

Ithaca College - Instructor Richard Tudway

International Business Operations

Course 881 36500

About your course - notice to all students

Please read these notes carefully

A. Objectives

The objective of this course is to provide the student with a clear framework within which to understand the principal organisational and risk management issues which affect international businesses. During the course the student will examine the importance of different strategic, economic, financial, marketing and cultural challenges which face managers of international businesses; and the different techniques, procedures and approaches which have evolved in the effective management of the associated risks.

Four main topic areas will be explored as follows. **First** the international economic, political, legal and cultural environment in which international businesses operate will be explored. This will include an examination of the principal economic indicators in respect of the global economy in general and the G7 (group of 7 largest economies) in particular. An assessment of the size and the structure of global GDP, growth, population, trade and current balances and the significance of these indicators, with particular reference to exchange rates, will also be made. An assessment of future shape of the global economy and the distribution of population will also be made with particular reference to China. Students will be alerted to the many different aspects of 'custom and practice' worldwide and the legal and institutional systems in operation and the challenges these pose to multinational businesses.

Second an assessment of policy in the post war Bretton Woods fixed exchange rate period and beyond in regard to trade and development and the deregulation of money and capital markets will be made. This will include an assessment of the economic and political history of trade theories and ideologies. It will also cover an assessment of the role of GATT, (the General Agreement on Tariffs and Trade), and its successor organisation WTO, (the World Trade Organisation) and the IMF, (International Monetary Fund). An assessment will also be made of the impact of FDIs, (foreign direct investments) on global development, the emergence of regional economic and trade groupings within the international economy such as the EU, (European Union), and NAFTA, (the North American free trade area), and the paradoxes associated with these developments. Special reference will be made to the key prospective development role of the China and the widespread political resistance to the processes of *globalisation*.

Third the course will explore international management practices in dealing with multicultural business development, marketing, human resource management and risk management. This will cover the planning and evaluation procedures commonly used in assessing international business opportunities; whether for example to set up marketing operations only or to manufacture/produce and market; and the 'rating and ranking' procedures commonly used to support decision taking. Using suitable case studies students will be acquainted with the use of **SWOT** as a method of assessing business opportunities.

Fourth the financial dimension of international business operations will be explored. This will include an assessment of the full range of options from 'green field' site development through to direct acquisition or some form of 'joint venture; questions of ownership and control; dividend repatriation and foreign exchange 'translation' and 'transactional' exposure. Students will assess the application of specific instruments such as forwards, futures and options in the hedging of risk.

B Learning Outturns.

The course will aim:

- (i) to provide students with an understanding of the international business environment by reference to the size, shape and development perspectives in respect of the global economy; to enable them to understand the role of international mediation institutions; to make use of published international statistical sources; to understand the issues surrounding the major policy debates, and to assess likely future development prospects.
- (ii) to provide students with an understanding of the historical evolution of theory politics and policy underpinnings of the international trade system with particular reference to GATT, (the general agreement on tariffs and trade) and its successor organisation the WTO (World Trade Organisation); and the roles of the IMF, the World Bank and the OECD in promoting FDIs, and fostering sustainable development.
- (iii) to provide students with an understanding of how conflicts arise between nations on matters of trade; how these impact upon international business and how these have (mostly) been resolved in post war years through the rules-based processes of the GATT and the WTO.
- (iv) to provide students with an understanding of the arguments used by particular nations to defend and justify the enforcement of tariffs, quotas and other measures to 'manage trade' and the implications for international business.
- (v) to enable students to understand how management practices have developed in response to the particular challenges of international operations. This will cover international business development strategy and planning, international marketing,

human resource management, different cultures and the management of the associated risks.

(vi) to enable students to understand the particular challenges to financial management of international operations with particular reference to business development activities either through 'green field' initiatives, acquisitions or joint venture activities and the funding of these operations and repatriation of dividends.

