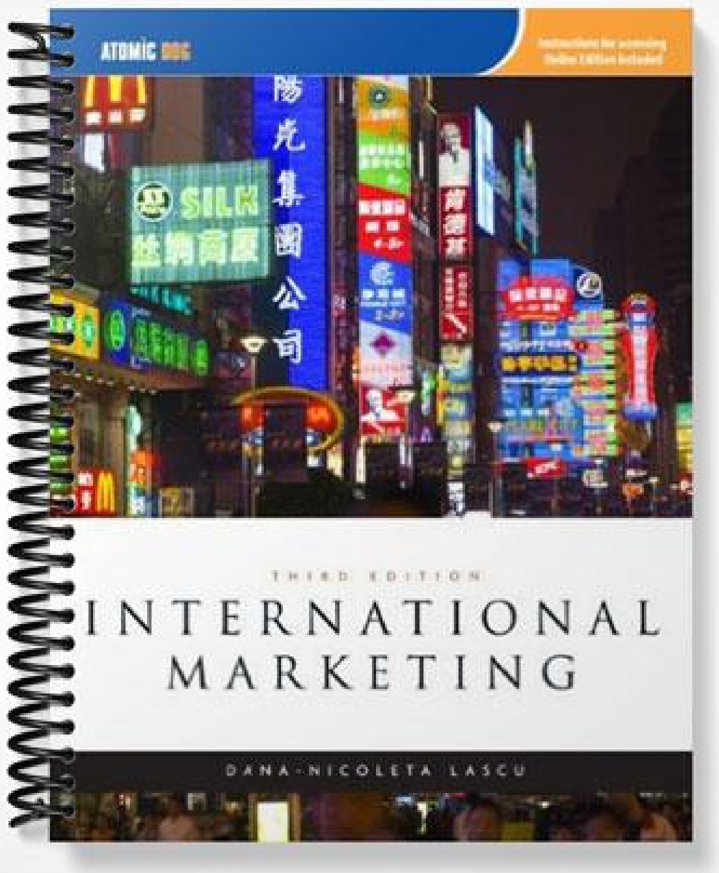
SOLUTIONS MANUAL



CHAPTER 2

An Overview of the International Marketing Environment

LEARNING OBJECTIVES

After studying this chapter students should be able to:

- Provide an overview of the world economic environment and examine different perspectives on economic development.
- Address differences between countries of different levels of economic development and discuss the importance of emerging markets.
- Examine the indicators of political risk and address international firm approaches to political risk management.
- Describe how international law, home-country law, and host-country law affect international firm operations and how to address issues related to jurisdiction.
- Discuss different legal systems, intellectual property laws, and national laws with extra-territorial impact that affect international firms.
- Examine the natural and technological environments and the potential limitations they present to international firms.

CHAPTER SPOTLIGHTS

- The Economic Environment of International Marketing: Interdependence is becoming the leading principle of globalization.
- Perspectives on Economic Development: The primary Western model of economic development is the Rostow model, which describes economic development as a function of productivity, economic exchange, technological improvements, and income. Alternative models offer different perspectives on economic development – for example, Marxist-Leninism depicts development as a class struggle culminating with a political and economic revolution and subsequent advancement.
- Levels of Economic Development: Countries are categorized into three distinct economic development categories, according to the World Bank: high-income countries, middle-income countries (many of which are countries with emerging markets), and low-income countries.
- Political Environment of International Marketing: Companies involved in international operations must have extensive knowledge of the international political environment. Firms must consider the stability of government policies, the existence of anti-foreigner sentiment, along with political risk signals such as poor economic performance and political repression. Political risks might include risks related to government trade policies, such as confiscation and expropriation, risks related to labor/action groups, and risks related to terrorism.

- International Legal Environment: International marketing is affected by international laws imposed by international and supranational bodies; host-country laws; and home-country laws - U.S. firms are affected by antitrust and corruption laws, in particular. Three legal systems are predominant worldwide: common law, code law, and Islamic law. With many different legal systems and overlapping jurisdiction, it is important to agree upon commonly acceptable venues for resolving international legal disputes. High on the priority of international firms is the protection of intellectual property rights.

