



Course Ball: International Business
 12th Edition
 Chapter 7



<http://create.mcgraw-hill.com>

Copyright 2012 by The McGraw-Hill Companies, Inc. All rights reserved. Printed in the United States of America. Except as permitted under the United States Copyright Act of 1976, no part of this publication may be reproduced or distributed in any form or by any means, or stored in a database or retrieval system, without prior written permission of the publisher.

This McGraw-Hill Create text may include materials submitted to McGraw-Hill for publication by the instructor of this course. The instructor is solely responsible for the editorial content of such materials. Instructors retain copyright of these additional materials.

ISBN-10: 1121537324 ISBN-13: 9781121537323

Contents

1. Economic and Socioeconomic Forces	2
--------------------------------------	---

Credits

1. Economic and Socioeconomic Forces: *Chapter 7 from International Business: The Challenge of Global Competition, 12th Edition by Ball, Geringer, Minor, McNett, 2010* 2

7

Economic and Socioeconomic Forces



There are well over one billion people in seventeen developing nations and three transition nations with enough income to rank as thoroughly middle class. They enjoy a collective spending power, measured in local purchasing capacity, of \$6.3 trillion per year. They could well increase their numbers by half as soon as 2010, and their spending power by still more. This is the biggest consumption boom ever known in such a short time.

—Norman Myers, author of *The New Consumers: The Influence of Affluence on the Environment*

بالهوية
Los negocios internacionales
Internacionales
ارة العالمية
Los negocios

Of Zippies and the China–India Development Race

Newspapers in India refer to young people with good jobs as “zippies”—walking with confidence (zip in their step) and with plenty of money in their pockets. And there are plenty of these relative youngsters—India’s 20- to 34-year-old population is nearly 300 million. They are the young consumerist edge of a population of 1.15 billion and the fourth-largest economy in the world (based on purchasing power parity). The country’s middle-income population is estimated at nearly 600 million people.

But is India or China likely to “hit it rich” first? The current assumption is that China will be rich faster. China has a larger population, at 1.33 billion, as well as a larger economy. China has a higher savings rate. India attracted only 7 percent as much as the more than \$650 billion in foreign direct investment that poured into China from 1990 to 2007. China’s manufacturing productivity is higher: one source says that a Chinese worker makes 35 shirts in the time it takes an Indian to make 20.

China also has more high-net-worth individuals, with approximately 350,000 millionaires versus only 100,000 in India as of the beginning of 2007. China is ranked third in the world in sales of luxury goods, accounting for more than 5 percent of the total world luxury market.

Looking further down the road, however, India has advantages for the long run. Not only do more Indians speak English—one estimate is that 150 million to 200 million Indians are completely fluent in English, and perhaps

20 million speak it as their primary language—but many are watching *Friends* reruns at employer expense to become accentless. Although the numbers are disputed, there may be more Indians in college, producing 2.2 million university graduates annually from its 380 universities and 1,500 research institutes. India’s strength so far has been in services; China is the manufacturing powerhouse. Both countries have become major destinations for the outsourcing of business activities from the United States.

In fact, many observers feel that both India and China will have larger economies than that of the United States by mid-century. ■

Sources: U.S. Census Bureau, *International Data Base*, <http://www.census.gov/ipc/www/idb/> (June 17, 2008); “What’s behind the Overseas Forays of U.S. Online Giants?” Knowledge@Wharton, July 14–27, 2004, knowledge.wharton.upenn.edu/article/1013.cfm (June 17, 2008); Takashi Kitazume, “Young and Tech-Savvy, India’s Market Remains Largely Untapped,” *The Japan Times Online*, September 30, 2006, <http://classified.japantimes.com/ads/kkc/2006/kkc20060930a1.htm> (June 17, 2008); Om Malik, “The New Land of Opportunity,” *Business 2.0*, July 2004, pp. 74–79; Jeffrey D. Sachs, “Welcome to the Asian Century,” *Fortune*, January 2004, pp. 53–54; Anand Krishnamoorthy, “India Eases into the Lap of Luxury,” *International Herald Tribune*, July 28, 2004, p. B4; “India’s Millionaires Over 1 Lakh,” *The Financial Express*, June 28, 2007, http://www.financialexpress.com/old/latest_full_story.php?content_id=168475 (June 17, 2008); “China Has 345,000 Millionaires: Study,” *AFP*, October 17, 2007, <http://afp.google.com/article/ALeqM5ixQIU1GeghWewh1PFb2nZwzEPPg> (June 17, 2008); “Millionaire Boom Favors Banks,” *The Standard*, September 20, 2006, www.thestandard.com.hk/news_detail.asp?pp_cat=22&art_id=27647&sid=9992379&con_type=1 (June 17, 2008).

LEARNING OBJECTIVES

After reading this chapter, you should be able to:

- L01 State** the purpose of economic analyses.
- L02 Identify** different categories based on levels of national economic development and the common characteristics of developing nations.
- L03 Describe** the economic and socioeconomic dimensions of the economy and different indicators used to assess them.
- L04 Discuss** the importance of a nation’s consumption patterns and the significance of purchasing power parity.
- L05 Explain** the degree to which labor costs can vary from country to country.
- L06 Discuss** the significance for businesspeople of the large foreign debts of some nations.
- L07 Discuss** the new definition of economic development, which includes more than economic growth.

Emerging Markets

Economic forces are among the most significant uncontrollable forces for managers. To keep abreast of the latest developments and also to plan for the future, firms for many years have been assessing and forecasting economic conditions at the national and international levels.

To do so, analysts use data published by governments and international organizations such as the World Bank and the International Monetary Fund (IMF). The data published by these organizations may not be as timely or as accurate as business analysts would like, but there is a large amount available.

Analysts do not work solely with government-published data. Private economic consultants—such as Data Resources Inc., Chase Econometric Associates, Business International, the Economist Intelligence Unit, and Wharton Economic Forecasting Associates—provide economic forecasts (some do industry forecasts as well) to which many multinationals subscribe. Other sources are various industry associations, which generally provide industry-specific forecasts to their members.

In addition, economists and marketers use certain economic indicators that predict trends in their industry. We discuss the use of market indicators further in Chapter 14, “Assessing and Analyzing Markets.”

The purpose of economic analyses is first to appraise the overall outlook of the economy and then to assess the impact of economic changes on the firm. An examination of Figure 7.1 will illustrate how a change in just one factor in the economy can affect all the major functions of the company.

A forecast of an increase in employment in a particular market would cause most marketing managers to revise their sales forecasts upward, which in turn would require that production managers augment production. This might be accomplished by adding an additional work shift, but if the plant is already operating 24 hours a day, new machinery will be needed. Either situation may require more workers and raw materials, which will result in an extra workload for the personnel and purchasing managers. Should both the raw materials and labor markets be tight, the firm will probably have to pay higher-than-normal prices and wage rates.

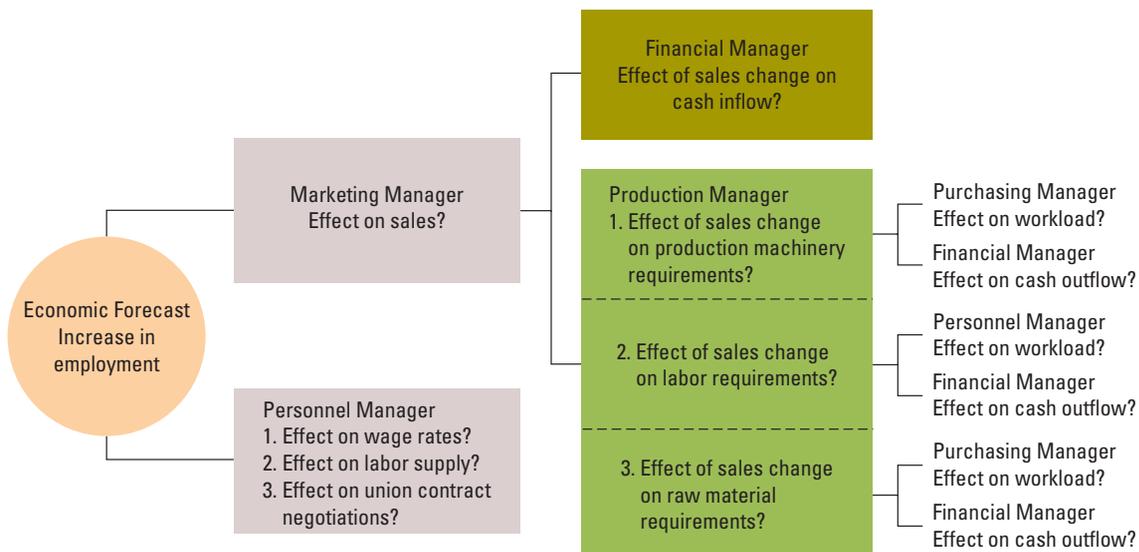
The financial manager may then have to negotiate with the banks for a loan to enable the firm to handle the greater cash outflow until additional revenue is received from increased sales. Note that this cascade of effects occurs because of a change in only one factor. Actually, of course, many economic factors are involved, and their relationships are complex. The object of an economic analysis is to isolate and assess the impact of those factors believed to affect the firm’s operations.

L01

State the purpose of economic analyses.

FIGURE 7.1

Impact of Economic Forecast on Firm’s Functional Areas.



International Economic Analyses

When a firm enters overseas markets, economic analyses become more complex because now managers must operate in two new environments: foreign and international. In the foreign environment, there are many economies instead of one, and they are highly divergent.

Because of these differences, policies designed for economic conditions in one market may be unsuitable for conditions in another market. For example, headquarters may require that its subsidiaries maintain the lowest inventories possible, and the chief financial officer may decree that they make only foreign currency–denominated loans because of more favorable interest rates. For nations whose annual inflation rates are low (0 to 15 percent), these policies usually work well. But what about countries such as Zimbabwe, which saw its inflation rate soar to 138,000 percent in 2008, or more than 370 percent per day?

The least desirable scenario is for the subsidiaries in these countries to have cash or foreign currency–denominated loans, and so the policy for markets with high inflation rates will be just the reverse of what it is for countries with low inflation rates (see Table 7.1). Besides monitoring the foreign environments, analysts must stay informed of the actions taken by components of the international environment, such as regional groupings (European Union, Central American Free Trade Agreement) and international organizations (United Nations, International Monetary Fund, World Trade Organization). American firms are very attentive to the EU's progress in reaching its goals and to the impact this will have on EU–U.S. trade relations. They are also following closely the UN's progress in developing world pollution standards, health standards, and so forth. Any of these actions can seriously affect firms.¹

International economic analyses should provide economic data on both actual and prospective markets. As part of the competitive forces assessment, many companies monitor the economic conditions of nations in which their major competitors are located, because changing conditions may strengthen or weaken their competitors' ability to compete in world markets. Because of the importance of economic information to the control and planning functions at headquarters, the collection of data and the preparation of reports are usually the responsibility of the home office. However, foreign subsidiaries and field representatives are expected to contribute heavily to studies concerning their markets. Data from areas where the firm has no local representation can usually be somewhat less detailed and are generally available from national and international agencies.² The reports from

**Relevance for
Managers**

TABLE 7.1 Annual Rates of Inflation in Consumer Prices for Selected Countries

Country	1995	2000	2008
Angola	2,672%	325%	9%
Congo, Democratic Republic of	542	550	9
Zimbabwe	23	56	138,000
Turkey	94	55	5
Belarus	709	169	10
Georgia	163	4	8
Russia	197	21	8
Turkmenistan	1,005	8	9
Ukraine	376	28	11
Brazil	66	7	4
Ecuador	23	96	2
Uruguay	42	5	7
Myanmar	29	–2	28

Sources: 1995 data from International Monetary Fund, *World Economic Outlook*, October 2000, www.imf.org/external/pubs/ft/weo/2000/02/index.htm (June 17, 2008), 2000 and estimated 2008 data from International Monetary Fund, *World Economic Outlook 2007*, <http://www.imf.org/external/pubs/ft/weo/2007/02/pdf/tblPartA.pdf> (June 17, 2008).

central or international banks are especially good sources for economic information on single countries. Other possible sources are the chambers of commerce located in most of the world's capitals, the commercial officers in embassies, the United Nations, the World Bank, the International Monetary Fund, and the Organisation for Economic Cooperation and Development.

L02

Identify different categories based on levels of national economic development and the common characteristics of developing nations.

developed

A classification for all industrialized nations, which are the most technically developed

developing

A classification for the world's lower-income nations, which are less technically developed

newly industrializing countries (NICs)

The four Asian tigers and the middle-income economies such as Brazil, Mexico, Malaysia, Chile, and Thailand

newly industrialized economies (NIEs)

The fast-growing upper-middle-income and high-income economies of South Korea, Taiwan, Hong Kong, and Singapore

Emerging Markets

Levels of Economic Development

When managers move from domestic to international business, they encounter markets with far greater differences in levels of economic development than those in which they have been working. It is important to understand this because a nation's level of economic development affects all aspects of business, including marketing, production, and finance. Although nations vary greatly with respect to economic development levels, we commonly group them into categories based on their level of economic development.

