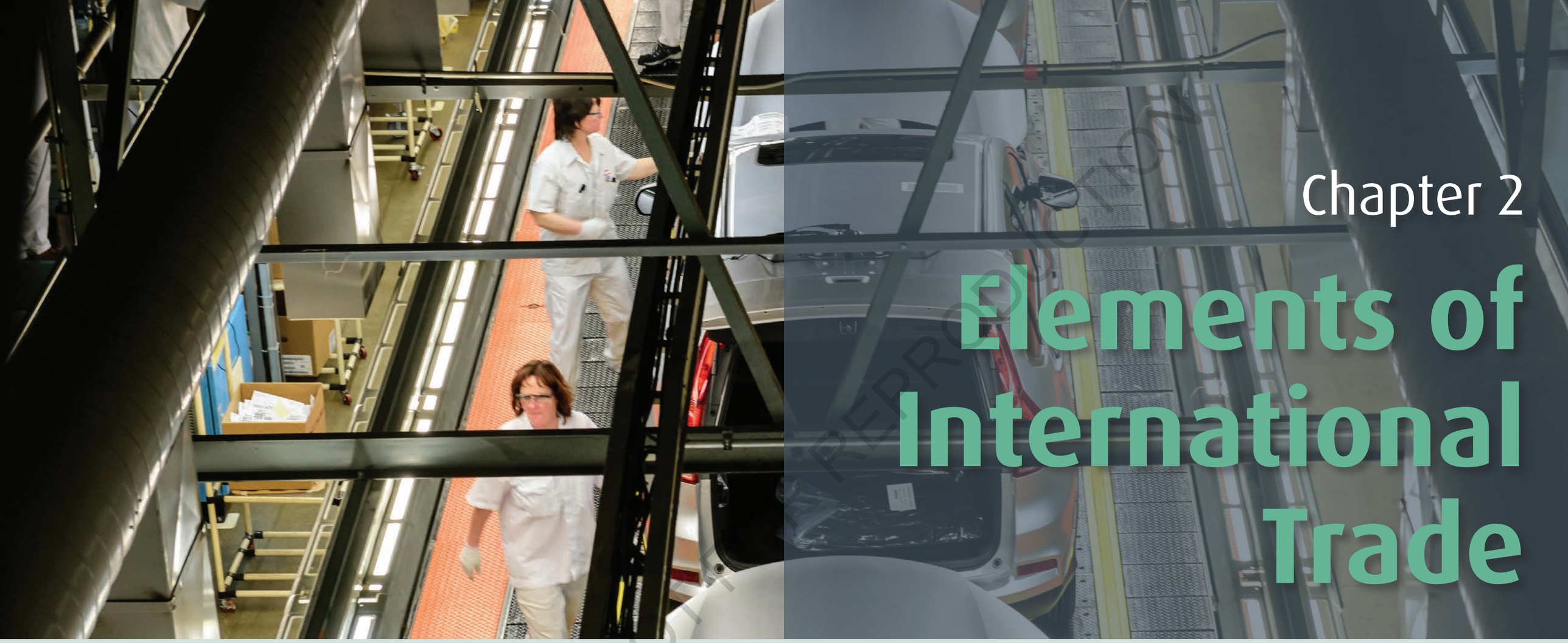


Chapter 2

Elements of International Trade

Learning Objectives

By the time you finish this chapter you should be able to:

- Identify the types of international businesses
- Describe, drawing on information from a variety of sources including the Internet, the impact technology has had on the international business environment
- Identify the factors that affect foreign exchange rates
- Explain how changes in the value of the Canadian dollar can affect business opportunities
- Identify the types of products that trade freely into and out of Canada and those that are restricted in their movement
- Identify and locate on a map Canada's major trading partners

Key Terms

importing
global sourcing
exporting
value added
licensing agreement
exclusive distribution rights
franchise
joint venture
foreign subsidiary
protectionism
tariff
trade quota
trade embargo
trade sanctions
World Trade Organization (WTO)
exchange rate
floating rate
currency devaluation
inflation
terms of trade
hard currencies
soft currencies
currency speculating

2.1 Types of international business

International trade plays a critical role in Canada's success as a nation. Canada trades for a variety of reasons. These include:

- Company growth
- Entry into new markets
- Expanded customer base
- Increased profits
- Access to inexpensive supplies
- Lower labour costs
- Access to financing

You are affected by international trade many times a day without even realizing it.

There are many types of international business. Some are very simple. In Chapter 1, you learned that many Canadians invest in other countries through foreign portfolio investment. Other kinds of international business are more complex. Companies may enter international markets through importing, exporting, licensing agreements, or franchising. The riskiest types of international business are joint ventures and foreign subsidiaries. They involve a high degree of risk because the parent company shares ownership or allows the subsidiary to be run by foreign nationals with little interference from the home country.

Foreign portfolio investment

Many Canadians invest in businesses by purchasing stocks, bonds, and financial instruments. Canadians do this to increase their wealth or save for retirement. Some of these investments are made outside of Canada. Foreign portfolio investments are made because investors look for dividends—the interest that can be gained on these investments. These investments can take many forms.

One way to invest is through money markets, where investments are short-term and are considered safe and liquid (easily converted into cash). Major corporations invest in money markets to earn interest on their current cash.

Another form of foreign portfolio investment is made through capital markets. Individuals can invest in capital markets by directly purchasing stocks on international stock markets such as the New York or Tokyo stock exchanges (NYSE or TSE). Some Canadians invest in capital markets through mutual funds, in which contributions from many people are combined and invested in various assets.

One reason that Canadians invest outside of Canada is because it allows them to diversify, or spread out, their investments, which is less risky than investing in just one area. Another reason is that many foreign investments provide greater rates of return. Ignoring investments outside of Canada dramatically limits investment opportunities. Great returns can be found in emerging markets such as China, Brazil, and India, which are experiencing strong economic growth. However, investing in these countries can also be risky.

Because the world's money markets, capital markets, and global banks are interrelated, a major change in one country is felt around the world. For example, the financial crisis that began in the United States in 2008 rippled across the globe. Banks in many countries failed or faltered because they were unable to collect on loans. Stocks plummeted in Brazil, Japan, and other major markets following the news that the U.S. stock market had dropped.

Canadians can invest in businesses by directly purchasing stocks on international stock markets. Here, a man stands in front of the Toronto Stock Exchange (TSX).

Importing

Importing means bringing products or services into a country. These goods and/or services may be intended for use by another business or for resale. Business-to-business (B2B) importing is common in Canada. Many Canadian manufacturers import products to use in their factories, while other companies purchase finished goods. This is referred to as **global sourcing**, which is the process of buying equipment, capital goods, raw materials, or services from around the world. For example, many companies purchase computers from Lenovo, a company with its headquarters in the United States; however, the computers are manufactured in China. Companies use global sourcing because it keeps costs down, improves quality, and allows access to new technologies.

