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International Business Management

Global sourcing, production, and logistics

Week 4

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Explore your emotions

Befor Before you begin, do the following mental activity that will help you to improve your concentration.

https://youtu.be/zmGogSbH5FQ

Introduction

In this fourth week, we will explore the global sourcing, production and logistics in the companies. Moreover, we will analyze how these elements influence the free trade agreements on the regions and how the business environment is shaped by each one of them.

Explanation

We understand production as the activities involved in creating a product. It includes both service and manufacturing activities because one company can produce a service or produce a physical product. On the other hand, logistics is the activity that controls the transmission of physical materials through the value chain, from procurement through production and into distribution.

Explanation

"Production and logistics are closely linked because a firm's ability to perform its production activities efficiently depends on a timely supply of high-quality material inputs, for which logistics is responsible."

First strategic objective:

Lowering costs

Second strategic objective:

Increasing product quality

Third strategic objective:

Accommodating demands for local responsiveness

Fourth strategic objective:

Responding to shifts in customer demand

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Where to produce

An essential decision facing an international firm is where to locate its production activities to best minimize costs and improve product quality. Before taking a decision, they must consider several factors; country factors, technological factors, and product factors.

Country factors

We know that some countries have a comparative advantage for producing certain products. Therefore, a firm should locate its various manufacturing activities where the economic, political, and cultural conditions are conductive to the performance of those activities.

Some specific country factors that can affect location decisions include the following:

- The availability of skilled labor and supporting industries
- Formal and informal trade barriers
- Expectations about future exchange rate changes
- Transportation costs
- Regulations affecting foreign direct investments

Technological factors

The **type of technology** that a firm uses in its manufacturing can affect location decisions. There are three characteristics of a manufacturing technology to consider.

The level of fixed costs

If the fixed costs of setting up a manufacturing plant are high, it might make sense to serve the world market from a single location or from a few locations.

When fixed costs are relatively low, multiple production plants may be possible.

Producing in multiple locations allows firms to respond to local markets and reduces dependency on a single location.

The minimum efficient scale

The larger the minimum efficient scale (the level of output at which most plant-level scale economies are exhausted) of a plant, the more likely centralized production in a single location or a limited number of locations makes sense.

A low minimum efficient scale allows the firm to respond to local market demands and hedge against currency risk by operating in multi-ple locations.

The flexibility of the technology

Flexible manufacturing technology or lean production covers a range of manufacturing technologies that are designed to reduce set up times for complex equipment, increase the utilization of individual machines through better scheduling, and improve quality control at all stages of the manufacturing process.

Explanation

The strategic role of foreign factories and the strategic advantage of a particular location can change over time. For instance, factories initially established to take advantage of low-cost labor can evolve into facilities with advanced design capabilities. Such improvement comes from two sources.

- Pressure from the center to improve the site's cost structure and/or customize a product to the demands of consumers in a particular nation.
- An increase in the availability of advanced factors of production in the nation in which the factory is located.

Explanation

Outsourcing production

Should an international business make or buy the component parts to go into their final product? **Make-or-buy decisions** are an important aspect of the strategy of many firms; decisions about whether they should perform a certain value creation activity themselves or outsource it to another entity.

These are the advantages of make decisions.

- Lower costs
- Facilitate investments in highly specialized assets
- Protect property technology
- Facilitate the scheduling of adjacent processes

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The advantages of buy

In terms of global logistics, buying component parts from independent suppliers can:

- **Give the firm greater flexibility.**
- **Help drive down the firm's cost structure.**
- **Help the firm capture orders from international customers.**

Activity

Reflect on what you have learned and answer the following activity:

Research on next topics and compare your answers with a classmate.

1. The factors behind global logistics and production.
2. The advantages of foreign production sites.
3. The tools used for managing global supply chains.