Developed is the name given to the industrialized, or postindustrial, service-based nations that have achieved high income per capita. Countries classified as being economically developed typically include the western European nations, Japan, Australia, New Zealand, Canada, Israel, South Korea, and the United States. The term **developing** is a classification for the world's lower-income nations, which are less technically developed. Characteristics of developing countries are included in the nearby Worldview box, "Characteristics of Economically Developing and Developed Nations." At one time, **newly industrializing countries (NICs)** was a category that included only the four Asian tigers (Taiwan, Hong Kong, Singapore, and South Korea). These countries (1) had what the World Bank considers to be fast-growing, middle-income, or higher economies; (2) possessed a heavy concentration of foreign investment; and (3) exported large quantities of manufactured goods, including high-tech products. Subsequently, other nations have achieved sufficient progress in their industrialization process to also be classified as NICs by various organizations. Depending on the criteria employed, more recent listings of NICs include some or all of the following countries: Brazil, Mexico, Argentina, Malaysia, Thailand, Chile, Venezuela, Hungary, South Africa, Indonesia, Pakistan, and China.

Because the economies of the four tigers have grown faster than those of other NICs and are approximating the size of developed nations' economies, the IMF and other organizations have begun to use the term **newly industrialized economies (NIEs)** to refer to the tigers.

You will also find that various different classification systems are employed by international agencies such as the United Nations, International Monetary Fund, and World Bank for reporting statistics.* For example, the IMF combines the NIEs with the industrialized nations to form a category termed *advanced economies*.

The rest of the noncommunist nations are in the category *developing countries*, which has a subcategory, *emerging market economies*, that includes Chile, Malaysia, China, Thailand, and Indonesia. The third category, called *transition countries*, includes the former communist countries. The UN uses simply *developed* and *developing economies* and refers to the former communist nations as *eastern Europe* and the *former USSR*. When speaking of developed and developing nations as a bloc, UN economists frequently use the terms *North* and *South*, respectively.

The World Bank, by contrast, uses a classification based on 2006 gross national income per capita:

1. Low income (\$905 or less).
2. Lower middle income (\$906–\$3,595).
3. Upper middle income (\$3,596–\$11,115).
4. High income (\$11,116 or more).³

*These agencies were discussed in Chapter 4.



WORLD view

Characteristics of Economically Developing and Developed Nations

Although there is great diversity among the many developing nations, most share the following common characteristics:

1. GNI/capita of less than \$11,116 (World Bank criterion).
2. Unequal distribution of income, with a very small middle class.
3. *Technological dualism*—a mix of firms employing the latest technology and companies using very primitive methods.
4. *Regional dualism*—high productivity and incomes in some regions and little economic development in others.
5. A majority of the population earning its living in a relatively unproductive agricultural sector.
6. Disguised unemployment or underemployment—two people doing a job that one person could do.
7. High population growth (2.5 to 4 percent annually).
8. High rate of illiteracy and insufficient educational facilities.
9. Widespread malnutrition and a wide range of health problems.
10. Political instability.
11. High dependence on a few products for export, generally agricultural products or minerals.
12. Inhospitable topography, such as deserts, mountains, and tropical forests.
13. Low savings rates and inadequate banking facilities.

While economically developed nations also evidence differences among themselves, most such nations share the following characteristics:

1. Per capita gross national income of \$11,116 or more (World Bank criterion).
2. A high material standard of living, high quality of life index, and a substantial portion of population classified as being middle class.
3. Frequent application of the most advanced production techniques and equipment.
4. A large base of productive capital, sophisticated financial markets and banking systems, and vigorous international trade involving a range of sectors.
5. Agriculture typically has a very small share of total output and the proportion of manufacturing within total output is declining.
6. Well-established governmental and legal systems.
7. Sufficient educational opportunities are provided for the nation's people, with low rates of illiteracy.
8. Relatively low levels of unemployment or underemployment.
9. Low levels of population growth (typically less than 2 percent annually).
10. Adequate or high levels of nutrition and access to health care.

You can see from these different sets of characteristics that a tremendous gap exists between the levels of living of the inhabitants of developing nations and those of developed nations. Although economists have studied and theorized about the various aspects of economic development for more than two centuries, their preoccupation with the poorer nations of the world really began only after World War II. Among the developing nations, the United Nations lists the following as the 50 least developed countries in the world:

Afghanistan	Madagascar
Angola	Malawi
Bangladesh	Maldives
Benin	Mali
Bhutan	Mauritania
Burkina Faso	Mozambique
Burundi	Myanmar
Cambodia	Nepal
Cape Verde	Niger
Central African Republic	Rwanda
Chad	Samoa
Comoros	São Tomé and Príncipe
Democratic Republic of the Congo	Senegal
Djibouti	Sierra Leone
Equatorial Guinea	Solomon Islands
Eritrea	Somalia
Ethiopia	Sudan
Gambia	Timor-Lesté
Guinea	Togo
Guinea-Bissau	Tuvalu
Haiti	Uganda
Kiribati	United Republic of Tanzania
Lao People's Democratic Republic	Vanuatu
Lesotho	Yemen
Liberia	Zambia

Sources: "Country Classification," World Bank, <http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/0,,contentMDK:20420458~menuPK:64133156~pagePK:64133150~piPK:64133175~theSitePK:239419,00.html> (June 17, 2008); "UN List of LDCs After the 2006 Triennial Review," United Nations Conference on Trade and Development, <http://www.unctad.org/Templates/Page.asp?intItemID=3641&lang=1> (June 17, 2008); "Glossary," United Nations, www.un.org/cyberschoolbus/infonation3/menu/advanced.asp (June 17, 2008); and "The World's Economies," www.infoplease.com/cig/economics/world-economies.html (June 17, 2008).

gross national income (GNI)

The total value of all income generated by a nation's residents from international and domestic activity

The World Bank formerly employed a classification system based on gross national product (GNP) per capita, but in 2002 it changed to **gross national income (GNI)** per capita, which follows the current statistical practice of most countries. GNI measures the income generated by a nation's residents from international and domestic activity and is preferred by international organizations to GDP, which measures income generated from domestic activity by residents of the country as well as nonresidents. Every economy is classified as low income, lower middle income, upper middle income, and high income, classes that are based on the World Bank's operational lending categories. The Bank also employs the term *developing countries* to refer to low- and middle-income countries.⁴

Dimensions of the Economy and Their Relevance for International Business

To estimate market potentials as well as to provide input to the other functional areas of the firm, managers require data on the sizes and the rates of change of a number of economic and socioeconomic factors. To be a potential market, an area must have sufficient people with the means to buy a firm's products. Socioeconomic data provide information on the number of people, and the economic dimensions tell us if they have purchasing power.

L03

Describe the economic and socioeconomic dimensions of the economy and different indicators used to assess them.

ECONOMIC DIMENSIONS

Among the more important economic indicators are gross domestic product, gross national income, distribution of income, private consumption expenditures, personal ownership of goods, private investment, unit labor costs, exchange rates, inflation rates, and interest rates.

Gross National Income As mentioned earlier, GNI is a measure of the income generated by a nation's residents from international and domestic activity. Most international organizations prefer GNI to GDP as a measure of economic size, because GDP measures income generated from domestic activity by residents of the country as well as nonresidents. GNIs range from \$13.4 trillion for the United States to \$.1 billion for Kiribati.⁵ What is the relevance of GNI for the international businessperson? Is India, with a GNI of \$909 billion, a more attractive market than Denmark, whose \$283 billion GNI is less than one-third the size? To compare the purchasing power of nations, managers need to know how many people GNI is divided among.

GNI/Capita Employing GNI per capita from the tables of the World Bank to compare purchasing power reveals that Denmark is far richer than India: GNI/capita is \$52,110 in Denmark versus \$820 in India. Although India's economic pie is more than three times as big as Denmark's, there are more than 210 times as many people to eat it.

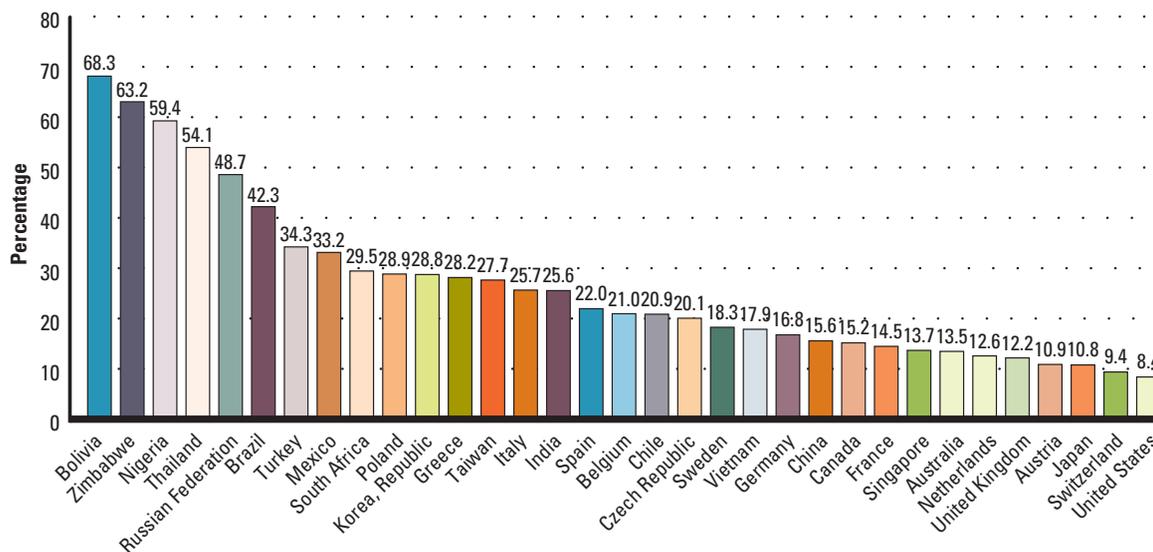
What can we learn from GNI/capita? We can generally assume that the higher its value, the more advanced the economy. Generally, however, the rate of growth is more important to marketers because a high growth rate indicates a fast-growing market—for which they are always searching. Frequently, given the choice between investing in a nation with a higher GNI/capita but a low growth rate and a nation in which the conditions are reversed, management will choose the latter.

Although GNI per capita is widely used to compare countries with respect to the well-being of their citizens and to assess market or investment potential, managers must use it with caution. For example, to arrive at GNI, government economists must impute monetary values to various goods and services not sold in the marketplace, such as food grown for personal consumption. Moreover, many goods and services are bartered in both low-income nations (because people have little cash) and high-income countries (because people wish to reduce reported income and thus pay less income tax). Transactions of this type are said to be part of the *underground economy*.

Relevance for Managers

FIGURE 7.2

Underground Economies in Selected Nations, as a Percentage of Official GDP



Figures are based on 2002–2003.

Source: Friedrich Schneider, “The Size of the Shadow Economies of 145 Countries All Over the World: First Results Over the Period 1999 to 2003” IZA Discussion Paper No. 1431, (December 2004), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=636661 (accessed June 17, 2008).

Underground Economy Much has been written about the part of the national income that is not measured by official statistics because it is either underreported or unreported. Included in this **underground economy** (also referred to as *black*, *parallel*, *informal*, *submerged*, or *shadow economy*) are undeclared legal production, production of illegal goods and services (e.g., illegal drugs, illicit copies of copyrighted music or video, or prostitution), and concealed income in kind (barter). As a general rule, the higher the level of taxation and the more oppressive the government red tape, the bigger the underground economy will be. Figure 7.2 shows estimates of some underground economies. The underground economy in the United States increased from 4 percent of GDP in 1970 to more than 8 percent in 2003. On average for the 2002–2003 time period, it is estimated that the underground economy accounted for 16.3 percent of GDP in OECD countries, 30.8 percent in 27 Asian countries, 40.1 percent of GDP in 25 east and central European and former Soviet Union transition economies, 43.2 in 37 African countries, and 43.4 percent in 21 Central and South American countries.⁶ The underground economy in several nations exceeded 50 percent of GDP, including more than 68 percent in Bolivia and Georgia. Estimates of the underground economy vary widely because of the different methodologies used to compile them; also, people who have undeclared income are not likely to admit it and be liable to prosecution for tax evasion. In addition to reducing the total taxes paid to government, the underground economy can result in distortions of economic data, which managers must take into account when using these data for business decisions.

underground economy

The part of a nation's income that, because of unreporting or underreporting, is not measured by official statistics

Ethical & Social Dilemma

Currency Conversion Another problem with GNI estimates is that to compare them, the GNIs in local currency must be converted to a common currency—conventionally the dollar—by using an exchange rate. If the relative values of the two currencies accurately reflected consumer purchasing power, this conversion would be acceptable. However, the World Bank recognizes that “the use of official exchange rates to convert national currency figures to U.S. dollars does not reflect domestic purchasing powers of currencies.”⁷

purchasing power parity (PPP)

The number of units of a currency required to buy the same amounts of goods and services in the domestic market that one dollar would buy in the United States

To overcome this deficiency, the UN International Comparison Program (ICP) has developed a method of comparing GNIs that is based on **purchasing power parity (PPP)** rather than on the international demand for currency (exchange rates). Here is how purchasing power parity rates are calculated.