CHAPTER OVERVIEW

This chapter provides an overview of the world economic environment and addresses different views on economic development. The chapter introduces two models of economic development and addresses differences between countries of different levels of economic development, discussing the importance of big emerging markets to regional economic development. Indicators of political risk and international firm approaches to political risk management are examined. The chapter also examines the effect of international law, home-country law, and host-country law on international firm operations. Finally, the chapter offers an overview of different legal systems, intellectual property laws, and national laws that affect the international firm.

CHAPTER OUTLINE

2-1 Economic Environment of International Marketing.
The economic, political, legal, natural, and technological environments pose many challenges to the international marketing operations of firms, but they also offer many opportunities for growth and return on investment.

2-1a The World Economy
Globalization has led to a unified international economy and leading companies cannot afford to have a local, home-country focus, as the market share game is played increasingly on a world scale. Top 100 multinationals control 20 percent of all foreign assets, employ 6 million workers, and account for 7 percent of total world economic activity.

2-1b The Economic Development Disparity: There is an economic development disparity between high-income, industrialized and low-income, developing countries, with firms from the former dominating the world economy.

2-2 Perspectives on Economic Development
Two leading models of economic development are introduced here: a Western model, Rostow’s, and the Marxist-Leninist development model, which still constitutes a dominant development philosophy in developing countries.

2-2a The Rostow Modernization Model

According to this Western development model, each stage of economic development is a function of productivity, economic exchange, technological improvements, and income. Modernization stages are:

1) Traditional society: Economy dominated by agriculture, minimal productivity and low growth in per capita output.
2) Transitional society: Increased productivity in agriculture; manufacturing begins to emerge.
3) Take-off: Growth becomes the norm, income rises, leading sectors emerge.
4) Drive to maturity: Modern technology is applied in all spectrums of the economy.
5) High mass consumption: Leading sectors shift toward durable goods; increased allocation to social welfare programs.

2-2b Alternative Models of Economic Development

Alternative models of economic development are embraced by developing nations seeking to avoid domination by industrialized countries. The Marxist-Leninist Model addresses economic advancement is a function of the control of means of production, of production outcomes, of resource allocation, and the development of a non-materialistic mindset. The stages of development are the following:

1) Primitive society, characterized by the joint tribal ownership of primitive means of production centered on agricultural tasks.
2) Slavery-based society, characterized by dominant tribes claiming ownership of conquered tribes and their property.
3) Feudal society, characterized by the dominance of feudal lords, who own the land and its dwellers.
4) Capitalism, characterized, in its early stages, by an emerging bourgeoisie, the shift of production from the agrarian sector to the industrial sector, and, in its later stages, by imperialism, where capital loses its national identity by crossing borders and establishing monopolies.
5) Socialism, characterized by the disappearance of private property and its replacement with collective, state property.
6) Communism, characterized by state and cooperative ownership of all means of production and property.

2-3 Levels of Economic Development:

There are three categories of countries based on the categorization used by the World Bank:

1) High-income countries—highly industrialized countries with well-developed industrial and service sectors, with a GNI per capita of US$10,726 or more.
2) Middle-income countries—countries with emerging markets that are both developing rapidly and have great potential, with a GNI per capita of US$875 to US$10,725.

3) Low-income countries—countries that are primarily agrarian, have low per capita income, and a GNI per capita of less than US$875.

2-3a The Importance of Emerging Markets

Emerging markets are attractive to multinational firms because of their high rate of economic growth. Big Emerging Markets are countries that share all the traits of emerging markets but also are large, populated, and able to set a high development pace for the entire regional economy.

2-4 Political Environment of International Marketing

At the basis of international law lies the concept of sovereignty – the country's self-determination and independence from external interference in internal affairs and complete authority over all nationals living in the country and beyond its borders (individuals and corporations). All countries in the world are sovereign, and yet all must curtail their sovereignty to coexist in the world of nations and defend their national interests. By permitting international trade and by entering into international agreements, countries limit their sovereignty.

2-4a Political Risk

A company can evaluate the political risk of a potential market using governmental and non-governmental sources. Political risk signals that should be monitored include economic and general business performance, political and general repression, and internal diversity and incongruent interests. Political stability is important for success of an international firm. Political turmoil can instantly affect firm stability and profit margins.

