Chapter 4

Assessing Global Conditions

Learning Objectives

❶ Explain why U.S. firms engage in international business.

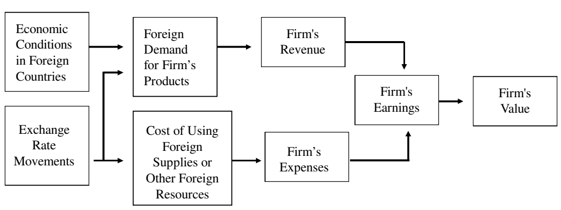
❷ Describe how firms conduct international business.

❸ Explain how foreign characteristics can influence a firm's international business.

❹ Explain how exchange rate movements can affect a firm's performance.

Affecting a Firm's Revenue, Expenses and Value

International Conditions



Why Engage in International Business

- Attract foreign demand.
- Capitalize on technology.
- Use inexpensive resources.
- Diversify internationally.
- Combination of the above motives.

Foreign Expansion in the U.S.

- Some countries have very low labor costs affecting labor intense production cost.
- Some foreign made products are perceived to be of better quality.

How Firms Engage in International Business

- Importing.
- Exporting.
- Direct foreign investment (DFI).
- Strategic alliances.

Importing

The purchase of products made or grown abroad but sold domestically.

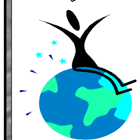
Importing Considerations

1. **Government Trade Barriers**
   - •Tariff (considered a tax)
   - •Quota (limits on amount of product a firm can bring into the country)
2. **Removing Trade Barriers**
   - •NAFTA (North American Free Trade Agreement)

Exporting

The sale of products made or grown domestically but shipped and sold abroad.

Exporting Considerations

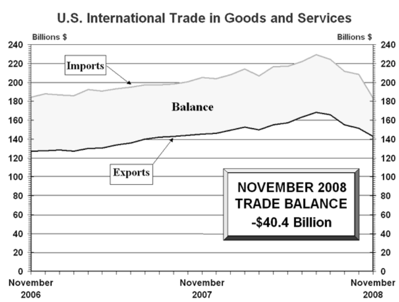


•Absolute advantage..nation's ability to produce something more cheaply than any other country, very rare.

•Comparative advantage..nation's ability to produce some products more cheaply or better than others.

•Exchange rate.

Recent Three Year Trend Exports and Imports



Source: www.census.gov

Trade Barriers

Recent Reductions Include:

- NAFTA
- GAAT
- Latin America
- European Union

Remaining Barriers Include:

- Protection and Punishment
- Disagreements
  - Environment, Labor, Bribery, Taxation

Direct Foreign Investment (DFI)

Feasibility of Direct Foreign Investments

① A firm that has successfully exported to a foreign country desires to reduce its transportation costs.

② A firm that has been exporting products is informed that the foreign government will impose trade barriers.

③ A foreign country is desperately in need of advanced technology.

④ A U.S. firm believes it could reduce its labor cost by shifting production facilities.

Strategic Alliances

❶ <u>Joint Venture</u>

☑ Agreement between two firms about a specific product

❷ <u>Alternative joint venture</u>

☑ Involves two firms in the production of a product.

❸ <u>International licensing agreement</u>

☑ Firm (licensor) allows foreign company (licensee) to produce its products.

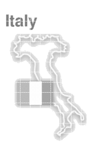
Strategic Alliances

France
Coca-Cola was introduced in France in 1933 in the "Café de l'Europe" in Paris. Coca-Cola has been the number-one soft drink in France since 1966, and its total sales have doubled in eight years. Coca-Cola France has created more than 1000 jobs and has invested more than 3 billion francs in France since 1989.

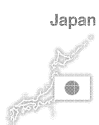
Today, French consumers drink an average 88 servings of Coca-Cola products each year.

Source: Coke Cola Web Page

Five Characteristics of Foreign Countries



① Culture



② Economic System

③ Economic Conditions

④ Exchange Rates

⑤ Political Risk

Three Major Economic Systems

Economic system reflects the degree of government ownership and intervention.

Capitalism
Communism
Socialism

Capitalism

- Minimal government ownership.
- Most businesses are owned privately.
- Owners have a right to compete and profit.

Communism

- Government decides what products to produce and the quantity.
- Government serves as central planner.
- No focus on profits or customer satisfaction.

Socialism

- Contains features of both capitalism and communism.
- Basic industries owned by the government.
- Private owners operate some types of enterprises.
- High tax rates imposed on income.
- Government offers high level of benefits to unemployed.

Exchange Rates and Importing

How exchange rate movements can affect an importer:

- Weak dollar
  - More dollars needed to buy foreign goods.
  - Profits decline for same merchandise.
- Strong dollar
  - Fewer dollars needed to buy foreign goods.
  - Profits increase.

Exchange Rates and Exporting

How exchange rate movements can affect an exporter:

- Weak dollar
  - Foreign currency buys more U.S. goods.
  - Increase in demand for U.S. exports.
- Strong dollar
  - Foreign currency buys fewer U.S. goods.
  - Decrease in demand for U.S. exports.

Hedging Against Foreign Currency

Hedge: protect against exchange rate movements.

Forward contract: an exchange of currencies that will occur at a specified change rate at a future point in time.

Forward rate: exchange rate that the bank would be willing to offer at a future point in time.

Spot exchange rate: exchange rate quoted for immediate transactions.