

Global Marketing

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Edition

The Global Economic Environment

Chapter 2

Learning Objectives

1. Identify and briefly explain major changes in the world economy over the last 100 years
2. Compare and contrast types of economic systems that are found in the different regions of the world
3. Explain the stages of economic development used by the World Bank and identify the key emerging country markets at each stage of development
4. Discuss the significance balance of payments for the world's major economies
5. Identify the countries that are leading exporters
6. Briefly explain how exchange rates impact a company's opportunities in different parts around the world

The World Economy—An Overview

- In the early 20th century economic integration was at 10%; today it is 50%
- EU and NAFTA are very integrated
- Global competitors have displaced or absorbed local ones

The World Economy—An Overview

- The new realities:
 - Capital movements have replaced trade as the driving force of the world economy
 - Production has become uncoupled from employment
 - The world economy, not individual countries, is the dominating factor

The World Economy—An Overview

The new realities, continued:

- The struggle between capitalism and socialism began in 1917 is over
- E-Commerce diminishes the importance of national barriers and forces companies to re-evaluate business models

Zeroing in on Economic Systems

- Globalization has made it harder to pigeonhole economies within the four-cell matrix
- Also consider:
 - Type of economy: advanced industrial state, emerging or transition economy, or developing nation?

Zeroing in on Economic Systems

- Type of Government: Monarchy, dictatorship, tyrant? One-party system? Dominated by another state? Democracy? Terrorist?
- Trade and capital flows: Free trade, part of trading bloc? Currency board or exchange controls?
- The commanding heights: Transportation, communications & energy sectors. State, private, or mixed ownership?

Zeroing in on Economic Systems

- Services provided by the state or state funded: Pensions, health care, education.
- Institutions: Country characterized by transparency, standards, absence of corruption? Standards ignored and court system compromised?
- Markets: Entrepreneurial high risk/high reward? Socialized market? Government dominated price and wage controls?

Economic Systems

Resource Allocation

Market

Command

Private

Market
Capitalism

Centrally
Planned
Capitalism

Resource

Ownership

State

Market
Socialism

Centrally
Planned
Socialism

Market Capitalism

- Individuals and firms allocate resources
- Production resources are privately owned
- Driven by consumers
- Government's role is to promote competition among firms and ensure consumer protection

Western Market Systems

| Type of System | Key Characteristics | Countries |
|-----------------------------|---|--------------------------------------|
| Anglo-Saxon model | Private ownership; free enterprise economy; capitalism; minimal social safety net; highly flexible employment policies | United States, Canada, Great Britain |
| Social market economy model | Private ownership; “social partners” orientation that includes employer groups, unions, and banks; unions and corporations are involved in government, and vice versa; inflexible employment policies | Germany, France, Italy |
| Nordic model | Mix of state ownership and private ownership; high taxes; some market regulation; generous social safety net | Sweden, Norway |

Centrally Planned Socialism

- Opposite of market capitalism
- State holds broad powers to serve the public interest; decides what goods and services are produced and in what quantities
- Consumers can spend only what is available
- Government owns entire industries and controls distribution
- Demand typically exceeds supply
- Little reliance on product differentiation, advertising, pricing strategy
- China, India, and the former USSR now moving towards some market allocation and private ownership

Centrally Planned Capitalism

- Economic system in which command resource allocation is used extensively in an environment of private resource ownership
- Example:
 - Swedish government controls 2/3s of all spending; a hybrid of CPS and capitalism (Market Socialism)
 - Swedish government plans move towards privatization

Economic Freedom

- Rankings of economic freedom among countries
 - “free” “mostly free” “mostly unfree” “repressed”
- Variables considered include such things as:
 - Trade policy
 - Taxation policy
 - Capital flows and foreign investment
 - Banking policy
 - Wage and price controls
 - Property rights
 - Black market

Economic Freedom— 2015 Rankings

Free

1. Hong Kong
2. Singapore
3. New Zealand
4. Australia
5. Switzerland
6. Canada
7. Chile
8. Estonia
9. Ireland
10. Mauritius
11. Denmark
12. United States

Repressed

169. Argentina
170. Republic of Congo
171. Iran
172. Turkmenistan
173. Equatorial Guinea
174. Eritrea
175. Zimbabwe
176. Venezuela
177. Cuba
178. North Korea

Not ranked: Afghanistan, Iraq, Kosovo, Libya, Liechtenstein, Somalia, Sudan, Syria

Stages of Market Development

- The World Bank has defined four categories of development using Gross National Income (GNI) as a base
- **BEMs**, identified 10 years ago, were countries in Central Europe, Latin America, and Asia that were to have rapid economic growth
- Today, the focus is on **BRICS**: Brazil, Russia, India, China and South Africa