2-4b Nationalism

The expression of nationalist sentiment in the country where the company is operating can harm the company and lead to the erection of barriers to international trade.

2-4c Political Risks and Risk Management in International Marketing:

There are a number of risks that a company can experience in an international market:

- Risks related to government trade policies: the host country can erect trade barriers, imposing tariffs and non-tariff restrictions on international business.
- Risks related to government economic policy: local governments may use taxes as a means to control foreign investment.
- Confiscation: seizing of company assets without any compensation.
- Expropriation: taking of company assets with some reimbursement for the loss, but not at market value.
- Creeping Expropriation: different government actions that discourage foreign investment require retrenchment on the part of international firms operating in the respective country.

- Nationalization: takeover by the local government with the aim of creating a government-run industry.
- Domestication: the requirement of local government to gradually transfer ownership and management to locals.
- Risks related to labor and action groups: boycotts and other legal but not government-sanctioned actions that can negatively influence international firms.
- Risks related to terrorism: international terrorist attacks against multinational interests.

2-5 International Legal Environment

International firms are affected by three bodies of law: international, host-country, and home-country laws, and must adhere to all three.

2-5a Legal Systems:

1) Common Law: based on prior court rulings (legal precedent); used by many of the former Great Britain colonies

2) Code (Civil) Law: comprehensive written laws that specify what constitutes legal behavior; used by most countries.

3) Islamic Law: system of law based on the interpretation of the Koran, Islam's holy book, and the practices and sayings of the prophet Muhammad, establishing rules for business practices that can affect firm operations; used in North Africa and the Middle East.

2-5b Jurisdiction in international legal disputes is important but can be difficult to establish and thus should be specified in the contract. Procedures other than litigation should be used, such as mediation (non-binding procedure involving an independent third party) and arbitration (involves independent third party but is a binding decision).

2-5c Intellectual Property Rights Protection

The violation of intellectual property is the most significant threat to the competitiveness of the company. Protection can take several forms:

- Protection of the patent, or the right of the inventor or of the firm employing the inventor to use and sell the invention for a specified period of time.
- Protection of the copyright, or the rights to an original work of art, allowing the owner the right to reproduce, sell, perform, or film the work.
- Protection of the trademark, or the brand name, mark, symbol, motto, or slogan that identifies a particular manufacturer's brand.
- Protection of the know-how, formulas, and special blends that are not protected by law, known as trade secrets.

Intellectual property rights violations are influenced my market factors, such as lack of appropriate legislation, lax enforcement, or unavailability of the authentic products, and by cultural factors – for example, by values that perceive imitation as a form of flattery, cultures characterized by interpersonal distrust, cultures emphasizing material wealth at the expense of others, belief that technology is in the common domain.

2-5d Home-Country Legislation Affecting Multinational Firms Operating Overseas
U.S. laws affect companies operating overseas. Two types of laws in particular affect operations and company competitiveness:

- Antitrust Laws: laws designed to prevent domestic anti-trust competitive activities such as the creation of monopolies.
- Corruption Laws: laws designed to prevent multinational corporations from using unethical means to obtain competitive advantage in a particular market, such as the U.S. Foreign Corrupt Practices Act.

2-6 The Natural Environment of International Marketing
The natural environment of international marketing addresses the relationship between natural resources worldwide and marketing. A country's geographic location determines access to its market, its climate determines production and productivity capability, and geography facilitates or impedes trade.

2-6a Geology and the Shortage of Natural Resources
A country's access to natural resources determines whether the country can be a viable trade partner in the international market. Its geology determines the natural resources available in the country and its potential for prosperity. There is a shortage of raw materials worldwide and prices are rapidly increasing.

2-6b Topography and Access to Markets
Topography determines access to the market and affects distribution decisions.

2-6c Hydrology and Economic Development
Hydrology determines access to markets: ocean access allows for the affordable shipping of goods to target markets. And hydroelectric power is essential to economic development.

2-6d Climate
Climate also contributes to economic development. Arid lands are inhabitable only at high cost. Excessive rain leads to flooding and the destruction of the infrastructure.

