SECTION 8. INTERNATIONAL ECONOMIC RELATIONS

8.1 International corporations as a strong force for economic globalization

Economic globalization refers to increasing economic interdependence of national economies across the world through a rapid increase in cross-border movement of goods, services, technology and capital. International corporations play a key role in this process.

The global economy has become more competitive as companies of all sizes seek to expand beyond domestic borders. The Internet and information technology are among factors that have made it possible for corporations to venture into foreign markets. Before making an international move, though, it is helpful to understand common reasons why corporations enter the international business arena [337, c. 2].

1. *New markets.* A saturated domestic industry leaves few opportunities for companies to snap up clients. This drives them to look abroad for new customers and markets. Finding another country where demand for corporate product is higher is a far superior option to simply waiting out the slump in sales. For example, developing countries can provide an ample opportunity for new revenue sources. Discovering resources or creating partnership opportunities may also contribute to corporation's ability to tap into overseas consumer markets. The corporation can quickly establish a strong foreign presence if it has a first-mover advantage.

2. *Geographic advantage.* Some companies expand internationally to develop synergies in resources and strengths that multiply the value of expansion. Access to new talent pools is a common motive. For instance, some U.S. companies have expanded into Asian markets to leverage the technological expertise of local populations, boosting their own capabilities while expanding their client bases. Distribution efficiency can also be enhanced by establishing effective global systems. This is especially true for companies that source supplies on a global basis.

3. *Risk diversification.* Operating in multiple countries offers greater insulation from economic downturns in one or two locations. A company doing business in the

U.S., Asia and Africa may not suffer as much from a U.S. economic slump if it's offset by better conditions in its other locations. In this example, the company can use revenue gained in other markets to sustain and develop its U.S. business.

4. *Competitive parity*. "Everyone is doing it" is a simple but real motive for many companies that go global. If the corporation's competitors enter foreign markets, it seems logical that this business should do so as well, conditions permitting. If the corporation has a competitive rivalry in the U.S., its competitor could gain increased brand exposure and recognition by entering markets where this corporation doesn't have the presence. By following along or entering before competitors, the corporation maintains parity in activities and exposure.

5. *Creating an economy of scale*. To put it simply, expanding will enable corporation to produce more units. The more units a corporation produces the lower its' per unit costs. This can increase its profit margins, but the corporation can only get the best of this through selling to more customers, which can only come through expanding to more countries. Such approach helps corporations to maximize on production and sales while effectively minimizing on the average costs.

6. *The gig economy*. The gig economy is one of the reasons why corporations go global. The Internet has opened the door for companies to trade all over the world. Previously, it was too expensive to do this. Now, you don't even need to have a physical presence in the country in order to do business. You can be an international company from the comfort of your own home. Many companies are now hiring teams they will never meet in person. The freelance economy can help a corporation to get projects done without the need to have employees in the same room as corporation's CEO. It's also cheaper than employing a full-time employer to do the same job. You can easily manage a global empire without visiting the places you are actually doing business in. Solid Wi-Fi connections and software options like Skype allow you to stay connected at all times. Expensive business travel is a thing of the past.

7. *Cultures are homogenizing*. Again, this is the work of the Internet. Cultures are becoming more and more similar as Western influences are allowed to permeate. Think back to the state of the former Soviet Union. Thirty years ago it would be

impossible for a Western company to appeal to this audience because they had little exposure to the West. Today they dress the same as the West and they love the same stuff as the West. The corporation's audience has increased without it having to do a thing.

8. *Become a trusted brand.* The fact of moving internationally will increase corporate prestige as a brand. It will increase corporate overall reach because customers are going to look at an international brand and assume they can be trusted. Expanding globally significantly increases the status quo of a given company and grows its prestige among competitors and further to its consumers as a worldwide trusted brand.

9. *Cost-saving reasons.* Sometimes it's just a matter of cost. It's cheaper to do business abroad because a corporation can reduce production costs and pay employees in more affordable countries less. There's a reason why Apple outsources the bulk of its iPhone production to Asia. Very often corporations are searching for tax preferences allowing to reduce costs. Tax preferences are a gold mine for major global companies. It's a chance to save most of corporate profits for stakeholders, but this can only happen by expanding internationally.

Let's dwell on domestic market explanation of global corporate expansion. In this case five situations are possible [339]:

1. Domestic markets are saturated and there is pressure to raise sales and profits. When a given product exists in too much surplus in a country, companies opt to find new markets where the product demand is higher. This helps the firms grow favorably the market base as opposed to sticking at the home country where the surplus is too high. Most corporations have very ambitious sales and profit targets. If such figures have to be realized, companies have to move out of their domestic markets.

2. Domestic markets are small. Companies which have ambitions to become big will have to look for bigger markets outside their boundaries.

3. Domestic markets are growing slowly. Most companies are no longer content to grow incrementally. If such companies have to achieve high growth rates, they have to obtain some of their sales from international markets.

4. Domestic market competition. Even if a company decides to concentrate on its domestic market, it will not be allowed to pursue its goals unhindered. Multinational companies will enter its market and make a dent in its market share and profit. The company has no choice but to enter foreign markets to maintain its market share and growth. Only a company which is internationally competitive can protect its domestic market. No market is or will be protected from incursion by multinational companies. A company's only choice is to go global, even if its prime interest is to protect its domestic turf.

5. High-cost domestic markets. The cost of doing business in certain markets is more favorable compared to other given markets, as such companies opt to expand globally and operate in the given tax heavens or regions with more friendly tax rates, or where the cost of doing business is favorably lower.

If the management of a corporation is thinking about going global, it should follow the step-to-step procedure which is as follows [340]:

1. At the first stage (market entry), companies tend to enter new countries using business models that are very similar to the ones they deploy in their home markets. To gain access to local customers, however, they often need to establish a production presence, either because of the nature of their businesses (as in service industries like food retail or banking) or because of local countries' regulatory restrictions (as in the auto industry).

