INTL 466: Course Summary

- Opportunities & Risks
- The Non-Market Environment & Specific Strategies
- Strategy Generalizations
- Further Reading

Growth Miracles and Disasters: Average per-capita growth rates (PPP) from 1960-2000

Miracles	Growth	Disasters	Growth
Singapore	6.6	Nicaragua	-0.4
Taiwan	6.0	Sierra Leone	-0.4
Hong Kong	5.4	Comoros	-0.5
Botswana	5.2	Chad	-0.6
South Korea	5.2	Madagascar	-1.0
Japan	4.6	Mozambique	-1.0
Cyprus	4.1	Niger	-1.5
Barbados	4.0	Angola	-1.6
Portugal	3.9	Congo (Kinshasa)	-1.9
China	3.8	C.A.R.	-2.0

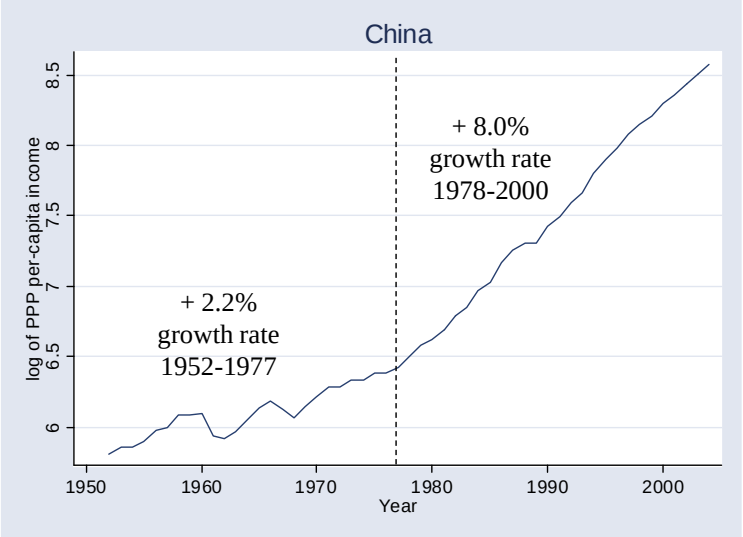
Volatility in Growth Rates

- Best 10-year avg growth rate in the USA since 1950: 3.3%
- Worst 10-year avg growth rate in the USA since 1950: 1.0%

	Percentage of Countries That Have	
	Outperformed US Best	Underperformed US Worst
Asia	86%	43%
Sub-Saharan Africa	64%	87%
Latin America	84%	77%

Sharp Changes: China

- China stagnated before 1978



Sharp Changes: Venezuela

• Venezuela's collapse

The Non-Market Environment

• Why don't the poor naturally catch up to the rich?

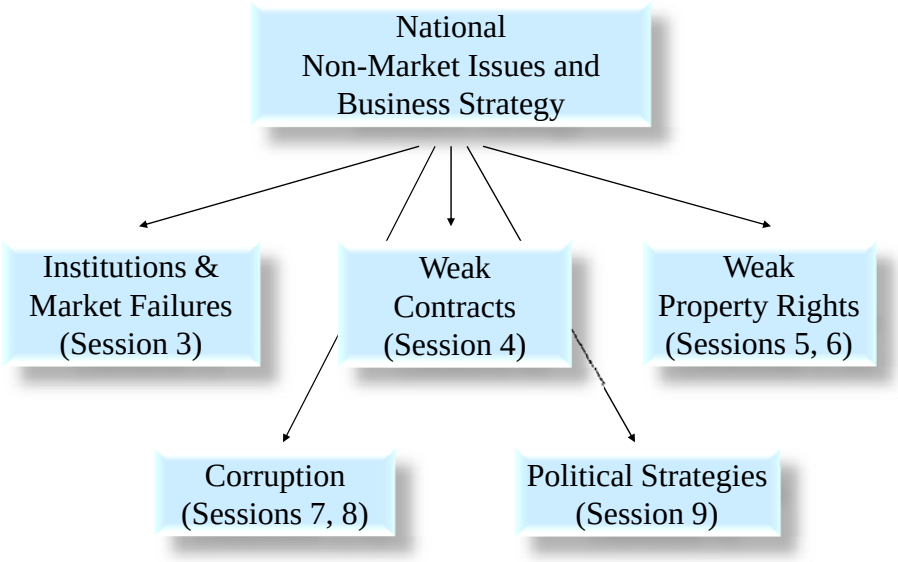
• Why do individual poor countries see such exceptional volatility?

} "Institutions", or "Non-market factors"

• How can firms mitigate the risks and tap the opportunities?