Companies may also import products that they want to resell. For example, Canadian Tire imports barbeques made in the United States, The Bay imports clothing from Italy, and Best Buy imports televisions from Japan. Roots imports its clothing from Asia and South America.

Services can also be imported. Call centres located throughout the world answer calls from Canadians who have questions about their computers and appliances. It is not uncommon to interact with people in other countries when phoning for tech support for your new computer. For example, Sykes Enterprises Inc. is a global outsourcer of digital marketing and customer service. It operates call centres in more than 23 countries on five continents. One of these call centres has been imported into London, Ontario. Sykes Assistance Services provides healthcare, financial, and automotive services for Canadians.

Canada imports a variety of products, primarily from the United States, China, and Mexico. According to the CIA *World Factbook*, Canada's top imports include machinery and equipment, motor vehicles and parts, oil, chemicals, electricity, and consumer goods. In 2016, Canada's imports were worth approximately $547 billion.

Exporting

Exporting occurs when companies outside of Canada purchase Canadian goods and services. Just like imports, exports may be B2B or for resale. For example, Magna is a leading global producer of automotive parts. Its headquarters is in Aurora, Ontario. It has operations in 29 countries, which gives Magna access to every major auto manufacturer in the world. As the most diversified automotive supplier on Earth, it designs, develops, and manufactures automotive parts.

The Magna booth at the 67th International Motor Show in Frankfurt, Germany

Canada also exports services. For example, TeleTech is a multinational company based in Colorado with Canadian headquarters in Montreal and locations in Prince Edward Island, New Brunswick, and Ontario. It provides consulting services and call centres for companies all around the world.

Canada exports a variety of goods and services, primarily to the United States, China, and the United Kingdom. According to the CIA *World Factbook*, Canada's top exports include motor vehicles and parts, industrial machinery, aircraft, telecommunications equipment, chemicals, plastics, fertilizers, wood pulp, timber, crude petroleum, natural gas, electricity, and aluminum. In 2016, Canada's exports reached approximately $521 billion. Exporting is critical to Canada's economic success. More than 31 percent of our gross domestic product is exported. Our largest trading partner, the United States, accounts for more than 75 percent of our exported goods and services.

Figure 2-1 Canada's Top Imports by Country

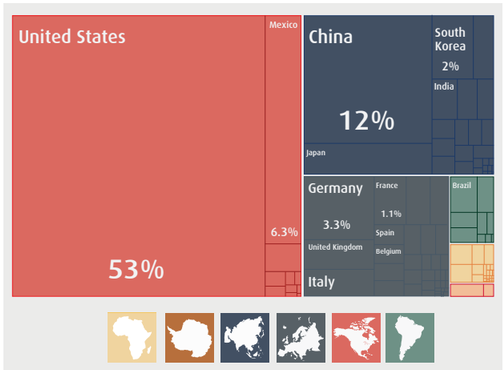
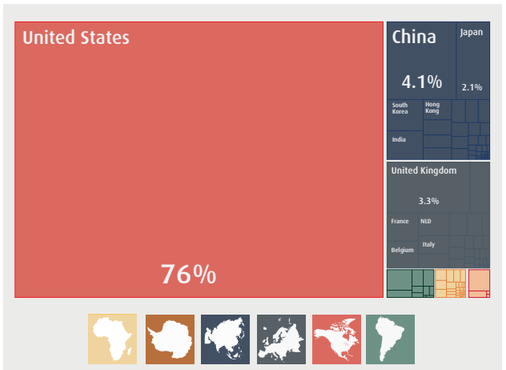


Figure 2-2 Canada's Top Exports by Country



Value added

One problem with Canada's exports is the lack of value added inherent in the products. **Value added** is the amount of worth that is added to a product as it is processed. It is the difference between the cost of the raw materials and the cost of the finished goods. Companies that focus on extraction of primary goods do not make as much money as companies that process these goods.

For example, consider the production of a dining room table. The lumber needed comes from a company in British Columbia. To build the table, $50 worth of lumber is required. An American company buys the wood and creates a beautifully crafted dining room table that it sells back to a Canadian retailer for $3,000. The Canadian retailer sells it to a customer for $4,500. Who makes the greatest profit from this transaction? The American furniture company because it applies the most value added. This is common in Canadian businesses. Most of our exports are from primary industries. Other countries process our goods into finished products, therefore gaining most of the profit from the processed good. Improving value added in our products is critical for Canada's future success in international business.

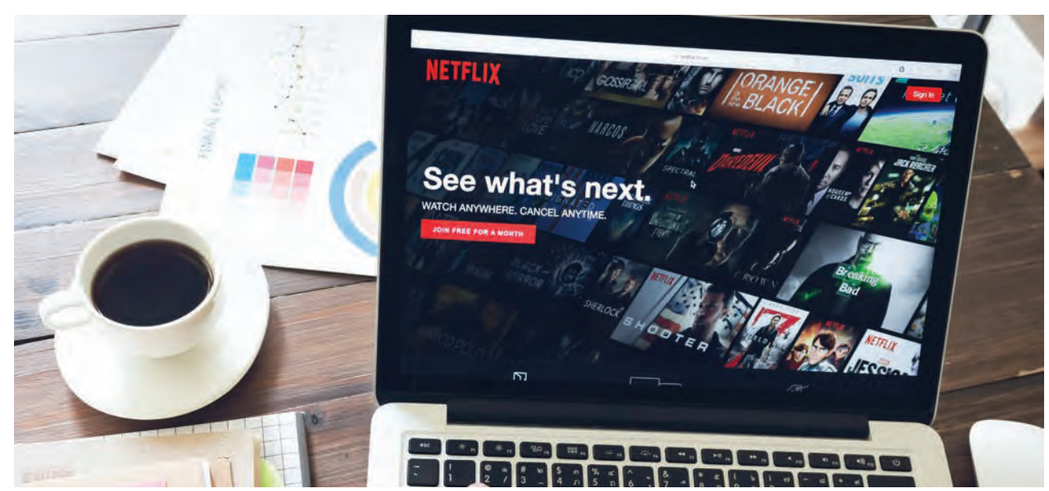
A medium-size call centre in India. The first call centre in India opened in 1998 and had just 18 employees with desks divided by fabric used to make saris.

Licensing agreements

A **licensing agreement** gives a company permission to use a product, service, brand name, or patent in exchange for a fee or royalty. Often the licence is applicable only in a specific region. For example, Virgin Mobile, a British company, has a licensing agreement with Bell Canada, Canada's largest communications company. This agreement allows Bell Mobility to use the Virgin Mobile brand in Canada. Richard Branson, chairman of the Virgin Group, states that the licensing agreement will allow both companies to experience faster growth, flexibility, and operating efficiencies. Canadians benefit from this agreement by having access to Virgin's extensive wireless service options. Virgin Mobile Canada is the number one mobile network used by young people and achieved the highest customer satisfaction ratings by J. D. Power and Associates. Virgin Mobile benefits from this licensing arrangement with Bell Canada through increased profits.