(vii) to enable students to understand the nature of economic and financial risk as it arises through 'translation' and 'transactional' currency exposures, together with other financial exposures arising from securities issuance, and floating rate borrowings, and how these risks are managed.

C. Schedule of meetings

The course in international business operations will take place over 14 meetings as follows:

Meetings Mondays 10.30 - 13.30

Topic 1 The international economic, political and legal framework of the global economy and the role of international business operations

Meeting 1 Mon 15 Jan

Introduction to the programme and its scope. The size and structure of the international economy. Who makes? Who consumes? Who saves? The concentrations of population and wealth. The North/South divide. The OECD 'Rich Man's Club'. The 'emerging markets' of South East Asia, South America and Eastern Europe and the former Soviet Union. Where the global economy is headed next. Diversity versus homogeneity.

The role of the multinational corporation in the generation of output and employment. The threats, challenges and opportunities that face the managers of international business operations and the procedures and practices they have evolved in assessing those opportunities and managing the hazards associated with them. The challenges of globalisation.

Dealing with multinational and multicultural marketing, and the management of risks associated with multinational operations in particular capital and current account risks that take the form of translation and transactional exposures. How the institutional and policy framework is likely to evolve. The threats and challenges in prospect.

Meeting 2

Mon 22 Jan

Looking at the global economy in more detail. Global GDP and its distribution between nations. Trade and development Who produces and who consumers. Comparative income and income distribution within the world economy. Patterns of savings and consumption. The structure of trade and current account between the major countries

Meeting 3

Mon 29 Jan

The scale of multinational business operations and how these have shaped economic, social and political developments. The impact on national growth, investment and employment. The role of multinational companies in providing capital inflow to support economic development. The particular challenges for transitional economies. Some specific examples. The role of multinational businesses in transferring technology and other much needed business and administrative skills.

Written essay assignment to be issued

Topic 2

An assessment of policy in regard to trade and development in the post war period and the impact on international business operations

Meeting 4

Mon 5 Feb

An examination of the pure theory of international trade as elaborated by Adam Smith and David Ricardo. The theories of absolute and comparative advantage and the argument that through specialisation based on comparative advantage economic welfare is maximised. Repudiation of the conflict laden theory of absolute advantage.

Meeting 5

Mon 12 Feb

A historical account of the conflict between trade theory and practice and the retreat from the principles of free trade and the emergence of nationalism and mercantilism in trade and the imposition of wide ranging tariff barriers. Examples from the 20's and 30's. The impact of this on economic and political behaviour

Meeting 6

Mon 19 Feb

The emergence of major trading blocs within the world economy and the potential threat these developments pose for free trade and 'open markets'. Deregulation throughout the global economy, designed to expand trade opportunities, is also threatened by 'protective' pressures within the large

exclusive trade groupings. The new challenge from ‘money using entrepreneurial economies’ and the threat to employment. ‘Welfare from trade’ arguments turned upside down.

Topic 3

Multinational management practice in addressing the challenges and threats to business development opportunities

**Meeting 7
Mon 26 Feb**

The development by multinational businesses of comprehensive management routines and procedures for addressing the wide ranging problems they face in operating often in many different economic, social and political contexts and environments. These cover routines for business development; the identification and assessment of commercial opportunities; due diligence through to decisions about whether to manufacture or produce locally; or to create marketing and distribution outlets for products and services produced elsewhere.

Mid term assignment - written examination second half of session

***Mid Term Spring Break 5 March - 9 March
No Classes***

**Meeting 8
Mon 12 Mar**

How business development opportunities are assessed. A review of case material of the sort used by international businesses looking at specific market opportunities. This case will involve assessing a business development proposal for the airline industry - the double jumbo jet case [Boeing versus Airbus Industrie]

**Meeting 9
Mon 19 Mar**

Class project involving the evaluation of different specific business development opportunities using standard management techniques and procedures. Case material will be distributed.