Suppose Thailand reports to the World Bank that its GNI/capita for last year is 93,624 baht/capita. The Bank must translate this value to U.S. dollars. If the current exchange rate is 37.6 baht = \$1, then using this rate would convert 93,624 baht to \$2,490 (93,624/37.6). How well does this measure Thailand's welfare? What can a Thai citizen consume with the 93,624 baht compared with what an American can consume with the \$41,440 per capita income of the United States? Suppose that the following table reflects local prices in both countries of the same basket of goods:

Goods	Thailand (baht)	U.S. (\$)
Soap (bar)	40	.50
Rice (pound)	25	.35
Shoes (pair)	495	60.00
Dress	580	450.00
Socks (pair)	95	2.00
Total	1,235	\$107.85

In Thailand 1,235 baht buys what \$107.85 buys in the United States. Therefore, comparing the purchasing power of the currencies, $1,235 \text{ baht}/\$107.85 = 11.45$ baht per \$1. Using the exchange rate of 11.45 baht per dollar, Thailand's GNI/capita is now $93,624/11.45 = \$8,177$. At the official exchange rate of 37.6 baht/\$1, Thailand's GNI is \$2,490. At the purchasing power parity rate of 11.45 baht/\$1, Thailand's GNI is \$8,177.

Table 7.2 illustrates that comparisons based on PPP result in GNI/capita values that are considerably higher than those regularly given for developing nations and lower for many developed nations; that is, in considering purchasing power, the differences between the GNIs of developing and developed nations are smaller than those generally published. You will note how the smaller buying power of the Japanese yen compared to that of the U.S. dollar affects the GNI/capita based on purchasing power parity.

The Atlas Conversion Factor Dissatisfaction with both the PPP and the conversion by using official exchange rates caused the World Bank to adopt the Atlas methodology to derive per capita GNI estimates. The *Atlas conversion factor* is the arithmetic average of the current exchange rate and the exchange rates in the two previous years adjusted by the ratio of domestic inflation to the combined inflation rates of the euro zone, Japan, the United Kingdom, and the United States. Incomes measured by the Atlas conversion factor are generally more stable over time and changes in income rankings are more likely to be due to relative economic performance than fluctuations in the exchange rate.

Although differences in GNI/capita do tell us something about the relative wealth of a nation's inhabitants, the information is somewhat misleading because wealth is usually not evenly spread. This first crude estimate of purchasing power must be refined by incorporating data on how national income is actually distributed.

Income Distribution Data on **income distribution** are gathered by the World Bank from a number of sources and published yearly in the *World Development Indicators* (see Table 7.3). Despite the difficulties associated with income distribution studies, such as inconsistent measuring practices and wide variations in the representativeness of samples, the data provide useful insights for business.


Ethical & Social Dilemma
income distribution

A measure of how a nation's income is apportioned among its people, commonly reported as the percentage of income received by population quintiles

TABLE 7.2 GNI/Capita Based on UN ICP for Selected Countries

Country	GNI/Capita in US\$ Converted at World Bank-Adjusted Exchange Rates	Adjusted Exchange Rates Ranking	GNI/Capita in US\$ Based on Purchasing Power Parity	Purchasing Power Parity Ranking
Luxembourg	\$80,315	1	70,014	1
Qatar	51,809	4		2
Denmark	47,793	7	33,636	16
United States	41,674	8	41,674	6
Sweden	39,621	9	31,995	19
United Kingdom	37,266	11	31,580	20
Japan	35,604	15	30,290	23
Canada	35,133	16	35,078	13
Singapore	26,879	22	41,479	7
Mexico	7,401	46	11,317	54
Russian Federation	5,342	54	11,861	51
Argentina	4,836	61	11,063	55
China	1,721	88	4,091	86
Egypt	1,412	93	5,049	79
Nigeria	868	106	1,892	111
India	707	115	2,126	108

Data are for 2005.

Source: International Bank for Reconstruction and Development/The World Bank, *2005 International Comparison Program: Tables of Final Results* (Washington, D.C.: World Bank, February, 2008), http://siteresources.worldbank.org/ICPINT/Resources/ICP_final-results.pdf (accessed June 17, 2008).

1. They confirm the belief that, generally, income is more evenly distributed in the richer nations, although there are important variations among both developed and developing nations.
2. Comparisons over time demonstrate that income redistribution proceeds very slowly so that older data are still useful.
3. The same comparisons indicate that income inequality increases in the early stages of development, with a reversal of this tendency in the later stages. For example, even as China's economy skyrockets, the number of truly destitute grew by 800,000 to nearly 85 million in 2004.⁸ The fact that the middle quintiles in some nations are growing at the expense of the top and bottom 20 percent signifies an increase in middle-income families, which are especially significant to marketers.

Depending on the type of product and the total population, either situation (relatively even or uneven income distribution) may represent market opportunities. For example, although Costa Rica's GNI was \$43 billion in PPP terms, the fact that just 20 percent of the population receives more than 53 percent of that income indicates that a sizable group of people are potential customers for low-volume, high-priced luxury products. On the other hand, the market is rather small (4.1 million population) for low-priced goods requiring a high sales volume. This simple calculation based on GNI, total population, and income distribution may be all that is required to indicate that a particular country is not a good market; however, if the results look promising, the analyst will proceed to gather data on private consumption.

Private Consumption One area of interest to marketers is the manner in which consumers allocate their disposable income (after-tax personal income) between purchases of essential and nonessential goods. Manufacturers of household durables, for instance, will

L04

Discuss the importance of a nation's consumption patterns and the significance of purchasing power parity.

TABLE 7.3 Percentage Share of Income or Consumption

Country	Lowest 20 Percent	20–40 Percent	40–60 Percent	60–80 Percent	Highest 20 Percent	Highest 10 Percent
Argentina (2004)	3.1%	7.6%	12.8%	21.1%	55.4%	38.2%
Bangladesh (2005)	8.8	12.2	15.6	21.0	42.5	28.0
Bosnia and Herzegovina (2005)	7.0	11.6	15.9	22.3	43.2	27.5
Brazil (2005)	2.9	6.5	11.1	18.7	60.8	44.9
Canada (2000)	7.2	12.7	17.2	23.0	39.9	24.8
Chile (2003)	3.8	7.3	11.1	17.8	60.0	45.0
China (2004)	4.3	8.5	13.7	21.7	51.9	34.9
Colombia (2004)	2.9	6.9	11.0	18.3	60.9	45.0
Costa Rica (2004)	4.1	8.5	13.2	20.9	53.3	36.7
Croatia (2004)	8.8	13.3	17.3	22.7	37.9	23.1
Dominican Republic (2005)	4.1	8.1	12.6	19.9	55.3	39.0
Egypt (2004)	8.9	12.7	16.0	20.8	41.6	27.6
Gambia (2003)	4.8	8.7	13.0	20.7	52.9	36.9
Georgia (2005)	5.4	10.5	15.3	22.2	46.7	30.7
Germany (2000)	8.5	13.7	17.8	23.1	36.9	22.1
Guatemala (2004)	3.9	8.2	13.1	20.6	54.1	38.0
Honduras (2003)	3.4	7.1	11.6	19.6	58.3	42.2
Hungary (2004)	8.6	13.1	17.1	22.3	38.9	24.2
India (2004)	8.1	11.3	14.9	20.4	45.3	31.1
Indonesia (2005)	7.2	10.7	14.4	20.5	47.3	32.3
Iran (2005)	6.5	10.9	15.5	22.1	45.1	29.6
Italy (2000)	6.5	12.0	16.8	22.8	42.0	26.8
Jamaica (2004)	5.3	9.2	13.2	20.6	51.6	35.8
Japan (1993)	10.6	14.2	17.6	22.0	35.7	21.7
Kazakhstan (2003)	7.4	11.9	16.4	22.8	41.5	25.9
Latvia (2004)	6.8	11.7	16.2	22.3	42.9	27.5
Malawi (2004)	7.0	10.9	14.8	20.7	46.6	31.8
Mexico (2004)	4.3	8.3	12.6	19.7	55.1	39.4
Nepal (2003)	6.0	9.0	12.4	18.0	54.6	40.6
Netherlands (1999)	7.6	13.2	17.2	23.3	38.7	22.9
Nigeria (2003)	5.1	9.6	14.5	21.7	49.2	33.2
Norway (2000)	9.6	14.0	17.2	22.0	37.2	23.4
Pakistan (2005)	9.1	12.9	16.1	21.1	40.8	26.5
Peru (2003)	3.7	7.7	12.2	19.7	56.7	40.9
Philippines (2003)	5.4	9.1	13.6	21.3	50.6	34.2
Poland (2005)	7.4	11.7	16.1	22.3	42.5	27.2
Russian Federation (2002)	6.1	10.5	14.9	21.8	46.6	30.6
Senegal (2001)	6.6	10.3	14.2	20.6	48.4	33.4
South Africa (2000)	3.5	6.3	10.0	18.0	62.2	44.8
Sri Lanka (2002)	7.0	10.5	14.2	20.4	48.0	32.7
Sweden (2000)	9.1	14.0	17.6	22.7	36.6	22.2
Thailand (2002)	6.3	9.9	14.0	20.8	49.0	33.4
Ukraine (2005)	9.0	13.5	17.4	22.7	37.4	22.6
United Kingdom (1999)	6.1	11.4	16.0	22.5	44.0	28.5

(continued)

TABLE 7.3 Percentage Share of Income or Consumption (*continued*)

Country	Lowest 20 Percent	20–40 Percent	40–60 Percent	60–80 Percent	Highest 20 Percent	Highest 10 Percent
United States (2000)	5.4	10.7	15.7	22.4	45.8	29.9
Venezuela (2003)	3.3	8.7	13.9	22.0	52.1	35.2
Vietnam (2004)	7.1	11.1	15.1	21.8	44.8	28.9
Zambia (2004)	3.6	7.9	12.6	20.8	55.1	38.8

Note: Numbers in parentheses indicate year of study.

Sources: From *World Development Indicators 2006* by World Bank; *World Development Indicators 2008* by World Bank; and United Nations Statistics Division, “Millennium Development Goals Indicators, <http://millenniumindicators.un.org/unsd/mdg/SeriesDetail.aspx?srld=585> (accessed June 18, 2008).

want to know the amounts spent in that category, whereas producers of nonessentials will be interested in the magnitude of **discretionary income** (disposable income less essential purchases), for this is the money available to be spent on their products. Fortunately, disposable incomes and the amounts spent on essential purchases are available from the *UN Statistical Yearbook*, and discretionary income may be obtained by subtracting the total of these items from disposable income. More detailed expenditure patterns can be found in the *World Development Indicators* published by the World Bank. Data from that publication are reproduced in Table 7.4, which includes data on private consumption expenditures for 10 high-income and 10 low-income economies, using PPP equivalents.

Because PPP-based consumer expenditures eliminate differences in relative prices, marketers use these data to analyze how the composition of consumption changes with the level of development. For example, the percentages of household expenditures spent on food and clothing by residents of developing nations are double the percentages consumers in industrialized nations spend. On the other hand, the percentages spent on (1) transport and communication, (2) consumer durables, (3) health care, and (4) other consumption (beverages, tobacco, and services, including meals eaten in restaurants or taken out) by households of developed nations are twice the percentages of those in developing nations. Note that the percentage differences within a consumption category do not vary with the consumption expenditures per capita. An example is clothing and footwear. Interestingly, in spite of the allure of French haute-couture, the percentage spent on clothing in France is less than half that spent by the residents of Hong Kong and only 78 percent of U.S. expenditures.

International business managers know better than to underestimate the importance of small percentage differences among nations. They are aware that each percentage point is worth a large sum of money. To appreciate its value, try multiplying the total per capita consumption expenditure by 1 percent of the population. French designers might want to note that if American consumers had spent 1 percent more on clothing, for example, this would have amounted to $\$43,740 \times .01 \times 296$ million inhabitants, or \$129.5 billion in additional sales for the clothing industry.

Other indicators that add to our knowledge of personal consumption are those concerned with (1) the ownership of goods and (2) the consumption of key materials. For example, commercial energy use per capita is related to the size of the modern sectors—*urban areas*, *industry*, and *motorized transport*. The World Bank has found that the populations living in high-income economies use nearly seven times as much commercial energy per capita as do people in developing economies, and the quantity and mix of energy constitute a rough indicator of a country’s level of development. As Table 7.5 illustrates, the more industrialized nations have considerably higher values for these indicators than do the developing nations.

