in the next section to a discussion of the environmental context within which the international firm must operate. In the next chapter, we set the stage with an overview of the current global economic environment, highlighting some trends that are important for international managers.

The Environment of International Management

A manager in an international company performs her or his managerial functions in an environment that is far more complex than that of her or his counterpart in a domestic company (see Figure 1.3). The international environment is the total world environment. However, it is also the sum total of the environments of every nation in which the company has its foreign affiliates. The environment within each nation consists

FIGURE 1.3
The International Environment

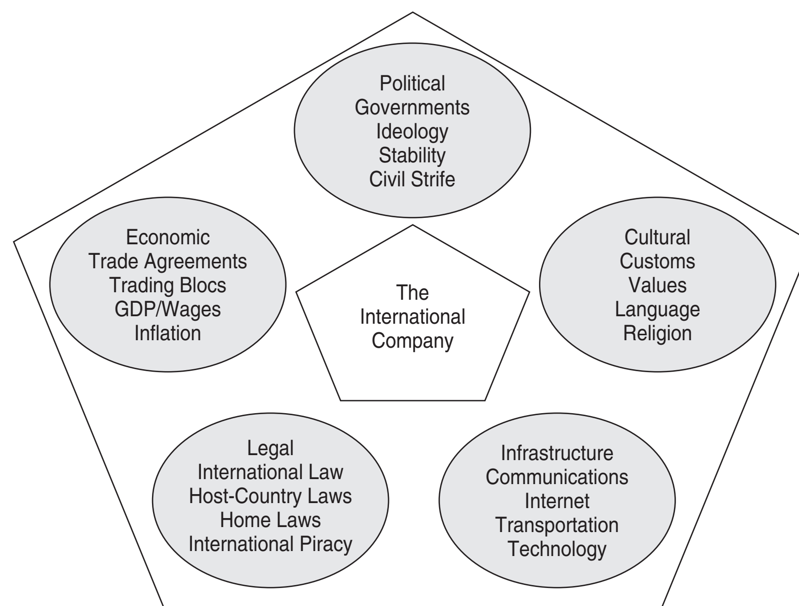


EXHIBIT 1.2
The International Environment

Economic Environment

Economic system
Level of economic development
Population
Gross national product
Per capita income
Literacy level
Social infrastructure
Natural resources
Climate
Membership in regional economic blocs (EU, NAFTA, LAFTA)
Monetary and fiscal policies
Wage and salary levels
Nature of competition
Foreign exchange rates
Currency convertibility
Inflation
Taxation system
Interest rates

Political Environment

Form of government
Political ideology
Stability of government
Strength of opposition parties and groups
Social unrest
Political strife and insurgency
Governmental attitude toward foreign firms
Foreign policy

Legal Environment

Legal tradition
Effectiveness of legal system
Treaties with foreign nations
Patent trademark laws
Laws affecting business firms

Cultural Environment

Customs, norms, values, beliefs
Language
Attitudes
Motivations
Social institutions
Status symbols
Religious beliefs

Technological Environment

Inventions
New-product development
New-process innovations
Internet capabilities

of five dimensions: economic, political, legal, cultural, and technological. Exhibit 1.2 lists the factors typically found in each of these environments. We examine the new economic infrastructure that includes trade agreements and regional economic integration initiatives in Chapter 2, the political and legal dimensions in Chapter 3, and the cultural dimension in Chapter 4.

Summary

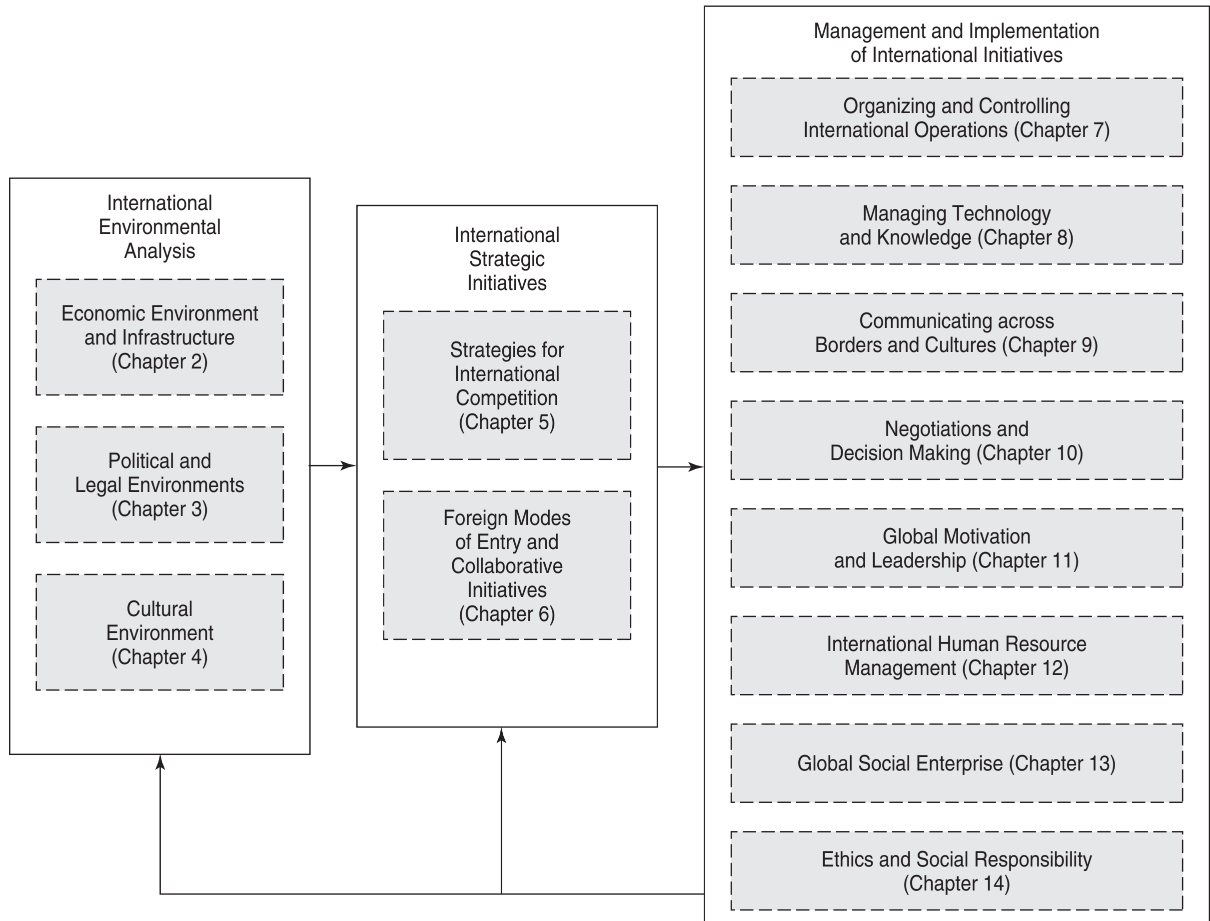
This chapter provides an introduction to international management and to the world of the so-called international company. The nature of international business was explained first, and we saw that the need for international management and managers arises for many strategic and market reasons.