**Meeting 10
26 Mar**

Review of class generated business development proposals in **Mon** terms of strengths weaknesses, opportunities and threats **SWOT**

Topic 4

The financial dimension of international business operations and the management of risk

Meeting 11

Mon 2 Apr

International business operations demand sophisticated financial appraisal and control routines. When decisions are taken to set up manufacturing or marketing operations in overseas territories an appraisal has to be made not only of the expected rate of return from the project but also the sovereign risks associated with the venture. Endogenous as well as exogenous risks have to be explored, ranked and rated.

What has been the past performance of the economy? What is its likely future performance. If the decision of locate has been taken primarily for production reasons then the reasons for the decision need to be thoroughly assessed. Often production decisions are based on fiscal incentives and other capital incentives such as rent free or subsidised plant. If the decision is taken on marketing grounds the particular attention will need to be paid to the likely progress of the local market in terms of growth and real consumer spending.

***Meeting 12
Mon 9 Apr***

International businesses have exposures which are peculiar to operating in different currencies in different countries. Not only are their operations affected by economic, fiscal and monetary policies implemented in the country in which they are operating - they are affected when performance on capital and current account is reported back into the consolidated balance sheet and profit and loss account. International businesses face 'translation' and 'transactional' exposures. These risks have to be effectively managed and monitored.

Written essay assignment to be issued

***Meeting 13
Mon 16 Apr***

How are international treasury operations run and how to multinational businesses manage their cash? How do they deal with hedging balance sheets and receivables/ payables in different currencies.

How do they fund their operations in different markets using debt instruments such as bonds and other securities. How do multinational businesses make use of the swaps markets? How do they hedge against interest rate fluctuations?

***Meeting 14
Mon 23 Apr***

Course review and discussion in class of main topics.
Preparation for written examination.

Final Examination Monday 30 April 2006

D. Required and Recommended Reading

During the course students will be issued with written material in the form of course notes. Case material will also be issued. This is ***required reading***. Four books are also identified as ***recommended reading***. These are set out below. International Business by Daniels and Radebaugh will be the ***principal course textbook***.

Course notes will be supplemented by additional reading as directed. Students will be required to read both The Economist newspaper - current and past issues which are available on CD ROM at Imperial College Library, the Financial Times and the Wall Street Journal. Details of other reference material will be announced as the course advances. Three text books are recommended as follows:

International Business - J D Daniels and Lee H Radebaugh
International Economics Samuelson et al
International Economics Peter Lindert & Thomas Pugel

The Financial Times can be obtained easily in London and will be used for instructional purposes throughout the course. Students are also expected to read The Economist which is published each Friday.

E. Grading Plan

Grading will aim to measure contributions from student members throughout the duration of the course. Markings will be on a scale A to D with D and F as fail grades.

Course assessment will be calculated on the following basis in terms of total marks:

Two Essays - 1500 words (30%)
Debate and Class Presentations (20%)
Mid Term and Final examination (50%)

Essays (25%)

Two essays of approximately 1500 words on a topic to be agreed between each student and the instructor to be submitted by the time agreed.

Presentation & Debate (25%)

One presentation per student will be expected on a topic to be agreed. Debate and discussion in class will be encouraged and assessed on an on-going basis.

Mid Term Test and Final Examination (50%)

Two examinations will be held. There will be a mid term test which will be held on 3 March. A final examination will be held on 5 May. Both examinations will be held over two hours. Four questions should be answered.

F Grading Guidelines

The final grade is determined solely by the lecturer. Grade appeals to the lecturer should be made only on the basis of suspected errors in calculation.

The following table explains the grading system that will be used during this course.

<i>Grade</i>	<i>Honour Points</i>	<i>%</i>
A	4.0	93-100
A-	3.7	89-92
B+	3.3	85-88
B	3.0	81-84
B-	2.7	77-80
C+	2.3	73-76
C	2.0	69-72
C-	1.7	65-68
D	1.0	60-64
F	0.0	Below 60

Grading Criteria

Incomplete grades are **not** permitted, because of the obvious difficulty in making up missed work once the student has left London. **All work must be completed on time.** The grades reflect the quality of the work. The following criteria for an understanding of what each grade means will be used.