Unit Labor Costs One factor that contributes to a favorable investment opportunity is the ability to obtain **unit labor costs** (total direct labor costs/units produced) lower than those currently available to the firm. Foreign trends in these costs are closely monitored because each country experiences a different rate of increase.

discretionary income

The amount of income left after paying taxes and making essential purchases

Relevance for Managers

Relevance for Managers

L05

Explain the degree to which labor costs can vary from country to country.

unit labor costs

Total direct labor costs divided by units produced

TABLE 7.4 Private Consumption Based on Purchasing Power Parity

Country	GNI/Capita Based on Exchange Rates, 2005	GNI/Capita Based on PPP, 2005	Household Consumption Expenditure % of GDP, 2005	Percentage of Household Consumption						
				Food	Clothing and Footwear	Education	Health Care	Transportation and Communication	Other Consumption	
Austria	36,980	33,140	56	20	10	9	4	9	48	
Canada	32,600	32,220	56	14	5	21	4	9	47	
Belgium	35,700	32,640	54	17	6	1	3	7	66	
Denmark	47,390	33,570	48	16	6	17	3	5	53	
France	34,810	30,570	56	22	7	8	3	12	48	
Germany	43,580	29,210	59	14	6	10	2	7	61	
Hong Kong China	27,670	34,670	59	10	17	8	2	6	57	
Japan	38,980	31,410	57	12	7	22	2	13	44	
Kenya	530	1,170	70	31	9	8	2	3	47	
Madagascar	290	880	84	61	8	2	2	5	22	
Malawi	160	650	95	50	13	6	2	9	20	
Mali	380	1,000	79	53	15	5	4	2	21	
Nigeria	560	1,040	41	51	5	8	2	2	22	
Sierra Leone	220	780	90	47	9	13	3	8	20	
Switzerland	54,930	37,080	61	19	6	18	3	8	46	
Tajikistan	330	1,260	95	48	7	14	0	5	26	
Tanzania	340	730	77	67	6	12	4	6	5	
United States	43,740	41,950	71	13	9	6	4	8	5	
Yemen	600	920	80	25	5	5	3	5	57	
Zambia	490	950	70	52	10	11	2	3	22	

Sources: *World Development Indicators 2004*, www.worldbank.org/data/wdi2004/tables/table1-1.pdf (accessed July 2, 2004); *World Development Report 2003*, pp. 238–39 and pp. 234–35; and *World Development Report 2007*, pp. 288–89.

TABLE 7.5 Per Capita Ownership or Consumption of Key Goods and Services for Selected Countries

Region/Country	Telephone Main Lines per 100 Inhabitants, 2005	Mobile Subscribers per 100 Inhabitants, 2005	Electricity Consumption/Capita (1,000 kWh), 2003	Internet Users per 100 Inhabitants, 2005
Europe				
Switzerland	69	92	8,191	50
Germany	67	96	6,896	45
France	59	79	—	43
Sweden	72	93	15,403	75
United Kingdom	56	102	6,209	63
Italy	43	124	5,620	48
Middle East				
Israel	43	112	6,599	47
Kuwait	19	89	14,808	26
Saudi Arabia	15	54	6,259	7
Egypt	14	18	1,127	7
Africa				
Mauritius	29	57	—	15
South Africa	10	72	4,399	11
Cameroon	1	14	178	1
Ghana	1	13	248	2
Ethiopia	1	1	28	0.2
Asia				
Japan	46	74	7,818	50
South Korea	49	79	7,018	68
China	27	30	1,379	8
India	5	8	435	5
Bangladesh	1	6	128	0.2
South America				
Uruguay	31	19	1,781	21
Chile	22	68	2,880	62
Brazil	23	46	1,883	12
Colombia	17	48	834	10
Bolivia	7	26	422	5
Eastern Europe				
Hungary	33	92	3,637	30
Czech Republic	31	115	6,070	50
Poland	31	76	3,329	26
Russia	28	84	5,480	15
Kazakhstan	17	33	3,510	3

(continued)

TABLE 7.5 Per Capita Ownership or Consumption of Key Goods and Services for Selected Countries (*continued*)

Region/Country	Telephone Main Lines per 100 Inhabitants, 2005	Mobile Subscribers per 100 Inhabitants, 2005	Electricity Consumption/Capita (1,000 kWh), 2003	Internet Users per 100 Inhabitants, 2005
North America and Caribbean				
United States	61	68	13,078	63
Canada	57	51	17,290	62
Trinidad and Tobago	25	61	4,721	12
Mexico	18	44	1,801	17
Haiti	2	5	31	6

Sources: Electricity consumption—*World Development Indicators 2006*, table 5.9, <http://devdata.worldbank.org/wdi2006/contents/Section5.htm> (June 17, 2008); telephone mainlines, mobile phones, and Internet hosts—International Telecommunication Union, www.itu.int/ITU-D/ict/ey/Indicators/Indicators.aspx# (accessed June 17, 2008); and World Bank, “Key Development Data & Statistics,” <http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/0,contentMDK:20535285~menuPK:64133163~pagePK:64133150~piPK:64133175~theSitePK:239419,00.html> (accessed June 17, 2008).

Countries with slower-rising unit labor costs attract management’s attention for two reasons. First, they are investment prospects for companies striving to lower production costs, as discussed in Chapter 2; second, they may become sources of new competition in world markets if other firms in the same industry are already located there.

Changes in wage rates may also cause a multinational firm that obtains products or components from a number of subsidiaries to change its sources of supply.

Nike, which produces none of the shoes it sells in the United States, began using Japanese plants in 1964. When labor costs rose there in the mid-1970s, the company changed to factories in South Korea and Taiwan. Later, Nike added Thailand. But as labor costs rose in those countries, Nike began buying in over 50 Indonesian factories and in China. Alarmed because its \$75 to \$100 (retail) shoes were costing as much as \$10 to produce and ship to the United States, Nike contracted for production in Vietnam and is also the largest seller of athletic shoes in China.⁹

What are the reasons for the relative changes in labor costs? Three factors are responsible: (1) compensation, (2) productivity, and (3) exchange rates. Hourly compensation tends to vary more widely than wages because of the differences in the size of fringe benefits. Unit labor costs will not rise in unison with compensation rates if gains in productivity outstrip increases in hourly compensation. In fact, if productivity increases fast enough, the unit costs of labor will decrease even though the firm is required to pay more to the workers.

Table 7.6 reveals why international firms keep a close watch on labor compensation rates around the world. For example, in 1975 Sweden had the highest hourly rate, with the United States and Germany tied for fifth place. Note that Japan’s average hourly rate was less than half the American rate. However, by 1985, the U.S. rate was the world’s highest, and American managers were searching for overseas production sites. Yet just 10 years later, the United States had fallen to 13th place in the hourly compensation cost ranking. Every European nation but the United Kingdom and Spain had higher costs. In 1995, American costs were still in 11th place, but there was one important change in the rankings: Japan’s labor compensation rate, which was less than half of the U.S. rate in 1985, had jumped to 138 percent of the U.S. compensation rate. By that point many Japanese firms had moved significant parts of their production to other Asian countries with lower labor costs, such as Thailand, China, and Indonesia. (This movement abroad was also influenced by the retirement of many skilled machinists and other artisans in Japan, which made foreign labor more attractive.) By 2006, 12 of the 13 European nations listed in the table had higher labor costs than the United States, led by Norway’s premium of 69.8 percent, while Japan’s relative labor costs had declined to only 84 percent of those in the United States.

TABLE 7.6 Labor Compensation Costs, 1975–2006*

Country	Average Hourly Rate Including Fringe Benefits (US\$ and Local Currencies)							
	2006		1995		1985		1975	
	US\$	Local	US\$	Local	US\$	Local	US\$	Local
Canada	25.74	29.19	16.04	22.02	10.94	14.94	5.96	6.07
United States	24.18	24.18	17.19	17.19	13.01	13.01	6.36	6.36
Mexico	2.75	30.01	1.51	9.66	1.59	409.00	1.47	18.00
Asia and Oceania								
Hong Kong	5.78	44.92	4.82	37.30	1.73	13.46	0.76	3.73
Japan	20.20	2,350	23.66	2,223.00	6.34	1,512.00	3.00	889.00
Taiwan	6.43	209.2	5.82	154.26	1.50	59.60	0.40	15.17
Europe								
Austria	30.46	24.25	25.38	255.87	7.58	156.75	4.51	78.46
Belgium	31.85	25.35	26.88	792.10	8.97	532.39	6.41	235.10
Denmark	35.45	210.6	24.26	135.86	8.13	86.18	6.28	36.00
Finland	29.90	23.80	24.83	108.64	8.16	50.56	4.61	16.88
France	24.90	19.82	19.34	96.45	7.52	67.49	4.52	19.34
Germany [†]	34.21	27.23	31.85	45.61	9.60	28.23	6.35	15.59
Italy	25.07	19.96	16.52	26,911.00	7.63	14,563.00	4.67	3,048.00
Netherlands	32.34	25.74	24.18	38.79	8.75	29.04	6.58	16.59
Norway	41.05	263.2	24.38	154.46	10.37	89.11	6.77	35.29
Spain	18.83	14.99	12.70	1,582.00	4.66	792.00	2.53	145.00
Sweden	31.80	234.4	21.64	154.51	9.66	83.12	7.18	29.73
Switzerland	30.67	38.43	29.30	34.61	9.66	23.71	6.09	15.72
United Kingdom	27.10	14.69	13.73	8.70	6.27	4.84	3.37	1.52

*Dollar conversions are at average annual exchange rates.

[†]Former West Germany.

Sources: Bureau of Labor Statistics, "International Comparisons of Hourly Compensation Costs for Production Workers in Manufacturing, Supplementary Tables," www.bls.gov/fls/hcompsupptabtoc.htm (accessed October 6, 2004); and Bureau of Labor Statistics, "Hourly Compensation Costs for Production Workers in Manufacturing, 34 Countries or Areas, 22 Manufacturing Industries, 1992–2006," [ftp://ftp.bls.gov/pub/special.requests/ForeignLabor/pwCountryTables.txt](http://ftp.bls.gov/pub/special.requests/ForeignLabor/pwCountryTables.txt) (accessed June 17, 2008).

Other Economic Dimensions We have mentioned only a few of the many economic indicators that analysts study, and you will learn about the importance to businesspeople of interest rates, balances of payments, and inflation rates in Chapter 10. The analyst will choose which economic measures to study depending on the industry and the purpose of the study.

The large international debts of a number of middle- and low-income nations are causing multiple problems not only for their governments but also for multinational firms. Just look at the situation of the developing countries with the highest debts that are listed in Table 7.7.

Is this a problem for international bankers only, or should it concern multinational managements as well? Is it significant to global and multidomestic firms with subsidiaries in these countries that high-indebtedness indicators such as debt to GDI and debt service to exports are a cause for concern? The World Bank claims that an empirical analysis of developing countries' experience shows that "debt service difficulties become increasingly likely when the ratio of the present value of debt to exports reaches 200 to 250 percent and the debt

LO6

Discuss the significance for businesspeople of the large foreign debts of some nations.

Emerging Markets**Ethical & Social Dilemma**

TABLE 7.7 Major International Debtors among Developing Countries

Country	Total External Debt (\$ billion)			2004 Debt as Percentage of 1980 Debt
	2007	1990	1980	Percent
Brazil	\$241	\$120	\$72	335%
Mexico	193	104	57	339
Argentina	123	62	27	456
China	363	55	5	7,260
Russia	460	6	—	7,667*
Indonesia	141	70	21	671
Turkey	247	49	19	1,300
India	201	84	21	957

*Comparison is to 1990 debt.

Sources: www.oecd.org/dac/debt/htm/data_index.htm, various country files; *World Bank Indicators 1999*; <http://siteresources.worldbank.org/GDFINT2004/summary-tables/20179304/reg-external-debt.PDF> (accessed July 20, 2004); *World Development Indicators 2006* (October 7, 2006); and World Bank, "Table 1 Gross External Debt Position by Sector," http://ddp-ext.worldbank.org/ext/ddpreports/ViewSharedReport?REPORT_ID=840&REQUEST_TYPE=VIEWADVANCED (accessed June 18, 2008).

service ratio exceeds 20 to 25 percent."¹⁰ If management agrees, then it will expect periodic reports on this situation from its analysts. Let's examine the ramifications of these large foreign debts for an international firm.

If a major part of the foreign exchange a nation earns cannot be used to import components used in local products, then either local industries must manufacture them or the companies that import them must stop production. Either alternative can cause the multinational to lose sales if it has been selling the parts made in one of its home country plants to its subsidiary, a common occurrence because the home plant is usually more **vertically integrated** than its subsidiaries. A scarcity of foreign exchange can also make it difficult for the subsidiary to import raw materials and spare parts for its production equipment. If headquarters wants its affiliate to continue production, it may have to lend the foreign exchange and wait for repayment. In response, some multinationals have closed their operations in a country, resorted to barter, or even begun to export their subsidiaries' products even though these actions have reduced exports or even local sales of their domestic plants.

Governments may impose price controls (which make it difficult for a subsidiary to earn a profit), cut government spending (which reduces company sales), and impose wage controls (which limit consumer purchasing power). The economic turmoil that follows can turn into a political crisis, as occurred in Argentina and Peru when rioting resulted after their presidents tried to impose austerity measures. During the Asian financial crisis, South Korea experienced nationwide strikes in response to laws passed to ease that country's economic problems.