Canadians are impacted by licensing agreements when watching Netflix. It is frustrating when popular shows on the American Netflix are not available on the Canadian version. One reason is because a company like Shomi or Crave or a traditional TV channel may own the copyright for its shows. Shows on Netflix are also licensed for specific platforms and time slots. These restrictions are not easily rolled back. One thing is clear, however: Americans have access to more than three times the Netflix content as do Canadians—approximately 10,000 titles offered in the U.S. compared to 3,600 titles offered in Canada (as of the start of 2018).

Licensing agreements are a good thing, but can still be restrictive. Limited offerings on Netflix in Canada are one example of licensing with numerous restrictions.



Exclusive distribution rights are another form of licensing agreement. These rights allow a company to be the only distributor of a product in a geographic area or in a specific country. This strategy is often used to gain initial entry into a foreign market. (For more information, see Chapter 8.) An example of exclusive distribution rights occurred when the iPhone entered Canada. Rogers Communications had the only technology that would support the iPhone, and they had exclusive Canadian rights to sell it. Subscribers had to use a Rogers plan if they wanted to use an iPhone. Eventually, all providers obtained the necessary technology and entered the market as well.

Licensing is most frequently used for manufacturing processes. Often, management expertise will accompany the licensing agreement. It is common for the parent company to send senior management to the foreign country to help with the implementation of the licence. Once the foreign company is comfortable with the new technology or manufacturing process, the managers return to their home country, and employees in the foreign country manage the manufacturing using the protocol learned from head office. Licensing agreements have little risk, but the monetary gain is also limited.

International Blunders
Pampers® Diapers

When children are very young, most parents answer the question "Where did I come from?" with cute stories that vary from culture to culture. But in Japan, Pampers® Diapers caused great confusion with an ad showing a stork delivering a baby to a home. Japanese moms and dads did not understand why a bird would bring a baby. In Japan, babies are delivered by large floating peaches! One popular figure in Japanese folklore is Momotarō, a heroic figure who came to Earth inside a giant peach that was spotted floating down a river.

Franchising

A **franchise** is similar to licensing in that it is an agreement to use a company's name, services, products, and marketing. The franchisee signs a contract and agrees to follow all of the franchisor's (the parent company's) rules. For a fee, the franchisor provides service support in financing, operations, human resources, marketing, advertising, quality control, and many other areas.

Examples of foreign-owned franchises commonly found in Canada are McDonald's, Wendy's, Subway, Little Caesars, Pak Mail, and Maaco Collision Repair and Auto Painting. Canadian-owned franchises include Casey's Bar and Grill, Boston Pizza, Mr. Sub, Second Cup, Great Canadian Dollar Store, Kumon, and Kernels Popcorn.

The advantages for the franchisee (who buys and runs the franchise) are lower risk, access to expert knowledge and research, and financial aid. The disadvantages are less profit, stringent guidelines, and loss of control.

One of the most successful Canadian franchises is Boston Pizza. Started in Edmonton in 1964, it has grown to become Canada's number one casual dining brand with over 380 locations making over $1 billion in revenue a year. The restaurant caters to families during dinnertime and attracts sports teams and enthusiasts who watch the large-screen televisions in the sports bar in the evenings. Boston Pizza's strategy is to provide two experiences under one roof. Boston Pizza has not always been an international success. In 1988, it expanded into Asia. It adapted its décor to suit Asian tastes and traditions, but the restaurants looked outdated and drab. Boston Pizza agreed to short-term real estate leases in Asia, and the landlords increased the rent dramatically at renewal time. All of the Asian restaurants closed by 1996. Currently, Boston Pizza is experiencing success in its international expansion into the United States and Mexico under the name Boston's The Gourmet Pizza.

A Boston Pizza restaurant in Niagara Falls, Ontario

Joint ventures

A common type of international business used to establish a presence in a foreign country is a joint venture. A **joint venture** occurs when two businesses, one of which is usually located in the foreign country, form a new company with shared ownership. In fact, 25 percent to 40 percent of all foreign investment is in the form of joint ventures.

One main reason companies create a joint venture is to be allowed into a country. For example, many Canadian businesses are able to enter the communist countries of China and Cuba because they are willing to enter a joint venture with the governments of these countries. For example, the Toronto-based company Internet of Things Inc. has entered into a joint venture with the Chinese company New Hope Group to provide global industrial technology to New Hope's manufacturing facilities. In Cuba more than 60 Canadian companies do business. Most of these joint ventures are in the mining industries in addition to Delta Hotels and Resorts, Sunwing, Air Transat, and Pizza Nova. Joint ventures allow companies to gain access to markets, products, and customers that were not previously accessible. Other advantages of joint ventures include shared financing, managerial expertise, technology, cultural information, economies of scale, and risk reduction.

However, 50 percent of all joint ventures fail. For example, Tiffany & Co. jewellery was ordered to pay Swatch, the world's largest watch manufacturer, $448 million for a failed joint venture. The Swiss Swatch sued Tiffany, a company headquartered in New York, in a Netherland's court because that is where the joint venture was registered. Joint ventures that do succeed often take years to generate a profit. Joint ventures take longer to negotiate and establish because the needs and wants of two companies must be taken into consideration.

Some ways to overcome problems in a joint venture include clearly defining each company's roles, establishing formal contracts, and paying close attention to detail. Companies need to research the cultural differences and business methodologies of each company and the country in which the joint venture is located.

An example of a Canadian company that has successfully navigated a joint venture is Sun Life Financial. Sun Life Everbright is a joint venture in China between Sun Life and the China Everbright Group, a government-owned entity. The new company sells insurance products to an expanding middle class throughout China. One reason for its success is the clear delineation of duties for each company. Sun Life is accountable for the day-to-day operations of the new company, while Everbright takes care of distribution networks and local management expertise. Currently, there are over 8.5 million Everbright customers in China, serviced by more than 2,500 employees in 116 locations.

A Swatch store in London, England

A high-speed train manufactured by Bombardier Sifang (Qingdao) Transportation Ltd. (BST) in China for the Chinese Ministry of Railways.

Foreign subsidiaries

The most comprehensive type of international business is called a foreign subsidiary. A **foreign subsidiary**, often referred to as a wholly owned subsidiary, exists when a parent company allows a branch of its company, in another country, to be run as an independent entity. The parent company often sets financial targets for sales, profits, and growth. As long as those targets are being met, the parent company generally leaves the subsidiary to run its own day-to-day operations. This decentralized decision-making process allows the local management to incorporate the host country's culture and customs.