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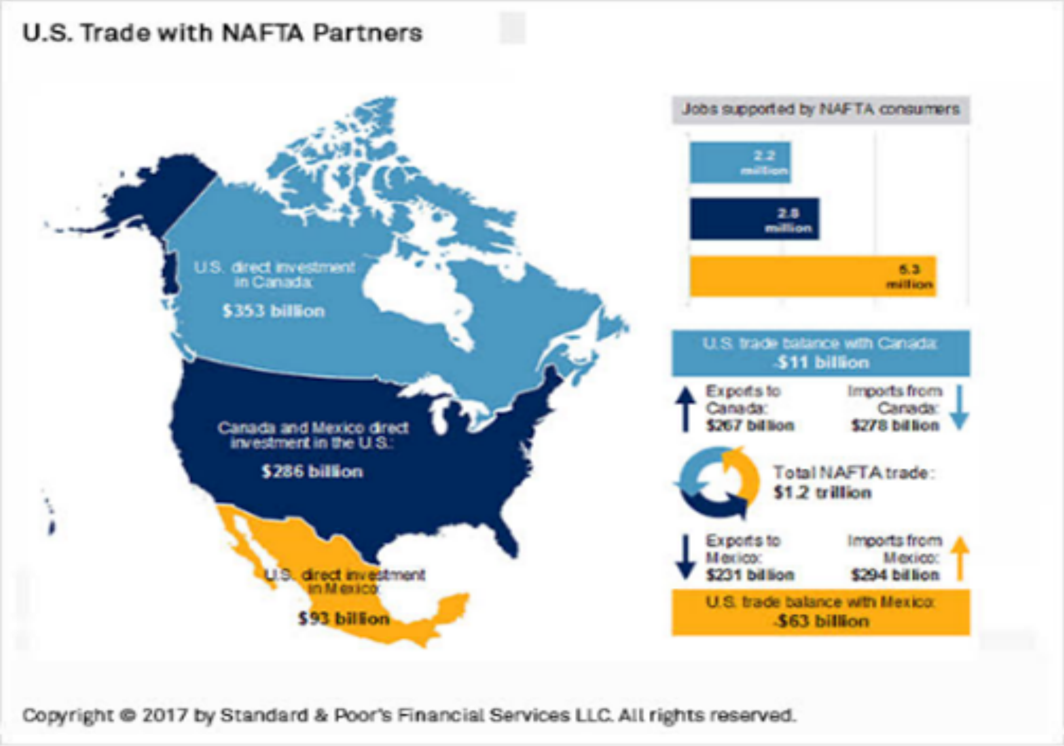
Free trade agreements in the region

Week 4

Explanation

NAFTA started as an agreement between the USA and Canada in 1988 (FTA), taking effect in 1989. As with any other free trade agreement, the goal was to eliminate barriers to commerce between member states. It soon expanded in order to include Mexico, this becoming the North American Free Trade Agreement enforced on January 1st, 1994. As a result, business in the region now can benefit from the abolition of tariffs on 99% of the goods they trade.



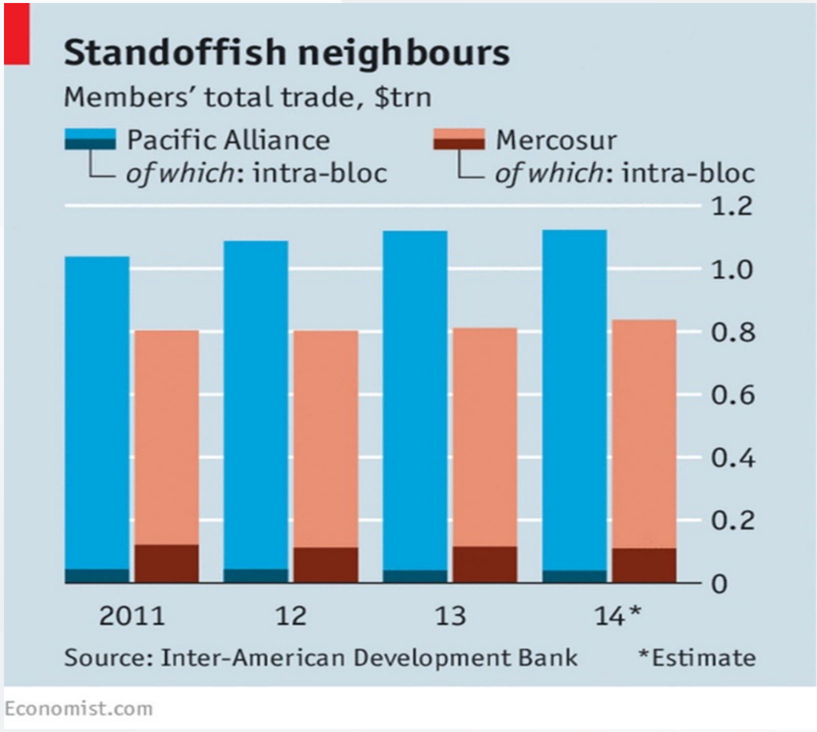
Kingston, J., Bovino, B., Cottani, J., y Palombi, R. (2018). The Economic Impact of NAFTA – Frequently Asked Questions. Retrieved from https://www.spglobal.com/en/research-insights/articles/faq-the-economic-impact-of-nafta

Introduction

The agreement has had a negative effect on job creation in the United States, not as bad as granting the most favored nation status to China or the deficit with Japan, but still a negative figure. So now there is a quick link between imports and job loss, just as exports increase jobs in the sourcing country. That scenario generates further political implications that make free trade a difficult issue to deal with.

All sides came to an informal agreement on September 30, 2018. It was formally signed on November 30, 2018, by Donald Trump, Enrique Peña Nieto and Justin Trudeau. The revised and final version was signed on December 10, 2019, and ratified by all three countries in March 2020. The agreement came into effect on July 1, 2020.

USMCA key changes vs. its predecessor include increased environmental and working regulations; enhances in intellectual property and digital trade regulations, greater incentives for automobile production in the US, among others.



The Pacific Alliance is another initiative of regional integration among Chile, Colombia, Mexico and Peru that has attracted interest from around the world. Observers from 34 countries and requests from Asian officials to be admitted as full members are some examples of that interest. The main challenge remains to increase intra-trade among member states that are geographically dispersed and rely on their Asian links to boo investment to do so.

