ESSENTIALS OF MANAGEMENT

Pearson

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INT0005 Introduction to Management

Essentials of Management

receiving country does the final distribution of exports, there are few implications for the exporter's staff.

Offshoring

Offshoring is the practice of contracting out activities to companies in other countries who can do the work more cost-effectively.

Offshoring happens when managers decide to transfer activities to countries that will add more value. This began when companies in developed Western economies transferred routine manufacturing activities to low-wage developing countries. The internet enables companies to transfer administrative activities (such as payroll or accounting) overseas.

Foreign direct investment

Foreign direct investment (FDI) is the practice of investing shareholder funds directly in another country, by building or buying physical facilities, or by buying a company.

Foreign direct investment (FDI) is when a firm builds or acquires facilities in a foreign country, and manages them directly. Motor companies do this – Nissan and Tata manufacture in the UK, General Motors in India. If the venture is a wholly-owned subsidiary, profits stay in the company, which retains control over expertise, technology and marketing. Nissan and GM built and managed their facilities. Others, like Kraft when it purchased Cadbury's, buy the assets of an existing business.

Key ideas Contextual intelligence

'Context matters. Most managers and entrepreneurs agree, for example, that creating value and motivating talent are at the heart of what they do. But once you drill below the homilies, differences quickly emerge over what constitutes value and how to motivate people. That's because conditions differ enormously from place to place, in ways that aren't easy to codify – conditions not just of economic development, but of institutional character, physical geography, educational norms, culture and language. Students of management once thought that best manufacturing practices (to take one example) were sufficiently established that processes merely needed tweaking to fit local conditions. More often, it turns out, they need radical rewriting – not because the technology is wrong, but because everything surrounding the technology changes how it will work … '

Khanna (2014) illustrates the theme with an example from the cement industry:

> **The technology for manufacturing cement is the same everywhere, but individual cement plants are located in specific contexts that vary widely. Corrupt material suppliers may adulterate the mixtures that go into cement. Unions may impede or support plant operations. Finished cement may be sold to construction firms in bulk or to individuals in bags. Such variables often outweigh the unifying effects of a common technology (p.81).**

Source: Khanna (2014).

Licensing

Licensing is when one firm gives another firm the right to use assets such as patents or technology in exchange for a fee.

Franchising is the practice of extending a business by giving other organisations, in return for a fee, the right to use your brand name, technology or product specifications.

Licensing occurs when a business licenses (grants the right to) a firm (the licensee) in another country to produce and sell its products – such as the deal between Imperial Tobacco and a Chinese group to produce and distribute Imperial brands in the world's largest cigarette market. The licensing firm receives a payment for each unit sold (usually called a royalty payment), while the licensee takes the risk of investing in manufacturing and distribution. **Franchising** is similar, used by service businesses to expand rapidly. The expanding firm sells the right (the franchise) to a company which allows it (the franchisee) to use the brand name and product design to build a business in the target market. The seller usually imposes tight conditions on quality, working procedures and customer service: franchisees run many retail outlets.

Joint ventures

Joint ventures enable firms in two or more countries to share the risks and resources required to do business internationally. Most joint ventures link a foreign firm with one in the host country to take advantage of the latter's facilities and/or knowledge of local customs, politics and ways of working. They agree their respective investment and how to share the profits. In 2018, Nestlé and Starbucks agreed a joint venture which will enable Nestlé to sell Starbucks products in parts of the world where Starbucks is weak: Starbucks sells packaged goods in 28 countries, while Nestlé operates in almost 290 (*Financial Times*, 8 May 2018, p.14). Joint ventures bring advantages – and also the hazards of misunderstandings due to cultural differences.

A **joint venture** is an alliance in which the partners agree to form a separate, independent organisation for a specific business purpose.

Wholly-owned subsidiary

Managers who want to retain close control over international activities create a foreign subsidiary. This is costly: the benefit is that the company retains the profits as well as control over its expertise, technology and marketing. The company establishes the subsidiary as a new entity or by acquiring an existing business, and usually employs local staff.

Johnson and Tellis (2008) found that success depended on how much control the lead company retained. Exporting (cheap) gives little control, as managers cannot decide how their products are finally distributed and sold. A wholly-owned subsidiary (expensive) gives high control, as the company can deploy finance or marketing knowledge if required. Firms with a high degree of control were consistently more successful than those without.

Companies also develop forms of organisation through which to conduct their international business – multinational, transnational and global.