2-6e Population
Population growth is especially problematic today, in light of the scarcity of natural resources. The population growth rate is highest for the developing countries of South Asia and Sub-Saharan Africa.

2-6f Environmental Quality

Concerns about the effects of population growth and industry on the natural environment have led to the active regulation of business, especially in industrialized countries.

2-7 The Technological Environment

The technological environment is changing rapidly, with new product development proceeding at fast pace and thousands of patents and trademarks registered worldwide on a daily basis. Technology has greatly changed international marketing.

KEY TERMS:

Antitrust Laws: Laws designed to prevent domestic anticompetitive activities, such as the creation of monopolies and cartels.

Arbitration: Binding procedure for conflict resolution involving an independent third party; a faster and less costly procedure than a lawsuit.

Big Emerging Markets: Large markets characterized by rapid economic development and high potential; big emerging markets set the pace for the economy in their geographic region.

Bourgeoisie: A dominant social class, which, according to Marxist-Leninst theory, establishes lucrative means of production and achieves high productivity at the expense of exploited workers.

Capitalism: A stage of economic and political development, which, according to Marxist-Leninist theory, is characterized, in its early stages, by an emerging bourgeoisie, the shift of production from the agrarian sector to the industrial sector, and, in its later stages, by imperialism, where capital loses its national identity by crossing borders and establishing monopolies.

Code Law: Comprehensive written laws that specify what constitutes legal behavior.

Common Law: Laws that are based on prior court rulings (legal precedent).

Communism: A stage in economic and political development, which, according to Marxist-Leninist theory, is characterized by state and cooperative ownership of all means of production and property.

Confiscation: The foreign government seizure of company assets and investors' assets without any compensation.

Copyright: The rights to an original work of art (literature, music, film, design, and other works), enabling the owner to reproduce, sell, perform, or film the work.

Corruption Laws: Laws designed to prevent multinational corporations from using unethical means to obtain competitive advantage in a particular market.

Creeping Expropriation: A situation characterized by bureaucratic red tape and corruption, an unreliable judicial system, and shifting regulations, where foreign government actions discourage foreign investment, especially investment in nonessential sectors.

Domestication: The process initiated by a foreign government leading to the gradual transfer of ownership and management to locals.

Drive-to-Maturity Stage: A stage in economic development, described by Rostow, as characterized by the technological and entrepreneurial skill to produce anything society chooses to produce.

Emerging Markets (also middle-income countries): Countries that are both developing rapidly and have great economic potential.

Expropriation: The foreign government seizure of company assets with partial reimbursement, usually not at market value.

Feudalism: A stage in economic and political development, which, according to Marxist-Leninist theory, is characterized by the dominance of feudal lords, who own the land and its dwellers.

Foreign Corrupt Practices Act: Legislation that makes it illegal for companies and their representatives to bribe government officials and other politicians or candidates to political office, either directly or through third parties.

High Mass Consumption: A stage in economic development, described by Rostow as characterized by leading sectors shift toward durable goods.

Home-Country Laws: Laws of the company's home country. Home-country laws follow the company all over the world.

Host-Country Laws: Local laws of the different countries where the company operates.

Imperialism: A stage of economic and political development, in which, according to Marxist-Leninist theory, capital loses its national identity by crossing borders.

Intellectual Property Rights: Laws protecting the rights of the inventor or of the firm employing the inventor to use and sell an invention for a specified period of time.

International Laws: Rules and regulations that countries agree to abide by, addressing agreements among countries with regard to trade, protection of property, and other issues in the political and economic sphere.

Islamic Law: A system of law based on the interpretation of the Koran, Islam's holy book, and on interpretations of the practices and sayings of the prophet Muhammad

Jurisdiction: The country and legal body where a particular dispute should be adjudicated, according to the country's law, or according to the legal body's principles, respectively.

Marxist-Leninist Development Model: A development model attributed to Karl Marx and Vladimir Lenin that maps the development of society from an agrarian, traditional society to a society characterized by shared ownership of the means and outcomes of production and an equitable resource allocation; advancement from one stage to another is based on class struggle and transfer of ownership from one class to another and, ultimately, to the state.