Toyota has traditionally been a successful foreign subsidiary in Canada through Toyota Motor Manufacturing Canada (TMMC), which operates in Cambridge and Woodstock, Ontario. These plants produce the Corolla sedan and RAV4 Toyota models and assemble the Lexus RX 350 and Lexus 450h, the only Lexus vehicles produced outside of Japan. This subsidiary has many advantages for Toyota. It saves on distribution costs because the plant is closer to Toyota's North American customers, and it provides access to a well-educated workforce. These factors help to increase profitability. Canada also gains from this subsidiary. TMMC employs more than 8,000 people.

Canadian companies also have subsidiaries around the world. Bombardier, the Quebec-based producer of snowmobiles, Sea-Doos, trains, and airplanes, has seven subsidiaries in China. TD Bank Financial Group, which operates TD Canada Trust throughout Canada, has a subsidiary in the United States. TD Bank is the 10th largest bank in the US. It operates in the Northeast, Mid-Atlantic, Carolinas, and Florida, providing services such as online banking, commercial banking, investments, and insurance. It has over 13 000 locations servicing approximately 8.5 million customers. As a result of Canada's strong banking expertise, the TD Bank Financial Group was able to expand its company into an area of business that had historically experienced major upheaval and financial difficulty.

Section review

1. State two reasons Canadians invest.
2. State two reasons Canadians invest outside of Canada. State one disadvantage of this.
3. What is importing? Give an example of an item you own that was imported.
4. Identify five of Canada's major imports.
5. What is exporting?
6. Identify five of Canada's major exports.
7. Explain the concept of value added. Describe Canada's ability to provide value added.
8. Define licensing agreement. Give an example.
9. Define franchise.
10. What information is included in a franchising agreement?
11. Name five Canadian-owned franchises.
12. What is a joint venture? Give an example of a Canadian joint venture.
13. What is a foreign subsidiary? Give two examples of Canadian-owned foreign subsidiaries.

Canada Imports and Exports

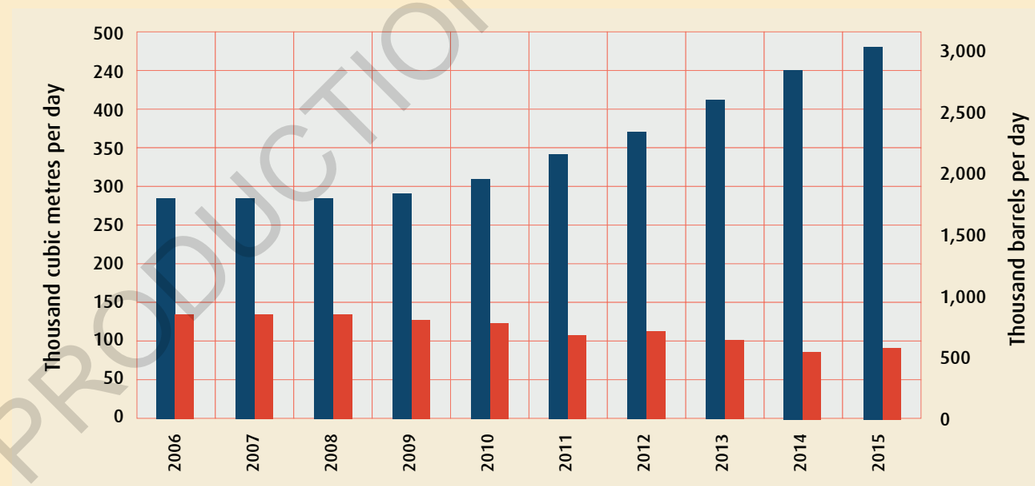
Oil

Oil is one of Canada's major imports and exports. Why would a country export a product that it could have used domestically? One of the main reasons is Canada's vast size. Oil reserves in the West are not used in the East.

Canada has the third largest oil reserves in the world, which account for 10 percent of the total global supply. Saudi Arabia and Venezuela are first and second. More than 95 percent of Canada's oil is found in the Alberta oil sands. Reserves can also be found in Saskatchewan, and in offshore Newfoundland and Labrador. Most of the oil exported in Canada goes to the United States. Canadian oil exports account for 41 percent of the United States imports of oil.

Canada also imports oil. In 2016, it imported 759,000 barrels per day. More than half that amount came from the United States and a third came from OPEC member countries: Saudi Arabia, Algeria, Nigeria, and the United Arab Emirates. Imports also came from Iraq and Norway. Oil is imported into eastern Canada to supply the oil needs of that part of the country.

Figure 2-4 Canadian Crude Oil Net Export Volumes, 2006–2015

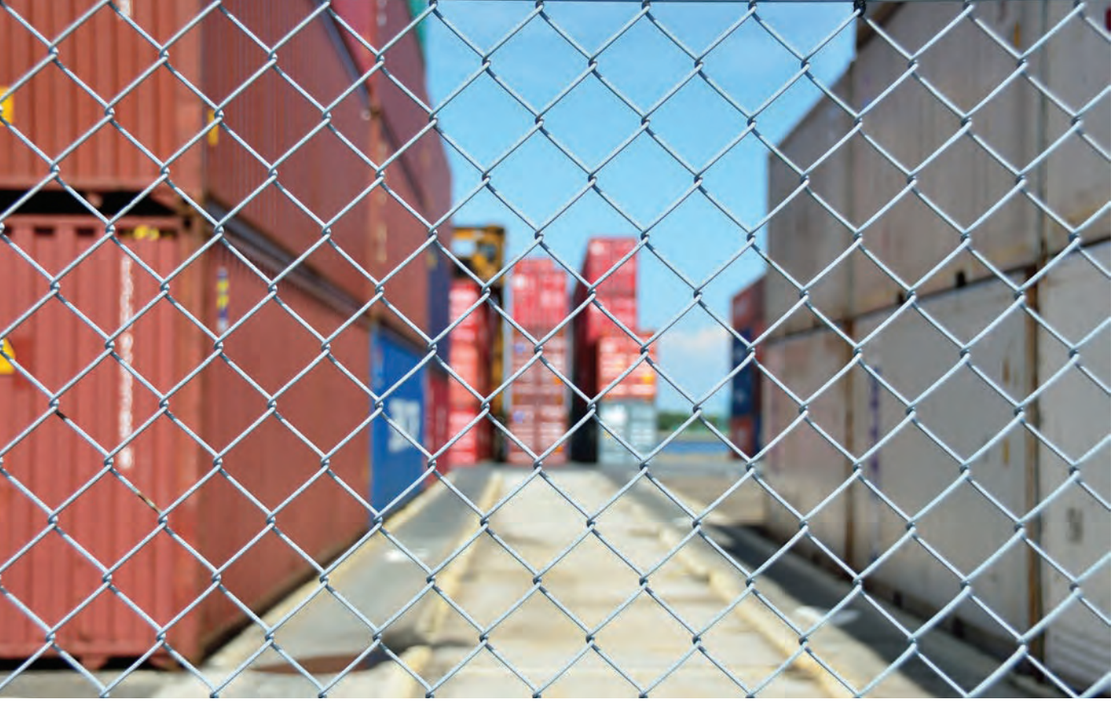


Source: National Energy Board

There is a proposal for a 4,500-kilometre pipeline from Alberta to eastern Canada. The goal is to boost Canada's oil exports and minimize the need for imports. The plan is to convert an existing natural gas pipeline to an oil one. New sections will also be constructed. The earliest this pipeline could be operational is 2021. One of the many problems with this proposed pipeline is that the eastern refineries will have to upgrade their equipment to cope with the heavier oil. If the refineries are not upgraded, most of the oil will be exported abroad. This pipeline may also put First Nations' land at risk by posing a variety of environmental challenges.