Multinational companies are managed from one country, but have significant production and marketing operations in many others.

Key ideas — Rationality in multinational companies' investment methods

In a review of Herbert's (1999) classic article on multinationals' investment methods, Richard Whittington (2017) recalled that Herbert noted that, at that time, multinational investment decisions reflected specific cultural assumptions, such as that decisions are fundamentally rational, relying on accurate data, systematic analysis and frank discussion.

Many multinationals also appeared to share common assumptions:

- about the importance of timely information
- about the priority of organisational interests and
- that individuals value their careers before family or social interests.

Herbert's research had shown that, in many cultures, the reality is otherwise:

- information is only given when demanded face-to-face and
- local managers' political histories loom large over organisational decisions.

Context matters (p.34).

Source: Whittington (2017).

Multinational companies are based in one country, and have significant production and marketing operations in many others – perhaps over a third of sales. Managers in the home country make the big decisions.

Transnational companies also operate in many countries, but decentralise many decisions to local managers. The company uses their local knowledge to build the business, while still projecting a consistent company image.

Transnational companies operate in many countries and delegate many decisions to local managers.

Global companies work in many countries, securing resources and finding markets in whichever country is most suitable.

Global companies work in many countries, securing resources and markets in the most suitable. Production or service processes are performed, and integrated, across many global locations – as are ownership, control and top management. Staff at Trend Micro (www.trendmicro.com), a global leader in IT security, must respond rapidly to threats anywhere. Trend's financial headquarters is in Tokyo; product development is in Taiwan (a good source of staff with a PhD); and the sales department is in California – inside the huge US market. Nestlé (www.nestle.com) is another example: although headquarters are in Switzerland, 98 per cent of sales and 96 per cent of employees are not. Such businesses are often organised by product, with those in charge of each unit securing resources from whichever country gives best value.

Activity 4.1 Choosing between approaches

Consider the different ways of expanding a business internationally.

- For any two of the methods outlined above, note the possible limitations.
- Identify a company with international operations, and find out which method(s) it has used.
- What assumptions may have influenced the choice?
- Compare your results with colleagues on your course, and prepare a short presentation summarising your conclusions.

Case questions 4.2

- Which of the modes of entry outlined above has Carlsberg used?
- Using the definitions here, is Carlsberg a multinational, transnational or global firm?

4.3 The contexts of international business – PESTEL

Those managing internationally pay close attention to the international aspects of the general business environment (Chapter 3), shown in Figure 4.2. This is similar to Figure 3.5, in the sense that it is a compilation of groups of factors to which practitioners pay attention when managing internationally. The factors are always present in their context, but are only likely to come to their attention, become part of their agenda, when they start doing business internationally. Section 4.3 outlines four of these (beginning, for clarity, with the economic context), and Sections 4.4 and 4.5 present the socio-cultural contexts. Material on the legal context, including the European Union and the General Agreement on Tariffs and Trade, is on the companion website.

Economic

The **theory of absolute advantage** is a trade theory which proposes that by specialising in producing goods and services which they can produce more efficiently than others, and then trading them, nations will increase their economic wealth.

One area of economic theory aims to understand why nations trade with each other, rather than being self-sufficient. The **theory of absolute advantage** states that by specialising in the production of goods which they can produce more cheaply than other countries, and then trading them, nations will increase their economic well-being. If countries use the resources in which they have an advantage (land, raw materials or efficient methods) to produce goods and services, and exchange them with countries for things in which *they* are most efficient, this will add more value than if everyone was self-sufficient. Self-sufficiency sounds attractive, but costs more than buying things from someone else. The theory is