Although there are scores of small international companies, generally when one speaks about them, the reference is to the large multinationals. Increasingly, people are referring to these giant companies with operations throughout the world as international, multinational, and global companies. Because the other connotations are used more specifically

in later chapters, we use the term *international companies* to define the entities with overseas sales and/or operations. International management and international companies are more or less like conjoined twins or the two sides of a coin. The growth of international companies has resulted from the astute management of these enterprises by international managers. And the management of these corporations epitomizes what international management is all about.

We saw something of the dimensions and drastic growth of multinational companies since the 1960s. We also examined the market-based, cost-based, and strategic motives a firm has to expand internationally. After this, we studied how global companies exploit economies of scale, economies of scope, and national differences to achieve their three generic objectives: (1) efficiency in current operations, (2) managing risks, and (3) innovation, learning, and adaptation. We concluded by introducing the nature and complexity of the international environment of international companies. Figure 1.4 illustrates the roadmap for the remainder of the book.

FIGURE 1.4 **International Management: A Model of International Management**



Key Terms and Concepts

cost-reduction motives for international expansion, *11*
foreign direct investment (FDI), *4*
global strategy, *16*
international business, *5*
international company, *7*
international management, *6*
market-seeking motives for international expansion, *9*
strategic motives for international expansion, *13*

Discussion Questions

1. What is international business? How does it differ from international management?
2. Discuss the characteristics of multinational companies. What forces have contributed to their development and growth?
3. What are strategic, cost-based, and marketing-based company motives for expanding overseas?
4. Identify and explain the three categories of broad objectives of global companies. What strategic actions can a global company take in order to develop competitive advantage against its competitors?
5. Discuss the key differences between economies of scale and economies of scope.
6. Discuss how national differences can serve as a source of competitive advantage for a global company.

Minicase

Want to Be More Efficient, Spread Risk, and Learn and Innovate at the Same Time? Try Building a "World Car"

Japanese car companies like Toyota and the Honda Motor Company are pioneering the auto industry's truly global manufacturing system. The companies' aim is to perfect a car's design and production in one place and then churn out thousands of "world" cars each year that can be made in one place and sold worldwide. In an industry where the cost of tailoring car models to different markets can run into billions of dollars, the "world car" approach of Toyota and Honda—and which Ford is hoping to emulate—is targeted at sharply curtailing development costs, maximizing the use of assembly plants, and preserving the assembly line efficiencies that are a hallmark of the Japanese "lean" production system.

As for Honda, the goal is to create a "global base of complementary supply," says Roger Lambert, Honda's manager of corporate communications. "Japan can supply North America and Europe, North America can supply Japan and Europe, and Europe can supply Japan and the United States. So far, the first two are true. This means that you can more profitably utilize your production bases and talents."

The strategy of shipping components and fully assembled products from the U.S. to Europe and Japan couldn't have come at a more opportune time for the Japanese car companies, especially when political pressures are intense to reduce the Japanese trade surplus with the United States. The task was made easier due to the strength of the Japanese yen, which has risen about 50 percent against the U.S. dollar. That has made production of cars in the United States cheaper, by some estimates, by $2,500 to $3,000 per car. That saving more than compensates for the transportation costs for a car overseas. For the first time, Toyota is creating a system that will give it the capability to manage the car production levels in Japan and the United States. It is moving toward a global manufacturing system that will enable it to enhance manufacturing efficiency by fine-tuning global production levels on a quarterly basis in response to economic conditions in different markets.

Source: Adapted from Paul Ingrassia, "Ford to Export Parts to Europe for a New Car," *The Wall Street Journal,* September 29, 1992, p. A5; Jane Perlez, "Toyota and Honda Create Global Production System," *The New York Times,* March 26, 1993, pp. A1, D2.

DISCUSSION QUESTIONS

1. Discuss the strategies implemented by Toyota and Honda to achieve greater efficiency in car production.
2. How do the automobile companies plan to simultaneously manage risk and gain efficiencies?
3. Discuss how the car companies use national differences to gain a strategic advantage in the global car industry.

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