Check Your Understanding

1. Why does Canada import and export oil?
2. Identify the location of the world's largest oil reserves.
3. Where are Canada's oil reserves?
4. List the countries to which Canada exports oil.
5. From where does Canada import oil?
6. How will the proposed pipeline from Alberta to Eastern Canada impact the Canadian oil industry?
7. Research the current state of the pipeline. Include the risks and rewards of the pipeline.



2.2 Trade barriers

Although trade is beneficial for all countries, it is not always easy. Governments set up rules and regulations to protect local businesses, generate revenue, and protect citizens from harmful products; however, many of these regulations discourage international trade. This shielding against foreign competition is called **protectionism**.

Tariffs

The most common type of trade barrier is a **tariff**. Tariffs are taxes or duties charged on imported products or services. A tariff raises the cost of imported goods so that consumers will purchase locally manufactured products instead of imports. The other advantage of tariffs for domestic governments is an increase in revenue. The government imposing the tariff collects the money that the tariff generates.

Canada generally favours the reduction or eradication of tariffs. This is because when one country implements a tariff, its trading partner will retaliate with a tariff of its own. The North American Free Trade Agreement (NAFTA) is a trade agreement that eliminates trade barriers such as tariffs between Canada, the United States, and Mexico.

Winners	Losers
Domestic governments—they collect the additional taxes	Foreign producers—their goods are now more expensive
Local producers—their goods are more competitively priced	Consumers—the price of the products go up and consumers are forced to pay higher prices
Local employees—the people working in local companies keep their jobs	Foreign employees—the people working in companies overseas lose out on opportunities

Figure 2-5
Tariff Winners and Losers

		Canada	Import
Before Tariff	Raw materials	100	100
	Labour	50	10
	Shipping	5	10
	Total	155	120
	Markup (100%)	155	120
	Selling price	**310**	**240**
After Tariff	Raw materials	100	100
	Labour	50	10
	Total	150	110
	Tariff (50%)	—	55
	Shipping	5	10
	Total	155	175
	Markup (100%)	155	175
	Selling price	**310**	**350**

With the tariff added, the imported product is now more expensive than the Canadian product.

Figure 2-6
How Tariffs Work: Canada's Smartphone Production and Imports

Trade quotas

Trade quotas are another form of protectionism. A **trade quota** is a government-imposed limit on the amount of product that can be imported in a certain period of time. This protects domestic producers by limiting the amount of product imported and decreasing foreign competition.

Canadian importers are faced with trade quotas from around the world. For example, under CETA (the Canada–European Union Comprehensive Economic and Trade Agreement) the quota of high-quality cheese allowed into Canada from the EU will more than double the amount of cheese exports to Canada. This represents approximately 4 percent of the Canadian market. Canadian products subject to U.S. quotas include beef, cotton, wool, and man-made fibres.

Canada holds quotas on many products it imports. These include agricultural products, firearms, steel, textiles, shoes, and clothing. In the shoewear industry, for example, returns are carefully tracked. If returned shoes are of poor quality and must be scrapped, the shoe business in Canada will be entitled to a replacement import if the shoes came from a country where a quota is imposed.

Both tariffs and quotas provide protection for domestic producers. The imposition of a tariff or quota causes prices to rise; however, the difference between the two is that the extra revenue generated by a tariff goes to the domestic government, whereas with a quota, the increase in revenue is kept by the producers.

If you buy imported shoes and they must be returned for damage or poor quality, the store can import a replacement pair.

Trade embargoes and sanctions

When a government imposes a **trade embargo**, it bans trade completely between two countries. The strict rules the United States has for doing business with Cuba are an example of an embargo, and include a ban on finance, trade, and travel. This embargo started when Cuba adopted communism under Fidel Castro. Cuba has lost millions of dollars of potential sales in cigars and rum because of the restrictions. Under the Obama Administration, the U.S. was negotiating the lifting of the ban. However, the Trump Administration voted against the United Nations' resolution to condemn the U.S. trade embargo on Cuba. The vote was 191–2 in favour of halting the embargo. The United States and Israel were the dissenting votes.

Trade sanctions are often referred to partial embargoes and may involve limiting trade of specific products or with specific companies or individuals. For example, Canada has restricted the exportation of certain products to North Korea. These products include firearms, luxury goods, and aviation fuel, including rocket fuel. Canada has also restricted the importation of a variety of products including iron, coal, and gold.

Trade embargoes and sanctions are intended to pressure foreign governments to change their policies or to improve their human rights records. For example, Canada has imposed economic sanctions against Syria in response to its humanitarian crisis and breach of international peace in the region.

A trade embargo or sanction declared by Canada affects Canadians by increasing the need for domestic products that become unavailable as imports. It may cause the price of a product to increase because the supply has decreased. When another country imposes a trade sanction on Canadian products, there is surplus domestic supply. Canadian companies must find alternate markets to buy their products, or decrease production and close factories.

A poster welcoming former U.S. President Barack Obama's historic visit to Cuba in March, 2016. It was the first visit by a sitting U.S. president in nearly a century, and was meant to signal a change in U.S.–Cuban relations.

Foreign investment restrictions

Many countries have directly invested in Canada. You can see this when you walk down the street. You may have purchased a coffee at Starbucks, eaten lunch at McDonald's, driven a Ford truck to work, or purchased soap at The Body Shop. This foreign investment provides new products, technology, and employment, and increases productivity for Canadians. Foreign investors have input into the management and running of a domestic corporation, and also receive a return on their investment.

Many laws in Canada influence foreign investment. The law with the greatest impact is the Investment Canada Act. Its purpose is to ensure that all foreign investments are reviewed to determine how they will benefit Canada. Among the restrictions included in the legislation is a review of benefits to Canada of any direct investments over $5 million from countries that are not members of the **World Trade Organization (WTO)**, and of any direct investments over $1 billion from WTO countries. (The WTO oversees the rules of global trade.) Starting in 2021, the amounts will be revised based on growth in GDP. Foreign investments in the uranium, financial, transportation, and cultural industries are automatically reviewed regardless of the amount.