Scarcity of foreign exchange can affect even firms that merely export to nations with high foreign debt because the governments will surely impose import restrictions. When Latin American debt increased rapidly from 1981 to 1983, that region's share of U.S. exports dropped by one-third. To protect these export markets, firms had to extend long-term credit. From this you can see that managements will expect to receive information on the status of the foreign debt in nations where it is high in addition to the other economic data we have been examining.

SOCIOECONOMIC DIMENSIONS

A complete definition of market potential must also include detailed information about the population's physical attributes as measured by the socioeconomic dimensions. We shall begin this section with an analysis of total population.

vertically integrated

Descriptive term for a firm that produces inputs for its subsequent manufacturing processes

human-needs approach

View that defines economic development as a reduction of poverty and unemployment as well as an increase in income

import substitution

The local production of goods to replace imports

L07

Discuss the new definition of economic development, which includes more than economic growth.



WORLD view

New Approaches to Economic Development

Until the 1970s, economists generally considered *economic growth* to be synonymous with *economic development*. A nation was considered to be developing economically if its real output per capita as measured by GNI/capita was increasing over time. However, the realization that economic growth does not necessarily imply development—because the benefits of this growth so often have applied to only a few—has led to the widespread adoption of a new, more comprehensive definition of economic development.

The **human-needs approach** defines economic development as the reduction of poverty, unemployment, and inequality in the distribution of income. The definition of poverty also has been broadened. Instead of being defined in terms of income, as is common in developed countries, a reduction in poverty has come to mean less illiteracy, less malnutrition, less disease and early death, and a shift from agricultural to industrial production or service-based economic activity.

Because of the increased emphasis on human welfare and the lack of a clear link between income growth and human progress, the United Nations Development Program has devised a Human Development Index (HDI) based on three essential elements of human life: (1) a long and healthy life, (2) the ability to acquire knowledge, and (3) access to resources needed for a decent standard of living. These elements are measured by (1) life expectancy, (2) adult literacy, and (3) GDP/capita, adjusted for differences in purchasing power. In its latest report, as shown in the table accompanying, the program ranked Iceland as the most developed with respect to the HDI, followed by Norway, Australia, Canada, Ireland, Sweden, Switzerland, Japan, the Netherlands, and France. The 27 lowest-ranked countries are all located in Africa, a fact that further highlights the significant development challenges that confront that continent and its residents.

No Accepted General Theory of Development

The inclusion of noneconomic variables has made it impossible to formulate a widely accepted general theory of development. Instead of pursuing a general theory, development economists are concentrating on specific problem areas, such as population growth, income distribution, unemployment, transfer of technology, the role of government in the process, and investment in human versus physical capital.

What is the relevance of a lack of consensus among specialists about development theory? If a particular theory has fallen into disfavor among the experts, can managers neglect it when dealing with government officials? That depends. Perhaps those officials still subscribe to it. In that case, managers should emphasize the parts of their proposals that are germane to the theory, which is generally not too difficult because nearly every proposal will provide not only investment in physical capital but also training of employees, employment, and the transfer of technology. There will even be some redistribution of income through the creation of a middle class composed of managers and highly

skilled technicians. As an example, let's look at how managers might emphasize investment in human capital when making a proposal.

Investment in Human Capital

This development theory recognizes that more than just capital accumulation is needed for growth. There must also be investment in the education of people so that there will be managers to ensure that the capital is productive and skilled workers to operate and maintain the capital equipment. For developed countries, research suggests that investment in human capital has a return estimated at 4 to 12 percent per year of education. If basic labor has an income level of 100, then the return for 12 years of educational investments would yield an increased return ranging from 160 to 390 percent of that generated by basic labor.⁸

If managers know that this theory has strong acceptance in the country in which they have an operation or are seeking permission to establish one, they should emphasize this aspect of their investment. A multinational or global firm that does not have training programs for workers is rare, and nearly all send local managers to the home office to update their skills.

Import Substitution versus Export Promotion

Another strategy followed by some developing nations has been **import substitution**. Although developing nations have long considered the exporting of primary products (agricultural and raw materials) to be an important facet of their development strategy, many of these countries have not aggressively promoted the exporting of manufactured goods. Instead, they have concentrated on substituting these domestically manufactured products for imports as a way to lessen their dependence on developed countries.

Unfortunately, import substitution has not reduced their dependence on developed nations as much as it has changed the composition of imports from finished products to capital and semiprocessed inputs. Often, however, developing nations are unable to obtain these inputs because of a lack of foreign exchange, which can stop entire industries and throw thousands of people out of work, further increasing dependence on developed nations. This situation happened in several Asian nations as a result of the Asian economic crisis that began in 1997 and of subsequent events such as tightening of money supplies in conjunction with IMF assistance.

Another serious problem with the import substitution strategy stems from the protection to local industry that governments grant by levying high import duties on goods that also are made domestically. Under this umbrella, local manufacturers may not feel pressured to either lower their costs or improve their quality. Without such pressure, they rarely become competitive in world markets and thus cannot export. Furthermore, other domestic firms that must buy inputs from these protected industries cannot export either because their costs are excessive or their quality is inadequate.

Problems such as these have caused numerous governments to change from a strategy of import substitution to one

(continued)

HDI Rank	Country	Life Expectancy at Birth (years), 2005	Adult Literacy Rate (% ages 15 and above), 2005	GDP per Capita (PPP, US\$), 2005
1	Iceland	81.5	99%	\$36,510
2	Norway	79.8	99	41,420
3	Australia	80.9	99	31,794
4	Canada	80.3	99	33,375
5	Ireland	78.4	99	38,505
6	Sweden	80.5	99	32,525
7	Switzerland	81.3	99	35,633
8	Japan	82.3	99	31,267
9	Netherlands	79.2	99	32,684
10	France	80.2	99	30,386
11	Finland	78.9	99	32,153
12	United States	77.9	99	41,890
13	Spain	80.5	99	27,169
14	Denmark	77.9	99	33,973
15	Austria	79.4	99	33,700
168	Congo, Democratic Republic of	45.8	67.2	714
169	Ethiopia	51.8	35.9	1,055
170	Chad	50.4	25.7	1,427
171	Central African Republic	43.7	48.6	1,224
172	Mozambique	42.8	38.7	1,242
173	Mali	53.1	24.0	1,033
174	Niger	55.8	28.7	781
175	Guinea-Bissau	45.8	44.8	827
176	Burkina Faso	51.4	23.6	1,213
177	Sierra Leone	41.8	34.8	806
	High income	79.2	99	33,082
	Middle income	70.9	89.9	7,416
	Low income	60.0	60.2	2,531
	High human development	76.2	99	23,986
	Medium human development	67.5	78.0	4,876
	Low human development	48.5	54.4	1,112
	World	68.1	78.6	9,543

of promoting exports of manufactured goods. Spurring them on to this decision has been the rapid export growth of the newly industrializing nations and the general opening of world markets to international trade and investment.

This change in strategy affects international firms in a variety of ways. First, local affiliate managers must be prepared for demands to export by government officials. They may even be given ultimatums, as some foreign manufacturers operating in China have reported: "If you need to import parts for your output, you must earn the foreign exchange to pay for them by

exporting part of your production." Foreign companies seeking permission to set up a manufacturing facility are commonly asked by government administrators about plans for exporting. This is a new phenomenon to longtime managers accustomed to restricting an affiliate's sales to its internal market to save the export market for home country production. Second, managers can no longer count on having permanent protection from competing imports, as they once could. In some countries, they are likely to be told that after a certain date they will lose their protection and will be expected to compete internationally. Last,

in a situation where two firms are competing for permission to establish a plant, the deciding factor may be that one offers its multinational channels of distribution to the affiliate's exports.

^aIf basic labor has an income level of 100, and if each year of education yields a return of 4 to 12 percent, then a worker with 12 years of education would produce returns from $100 \times (1.04)^{12} = 160$ to $100 \times (1.12)^{12} = 390$.

Sources: *Human Development Report 2007/2008* (New York: United Nations Development Program), pp. 229–32, http://hdr.undp.org/en/media/hdr_20072008_table_1.pdf (accessed June 17, 2008); Charles Kindleberger and Bruce Herrick, *Economic Development* (New York:

McGraw-Hill, 1977), p. 1; Lee M. Stapleton and Guy D. Garrod, "Keeping Things Simple: Why the Human Development Index Should Not Diverge from Its Equal Weights Assumption," *Social Indicators Research* 84 (2007), pp. 179–188; Shyamal Chowdhury and Lyn Squire, "Setting Weights for Aggregate Indices: An Application to the Commitment to Development Index and Human Development Index," *Journal of Development Studies* 42, no. 5 (July 2006), pp. 761–771; George Psacharopoulos, "Returns to Investment in Education: A Global Update," *World Development* 22 (1994), p. 9; and Jean-Philippe Cotis, "Economic Growth and Productivity," www.oecd.org/dataoecd/49/34/37179645.pdf (accessed June 17, 2008).

Total Population Total population, the most general indicator of potential market size, is the first characteristic of the population that analysts examine. Population sizes vary immensely, from more than a billion inhabitants in both China and India to 2,701 for Svalbard and the uninhabited Bassas da India. The fact that many developed nations have fewer than 10 million inhabitants makes it apparent that population size alone is a poor indicator of economic strength and market potential. Only for a few low-priced products, such as soft drinks, cigarettes, and soap, might population size alone provide a basis for estimating consumption.

For products not in this category, large populations and populations that are increasing rapidly may not signify an immediate enlargement of the market, but if incomes grow over time, eventually some part of the population will become customers. Insight into the speed at which this is occurring may be obtained by comparing population and economic growth rates. Where GNI increases faster than the population, there is probably an expanding market, whereas the converse situation not only indicates possible market contraction but may even point out a country as a potential area of political unrest. This possibility is strengthened if an analysis of the educational system discloses an accumulation of technical and university graduates. These groups expect to be employed as and receive the wages of professionals, and when enough new jobs are not being created to absorb them, the government can be in serious trouble. Various nations already face this difficulty; Egypt is an example.

Age Distribution Because few products are purchased by everyone, marketers must identify the segments of the population that are more apt to buy their goods. For some firms, age is a salient determinant of market size, but the distribution of age groups within populations varies widely. Generally, because of higher birth rates, developing countries have more youthful populations than do industrial countries.

The population of developing countries is more than three-quarters of the world's total population. Figure 7.3 shows that of the 10 nations predicted to have the largest populations by the year 2050, only one is a high-income country (the United States); the rest are primarily low-income countries.

What does this mean for business managers? For the developed nations, there will be a decrease in the demand for products used in schools and for products bought by and for children, a smaller market for furniture and clothing, but an increased demand for medical care and related products, tourism, and financial services. Firms confronted by a decreasing demand for their products will have to look for sales increases in the developing economies, where the age distribution is reversed.

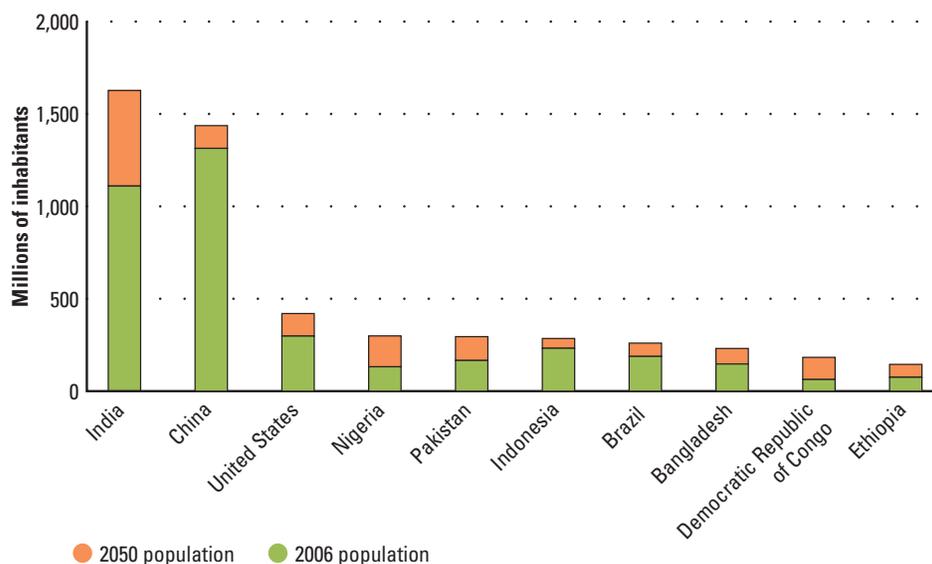
Many forces are responsible for reductions in birthrates. Governments are supporting family planning programs, to be sure, but there is ample evidence that improved levels of health and education along with an enhanced status for women, a more even distribution of income, and a greater degree of urbanization are all acting to reduce the traditional family size. In fact, experts have been claiming for some time that the combined effect of an effective family planning program and female education beyond the primary level is extremely powerful in reducing family size.