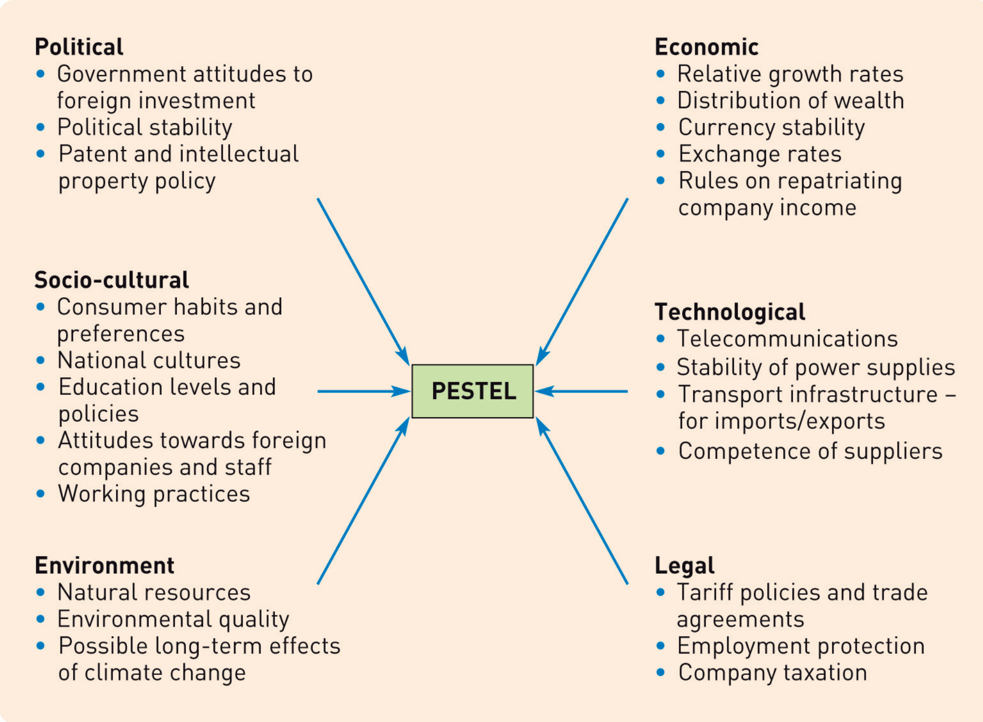

Figure 4.2 An international PESTEL analysis

more complex – but even this simple account begins to explain why nations trade, even though each could make the goods themselves.

The theory partly explains the rapid internationalisation of production since the 1960s. Firms in the developed world realised that labour-intensive manufacturing – especially in electrical goods, clothing, footwear and toys – cost more to make than to import. They quickly found suppliers in a small group of Asian countries – Taiwan, Hong Kong, South Korea and especially Singapore. These became major 'offshoring' centres, supplying goods and components to companies around the world. Mexico's cheap labour and low tariffs on imported has attracted many companies wanting to produce cars for the US market. Table 4.1 gives other examples.

Companies sometimes find that remote operations require more management time than they are worth (they add little value), so they 'repatriate' the outsourced activities.

Table 4.1 Examples of the internationalisation of production

Company	Work transferred	Reasons given
BT www.bt.com	Opened call centres in India, replacing the jobs of 2000 staff in the UK	'To meet cost-saving targets and remain competitive'
Gillette www.gillette.com	Closed three factories (two UK and one German) and transferred work to new factory in Eastern Europe	'To significantly reduce costs and improve operating efficiency'
Dyson www.dyson.co.uk	Moved production of domestic appliances from UK to Malaysia	'To reduce manufacturing costs to protect UK jobs in design and development'

The internationalisation of markets happens when companies in developed countries see market opportunities in less developed ones. Brewers like Heineken are investing heavily in Africa, where rising incomes and population stimulate demand. The Scotch whisky industry is expanding rapidly, with exports in 2017 rising by 9 per cent. Fifteen distilleries have opened in Scotland in the last five years – seven in the past twelve months – with a further twenty planned or under construction. Much of the output will go to emerging economies in Africa and Asia, where the growing professional classes have developed a taste for imported spirits (*Financial Times*, 28 May 2018, p.16). Hong Kong Disneyland reflects the company's belief that Asia's media and entertainment market will grow rapidly: the Chinese Government agreed, taking a 57 per cent stake. Disney hopes this will help it win good terms for other ventures – TV, films and consumer goods.

The economic context of a country includes its stage of development, the growth or otherwise of a middle class, inflation, exchange rates, debt, and so on. The usual measure of economic development is average income per person, though the World Economic Forum, which meets annually to debate the world economy, includes the level of inequality within a country as part of its assessment.

Key ideas How China's institutions support a market economy

Hitt and Xu (2016) give an insight into the transition of China from a state-run towards a market-based system. They show that a major focus of the Chinese Government has been to gradually create the institutions necessary to maintain their economic development.