Low-Income Countries

- GNI per capita of \$1,045 or less
- Characteristics
 - Limited industrialization
 - High percentage of population in farming
 - High birth rates
 - Low literacy rates
 - Heavy reliance on foreign aid
 - Political instability and unrest
 - Concentrated in Sub-Saharan Africa

Lower-Middle-Income Countries

- GNI per capita: \$1,046 to \$4,125
- Characteristics
 - Rapidly expanding consumer markets
 - Cheap motivated labor
 - Mature, standardized, labor-intensive industries like footwear, textiles and toys
- 50 bottom-ranked countries are LDCs—least developed countries
- India is the only BRIC nation

Upper-Middle-Income Countries



Venezuelans have to cope with a shortage of goods as oil prices have dropped.

GNP per capita: \$4,126 to \$12,745

Characteristics:

- Rapidly industrializing, less agricultural employment
- Increasing urbanization
- Rising wages
- High literacy rates and advanced education
- Lower wage costs than advanced countries

- Also called industrializing or developing economies
- BRICS: Brazil, China, South Africa
- Other countries: Malaysia, Chile, Venezuela, Mexico

Newly Industrializing Economies (NIEs)

- Lower-middle and upper income economies with the highest sustained rates of economic growth
 - Greater industrial output than developing economies
 - Exports of manufactured and refined products
 - Next -11 (N-11) a new country grouping identified by Goldman Sachs
 - NIEs include Egypt, Indonesia, the Philippines, (lower-middle income) Mexico, and Turkey (upper-middle income)

Mistaken Assumptions about LDCs

1. The poor have no money.
2. The poor will not “waste” money on non-essential goods.
3. Entering developing markets is fruitless because goods there are too cheap to make a profit.
4. People in BOP (bottom of the pyramid) countries cannot use technology.
5. Global companies doing business in BOP countries will be seen as exploiting the poor.

High-Income Countries

- GNI per capita: \$12,476 or more
- Also known as advanced, developed, industrialized, or postindustrial countries
- Characteristics:
 - Sustained economic growth through disciplined innovation
 - Service sector is more than 50% of GNI
 - Households have high ownership levels of basic products

High-Income Countries

- Characteristics, continued:
 - Importance of information processing and exchange
 - Ascendancy of knowledge over capital, intellectual over machine technology, scientists and professionals over engineers and semiskilled workers
 - Future oriented
 - Importance of interpersonal relationships

G-7, the Group of Seven

- Goal of global economic stability and prosperity
 - U.S.
 - Japan
 - Germany
 - France
 - Britain
 - Canada
 - Italy

Russia joined in 1998 changing the group to the G-8 but its membership was suspended in 2014 after it annexed the Crimean peninsula.

G-20, Group of Twenty

- Established in 1999
- Finance Ministers and central bank governors of 19 countries and the EU
- Russia remains a member, unlike in the G-7.

OECD, the Organization for Economic Cooperation and Development

- 34 nations
- Post-WW II European origin; based in Paris
- Canada, U.S. (1961), Japan (1964)
- Promotes economic growth and social well-being
- Focuses on world trade, global issues, labor market deregulation
 - Anti-bribery conventions

The Triad

- U.S., Western Europe, and Japan
- Represents 75% of world income
- Expanded Triad includes all of North America and the Pacific Rim and most of Eastern Europe
- Global companies should be equally strong in each part

Product Saturation Levels

- The percent of potential buyers or households who own a product
- India: 20% of people have telephones
- Autos: 1 per 43,000 Chinese, 21 per 100 Poles, 49 per EU adults, 8 per 1,000 Indians, 200 out of 1,000 in Russia, 565 out of 1,000 in Germany
- Computers: 1 PC per 6,000 Chinese; 11 PCs per 100 Poles; 34 PCs per 100 EU citizen

Balance of Payments

- Record of all economic transactions between the residents of a country and the rest of the world
 - Current account—record of all recurring trade in merchandise and services, and humanitarian aid
 - trade deficit—negative current account
 - trade surplus—positive current account
 - Capital account—record of all long-term direct investment, portfolio investment, and capital flows