A, A- This exceptional grade is assigned only to work that has consistently outstanding quality in both substance and presentation. The student must demonstrate a sustained capacity for independent thought and extensive study, producing rigorous and convincing analyses in well-ordered prose.

Awarded to work that is clearly focused and analytical, and based on wide reading. The student must cover all the principal points of a question and systematically develop a persuasive overall thesis, allowing for one or two less important omissions or inapt expressions.

B+, B, B- This range of grades indicates that the student has shown some evidence of original thought and intellectual initiative. The student has cited sources beyond the class materials, and shown a degree of originality in perception and/or approach to the subject. The work will show thoughtful management of material, and a good grasp of the issues. The differences between a B+, a straight B and a B- may reflect poor presentation of the material, or mistakes in punctuation, spelling and grammar.

C+, C, C- Work in this grade range is unsatisfactory. If the work is simply a recitation of the class materials or discussions, and shows no sign of genuine intellectual engagement with the issues, it cannot deserve a higher grade. Should an essay fail to provide a clear answer to the question as set, or argue a position coherently, the grade will fall within this range.

Quality of presentation can lift such work into the upper levels of this grade range. Work of this quality which is poorly presented, and contains errors in grammar, spelling and punctuation, will fall into the lower end of the range.

To earn a passing grade, the work must demonstrate that the student is familiar with the primary course material, be written well enough to be readily understood, be relevant to the assignment, and, of course, be the student's own work except where properly cited.

D or F The failing grade indicates the work is seriously flawed in one or more ways examples of which include:

- Lack of familiarity with the material
- Poorly expressed
- So brief and insubstantial that it fails to properly address the subject
- Irrelevant material and argument

Code of student responsibility

The value of any grade, credit, honour or degree received by a student presupposes that all work submitted by a student is his or her own. A student who uses or relies upon the work of others or who, except under conditions expressly permitted by the instructor, furnishes assistance to another student violates the standards of the University. Students must insist upon academic honesty and integrity from their fellow students and must report promptly any case of alleged violation of academic conduct. Failure to do so is a violation of this code.

Plagiarism can take many forms, including the reproduction of published material without acknowledgement, or representing work done by others as your own. This includes the increasingly common practice of purchasing and downloading work from Internet 'paper mills'.

You should be extremely careful when submitting work for this course that all work is correctly sourced. Print outs of web sites that have been used in research may be required by the lecturer in cases of a grade dispute and all web site based reference material should be kept by the student until after the end of the semester.

G Special policies

In order to ensure fairness and consistency of treatment students should bear in mind the following conditions which will be strictly adhered to.

1. Students are expected to attend each class punctually at the time stated. Late attendance will attract penalisation. Absence through sickness should be supported in writing. Non attendance will be penalised in the overall assessment of performance.
2. All work issued will be returned within the stipulated time period. Failure to do so, except for reasons of sickness or injury - or other exceptional circumstances - will attract penalisation

3. Mid and end of term examination scripts will be handed in for marking immediately on completion of the examination.

4. Any case of plagiarism or any other abuse associated with obtaining scripts written by other parties will automatically be referred to the appropriate academic standards authority.

H. The Compact

The course is organised and delivered on the basis of a mutual compact between tutor and tutored. The tutor commits to provide to all those tutored the best possible educational support.

Those being tutored for their part commit also to match that effort by ensuring that they participate fully in the education experience.

By working together the tutor and the tutored aim to realise the objectives set out in section A above.