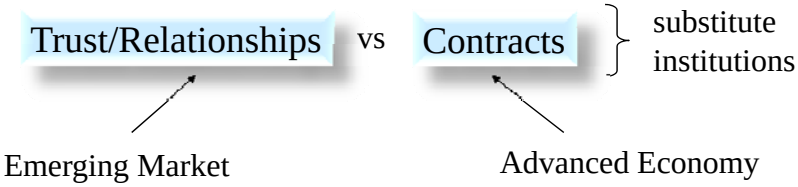
- Part I: National Non-Market Issues & Business Strategy
- Part II: International Non-Market Issues & Business Strategy

Part I (Session 3 – 9)



Specific Investments & Weak Contracts

- Specific Investments & the Hold-up Problem



- What do you do if a contract won't be useful?
  - Integration. (1) Full; (2) JV with investment sharing
  - Reputation. Create repeated interaction.
  - Technology. Make investment less specific.
  - Leverage. (1) Political strategy; (2) Jurisdiction choice

- Broadly: Align incentives over short and long term!
  Ask: Why *won't* partner hold you up?

Property Rights in Emerging Markets

- Minority shareholders' face special problems

  Asset stripping: lose *assets*
  Transfer pricing: lose *profits*
  Equity dilution: lose *ownership share*

  - Core Strategy: Maintain control of management decisions; i.e., avoid being minority shareholder
  - Due diligence needed, especially when partnering with opaque local firms. Why won't partner(s) do these things?

- Government expropriation
  - Outright expropriation less likely these days
  - But *creeping expropriation* – like a hold-up problem
  - Strategy: Buy-in government to success of enterprise
    - "If it's not fair, it's not sustainable"

Intellectual Property Rights in Emerging Markets

- Expropriation of IP can be an enormous risk
  - Lose it in one place, may lose many other markets too
  - Patents, Copyright, Trademarks, Trade Secrets

- Strategy

<u>Sensitive technology strategies</u>
- Complementarity
- Technological obfuscation
- Staging (R&D)

<u>Anti-counterfeit strategies</u>
- Avoid excess capacity
- Product tracking
- Complementarity

"We don't count on the legal system for protection; we count on the technologies themselves"

- But also: Non-Market *impact* strategies; e.g. WTO/TRIPS

Bribery & Corruption

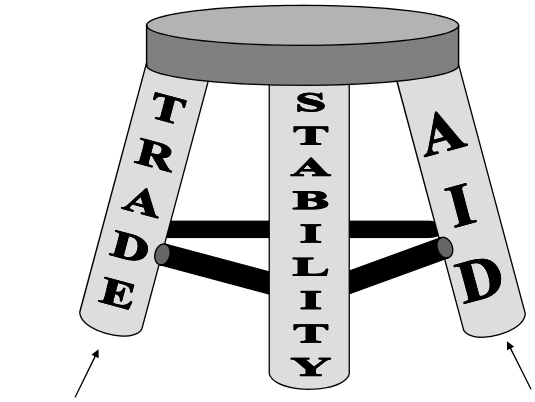
- Many reasons not to pay bribes
  - Ethics
  - Law
  - Profit

- Example: Profit. May win/continue this project but…
  - Inviting hold-up and renegotiation
  - Change in politician/bureaucrat = danger!
  - External reputation: easier target for others
  - Internal reputation: negative impact on corporate culture

- Strategies to contain bribe payments
  - Political strategies. Buy-in government.
  - External reputation commitments
  - Internal monitoring

Part II (Sessions 11 – 18)

Part II: The Three-legged Stool of the Bretton Woods Institutions



GATT
WTO

IMF

World Bank
& cousins

Trade & Political Economy

- Trade is good
  - Comparative Advantage => net gain for country
- Trade is bad
  - Some groups *within* countries lose in short run
  - May specialize in "bad" industries for growth (?)

- Net result: Nations obstruct free trade
  - Protectionism
  - Industrial strategy ("Import Substitution")
  - Active technology policies

Trade Institutions & Strategy

- Strategy & trade barriers
  - *React* to given set of trade restrictions
  - *Impact* trade regimes
    - Prevent unfavorable change
    - Encourage favorable change
- Remember: special interests are you
  - WTO constantly being renegotiated
  - Also FTA's, bilateral trade agreements
  - Some protectionism allowed within these trade regimes
- Ethical concerns
  - Labor standards ("Races to the Bottom")
  - TRIPS
  - Anti-dumping

Stability & the IMF

- Financial crises
  - Major source of volatility
  - Contagious
- IMF as international fire department
  - Prevents runaway devaluations, contagion
  - Does not prevent significant economic pain
- Strategy
  - Anticipating crisis: what are the warning signs?
  - Assessing private risk: how sensitive is business model?
  - Positioning beforehand to make any crisis less painful
  - Adjusting after crisis strikes
  - Tapping investment opportunities