Ethical & Social Dilemma

Relevance for Managers

FIGURE 7.3

Population Growth of the World's 10 Most Populated Countries by 2050 (millions of inhabitants)



Sources: U.S. Census Bureau, *International Data Base*, www.census.gov/ipc/www/idbpyr.html (accessed October 8, 2006); and Population Reference Bureau, *2006 World Population Data Sheet*, p. 2, www.prb.org/pdf06/06WorldDataSheet.pdf (accessed June 18, 2008).

Ethical & Social Dilemma

Concern in Developed Nations The decrease in family size is welcomed by some countries in Africa and the Middle East, where fertility rates are as high as seven children per woman. But declining birthrates are causing concern in industrialized nations. The World Bank reports that the fertility rates in these countries are considerably below the *replacement number* of 2.1 children.* India, Mexico, and China have also experienced declines in their birthrates.

An increasing number of young Europeans are not marrying, and those who do marry are doing so later and having fewer children. Italy's population is projected to fall by 15 million by mid-century, and the birthrate in Spain and Russia is even lower. By the year 2025, the present 9 percent unemployment rate in the European Union is projected to be replaced by a shortage of workers in many of the member nations. European governments will have to provide medical care and pensions for the 22 percent of their population that will be over 65 years old, and there will be fewer working taxpayers (see Figure 7.4).

Japan's situation seems to be even more serious. Its fertility rate is only 1.5 children per woman, well below the 2.1 population replacement value, and in the year 2025 Japan's population age 65 and older will make up 26.8 percent of its total population, whereas the same age group in the United States will amount to only 18.5 percent of the total population. By the year 2025 Japan, which is the fastest-graying nation in the industrial world, will have twice as many old people as it has children. The government's reserve of social security funds will have run dry because retirement and health costs for the elderly are forecast to consume 73 percent of national income.

Early retirements and the fact that retirees are living longer are also straining the social security systems of many other countries. In the industrialized nations, not only are the costs of social security systems rising because of the growing number of retirees, but there are fewer people working and paying into the system to support them. However, in developing nations, just the opposite is occurring. The higher birthrates result in a younger population, and this reduces the dependency ratios and the costs to the workers supporting the system.

Population Density and Distribution Other aspects of population that concern business managers are **population density** and **population distribution**. Densely populated areas tend to make product distribution and communications simpler and less costly

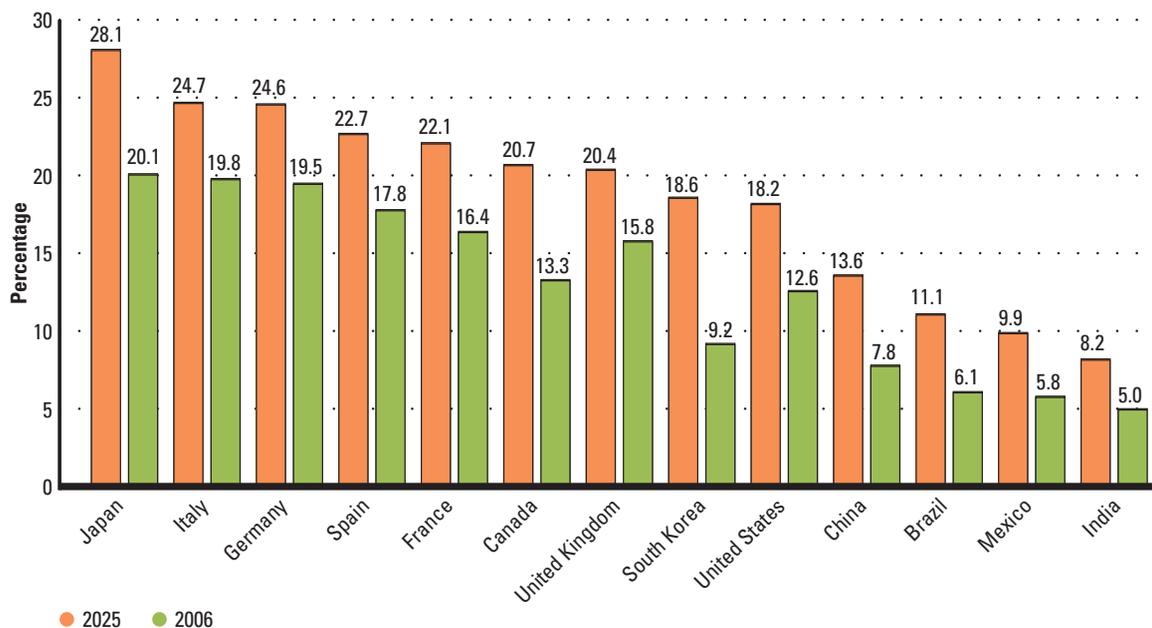
population density

A measure of the number of inhabitants per area unit (inhabitants per square kilometer or square mile)

population distribution

A measure of how the inhabitants are distributed over a nation's area

*Number of children who will be born to a woman if she lives to the end of her childbearing years and bears children according to current, age-specific fertility rates.

FIGURE 7.4 Percentages of Elderly (over 65) in Population, Selected Countries, 2006 and 2025

Source: U.S. Census Bureau, *International Data Base*, <http://www.census.gov/ipc/www/idb/summaries.html> (accessed June 18, 2008).

than they are in areas where population density is low; thus you might expect Pakistan, with 192 inhabitants per square kilometer, to be an easier market to serve than Canada (3 inhabitants/square kilometer) or Brazil (22 inhabitants/square kilometer).¹¹ The expectation, though, is another of those based on an arithmetic mean. We must know how these populations are distributed. One needs only to compare the urban percentages of total population to learn that Canada and Brazil possess population concentrations that facilitate the marketing process. While only 34 percent of Pakistan's population is urban, the percentages for Brazil and Canada are 83 and 80 percent, respectively.¹² The physical forces, as we saw in Chapter 6, contribute heavily to the formation of these concentrations.

An important phenomenon that is changing the population distribution is the **rural-to-urban shift**. This trend is occurring nearly everywhere around the world, especially in developing countries, as people move to cities in search of higher wages and more conveniences. An indicator of the extent of this movement is the change in the percentages of urban population. In 2008, for the first time, half of the world's population was living in cities, and this proportion is projected to increase to 60 percent by the year 2030. As Table 7.8 indicates, the greatest urban shifts are occurring in the low- and middle-income countries. This shift is significant to marketers because city dwellers, being less self-sufficient than persons living in rural areas, must enter the market economy. Many of these urban dwellers will live in slums, as shown in Figure 7.5, raising a range of social, economic, and other challenges and opportunities.

City governments also become customers for equipment that will expand municipal services to handle the population influx. Figure 7.6, which lists the 25 largest megacities, contains some potential sales prospects. Note that most of the fast-growing cities projected to be megacities by the year 2015 are in developing nations. In contrast, Figure 7.7 lists the 25 highest ranked centers of commerce in the world, and almost all of these cities are located in more economically developed nations.

rural-to-urban shift

The movement of a nation's population from rural areas to cities

Relevance for Managers

Other Socioeconomic Dimensions Other socioeconomic dimensions can provide useful information to management. The increase in the number of working women, for example, is highly significant to marketers because it may result in larger family incomes, a

TABLE 7.8 Rural-to-Urban Shift

	Percentage of Population in Urban Areas					Percentage Change, 1950–2015
	1950	1970	1990	2005	2015 (estimated)	
World	29%	36%	43%	49%	53%	82.8%
More developed regions	52	65	71	74	76	46.2
Less developed regions	18	25	35	43	48	166.7
Least developed countries	7	13	21	27	32	357.1
Less developed regions excluding least developed countries	20	27	37	46	51	155.0

Source: United Nations, *World Urbanization Prospects: The 2005 Revision Population Database*, <http://esa.un.org/unup/index.asp?panel=1> (accessed June 17, 2008).

promotional mix

A blend of the promotional methods a firm uses to sell its products

greater market for convenience goods, and a need to alter the **promotional mix**. Personnel managers are interested in this increase because it results in a larger labor supply. It also signifies that changes may be required in production processes, employee facilities, and personnel management policies.

Data on a country's divorce rate will alert the marketer to the formation of single-parent families and single-person households, whose product needs and buying habits differ in many respects from those of a two-parent family. In many countries, important ethnic groups require special consideration by both marketing and personnel managers.

Wal-Mart has had language problems on both sides of the border. In a country where labels and communications are made in English and French, the retailer mailed English-only circulars to residents of Quebec, where 83 percent of the population are French speakers. After apologizing for this mistake, Wal-Mart officials had to apologize a week later when the company was criticized severely for ordering Canadian employees to work 12 hours a week extra without pay by means of memos that also were in English only.

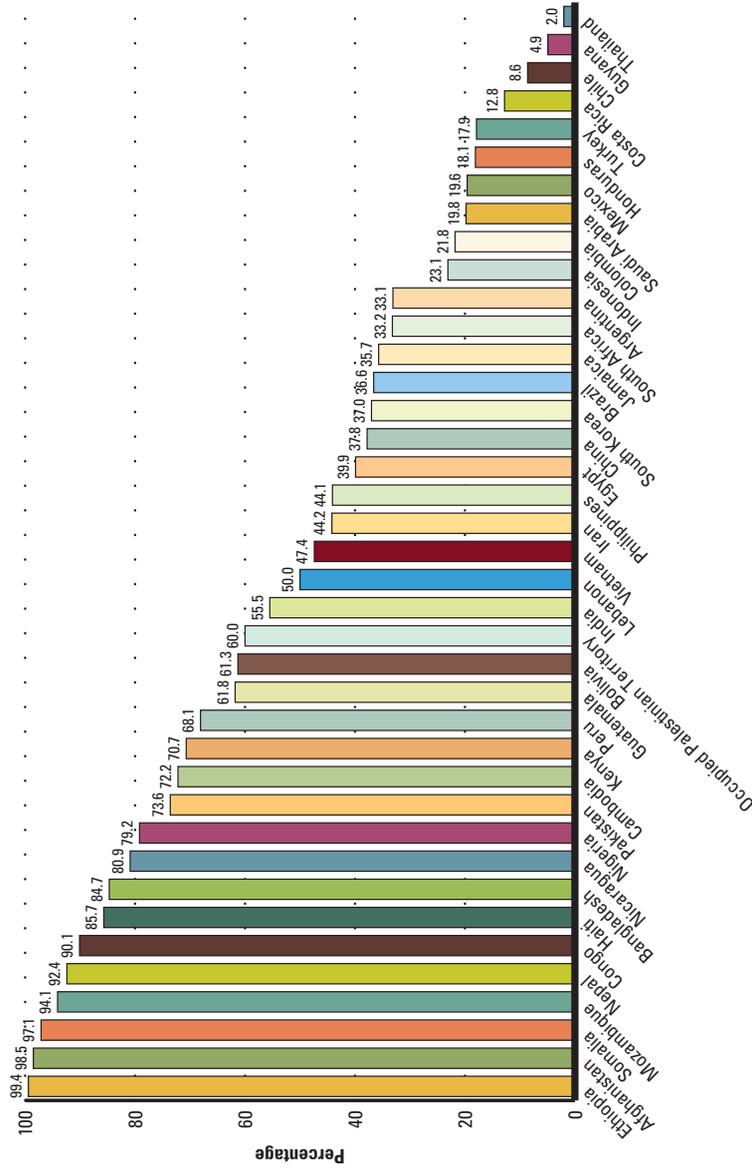
One month later, the company had language-law problems on the other border when Mexican trade inspectors temporarily closed its Mexico City superstore, claiming that the firm had violated a 40-year-old law that requires the seller to place Spanish-language labels on all products on display.¹³