Meeting 1
Mon 15 Jan

An overview on the challenge of heterogeneity

During our first meeting I want to give you an overview of what we will be exploring together in coming meetings and what we will be seeking to achieve. The topic is one of those essential to students both of economics, business and finance. In case this is not as obvious as it sounds let me set this proposition out in more formal terms. International businesses operate within the framework of the international economy. Whilst we talk about the 'international economy' as if it were something 'homogenous' it is, in fact, a highly 'heterogeneous' place! Habits, practices, standards of living, and ways of viewing the world, institutions, laws all vary enormously across the global economy. International businesses have to be able to 'internalise' these differences and to articulate management rules and procedures that will help them to survive and prosper. This is the first major consideration.

A second major consideration is the scale of importance of international business operations. We all naturally tend to think of the role of governments and the 'domestic' business enterprise sector as if these were the only important contributors to wealth and conventional measures of GDP. But this has to be examined carefully. The picture has changed dramatically since the 1950's and is continuing to do so. Let's see if we understand why. Of course governments have a critical role to play because of the huge amounts of GDP they 'handle' through re-distribution within the economy - whether they support social welfare, education or defence. This averages some 40% of GDP in OECD countries and despite Herculean efforts in recent decades to curb the amount of GDP handled by governments this has not changed significantly¹.

In much the same way we cannot understate the role of the 'butchers bakers and candlestick makers' to quote from Adam Smith, who are still so important in everyday life. The business enterprise sector is the *primary* source of wealth in all communities. The role of large domestic businesses and the small to medium sized business sector, (SME's) is critical in national wealth creation and employment. Within this broad generalisation there is also another very significant fact. Most people, we shouldn't forget, are still employed by businesses employing 500 or less – not larger businesses and certainly not the largest multinational enterprises! Whilst there might have been a time when some analysts believed that in the fullness of time we would all end up being employed by mega enterprises the truth is that this trend has not been sustained. We can, as a broad generalisation, conclude therefore that whilst businesses do expand organically and through acquisition there comes a point when expansion in terms of employment not only halts but even declines. There are many examples of this from Big Blue (IBM), which was at one stage a vast employer of skilled manpower world wide, to key industries such as steel and coalmining. In OECD countries corporations in these sectors have certainly declined in recent decades. Looking to the future the prime candidates for rationalisation are not difficult to identify. The global automotive industry is an obvious example. Capacity is, quite simply, too great to meet prospective global demand for

¹ Check the OECD official figures at <www.oecd.org>

autos. Rationalisation both in terms of physical plant but also, most importantly, labour is bound to take place.

The shifting mix of domestic versus international output in national GDP

Even so, one thing that is evident as a phenomenon worldwide is the growing importance of the multinational business in the 'make up' of national GDP. For any particular national economy the contribution to national output from purely domestic firms is of course hugely significant but a diminishing proportion. Putting this observation another way - the weighting of the foreign owned multinational in national GDP everywhere is of growing importance. Not all economies are the same and statistics are patchy as between countries. But evidence of the increasing 'contribution' of foreign owned multinationals in 'national' GDP is everywhere visible and growing. As a generalisation it is probably true to say that of the major OECD economies Japan is the least *multinationalised* from the point of view of contribution to domestic GDP. There are reasons for this, which we will be exploring. In contrast the British economy - the fifth or so largest economy by dollar GDP - reflects a significant contribution from foreign owned businesses. Some estimates put this proportion at around 30% of GDP. Again this is rising.

Looking elsewhere, if we take the US - often regarded as *fortress America* because of the sheer size of its national GDP and the small part that it plays in trade in relative terms - the output of purely domestic businesses is still a very large proportion of GDP apart from the contribution from US multinational businesses headquartered in the US. Excluding 'transfers' from the US government, purely domestic business output plus US headquartered multinationals accounts for something in the region of 90% of industrial, commercial and services output. The remaining 10% is accounted for by non-American multinational businesses operating in the US. Many of them are in the electronics and automotive sectors and include Japanese owned producers such as Honda and Sony. But there are others. See if you can identify some of these corporations and the sectors in which they operate. British American Tobacco (a largely British owned and registered corporation) has significant US operations. These are expected to expand. Daimler Benz (a German registered corporation) owns Chrysler - one of the "big three" US motor manufacturers. But there are many others. Telecoms, Banking, Insurance - the list is longer than most Americans think.