Balance of Payments

| | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|-----------------|-----------------|-----------------|-----------------|-----------------|
| A. Current Account | -376,551 | -470,898 | -465,926 | -460,749 | -400,254 |
| 1. Goods Exports | 1,069,491 | 1,288,882 | 1,497,406 | 1,561,540 | 1,592,784 |
| 2. Goods Imports | -1,575,400 | -1,934,006 | -2,235,819 | -2,303,785 | -2,294,453 |
| 3. <i>Balance on Goods</i> | <i>-505,910</i> | <i>-645,124</i> | <i>-738,413</i> | <i>-742,095</i> | <i>-701,669</i> |
| 4. Services: Credit | 505,547 | 553,603 | 605,961 | 654,850 | 687,410 |
| 5. Services: Debit | -380,909 | -403,216 | -427,428 | -450,360 | -462,134 |
| 6. <i>Balance on Services</i> | <i>124,637</i> | <i>150,387</i> | <i>178,533</i> | <i>204,490</i> | <i>225,276</i> |
| 7. <i>Balance on Goods and Services</i> | <i>-381,272</i> | <i>-494,737</i> | <i>-559,880</i> | <i>-537,605</i> | <i>-476,392</i> |
| B. Capital Account | -140 | -152 | -1,159 | 6,904 | -412 |

Overview of International Finance

- Foreign exchange allows companies to do business globally with different currencies
- Exchange risk occurs when the value of a currency changes as it is traded
- Spot market: immediate delivery
- Forward market: future delivery
- Currency market participants include countries' central banks, companies that convert foreign currency into their home currencies, currency speculators

Overview of International Finance

- Devaluation: the reduction of a nation's currency against other currencies
- Mercantilism or Competitive-currency politics: Countries do not allow their currency to fluctuate
- Revaluation: A nation allows its currency to strengthen

U.S. Goods and Services Trade with BRIC, 2013 (US \$ Millions)

| | China | India | Brazil | Russia |
|--|----------|---------|---------|---------|
| 1. U.S. Goods Exports to | 122,838 | 22,225 | 44,072 | 11,136 |
| 2. Goods Imports from | -441,616 | -42,014 | -27,221 | -27,086 |
| 3. <i>Balance on Goods</i> | -318,778 | -19,789 | 16,852 | -15,949 |
| 4. U.S. Services Exports to | 37,761 | 13,470 | 26,640 | NA |
| 5. Services Imports from | -14,327 | -19,041 | -7,346 | NA |
| 6. <i>U.S. Balance on Services</i> | 23,434 | -5,571 | 19,293 | NA |
| 7. <i>U.S. Balance on Goods and Services</i> | -295,344 | -25,360 | 36,145 | NA |

Top Exporters and Importers in World Merchandise Trade, 2012

| Leading Exporters | 2012 | Leading Importers | 2012 |
|-------------------|---------|-------------------|---------|
| 1. China | \$2,049 | 1. United States | \$2,336 |
| 2. United States | 1,546 | 2. China | 1,818 |
| 3. Germany | 1,407 | 3. Germany | 1,167 |
| 4. Japan | 799 | 4. Japan | 886 |
| 5. Netherlands | 656 | 5. United Kingdom | 960 |

Overview of International Finance

- Foreign exchange makes it possible to do business across the boundary of a national currency
- Currency of various countries are traded for both immediate (spot) and future (forward) delivery
- Currency risk adds turbulence to global commerce

Foreign Exchange Market Dynamics

- Supply and Demand interaction
 - Country sells more goods/services than it buys
 - There is a greater demand for the currency
 - The currency will appreciate in value

TABLE 2-8 Exchange Risks and Gains in Foreign Transactions

| Foreign Contract Exchange Rates | \$1,000,000 Contract | | €1,100,000 Contract | |
|------------------------------------|-------------------------|------------------------|-------------------------|------------------------|
| | U.S. Seller Receives | European Buyer Pays | U.S. Seller Receives | European Buyer Pays |
| €1.25 = \$1 | \$1,000,000 | €1,250,000 | \$880,000 | €1,100,000 |
| €1.10 = \$1 | \$1,000,000 | €1,100,000 | \$1,000,000 | €1,100,000 |
| €1.00 = \$1 | \$1,000,000 | €1,000,000 | \$1,100,000 | €1,100,000 |
| €0.85 = \$1 | \$1,000,000 | €850,000 | \$1,294,118 | €1,100,000 |

Managing Economic Exposure

- *Economic exposure* refers to the impact of currency fluctuations on the present value of the company's financial performance.
- Occurs when sales are in a foreign currency
 - Nestlé generates 98% of sales outside home country
 - Euro zone companies GlaxoSmithKline, Daimler AG, BP, for example, generate 1/3 of sales in the U.S.

Managing Economic Exposure

- Numerous techniques and strategies have been developed to reduce exchange rate risk
 - *Hedging* involves balancing the risk of loss in one currency with a corresponding gain in another currency
 - *Forward Contracts* set the price of the exchange rate at some point in the future to eliminate some risk