Relevance for Managers**INDUSTRY DIMENSIONS**

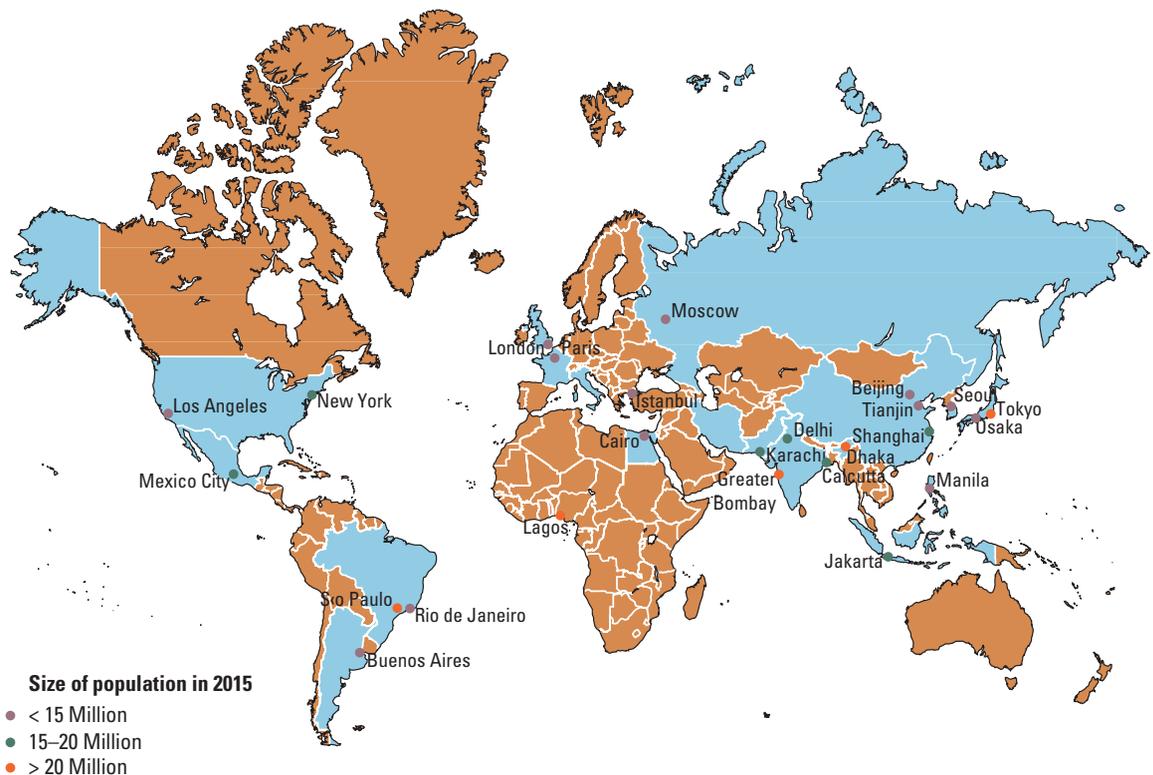
Every firm is concerned about the general economic news because of its impact on consumer purchases, prices of raw materials, and investment decisions, but certain factors are more significant than others to a given industry or to a specific functional area of a firm. The size and growth trend of the automobile industry are of paramount importance to a tire manufacturer, for example, but are of no interest to an appliance manufacturer. Nor would the quantity of machine operators graduated by technical schools be useful to financial officers, although these data are of vital interest to human resources managers of manufacturing plants. Managers want data not only about the firm's industry but also about industries that supply and purchase from the company. Some of the sources listed in the nearby mini MNE, "Using the Internet for Economic Research," may be of value in obtaining such data.

Industry studies are generally made by the firm's economists or its trade association, but they can also be purchased from independent research organizations, such as Fantus (New York) and the Economist Intelligence Unit (London). Government agencies, chambers of commerce, and trade publications such as *Advertising Age* publish them as well. Many international banks publish free newsletters containing useful economic data.

FIGURE 7.5 Slum Population as a Percentage of Urban Population, Selected Nations



Data are for year 2001.
 Source: United Nations Statistics Division, "Slum Population as Percentage of Urban, Percentage," Millennium Development Goals Indicators, <http://mdgs.un.org/unsd/mdg/seriesDetail.aspx?srid=710> (accessed June 18, 2008).

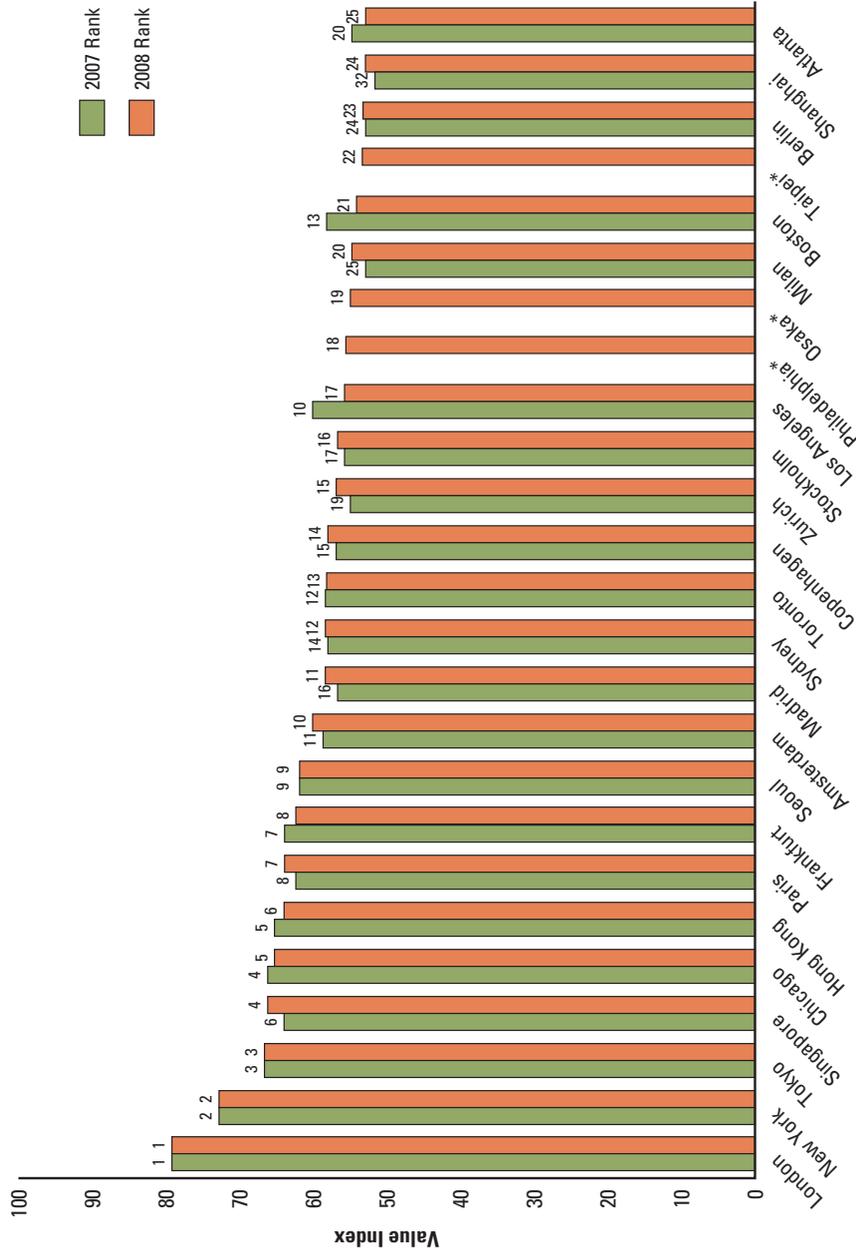
FIGURE 7.6 Twenty five Megacities 1970–2015 (millions)

Beijing 1970: 8.3 2015: 12.3	Calcutta 1970: 7.1 2015: 17.3	Bombay 1970: 6.0 2015: 26.1	Karachi 1970: 3.1 2015: 19.2	Los Angeles 1970: 8.4 2015: 14.1	Moscow 1970: 7.1 2015: 9.3	Paris 1970: 8.3 2015: 9.6	Seoul 1970: 4.5 2015: 13.1	Tokyo 1970: 14.9 2015: 26.4
Buenos Aires 1970: 8.6 2015: 14.1	Dhaka 1970: 4.3 2015: 21.1	Istanbul 1970: 1.8 2015: 12.5	Lagos 1970: 1.51 2015: 23.2	Manila 1970: 3.6 2015: 14.8	New York 1970: 16.3 2015: 17.4	Rio de Janeiro 1970: 7.2 2015: 11.9	Shanghai 1970: 11.4 2015: 19.1	
Cairo 1970: 5.7 2015: 13.8	Delhi 1970: 3.6 2015: 16.8	Jakarta 1970: 4.5 2015: 17.3	London 1970: 10.6 2015: 7.1	Mexico City 1970: 9.1 2015: 19.2	Osaka 1970: 7.6 2015: 11.0	São Paulo 1970: 8.2 2015: 20.4	Tianjin 1970: 6.9 2015: 10.7	

Sources: United Nations, 1995, www.megacities.nl/top_15/topworld/html; *The Economist*, April 29, 1995, p. 122; *World Development Report 1994*, pp. 222–23; and www.jhuccp.org/pr/urbanpre.stm.

World's 25 Highest Ranked Centers of Commerce

FIGURE 7.7



*Refers to not ranked in 2007 study.
 Source: Mastercard Worldwide, *Worldwide Centers of Commerce Index, 2008*, http://www.mastercard.com/us/company/en/insights/pdfs/2008/MCWWV_WCoC-Report_2008.pdf (accessed June 18, 2008).

mini MNE



>> Using the Internet for Economic Research

You own a small business, and you don't have the money to hire an economic analyst. Yet you need economic and socioeconomic data to help you plan for market expansion just as the big multinationals do. What can you do? Do you have a personal computer with an Internet connection? Use it to get the information free of charge that the analyst you were going to hire would have gotten and then charged you for.

Suppose that up to now you have confined yourself to the U.S. market, but you are curious about the possibilities of expanding into the Canadian and Mexican markets. They are both nearby and relatively easy to get to. Can you find information about doing business with these countries on the Internet?

A quick search using an Internet search engine should uncover many sources of information for you. For example, you can obtain a free online report on "Doing Business in Canada," including key economic trends, trade regulations, and standards, by visiting the U.S. Department of Commerce's Commercial Services Web site at <http://www.buyusa.gov/canada/en/ccg.html>. In addition to offering such services as assistance for American exporters in finding agents and distributors, mailing products, and establishing a Canadian office, this site has a Market Research Library that contains more than 100,000 reference sources, including industry and country-specific market reports. For trade statistics, geography, and culture, you can go to the Government of Canada's official Web site at http://canada.gc.ca/main_e.html.

To get data on Mexico, you can also visit the U.S. Department of Commerce's Commercial Services Web

site at <http://www.buyusa.gov/mexico/en/> for a broad variety of resources on doing business in that country. You can also visit sites such as www.latinworld.com/norte/mexico/index.html for economic forecasts and an extensive Mexican financial commentary.

Michigan State University supports Global-EDGE, an excellent site for information on Mexico, Canada, or other countries. You can access this site at <http://globaledge.msu.edu/ibrd/ibrd.asp>. Using the Country Guide and typing in "Mexico" will bring you to an extensive list of resources, including the "Mexico: Country Commercial Guide" and "Mexico: Economist Country Briefing." You can also go to the Commercial Section of the U.S. embassy in Mexico City, which offers services to companies that want to do business in Mexico. You can access this site from GlobalEDGE, or go directly to <http://mexico.usembassy.gov/eng/main.html>. Another site, www.zona-latina.com, will provide even more information.

If you decide to make an in-person visit to collect additional information about your prospective new market, the U.S. Department of State has information on travel to both Canada and Mexico at <http://travel.state.gov/>. If your company has products that may be subjected to export controls, you can visit the Web site of the Bureau of Industry and Security of the U.S. Department of Commerce at <http://www.bis.doc.gov/> to see if you will need special permits before you bring samples across the border to show to prospective customers. This site also provides other resources that may be valuable for a prospective exporter.

With the information you obtain from sites such as those listed here, you should be able to decide whether you want to move into these new international markets.



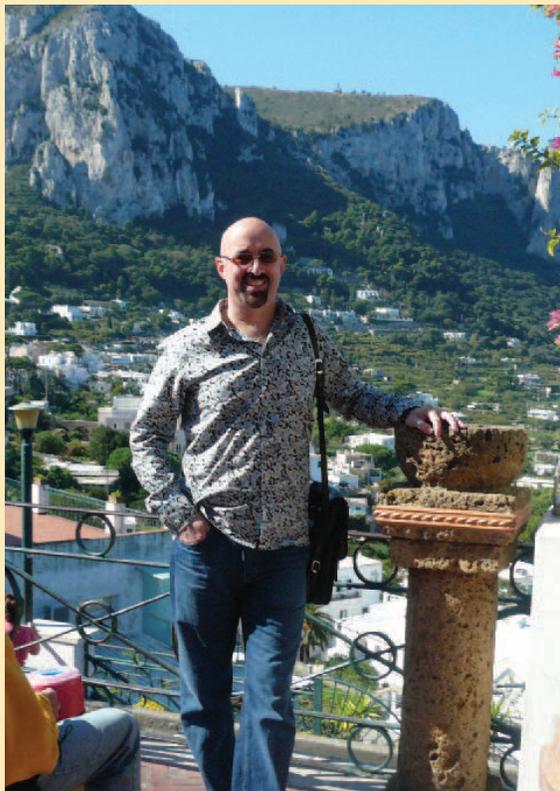
BUILDING YOUR GLOBAL RÉSUMÉ

Tips from Your Personal Global Mentor

Tim Taddei is cofounder and director of operations of RTO Group Limited, Fairfield, Connecticut. RTO Group Limited is an international printing and graphics services company with annual revenues approaching \$11 million. RTO Group is currently doing a considerable amount of work for Prudential, specifically working on client kits that are shipped worldwide in multiple languages from their plants in the United States. The company is also working with a large Seattle manufacturer of doors and windows with all manufacturing in Korea. This requires coordinating print production overseas and domestically to keep Home Depot stores throughout North America fulfilled with catalogs. RTO Group works with companies in Slovenia, Poland, and Korea, supplying

them with specialized labels used on packaging of china that ends up being sold back in the United States. This RTO business evolved as foreign sources of supply could not produce barcodes with the proper integrity when scanned at retail. International clients include Absolut Vodka, Sara Lee Coffee & Tea, Unilever, Pfizer, Lenox China, and Vineyard Wines, among others. RTO maintains an on-site facility at Pepsi-Cola, providing prepress services for promotions, advertising, and packaging, as well as project and digital asset management. The Printing Division of RTO uses overseas vendors for printing and ships finished products globally for their clients. RTO does business in Canada, Mexico, Slovenia, Poland, Korea, and France.