These figures, bear in mind, are not very precise in statistical terms. Greater precision would help us to see the picture more clearly; but even *guesstimates* such as these give a lie as to the land. The UK, in short, is a country where the contribution of non-British multinationals to GDP is at its highest at an estimated 30% with the US at around 10% and Japan less than 5%.

Let's stay with Britain - a small country when compared with the US or Japan. Its GDP currently turns in at around \$2.1tr² when compared with almost \$12.4tr for the US and \$4.8tr for Japan. Roughly 97% of that \$2.1tr is industrial, commercial and services

² GDP at current prices and exchange rates, 2005 - source OECD May 2005

output, (including education and health care financed in large measure by tax 'transfers' from the state to employees in state schools and hospitals). Agriculture counts for a very small part – probably now 3% or less. Industrial output includes not only oil but also factories and things like utilities - electricity, water - and coal. Fairly large chunks of British domestic output are now produced by foreign owned enterprises like Ford and General Motors (American) through locally owned subsidiaries, Siemens with several British subsidiaries (German), Eriksson telecoms (Swedish), Nissan Autos (Japanese) amongst many others. So too are a number of other services such as banking and insurance - even railways. Zurich Re and its subsidiaries (Swiss), and CONNEX a train operating company in the South East of the country - a subsidiary of the illustrious SNCF, (French). Then there is the omnipresent WALMART – now one of the largest grocery retailer in the UK (American).

Looking specifically at the City of London - sometimes referred as the world's financial centre - again some 70% of the 'output' of the City is probably generated by non-British entities. Putting it another way around only 30% of that traditionally 'domestic' or British element of output is now generated by businesses that are British owned. Take a few names if you're in any doubt - Goldman Sachs, Merrill Lynch, J P Morgan, apart from the other large US money centre banks, Bank America, Citigroup amongst others. Add to that the Japanese securities houses like Nomura, other international banks and the big German, French, Dutch and Italian Banks. All of these operate from the London market but as entities they are often owned outside the UK by shareholders in many other jurisdictions. Just to complicate matters further the institutional investment industry ensures that ownership of equity is constantly on the move as share portfolios are bought and sold in international capital markets.

Even the existence of the second largest bank in the world HSBC, (the Hong Kong and Shanghai Banking Corporation - to give it its full name) doesn't materially alter things. HSBC is now a British Bank, quoted in London, following the handover of Hong Kong (where it was founded and operated for almost 100 years) to the Chinese in 1999. HSBC has a very wide and diversified shareholder base. It is now a British clearing bank following its acquisition of an old (and mostly ailing British bank), Midland. There has, in short, been a huge dilution of the 'domestic' element in output over the past 30 years.

If we look at British manufacturing the shift is even more dramatic. The contribution of manufacturing in GDP has fallen as the proportion of manufacturing capacity held by foreign owned entities has risen. Though there are some special reasons which explain this in the case of Britain, it is fair to say that this phenomenon is visible everywhere in the world economy.

Special factors at work in the EU

One can go further by saying that the trend will continue in that direction in coming decades. It will continue to such an extent that some may be justified in arguing that sovereign governments, of smaller countries at least, may very well feel themselves overshadowed by the multinational businesses which operate from within its frontiers. Again though there are special factors at work within the EU - the scale of cross border

mergers, acquisitions and other operations has over the past 30 years has radically changed the patterns of industrial and commercial distribution throughout Europe. German corporations and banks have for example shifted activities in neighbouring countries and vice versa.