Other laws restrict foreign investment in Canada. The Bank Act, the Transportation Act, the Broadcasting Act, and the Telecommunications Act limit the amount of foreign ownership in each of these sectors. For example, the Transportation Act limits foreign ownership of a Canadian airline to 25 percent.

The Body Shop in Toronto, Ontario—one of its 133 stores in Canada

Standards

Trade barriers exist when countries have different standards for the way products are used or how they perform. Countries have different standards in areas such as environmental protection, voltage in electronic devices, and health and safety.

Different standards for voltage in electronic devices means that small appliances made in one market must be modified for other markets. For example, hair dryers in Canada operate on different electrical current and use different wall sockets than in Europe. Manufacturers must take these modifications into account not only when producing items, but when they are deciding whether or not to produce them at all. One major concern for business travellers is the voltage of their computers and smartphones. All of the information can be found on these devices. Most accept 120–220 volts. Therefore, voltage convertors are not needed but wall socket convertors are.

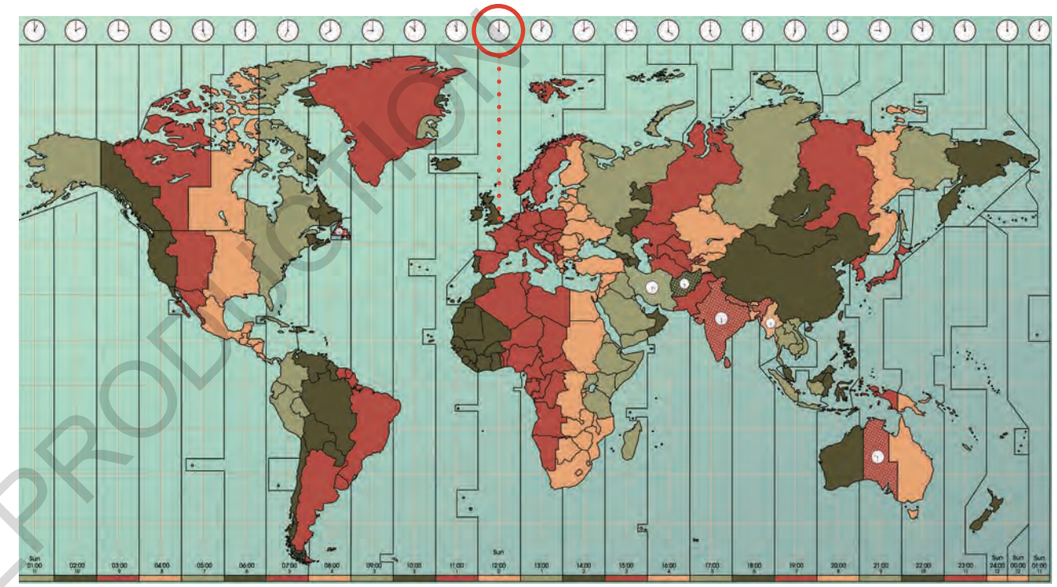
If the American government passes a law to make cars in the United States more fuel efficient, there will be a decrease in the amount of fuel consumed and lower carbon-dioxide emissions. Car manufacturers producing automobiles in Canada and exporting them will have to improve their vehicles' fuel efficiency to sell them across the border.

Different health and safety standards can also impede trade. It is difficult for a Canadian manufacturer to import goods from another country if the manufacturing process is not up to Canadian standards. Canadians will not be able to take advantage of lower-priced raw materials if the Canadian health and safety standards have not been achieved.

One way of overcoming standardization problems is to implement an ISO 9001 (quality) or 14001 (environmental protection) program. The ISO, or International Organization for Standardization, is a network of standardization groups from over 163 countries. It is a non-governmental organization (NGO) established to set quality regulations The ISO provides standards and specifications in the areas of quality, environmental protection, social responsibility, risk management, anti-bribery, and a variety of other topics. (For more information, see Chapter 7.)

While most electrical products require socket converters for use in different countries, other technology like USB—the Universal Serial Bus—is, as its name suggests, a global standard for charging a variety of mobile devices.

Thankfully, apps can quickly identify international time zones when you need to know what time it is for your international business contacts, and determine how best to reach them.



Greenwich time (the same as London time) is the time against which all other times are measured. You can find it by locating the clock that reads 12:00 and drawing a line with your finger down the coast of England.

Time zones

Suppose you need to make an important phone call to a customer in Japan. Should you call immediately? The answer will largely depend on the time difference. The time in Ontario is 14 hours behind the time in Japan. If it is 3:00 p.m. in Ontario, it is 5:00 a.m. in Tokyo—not a good time to call.

Time zones are another barrier to international trade. The international business world is open 24 hours a day. One of the major reasons for this is an improvement in communication technology. Emails and texts can be sent, and phone and conference calls made easily, almost anywhere in the world. Many call centres that service Canadian businesses are located in India because the companies can save on wages. Because of the time difference, the Indian employees must work at night to answer calls made from Canada during the daytime. This disrupts the family lives of the Indian workers.

Business people need to learn which communication medium is suitable in specific situations. While emails and reports can be accessed at any time and are not dependent on time zones, these methods do not allow for immediate feedback. Phone calls, presentations, and face-to-face meetings are dependent on time zones, but occur in real time and allow for interaction, questions, and immediate feedback.

Section review

1. What is a tariff?
2. Define protectionism.
3. What is a trade quota?
4. What is the difference between a tariff and a trade quota?
5. Define embargo.
6. Explain how standards can be a trade barrier.
7. Why are time zones considered a barrier to international business?

2.3 Currency fluctuations

Would you pay 62,000 Japanese yen for a new smartphone? How about 465 euros? (In reality, these are approximately the same amounts.) Currency fluctuations are a barrier to international trade because of the uncertainty they create in trying to price goods and services accurately. The **exchange rate** is the amount of currency in relation to the currency of another country. The Canadian dollar is often quoted with respect to the U.S. dollar, the euro, or the British pound. For example, if $1.00 CAD (Canadian dollar) = $0.79 USD (United States dollar), then $1.00 USD would cost you $1.27 CAD.

The Canadian dollar is most often quoted against the U.S. dollar because the two countries are the largest trading partners in the world. The exchange rate is important to the Canadian economy because Canada relies heavily on imports and exports. Historically, our dollar has been worth less than the U.S. dollar. It reached a low of $0.637 USD in 2002. In 2007, the Canadian dollar surpassed the U.S. dollar for four months. However, in 2013, it dipped below $1.00 and remained there as of early 2018. The Canadian dollar is the sixth most traded currency in the world.

Winners and losers of a high Canadian dollar

Many of us purchase online from American retailers such as eBay and Amazon. In these cases, we like it when the Canadian dollar is high. However, Canadian trade favours a low dollar because exports leaving Canada are less expensive and, therefore, foreign countries purchase more Canadian goods. There are many winners and losers of a high Canadian dollar.