> **The reforms began in about 1980 [since when] the change to a more capitalistic, open market has required changes in many formal and informal institutions. In the late 2000s the Chinese government began encouraging firms to make investments in foreign firms … Few had developed [the skills for this] but, with the support of the government, they started to seek and learn from alliance partners and use this knowledge to develop their own managerial capabilities.**
>
> **[At about the same time] new property rights laws were enacted. The new laws were necessary to comply with the requirements of membership of the World Trade Organization. [Equally significant] are new laws … for intellectual property protection. They provide the potential for greater access to new technologies developed primarily in Western countries …**
>
> **Another important economic reform is the official recognition and sanctioning of entrepreneurial activities … Successful managers and entrepreneurs also established strong relationships with government leaders at local and national levels. The government remained a major source of resources, and the relationships established were necessary to ensure access to these resources. (pp.590–1)**

Source: Hitt and Xu (2016).

Political

Political risk is the risk of losing assets, earning power or managerial control due to political events or the actions of host governments.

An **ideology** is a set of integrated beliefs, theories and doctrines that helps to direct the actions of a society.

Whatever economic theory predicts about the patterns of trade, political factors – such as governmental arrangements, political involvement with business, and corruption – also affect a country's attractiveness to investment. They shape the **political risk** facing an investor – the risk of losing assets, earning power or managerial control due to political events or the actions of host governments. Those considering overseas investment try to take account of the stability of the regime, the rule of law (or not), and the risks of terrorism.

The political system in a country influences business, and managers adapt to the prevailing **ideology**. Political ideologies are closely linked to economic philosophies and attitudes towards business. In the United States, the political ideology is grounded in a constitution guaranteeing property rights and freedom of choice. These are the foundations of a capitalist economy favourable to business. Australia or the UK are equally capitalist in outlook, while others such as Brazil or France have ideologies favouring social considerations.

There are close links between political and economic systems – especially in how they allocate resources and deal with property ownership. Governments set rules that establish what commercial activity can occur, and how people conduct it – in a capitalist way, a centrally-controlled way, or a mix. Political systems affect business life through:

- the balance between state-owned and privately-owned enterprises
- the amount of state intervention through subsidies, taxes and regulation
- policies towards foreign companies trading in the country, with or without local partners (the Indian Government wants foreign retailers to invest in the country by opening modern stores, but faces opposition from Indian retailers: it has developed strict and complex rules to discourage foreign retailers)
- policies on foreign companies acquiring local firms
- policies on employment practices, working conditions and job protection. Since 2015, *The New York Times* has increased its presence in London at the expense of its old European HQ in Paris.

> The company … acknowledged that French Government laws had played a part in the decision. 'There is more labour flexibility in London compared with Paris' it said. (*Financial Times*, 8 June 2015, p.19)

Management in practice Guarded globalisation

Bremner (2014) notes the emergence of what he terms 'guarded globalization', in the sense that:

> **Governments of developing nations have become wary of opening more industries to multinationals and are zealously protecting local interests. They choose the countries or regions with which they want to do business, pick the sectors in which they will allow capital investment, and select the local, often state-owned, companies they wish to promote. That's a very different flavour of globalization: slow-moving, selective, and with a heavy dash of nationalism and regionalism (p.104).**

Source: Bremner (2014).

Corruption

All states experience some degree of **corruption** – which Transparency International (www.transparency.org) defines as the use of entrusted power for private gain. Gideon Rachman wrote in an article for the *Financial Times* with the title 'Graft thrives in a globalized world':

Corruption is the use of entrusted power for private gain.

> Both Brazil and South Africa have seen presidents forced out of office by corruption scandals – with Jacob Zuma compelled to resign in South Africa this year, and Dilma Rouseff being impeached in Brazil in 2016. In Russia the ruling United Russia party is widely known as the 'party of crooks and thieves'. The rise to power [in India] of Narendra Modi was fuelled by his pledge to crack down on corruption amongst the elites. In China, President Xi Jinping's anti-corruption drive has seen more than 100,000 officials arrested. Meanwhile, Chinese exiles have spread online allegations that corruption extends into President Xi's inner circle (*Financial Times*, 19 June 2018, p.11).

Coping with corruption is part of the job of international managers, but Rodriguez et al. (2005) point out:

> while corruption is everywhere … it is not the same everywhere (p.383).

They introduce a framework to analyse the implications of corruption for business – based on its **pervasiveness** and **arbitrariness**. Pervasiveness is the extent to which a firm is likely to encounter corruption during transactions with officials. Arbitrariness is the degree

Pervasiveness (of corruption) represents the extent to which a firm is likely to encounter corruption in the course of normal transactions with state officials.

Arbitrariness (of corruption) is the degree of ambiguity associated with corrupt transactions.