Let us now turn our attention not only to particular sectors but also the scale of *multinationalisation* that is taking place. In media and broadcasting, for example, the publisher Robert Murdoch - an Australian who resides wherever his worldwide business needs require - controls a very large proportion of that sector in Britain. He does so also in other countries. He is not only increasing the scale of his operations in mainland Europe but in the US and the Far East. This raises very significant management problems for the company. It also raises some difficult problems for host governments. 'Who runs Britain - the government or Robert Murdoch?' is something, justifiably, on the minds of quite a lot of people. Media ownership everywhere is a source of concern.

I think you will by now be getting a feel for what is happening. *Multinationalisation* as a phenomenon is expanding at a very fast rate. The world in which the managers of these businesses operate is also becoming more complex. Being a multinational business is no longer about producing or sourcing in different countries or marketing and selling in foreign countries. The issue of where to locate is in part about availability of skilled labour which is not 'overpriced' or where there are definable cost benefits, many of them fiscally determined by governments, to be derived. But it is also driven by considerations such as the 'predictability' of the regime of the country in question. Everything from taxes through to membership of broader trade groupings.

Britain is again a topical example of a country 'sitting on the fence' as far as Europe is concerned and monetary union. The *euro* has been launched. Britain is still debating whether or not to take part. Some analysts of international business see this as a definite disadvantage for Britain. The uncertainties flowing from the policy response are judged to be negative. In contrast Mexico, on the face of things, has benefited from the creation of NAFTA, (the North American free trade area) as capital inflows from the US and Canada increase.

Looking to the future multinational businesses will inevitably become more and more involved in the political 'process'. This is going to force through all manner of new ways of making international business more accountable to 'locals'. The idea of 'foot loose capital' is often presented as a fundamental threat to democracy and accountability. Ways of addressing these anxieties will in coming decades will evolve. Such corporations will find themselves playing a much more explicit role as members of trade associations and other lobbying groups. Regional share listing is almost certainly going to embrace many more multinational businesses in a bid to diversify dependence on capital from the parent either from retained earnings or from new issues in the home capital markets.

There is another angle on all of this. Whilst *multinationalisation* is increasing, changes are also taking place in terms of patterns on ownership. What this means is that the notion of corporations necessarily being "national" in terms of ownership, is itself changing.

What this means is that very large US multinationals trading on the New York Stock Exchange may, because of changing share ownership end up by being owned or controlled by interests outside the US.³ Whether this represents another nail in the coffin of “national ownership” it must certainly tell us that the whole business of who owns and controls what in the multinational world is an increasingly more complicated matter.

The main features of the global economy

All of these matter we will be looking in coming weeks. But first things first we are going to need to get a handle on the size and structure of the world economy - who produces and income and population distribution. World GDP was currently running at around the \$67tr level in 2005.⁴ Let's not worry about great precision. The odd trillion discrepancy here and there is not of material significance! This provides a pretty good overview of the ‘big picture’.

Of that global total the most advanced economies, the countries of the OECD and other newly industrialised countries, generate around \$35tr - around 52.3% of global output. OECD output of \$35tr is generated by a total population of around 900 million souls out of a total global population of around 6 billion. This leaves the rest of the world, excluding OECD, and including some of the poorest countries, generating around \$32tr. If we look at this in terms of per capita income this yields around \$39,000 per head for OECD and other advanced countries [\$35tr/900m]. This compares with an estimated \$6,150 per capita income [\$32tr/5.2bn] for the rest of the non OECD world. In short OECD and the other advanced nations, with about 6% of the world's population [6bn/900m], produces around 52% of global output and enjoy income levels 6.3 times greater when compared with global per capita incomes [\$39,000/6,150]. Finally of the poorest countries of the world – mostly African, per capita incomes for those groups average some \$500! Ponder all of that carefully. **Better still check this out on the IMF web site <www.imf.com>.**