	Winners		Losers
Exporters	Foreign businesses want to buy Canadian goods when the CAD is lower. Canadian companies can sell more products because they are cheaper. This benefits Canada's manufacturing sector.	**Importers**	It's more expensive to import and sell products in Canada. Businesses that import expensive equipment, raw materials, and technology have higher production costs and lose efficiencies.
Canadian tourism	Foreign tourists visit Canada because their dollar buys more CAD. Tourist destinations such as Niagara Falls, Stratford, and Algonquin Park are more economical. In 2016, American tourists spent more than $9.6 billion while visiting Canada.	**Canadian travellers**	It costs more to travel to the United States for business or pleasure. Snowbirds (Canadians who live in the southern United States during the winter months) may not stay as long because the CAD buys less.
Canadian retail	Canadian retailers gain an edge because shopping in the United States—either in person or online—is more expensive. When shopping at U.S. websites, Canadians may be shocked by the total, including the exchange rate.	**Major sports teams**	Professional sports teams operating in Canada pay their players in USD to entice them to play here. When the Canadian dollar is low, it's more costly for the Toronto Blue Jays, the Calgary Flames, the Toronto Raptors, or the Ottawa Senators to attract talented players.

Figure 2-7
High Canadian Dollar: Winners and Losers

Factors affecting the exchange rate

Canada has a **floating rate**, which means our exchange rate changes with respect to other currencies. Supply and demand dictate the price at which the Canadian dollar is bought and sold. If demand is greater than supply, the value of the Canadian dollar increases. **Currency devaluation** occurs when supply is greater than demand and the value of the Canadian dollar decreases. Many factors affect the exchange rate: economic conditions in Canada, trading between countries, politics, and psychological factors.

Economic conditions in Canada

A variety of economic conditions affect the value of the Canadian dollar:

- **Inflation**—the rate at which the price of goods and services is rising and the buying power of the dollar is falling. A low inflation rate causes investors to prefer the Canadian dollar because of the stability of prices.
- Unemployment—the number of Canadians without jobs. A low unemployment rate signals a stable, healthy economy, causing the Canadian dollar to rise.
- **Gross domestic product (GDP)**—the value of all finished goods and services produced by a country in a specific time period. A stable or rising GDP similarly indicates a healthy economy, causing the Canadian dollar to rise.
- Interest rates—the rate charged those who borrow money. High interest rates in comparison to other countries attract investors to Canada. This also increases the demand for our dollar and causes it to rise.

In general, the more confident investors are in Canada's future prospects, the more the Canadian dollar is in demand. This causes an overall increase in the value of the Canadian dollar.

Trading between countries

The greater a country's exports in comparison to its imports, the greater the demand for its currency. The more favourable the **terms of trade** (the comparison of exports to imports), the higher the currency exchange rate.

Politics

The political stability of a country affects its exchange rate. If investors are worried about political tension or the threat of terrorism in a particular country, the demand for its currency decreases. This causes a devaluation in that country's currency, as happened in Venezuela in 2013. There was little confidence in the newly elected government. The inflation rate rose to 22 percent, a state of emergency was declared, and rations were put in place. As a result of this political instability, the Venezuelan dollar fell 32 percent. Citizens reacted by lining up to purchase airline tickets and televisions—prices for those products would dramatically increase because of the currency devaluation.

Psychological factors

Many currencies have a historical significance on the international markets. For example, in times of international upheaval, the Swiss franc is considered a refuge currency. The euro and the U.S. dollar are also seen as safe currencies. Stable currencies, such as the euro, U.S. dollars, and Canadian dollars, are referred to as **hard currencies** because they are easily converted to other currencies on the world exchange markets. **Soft currencies**, such as the Russian ruble or the Chinese yuan, are not as easily converted.

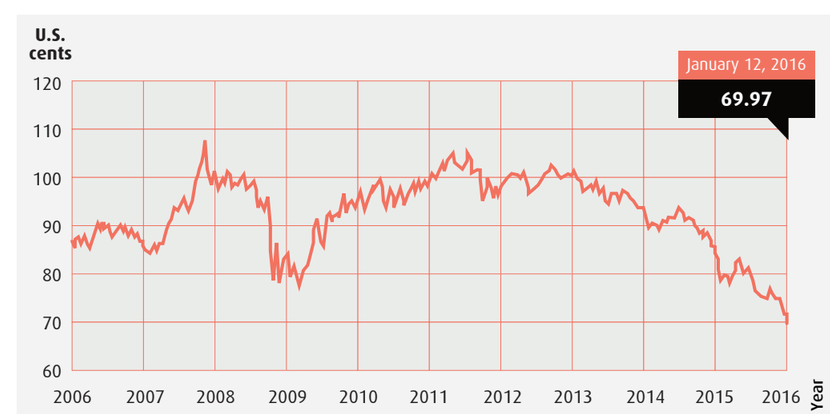


Figure 2-8
10 Years of the Canadian Dollar

Source: Bank of Canada and The Canadian Press

The weak international demand for oil from Canada is one of the key reasons that the Canadian dollar is valued under the U.S. dollar.

Why is the Canadian dollar relatively lower than the U.S. dollar?

There are a variety of reasons for this devaluation. One reason is the low price of oil. International demand for this major Canadian export is weak, which causes the demand for Canadian dollars to decline. Another reason is that the United States has threatened to implement protectionist measures. This would cause U.S. purchases of Canadian products to go down and therefore the Canadian dollar to decrease. A third reason is the fear that housing prices in Toronto and Vancouver are too high and will soon decline.

Speculating

One way to overcome the barrier of currency exchange is by speculating. **Currency speculating** involves buying, holding, or selling foreign currency in anticipation of its value changing. It is done to profit from the fluctuations in its price.

For example, if you were planning a trip to Florida in the winter, and you heard in the news that the Canadian dollar was probably going to go down in the next month, you would purchase U.S. dollars now in anticipation of the devaluation. This would save you money on the currency exchange for your trip. You would receive more U.S. dollars now than in the future for the same amount of Canadian dollars. Companies do this as well. They buy forward (purchase now) when they think the Canadian dollar will devalue, and hold U.S. dollars when they think the Canadian dollar will increase.

Why would Canadian companies quote their prices in U.S. dollars? The main reason is to attract customers. When a Canadian company sells in U.S. dollars, it assumes the risk of the currency fluctuations.

To overcome currency fluctuations, many companies have bank accounts in different currencies. It is common for Canadian companies that conduct business internationally to have Canadian and U.S. bank accounts.

Section review

1. What is an exchange rate?
2. Who are the winners and losers of a low Canadian dollar? Why?
3. What factors influence the exchange rate?
4. What is currency speculation?

Chapter Review

Knowledge

1 List three reasons why countries import and export products.

2 Explain the concept of value added. Why is it so important for Canada's success in international business?

3 Explain the main advantages and disadvantages of the following: licensing agreements, franchises, joint ventures, and foreign subsidiaries. Why might a company choose a licensing agreement rather than a franchise?