Mediation: Nonbinding procedure for conflict resolution involving an independent third party.

Monopolistic Capitalism: A stage of economic and political development, in which, according to Marxist-Leninist theory, multinational companies establish monopolies and expand internationally with
the goal of subjugating developing countries.

Nationalism: An expression of fierce nationalist sentiment in a country where a company is operating, which poses an implicit threat to the company and its operations.

Nationalization: The takeover of company assets by a foreign government with the aim of creating a government-run industry.

Overseas Private Investment Corporation: U.S. government corporation that provides loans, guarantees and insurance to U.S. corporations investing in countries that present high political risk.

Patent: Protection of the rights of the inventor or of the firm employing the inventor to use and sell the invention for a specified period of time.

Political Risk: The risk associated with actions of local, regional, and/or parastatal governing bodies affecting the international company, and with the overall economic and political stability within a particular country.

Primitive Society: The first stage of economic and political development, characterized, according to Marxist-Leninist theory, by the joint tribal ownership of the means of primitive means of production centered on agricultural tasks.

Rostow Modernization Model: An economic development model attributed to Rostow, according to which each stage of economic advance is a function of productivity, economic exchange, technological improvements, and income.

Slavery-Based Society: A stage of economic and political development, which, according to Marxist-Leninist theory, emerges as a result of tribes' dominance over other tribes: Dominant tribes claim ownership of conquered tribes and their property.

Socialism: A transition stage of economic and political development, characterized, according to Marxist-Leninist theory, by the disappearance of private property and its replacement with collective, state property.

Take-off: A stage in economic development described by Rostow as one in which economic growth becomes the norm and improvements in production lead to the emergence of leading sectors.

Trade Secrets: Intellectual property such as know-how, formulas, special blends, and other elements that are not registered, and are thus not protected by law.

Trademark: A brand name, mark, symbol, motto, or slogan that identifies a particular manufacturer's brand and distinguishes it from the competitors' brands in the same product category.

Trade-Related Aspects of Intellectual Property Rights: An international agreement under the World Trade Organization, that sets out minimum standards for the legal protection of intellectual property.

Traditional Society: A stage in economic development defined by Rostow as one in which the economy is dominated by agriculture and relatively few exchange transactions occur.

Transitional Society: A stage in the economic development process described by Rostow as characterized by increased productivity in agriculture and by the emergence of modern manufacturing.

DISCUSSION QUESTIONS:

1. Compare the Rostow and the Marxist-Leninist models of economic development. How do you explain the two models in light of developments over the past decade in Central and Eastern Europe? Why do developing countries continue to embrace the Marxist-Leninist model of economic development?

Both models agree on the first stage in any economic development--that of the traditional (Rostow) or the primitive (Marxist-Leninist) society stage. During this stage, the economic structure is dominated by agriculture, and there are no class distinctions. However, after this initial stage, the theories begin to differ.

Rostow sees the later developments as a sequence of economic advances, driven by increased productivity, increased economic exchange, technological improvements, and increase in the average income. Economic development is needed to proceed to the next stage in a step-by-step constant growth. The final stage, according to Rostow, is that of high mass consumption, where the masses can satisfy their secondary needs, and where per capita income is at its maximum.

Marxist-Leninist model, on the other hand, sees economic development as a class struggle that leads to a revolution needed for advancement to the next stage. The capitalist society, divided into the rise of the bourgeoisie and multinational imperialism, creates oppression of the working class, the proletariat on the national level, and the exploitation of developing countries on the international level. The next stage is socialism, which is a transition stage characterized by the disappearance of private property. Communism is the final stage of economic development, and the never-achieved ideal. During this stage, all means of production and private property are under state ownerships. There is thus no materialism in the society, and no oppression of any classes.

The two models are comparable up to a point. The final stage of the Rostow model is parallel to the capitalist stage of the Marxist-Leninist model. The latter, however, has a progression beyond capitalism to imperialism, where capital monopolies take over the world, followed by a revolution that brings about state ownership, under socialism. The last stage, not yet achieved by any country is communism, a Utopia of sorts where all are equal and working to build a bright communist future.