International Development

- Institutions
  - World Bank Group: IBRD/IDA; IFC; MIGA
  - *Many* other multilateral and bilateral organizations
- Motive & Methods
  - Typically: Alleviate poverty and symptoms of poverty
  - Lend, partner, insure, facilitate and advise
- Strategy
  - Win contracts
  - Obtain financing
  - Obtain leverage/insurance against non-market risks
  - Tap expertise

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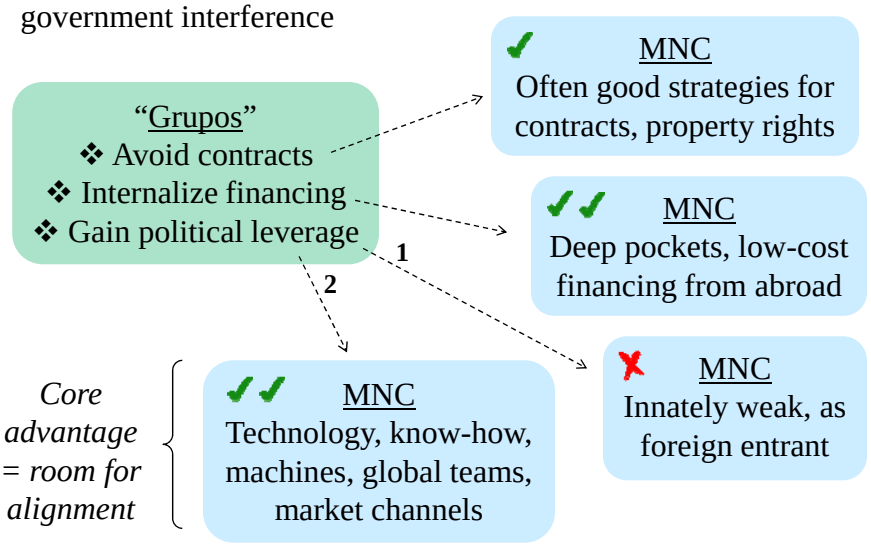
The Multinational Advantage

• Core issues: weak contracts, weak property rights, corruption, government interference



(Some) Strategy Essentials

• We have focused on many specific strategies to deal with specific issues, but some generalizations are also possible

- Common Games
  - Prisoner's dilemma
  - Coordination games

} What game are you playing?

- General strategic elements
  - *Identify* relevant counterparties
  - *Assess* their natural incentives
  - *Align* their incentives with yours
  - *Insure* against unfavorable changes
  - *Impact* the rules of the game

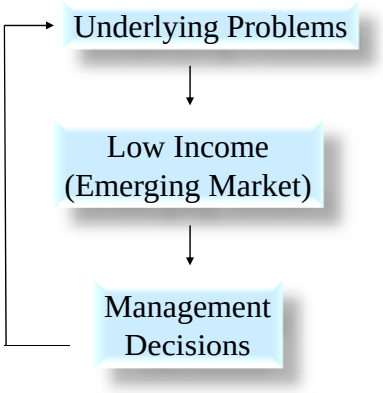
} Increasingly relevant when rule-based governance is weak

Volatility & Strategy

- Emerging markets are extremely volatile
  - Macroeconomic volatility (sources include leadership change in autocracies, trade concentration, and weak macroeconomic management leading to financial crises)
  - "Micro" volatility. Project specific problems

- Strategy
  - Prediction (hard) vs. Preparation
  - "Strategic resiliency" = Preparation
    = Knowing what the risks are
    = Thinking through possible consequences and designing strategies *ahead of time* that are flexible to anticipated problems

Ethics & Strategy



<u>The ideal strategy</u>
Innovative, bringing capital and technology. Using non-market strategy to open markets.

<u>The worst strategy</u>
Anti-competitive (anti-dumping, raising barriers), abusing workers or environment, using bribes and reinforcing bad local norms.

- The right ethical strategy is often the best profit strategy!
  "If it's not fair, it's not sustainable…"

Further Reading

- Trade
  - Douglas Irwin, *Free Trade Under Fire*
- Financial Crisis & International Monetary System
  - Paul Blustein, *The Chastening: Inside the Crisis that Rocked the Global Financial System and Humbled the IMF*
  - Reinhardt & Rogoff, *This Time is Different*
- Development & Growth
  - William Easterly, *The Elusive Quest for Growth*
  - Meier & Rauch, *Leading Issues in Economic Development*
  - Jared Diamond, *Guns, Germs, and Steel*
  - Pearl Buck, *The Good Earth*

END