4 What is a tariff, and why do governments impose them? When a tariff is imposed, who wins and who loses?

5 Define trade quotas, embargoes, and sanctions. Provide an example of each.

6 Explain the concept of an exchange rate, and how it is determined. When the Canadian dollar is high relative to another currency, explain who wins and who loses.

7 Explain how companies can profit from currency exchange. What is this called?

Thinking

8 One of the imports people in Canada enjoy the most is fresh fruit. Explain how a person in Canada's life would be altered if fruit were not imported.

9 A Canadian manufacturer of hearing aids is planning to expand into China. Which form of international business would you recommend and why?

10 List three winners and three losers of a low Canadian dollar. Explain.

11 Provide two examples of how a company might engage in currency speculation.

Communication

12 On a map of the world, colour and label each of the top five countries that import and export with Canada. Use one colour for import partners, a second colour for export partners, and a third colour for countries that do both.

13 Your business is located in Ottawa, and you are negotiating a purchase with a supplier in Shanghai, China. At 9:00 a.m. your time, you discover that you need information about a costing quotation. Should you phone or email the supplier? Explain your choice.

Application

14 A Canadian company can produce a mattress using $160 worth of raw materials and $120 worth of labour, and shipping costs will be $27. A Chinese company can produce the mattress using $160 of raw materials and $40 for labour, with $50 for shipping. Assume that the Canadian tariff for mattresses is 50%. The Canadian retailer has a markup of 150%. Calculate the price of the Canadian mattress and compare it with the price of the Chinese mattress before and after the tariff.

Considering the different factors involved in these options (e.g., the final price to the consumer, the profits for the retailer, domestic versus foreign production, tariffs, etc.), which do you think is the better scenario, and why?

15 Using a time zone map, complete the following questions:

- **a** If it is 9:00 a.m. in Toronto, what time is it in Frankfurt, Germany?
- **b** If it is 2:00 p.m. in Windsor, what time is it in Auckland, New Zealand?
- **c** If it is 3:00 p.m. in Vancouver, what time is it in Tokyo, Japan?
- **d** If it is 2:00 p.m. in St. John's, what time is it in Santiago, Chile?

16 As a Canadian manufacturer, you have the option to purchase raw materials from three countries. The United States is offering to sell the goods for $1.2 million USD; the United Kingdom for 650,000 GBP; and South Korea for 1.7 billion KRW.

- **a** Which is the best deal?
- **b** Would you want the supplier to be ISO-certified? Why or why not?
- **c** What other considerations would you take into account when making your decision?

17 Sara is preparing for a three-week trip to the United States, Mexico, and France. She has budgeted $2,400 CAD for her trip and is looking to convert $800 into each local currency before she leaves. Use the conversion chart below to calculate how much she'll receive in each currency. Upon return, Sara has $120 USD, 1,200 pesos, and 80 euros left over that she'd like to convert back into Canadian dollars. She notices that, while she was away, exchange rates have changed. Calculate Sara's remaining budget after converting back to Canadian currency.

Currency	Rates before trip	Rates after trip
United States Dollar	0.791	0.832
Mexican Peso	13.849	13.431
Euro	0.685	0.693

18 Vivek owns a business in Ontario, but 90 percent of his business is exported to the United States. He has a contract with an American company to sell $500,000 USD worth of product. Delivery is in 60 days. Vivek knows the CAD is $0.92 today, but is expected to drop to $0.89 in 60 days.

a Calculate the price of the shipment in CAD if **(i)** the customer pays today, and **(ii)** the customer pays in 60 days. When should Vivek ask for payment?

b Why might Vivek quote his price in USD? What are the risks?

c If Vivek had asked for payment in CAD, what could the customer do to save money? What is this called?

Inquiry Activity

Protectionism

In this chapter you learned that there are many forms of protectionism—tariffs, quotas, embargoes, and sanctions. In today's political climate, there is much debate over whether or not governments should protect local businesses. It is time for you to form your own educated opinion on this topic. Do some research on this issue using this chapter and outside resources. You might find it useful to make a chart like the sample below to organize your information, giving yourself plenty of room to include your responses.

In your own words, define protectionism:	
List three reasons protectionism is good for a country. 1 2 3	List three reasons protectionism is harmful for a country. 1 2 3
List a real-life example of when protectionism was good for a country.	List a real-life example of when protectionism was harmful for a country.
My opinion of protectionism is:	

Business Skills

Time Management

Time management is critical to a person's success. This is especially true in international business when supplies ordered from overseas will take longer to arrive, customers are in different time zones, and business travellers cannot afford to miss a flight. Time is a finite resource. Make sure you manage it effectively to focus on what is important. Life holds many distractions, so having good time management skills will result in higher quality work and decrease your stress.

Below are some tips on how to improve time management skills:

- Set priorities—it is easy to get distracted by unimportant things. Focus on what needs to be done first.
- Set a schedule—determine a plan to get things done. Set reasonable deadlines to help you focus, then stick to your plan.
- Avoid distractions—this may mean turning off your social media or finding a quiet place to work. Tell family, friends, and co-workers when you are unavailable.
- Use technology—it can provide shortcuts and support. There are calendar apps, time-tracking and expense-tracking apps, and apps that will help you create to-do lists.
- Avoid multi-tasking—most of us believe that we can do more than one thing at once. The truth is we are more productive when we focus on only one thing at a time.
- Stop procrastinating—good time management requires discipline. If it can be done today, do it today
- Learn to say "No"—busy people like to be involved in many areas. However, being over-taxed can lead to not doing anything well. When possible, politely decline work that will cause you to be overloaded.

Check Your Understanding

1. Why is time management important?
2. Why is time management critical in international business?
3. Create a list of your time management strengths and weaknesses.
4. State a time when you demonstrated poor time management skills. Describe the situation. How did you feel? What could you have done differently?
5. Create a schedule for yourself for the next week. Include all school work, extra-curricular activities, paid work, and family responsibilities.
6. You need to have conversation with a supplier in Paris. What time should you schedule the conversation so that both of you are still at work?
7. You are the global manager for a Canadian auto parts manufacturer in Toronto. You have arrived at work at 8:30 a.m. and need to plan your day. Create your schedule for the day and prioritize the following tasks:
   - Email a supplier in Hong Kong. This needs to be done before the open of business the next day in Asia.
   - Spend an hour writing a section of a culture report to your boss that needs to be completed next week.
   - Attend a 10:00 a.m. meeting.
   - Create a to-do list for tomorrow.
   - Complete an expense form for accounting.
   - Review and practise the presentation you are to give tomorrow.
   - Review and update today's to-do list.
   - Read and respond to email.
   - Prepare for today's 10:00 a.m. meeting.
   - Read a brief that will help you write the culture report due next week.