The Economist. (2015). How deep is their love? Retrieved from https://www.economist.com/news/americas/21646273-pacific-alliance-great-brand-search-shared-product-how-deep-their-love

Introduction

South America has an incredible attractiveness for natural resources, as shown in the increasing FDI rates that resulted from the benefits of the free trade agreement. Since the deal took effect, overall trade with the international community nearly doubled and, in general terms, there was a 90% reduction in tariffs among member countries.

Since economic integration requires every member to give up a certain level of sovereignty, that creates political friction among members with consequences of the agreements. The MERCOSUR is no exception. Mexico, for instance, left out the oil industry from the NAFTA agreement because of the sensitivity of the topic internally.

MERCOSUR. (2016). En pocas palabras. Recuperado de http://www.mercosur.int/innovaportal/v/3862/2/innova.front/en-pocas-palabras

Explanation

There are other free-trade treaties and initiatives that prevail in the region.

The **CAFTA** (Central American Free Trade Agreement), with seven members, was signed in 2006 but has some complications (the United States is also a member.)

The **FTAA** (Free Trade Area of the Americas) has as a goal to foster democracy in the continent, and it has not made great progress either because of labor and natural resources differences.

The **Andean Pact** (Comunidad Andina) after several member adjustments since it was founded in 1969, finally gained four members by granting associate membership to MERCOSUR. There is a push to create a South American Free Trade Agreement, following the steps of their main commercial partner so far, the European Union.

The **Mesoamerica Project**, formerly known as the Plan Puebla Panama. This initiative is led by Mexico and aims to include all the Central American countries.

And, finally, the Trans-Pacific Partnership.

Activity

Reflect on what you have learned and answer the following activity:

Look for recent news mentioning NAFTA/USMCA since 2018 regarding its negotiation. Make a timeline of declarations by leaders of Canada, the United States, and Mexico.

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Business environment

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Explanation

The business environment, understood as the state and private structures that promote a free economy with a proper regulation for copyrights, sets up the basis for successful businesses.

Companies have several tools at hand in order to uplift their operations. Entrepreneurship, for instance, is a deep-rooted value in the American culture. Therefore, there are plenty of local resources to support and nurture the start-up of a new business, taking advantage of networks and other resources to minimize failure possibilities. Despite this, the United States, Canada, Brazil and Chile are good cases to study, apart from the many continent-wide business-supporting international organizations.

Introduction

The United States' Small Business Administration is of the most important government institutions in the continent to assist businesses, having branches and economic development agencies all over the territory. In addition, the US Department of State also publishes some valuable information for foreign companies. Other government departments have specific agencies dedicated to serve certain business groups, like the Minority Business Development Agency at the Department of Commerce (it also hosts the Select USA program to promote investment.)

Among the private institutions that support businesses with loans or special information about certain markets and industries, we can find the following:

Introduction

Latin America and the Caribbean, with emerging market economies that have recently started to value entrepreneurship and business innovation. **There is a strong relationship between economic freedom and economic growth**.

This idea has permeated throughout Latin America, where we have witnessed a proliferation of free market initiatives (the so-called neoliberalism), which is making foreign investors more confident. **Mexico is a good example** of that, always pushing for free trade (map) with the help of Bancomext, a national development/exports bank, and ProMexico, a government agency created to attract foreign direct investments to our country and to help Mexican businesses in their international expansion endeavors.

The opposite, however, happens in countries like Ecuador and Venezuela, where centralism and big government have hampered their domestic economy in the long term. Venezuela's harsh policy of reckless expropriation has scared investors and created a very negative environment for business. One can just wonder... which are the worst Latin American countries to invest in?

Introduction

We can say that Brazil, Mexico and Chile are the single most attractive economies in Latin America. The business environment in these countries is rather positive and advanced, to the point that they have already developed domestic business support networks too.

However, Brazilians speaks Portuguese and even though it can be similar to Spanish (portuñol, as José Samarago called it), it is important to know the difference between the two, so you will not make any mistakes that could hurt the business operations there. Private support for business endeavors in Brazil can found in the SEBRAE and the Brazilian Consulate in Miami.

Finally, entrepreneurship and innovation play an important role there. New businesses are created daily with the support of government-backed programs like start-up Chile, from Chile's economic development agency. As opposed to Argentina, for example, Chile has succeeded in positioning itself as a main target for investors.

Activity

Reflect on what you have learned and answer thefollowing questions.

1. What institutions can provide you with assistance and information when expanding a business in the Americas.
2. What is the role of the private and public sector?
3. What are the economic indicators that are relevant when studying the business environment of a country in which you want to do business?

Closing

In this fourth week, we have learned about institutions that counsel and support international expansion, entrepreneurship, and competitiveness in general for the whole region (not an easy task), as well as the most important Free Trade Agreements in the region and the perks of these agreements into the global sourcing, production and logistics.