This picture has changed dramatically over the past 30 years as the most populous regions of non-OECD Asia have increased their wealth per head. Over the next 30 years the picture will change even more dramatically. China with its huge population - some 1.4bn - currently has a total purchasing power parity⁵ dollar GDP of around \$10tr with per capita incomes somewhat below the \$7,300 per head level [\$10tr/1.4bn]. It is likely to raise GDP in real terms by around 3 fold, over the next decade and a half or so to around \$30,000 by around 2020. At constant prices today, and leaving aside population growth in China, this means that by 2020 China will generate a total GDP well above total current US GDP of around \$12tr and per capita income at around \$40,000. Over the same period US GDP could well double in real terms from where it is today, to say \$24tr. If we factor into these forecasts population the picture changes dramatically. Growth of

³ There is even now the prospect that corporations like the London Stock Exchange, or New York could pass themselves in the hands of other parties as owners. The LSE is currently the focus of bidding interest from NASDAQ in th US and a consortium of European investors.

⁴ This data is published by the International Monetary Fund.

⁵ This data is calculated using a free floating rinnimbi equivalent rather than the fixed rinnimbi rate against the dollar which is currently around 7.83 per dollar. The adjusted rate greatly increases the value of Chinese GNP more than doubling the level calculated by the Chinese authorities.

population for China to (say) 2bn with per capita incomes 3 fold higher (\$21,000) will generate GDP of \$42tr. US population is likely to expand rather more slowly, (to perhaps the 350m level from 280 where it currently stands) and per capita incomes 2 fold higher (\$40,000 x 2 = \$80,000 x 300m = \$24tr). Chinese GDP by 2020 will have reached around \$42tr compared with US GDP of \$24tr. This is something that has staggering implications. Not only will China's total dollar spend be almost twice that of the US (even though its GDP per head will still lag the US), China will be the largest single market in the global economy. It certainly explains why everyone wanting to do anything in the global economy wants some part of the Chinese 'action'. See if you can work your way around these figures. See if you can weaknesses in the assumptions that have been made.

There are of course other implications. One of the most challenging is that as real incomes in Asia continue to rise - real incomes in other more prosperous regions today could very well face declines in real wealth. European citizens may very well be poorer - along with US citizens. OECD economies are likely to grow more slowly that's for sure. Capital will be drawn to markets that are expanding. It will be withdrawn from markets that are contracting or growing more slowly to more dynamic ones. The GDP outturns suggested above may not be realised. OECD might very well experience declining real wealth compared to China, India and other Asian economies.

Finally -consider the position in respect of trade. Total net imports and exports total around \$13.4tr - or 20% of global GDP. Of this the advanced economies account for 69% of the total with developing countries accounting for around 31%, China with exports around \$1tr is already the new "workshop of the world".

There are many issues for us to debate. As you can see they will have a critical role in determining the shape of the global economy in coming decades. Inevitably - and I conclude by referring to my opening comments about multinational businesses - international businesses are going to be playing an even more important role in world distribution of income and opportunities as the role of national governments decline. Unless of course something comes along to change all that. We shall see.

Questions for review

1. Why is the phenomenon of *multinationalisation* so important to the shape and structure of the world economy?
2. Does '*multinationalisation*' of the global economy necessarily mean 'homogenisation of the world economy'?
3. How do multinationals deal with cultural diversity?
4. How do multinationals deal with the problem of rating and ranking risk?

5. Do multinational businesses have a political role to play as distinct from a commercial one? How should this be given expression?
6. Are multinationals purely and simply interested in exploiting low cost production opportunities or do they have a wider view of what they are looking for?
7. Why do cultural conflicts arise for multinational businesses?
8. What do you think are the most important challenges and opportunities facing multinational businesses poised to enter China?
9. How would you react if you were heading up a global corporation if you were told that growth and real incomes in Europe were likely to fall in coming decades? How would that affect your investment decisions if you already had manufacturing plants in Europe?
10. How should multinational businesses be made democratically accountable to nations and their people?
11. What are the key statistics of output and population and trade for the global economy?
12. How is per capital income expected to grow for China over the next 20 years or so and what implications does this have for the global economy?