(continued)



Tim Taddei of RTO Group, Limited

Tim's advice on how to get a job in international business:

- Study foreign languages, especially Spanish and Chinese as they are spoken in today's most prevalent emerging marketplaces.
- Intern overseas (or with a domestic company doing business overseas) to find the critical mix of culture and business opportunity that fits your career development.
- Travel; use your language, sales and personal skills to develop your international business 'niche.'
- Be willing to take risks both personally and financially. Entrepreneurship requires hard work and patience—dealing with foreign entities can be time-consuming and frustrating—patience, perseverance, and dedication to your cause are not clichés; they work to turn problems into opportunities.

Tim's advice on succeeding in international business:

- Develop an intimate understanding of the metric system—conversions, measurements, and even transportation rely on the metric system throughout the world. Manufacturing depends on accurate and precise measurements (in metric).
- Study current socioeconomic trends in the countries you deal with—understand labor rates, labor laws, emerging trends effecting the eco-climate, culture, economy, and political climate within a given country.
- Understand exchange rate management—fluctuating currency can dramatically impact your cost/profit ratios.

- Understand import/export laws—know *exactly* what you can import/export to/from the United States and the cost ramifications before embarking on a manufacturing or production project.
- Understand timing issues related to overseas shipping and customs clearance.

Tim's thoughts on strategically growing your global business:

- Every problem presents itself as an opportunity—take responsibility for your mistakes in business and they will become an advantage rather than business failure. Bottom line: stand behind your product or service and if things go south in a deal; be prepared to make swift reparations at any and all costs. In the end your client/customer will commend your perseverance.
- Account penetration is the toughest part of a successful business model. Once established at the client level, find ways to help them save money in more areas than just your line of expertise. For example, if you are assisting a client in building overseas sales of a domestic product, take the time to research potential sources of suppliers closer to the final shipping point, or 'think outside the box' and research alternate shipping routes or modes that will lower overall cost. It's one thing to deliver a sound product or service but, when you can save money on top of that, it frees up the customer's marketing budget for additional work. Even if this doesn't fall into your lap, you will be recognized as a true 'business partner.' Kind of the 'spend the customer's money as if it were your own' mentality.
- Leave something on the table—make it a mind-set to discount work—by continually being the best game in time, best bang for the buck; your account penetration levels will deepen from division to division with a soft sell approach. Remember: pigs go to slaughter.

Growth areas Tim sees for current and future business opportunities:

- Infrastructure: As populations grow and economies begin to develop and/or flourish, roads, tunnels, bridges and building will require repairment. Invest in developing a working knowledge of what companies are being called upon for these services in engineering, planning, etc.
- Networking: International business can't be carried out effectively without up-to-date network engineering. E-commerce has changed business; this is a global economy now—take advantage of it. Whether on the marketing side, legal side, or actual engineering side, there is a lot of money to be made in this field. As the demand for MBAs decreases, the demand for engineers (mechanical, electrical, and computer) is at its highest levels.

To learn more about Tim's company, RTO Group Limited, visit its Web site: www.rtogroup.com.

Your Worldwide Resources. OECD (Organisation for Economic Cooperation and Development) supports sustainable economic growth through world trade and development: http://www.oecd.org/home/0,3305,en_2649_201185_1_1_1_1_1,00.html

(continued)

OECD links for country macroeconomic reports and data: <http://www.oecd.org/dataoecd/20/9/37130691.htm>

Eurointelligence provides information and data on global economics, finance, and politics and their impact on international trade and business relations: <http://www.eurointelligence.com/>

The Economist is a major world source for news, economics, finance, political, science and technology information worldwide: <http://www.economist.com/>

The Economist Intelligence Unit provides up-to-date country economic forecasts and analyses: <http://www.countryanalysis.eiu.com/>

ECONOMICexpert.com is an Economics information warehouse: <http://www.economicexpert.com/>

Culture Cue: Doing Business in Milan In Italy, appearance and dress are extremely important in business. Businessmen value fine-quality clothing and tailoring and spend a great deal of time putting together the right suit, shirt, tie, and shoes to make the appropriate fashion statement as a complement to their status as business professionals. The right hairstyle and briefcase are carefully selected to complete the desired impression. Women dress in fashionable, yet highly feminine styles and wear tasteful jewelry. Shoes for both men and women are critical to completing the perfectly

dressed Italian businessman or businesswoman. Refinement and dignity add to a professional demeanor at all levels of business in Italy and are expected of their foreign counterparts. Anything less will be seen as uncultured, uneducated, and unrefined. Dressing tastefully yet conservatively is critical to be accepted as a business professional in Milan and throughout Italy. The appropriate way to greet your Italian counterpart is to say “*Buon giorno*” and then their full name followed by a hand shake. When the business meeting is over, but prior to leaving, say “*Arrivederci*” and again shake hands. Never say “*Ciao*” as this is very casual and often seen as a trite slang comment used by unrefined people. Appointments are important commitments, but to be five-to-ten minutes late for an appointment is quite acceptable and will do no harm to business relations. If it appears that you will be later than this, a call explaining the situation is a must. Educational attainment is prized in Italy and if your counterpart has a four-year degree from a college or university, it is an appropriate sign of respect to address them as “*Dottore*” or “*Dottoressa*.” In business situations, it is prudent to address everyone you meet by these titles. However, if you are talking with a lawyer, address them as “*Avvocato*.” For an engineer, the title is “*Ingegnere*” and for an architect, it is “*Architetto*.” Lunch is a very important event in Italy and may last two to three hours. It is a time to relax and enjoy the fine food, wine, company, conversation, and life. Business is never discussed. The currency in Milan and in Italy is the Euro.

Summary

State the purpose of economic analyses.

To keep abreast of the latest economic developments and also to plan for the future, firms regularly assess and forecast economic conditions at the local, state, and national levels. When they enter international operations, the economic analysis increases in complexity because managers are operating in two new environments: foreign and international. There are more economies to study, and these economies are frequently highly divergent.

Identify different categories based on levels of national economic development and the common characteristics of developing nations.

Managers involved in international business encounter markets with far greater differences in levels of economic development than those in which they have been working in domestic business settings. A nation’s level of economic development affects all aspects of business, and we commonly group them into categories based on their level of economic development, such as developed, developing, newly industrializing, and newly industrialized economies. Developing nations have certain common characteristics, including unequal distribution of income, technological and regional

dualism, a large percentage of the population in agriculture, high population growth, high illiteracy rate, insufficient education, and low savings rates.

Discuss the economic and socioeconomic dimensions of the economy and different indicators used to assess them.

The various functional areas of a firm require data on the size and rates of change of a number of economic and socioeconomic factors. Among the more important economic dimensions are GDP, GNI, distribution of income, personal consumption expenditures, private investment, unit labor costs, and financial data (such as exchange rates, inflation rates, interest rates, and the amount of a nation’s foreign debt). The principal socioeconomic dimensions are total population, rates of growth, age distribution, population density, and population distribution.

Discuss the importance of a nation’s consumption patterns and the significance of purchasing power parity.

Marketers must know how consumers allocate their discretionary incomes, since this is money spent on their products. They must also use purchasing power parity (PPP) to understand what the true purchasing power of a nation is.

Consumers in a nation whose GNI appears to be too low to be a viable market may have some discretionary buying power when the GNI based on market exchange rates is converted to a GNI based on PPP.

Explain the degree to which labor costs can vary from country to country.

Hourly labor rates, especially when stated in U.S. dollars, change rather rapidly. There are three factors that are responsible: (1) real changes in compensation, (2) changes in productivity, and (3) changes in exchange rates.

Discuss the significance for businesspeople of the large foreign debts of some nations.

Large foreign debts may indicate that the government will impose exchange controls on its country's businesses. If a

large part of the country's export earnings go to service its external debt, there will be little remaining for use by firms in the country to pay for imports of raw materials, components used in their products, and production machinery. The government could impose price and wage controls. There is also the possibility that firms can buy some of the discounted debt to obtain local currency at a favorable exchange rate.

Discuss the new definition of economic development, which includes more than economic growth.

The human-needs approach defines economic development as the reduction of poverty, unemployment, and inequality in the distribution of income.

Key Words

developed (p. 214)

developing (p. 214)

newly industrializing countries (NICs) (p. 214)

newly industrialized economies (NIEs) (p. 214)

gross national income (GNI) (p. 216)

underground economy (p. 217)

purchasing power parity (PPP) (p. 218)

income distribution (p. 218)

discretionary income (p. 221)

unit labor costs (p. 221)

vertically integrated (p. 226)

human-needs approach (p. 226)

import substitution (p. 226)

population density (p. 230)

population distribution (p. 230)

rural-to-urban shift (p. 231)

promotional mix (p. 232)

Questions

1. What impacts do economic forecasts have on a firm's functional areas? If management learns from the economic analysis of Country A that wage rates are expected to increase by 10 percent next year, which functional areas of the firm will be concerned? Why will this be of concern to management?
2. What are the differences in the characteristics of economically developing and developed nations?
3. Of what importance to marketers is a nation's level of economic development?
4. What common problem does the use of GNI per capita and population density values present?
5. What is the underground economy? Why is the existence and level of an underground economy important for managers?
6. What is purchasing power parity, and why should managers of international companies be concerned about it?
7. Why is income distribution important to marketers in international companies?
8. If the clothing industry association to which your firm's German subsidiary belongs could mount a successful promotional program to cause the Germans to increase their clothing expenditures by 1 percent annually, what would be the total increase in sales for the clothing industry?
9. In 2006, Italy's average labor compensation costs stated in U.S. dollars were \$25.07 compared to \$16.52 in 1995, and they were 19.96 euros compared to 26,911 lira.
 - a. What was the percentage increase or decrease in dollars?
 - b. What accounts for the huge difference in local rates between 1995 and 2006 (hint: euros versus lira)?
10. The staff economist of a large multinational with a Turkish subsidiary has given to the firm's chief financial officer a report on Turkey's foreign debt situation, as shown in Table 7.7. What concerns might the chief financial officer have?

11. What is the human-needs approach to the assessment of economic development? What elements make up the Human Development Index that the United Nations Development Program has developed in order to conduct a human-needs assessment of countries?
12. What problems with the import substitution strategy have caused some governments to increase their emphasis on export promotion?
13. What problems is the reduction in birthrates causing for European and Japanese governments?
14. What implications might the rural-to-urban shift in developing countries have for international companies?
15. Choose a country and a product and estimate the market potential of the product based on the economic and socioeconomic dimensions. What other environmental forces should you investigate?

 globalEDGE globalEDGE.msu.edu

Research Task

Use the globalEDGE site (<http://globalEDGE.msu.edu/>) to complete the following exercises:

1. You are working at a manufacturing company that is planning to set up a factory in either Australia, Germany, Japan, Sweden, or the United Kingdom. Top management has informed you that labor costs and productivity will be decisive factors in evaluating these investment opportunities. Visit the *Foreign Labor Statistics* (FLS) site which provides international comparisons of variables such as hourly compensation costs, productivity, and unit labor costs. Prepare a brief report recommending which country your company should invest in based on these variables. Make sure you examine the trends the countries have been experiencing over the past few years.
2. You are working for a company that is planning to invest in Portugal. Your company's executives have requested a report from you regarding Portugal's current economic situation. One of your colleagues mentioned a useful Web site called *Country Briefings*, published by the *Economist* magazine. This site contains comprehensive information on 60 countries, including country profiles, recent news, political and economic forecasts, statistics, and more. Using this site, prepare a short executive report outlining Portugal's current economic situation.

Minicase 7.1 The Impact of Galawi's Development Policy

Armando Suarez, CEO of Industrias Globales, and Pedro Garcia, the firm's director of international operations, are discussing a statement made today by the secretary of treasury in Galawi.

Suarez: Pedro, did you listen to the secretary's comments today about the proposed change in development strategy?

Garcia: Yes, I did, and I'm concerned. We have spent considerable time and money planning our entry into the Galawi market, and if the government proceeds with the new economic strategy, we've got to change our plant design, plan to produce different product lines, and completely change our marketing plans.

Suarez: This apparently is more serious than I thought. How can a change in their development strategy from import substitution to export promotion affect us?

Garcia: Hang on to your chair, Chief, and I'll explain each strategy and how the change will affect our entire start-up program in Galawi. Oh, and by the way, our Galawi competitors are going to have to make changes, too.

Imagine you are Pedro Garcia.

1. Describe the two strategies for the CEO.
2. Explain how the change in development strategy will affect the firm in many ways.
3. What changes in its entry plans will the firm have to make?