2. At the second stage (product specialization), companies transfer the full production process of a particular product to a single low-cost location and export the goods to various consumer markets. Under this scenario, different locations begin to specialize in different products or components and trade in finished goods.

3. The third stage (value chain disaggregation) represents the next step in the company's globalization of the supply-chain infrastructure. At this stage, companies start to disaggregate the production process and focus each activity in the most advantageous location. Individual components of a single product might be manufactured in several different locations and assembled into final products

elsewhere. Examples include the PC industry market and the decision by companies to offshore some of their business processes and information technology services.

4. At the fourth stage (value chain reengineering), companies seek further increase of their cost savings by reengineering their processes to suit local market conditions, notably by substituting capital for lower-cost labor. General Electric's (GE) medical equipment division, for example, has tailored its manufacturing processes abroad to take advantage of low labor costs. The company only uses a more labor-intensive production processes, but also designs and manufactures the capital equipment for its plants locally.

5. Finally, at the fifth stage (the creation of new markets), the focus is on market expansion. The McKinsey Global Institute estimates that the third and fourth stages together have the potential to reduce costs by more than 50 % in many industries, which gives companies the opportunity to substantially lower their sticker prices in both old and new markets and to expand demand. The value of new revenues generated at this last stage is often greater than the value of cost savings at the other stages.

It should be noted that the five stages described above do not define a rigid sequence that all industries follow. As the McKinsey study notes, companies can skip or combine steps. For example, in consumer electronics, product specialization and value chain disaggregation (the second and third stages) occurred together as different locations started to specialize in producing different components (Taiwanese manufacturers focused on semiconductors, while Chinese companies focused on computer keyboards and other components).

Another approach for successful global expansion includes the following stages [341]:

1. *Aspirational stage*. This stage is marked by the aim, ambition and desire to expand globally. The corporation is ready to respond to the global challenges. This stage is characterized mainly by the following successful factors as efficient investing and well-educated human resources. This is the stage where rational approach is used to see the risk worth taking as the global market is competitive.

2. *Procedural stage*. The management has to apply the knowledge acquired at the initial stage. The international research has to be conducted to reveal market conditions and customer preferences. The management has to learn “the rules of the game”, develop technical knowledge and legislation knowledge, and to have adaptive learning to operate successfully. It is important to understand different legislative practices and different market characteristics. The first successful factor to be taken into account is conducting a research. The first step in the research is choosing an initial (target) market. Then, it is necessary to decide on such essential criterion as tax breaks. This helps to identify cost manufacturing opportunity and eliminate poor market opportunities. The research can be conducted by attending expert seminars and workshops as a mean to gain expertise in comprehensive information about target country, its market and consumers. The second step is choosing distribution channel. This can be done by hiring a sales representative who, preferably, has to be a native, well-educated, with good interpersonal skills, able to support business organizationally and technically, be personally acquainted with the prospective distributor and be able to evaluate cultural differences. The third step is a selection of financial arrangements. The best way to do business with an overseas buyer is a letter of credit as it keeps all transactions and eliminates worries about payment.

3. *Behavioral stage*. This stage is marked by awareness of new conditions in which the corporation operates. The sensitivity to environmental demands, cultural appreciation and the empathy are required when exploring a new market. At this stage, the corporation has to have better understanding the people and culture in order to create better business relationships. Companies tend to operate mainly in countries which language is similar to the owners of organization, because language similarity leads to a more thorough understanding and helps to avoid misunderstanding.

4. *Conceptual stage*. The management has to do a valuation of international business from its experience and observations. An attitude, believes, judgments, opinions, views and ways of thinking have to be included into such an assessment. Therefore, multiple logics have to be applied in order to become a top large company.

International corporations, MNCs in particular, can contribute to economic development in different ways. When a multinational invests in a host country, the scale of the investment (given the size of the firms) is likely to be significant. Indeed governments often offer incentives to firms in the form of grants, subsidies and tax breaks to attract investment into their countries. These foreign direct investments (FDI) have advantages and disadvantages for the host country.

The possible benefits of a multinational investing in a host country may include [342]:

1. Improving the balance of payments – inward investments will usually help a country's balance of payments situation. The investment itself will be a direct flow of capital into the country and the investment is also likely to result in import substitution and export promotion. Export promotion comes due to the multinational using their production facility as a basis for exporting, while import substitution means that products previously imported may now be bought domestically.

2. Providing employment – FDI will usually result in employment benefits for the host country as most employees will be locally recruited. These benefits may be relatively greater given that governments will usually try to attract firms to areas where there is relatively high unemployment or a good labor supply.

3. Source of tax revenue – profits of multinationals will be subject to local taxes in most cases, which will provide a valuable source of revenue for the domestic government.

4. Technology transfer – multinationals will bring with them technology and production methods that are probably new to the host country and a lot can therefore be learnt from these techniques. Workers will be trained to use the new technology and production techniques and domestic firms will see the benefits of the new technology. This process is known as technology transfer.

5. Increasing choice – if the multinational manufactures for domestic markets as well as for export, then the local population will gain from a wider choice of goods and services and at a price possibly lower than imported substitutes.

6. National reputation – the presence of one multinational may improve the reputation of the host country and other large corporations may follow suite and locate as well.

7. Source of management experience – the host country's business also gets management expertise from MNCs.

8. Economic liberalization – MNCs break protectionalism, curb local monopolies, create competition among domestic companies and thus enhance their competitiveness.

International corporations contribute to the global economic development significantly. In general, global corporations pay higher wages, increase productivity, are less likely to go out of business, and spur more efficient technological development.