The countries that formed the Soviet Bloc used to adhere to the Marxist-Leninist model, and were at the socialist stage of development at the point where communism collapsed.

2. Describe indicators of political risk. Examine current events and identify some of the political risks that multinational companies face in the world today.

Political risk can be defined as the risk associated with actions of local or regional governing bodies affecting the international company or the overall economic and political stability within a country. There are several country risk elements that a firm should monitor on a regular basis before and during its international involvement in a host country. The first political risk indicator is economic performance, both general economic performance and business performance (such as commercial payment terms and defaults on loans). Another important risk indicator is political repression – whether a general repression by the elite or a repression of ethnic groups, which signal potential political instability. Internal diversity and incongruent interests should also be closely monitored, as they can lead to conflict. Finally, the firm should watch the host country's political stability in general along with the stability of government policies. Any signs of instability, be it change in the ruling party or separatist movements, can spell trouble for companies operating in the country.

3. Discuss two home-country laws that affect U.S. businesses operating internationally.

Antitrust laws, designed to prevent anticompetitive activities such as the creation of monopolies, are imposed on U.S. firms operating abroad.

Corruption laws, designed to stop multinational corporations from using unethical means to obtain competitive advantage in a particular market, follow U.S. firms all over the world. The U.S. Foreign Corrupt Practices Act makes it illegal for companies and their representatives to bribe government officials and other politicians or candidates to the political office. This Act also prohibits payment to third parties when the company has good reason to assume that part of that payment is being used as a bribe. However, in some countries where bribery is the normal way of getting things done, this law can put U.S. firms at a competitive disadvantage.

4. What are some examples of violations of international property rights? Give some examples of counterfeiting.

Intellectual property rights are laws that protect the rights of the inventor or the firm employing the inventor to use and sell an invention for a specified period of time. This protection can come under the form of a patent (if the invention is an intellectual property). Copyright forbids unauthorized use of an invention that is an original work of art, such as music, film, or literature. An example of this type of violation would be downloading music from the Internet without the consent of the musician. A trademark protects the use of a brand name, mark, symbol, or slogan that identifies a particular brand. Counterfeiting, or violating trademark property rights, is the direct copying the product and selling it for a cheaper price. Making a fake Rolex and then selling it for 30 dollars as the real thing is counterfeiting. Finally, trade secret protection is used to keep control of formulas, special blends, and know-how.

REVIEW QUESTIONS:

True/False

1. True
2. True
3. False
4. True
5. False
6. False
7. True

Multiple Choice

1. D
2. A
3. C
4. A
5. B

CASE 2-1

Munich Re—Terrorism-Related Risk Management and Ecological Issues

1. Address the political risk signals that bring about terrorist actions. How can companies reduce their likelihood of becoming victims of terrorism?

Among political risk signals that brought about terrorist actions, including the September 11, 2001, events, are, in particular, the anti-American rhetoric in developing countries, and the perception that the gap between the haves and haves not in the world is rapidly increasing (true, especially with the technology boom of the late 1990's). The international company could reduce its risk of terror attacks by engaging in some of the following:

- Companies should create positive relationships with local communities where they operate, rendering themselves indispensable.
- Companies should be modest and not make enemies.
- Companies should always monitor their environment and assess their actions.
- Companies should not associate themselves too closely with one regime and ignore other local and regional opposition leaders.

2. Address the changes to each element of the marketing mix at Munich Re as a result of the September 11 terrorist attacks.

Product:

- in short-run, terror insurance was eliminated from the company's portfolio

- companies dealing with Munich Re were required to be more transparent and document all risks involved.

Price:
- price of the aviation insurance went up by 80%
- price for property insurance went up by 20 – 40%

Promotion:
- increased communication through Web site
- shared more information and communicated more often with customers and other stake holders

3. How is Munich Re an innovator when it comes to the coverage of environmental risk?

Munich Re is taking a proactive stance when it comes to the coverage of environmental risk. For environmental damage, Munich Re requires risk assessment, underwriting, and damage remediation to be performed only by experienced scientists, engineers and specialist underwriters to ensure that the company remains profitable in the environmental sector.