

Chapter 7

Market Barriers, Global and Regional Integration

The international activities of companies are closely related to the liberalisation of trade and to foreign direct investment (FDI) on a global level. The most important institution concerned with the rules of liberalisation has been GATT, replaced by WTO. The remarkable level of world trade and global FDI presently has another driving force: regional economic cooperation and regional economic integration. The objective of this Chapter is to describe the different types of market barriers and the forms of regional economic cooperation.

Types of Market Barriers

The major artificial barriers to trade are classified in Figure 7.1 as tariffs and non-tariff barriers.

Categories of Market Barriers

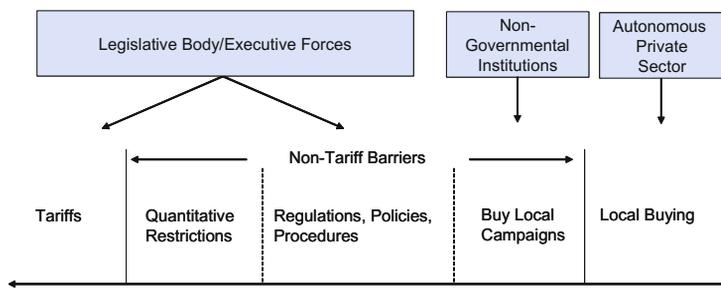


Figure 7.1

Tariffs, i.e., taxes on goods that are traded internationally, have traditionally been used to protect domestic industries by raising import prices. Because trade liberalisation has progressed over time, governments are increasingly using *non-tariff barriers* to protect some of their countries' industries: "Governments are very creative when it comes to the invention or virtuous use of non-tariff barriers to protect their countries' industries from international competition" (Mühlbacher/Leih/Dahring 2006, p. 147).

Trade Barriers

Non-tariff barriers can take three basic forms:

- quantitative restrictions, i.e., barriers that impose a limit on the quantity of a good that may be exported or imported
- laws, regulations, policies or procedures that impede international trade
- “buy local” campaigns.

Quotas and VER

Quotas are a popular example in the first category. These limit the quantity of a good that may be exported or imported during a certain time period, such as a year. Another example of numerical limits is the *voluntary export restraint* (VER), i.e., a promise by a country to limit its exports of a good to another country to a defined amount. This is often specifically announced to the target country in order to avoid import restrictions being imposed. Selected forms of *regulations, policies* and *procedures* are (Griffin/Pustay 2013, pp. 267-268):

- public-sector procurement policies
- local-purchase requirements
- product and testing standards.

Policies, Procedures, Campaigns

Public-sector procurement policies favour domestic firms in purchasing. *Local-purchase requirements* impede foreign firms by requiring domestic firms to purchase goods from local suppliers. *Product and testing standards* of a country have to be met by foreign products before the products can be sold in that country.

“Buy local” campaigns (e.g. “BuyAmerican” or “Achetez français”) are sometimes conducted by non-governmental (or even governmental) institutions “to persuade their nationals to buy locally made products and services rather than those of foreign origin” (Bradley 2005, p. 130). *“Local buying”* can also be an expression of a specific behaviour of individual consumers behaviour through a desire to protect domestic producers for *patriotic* or *chauvinistic* motives.

Trade Sanctions and Trade Embargos

Besides permanent tariff and non-tariff barriers, international trade is also influenced by temporary barriers which are imposed because of reactions to specific events in intergovernmental relations: *trade sanctions*. A sanction is, generally speaking, the retaliatory reaction of a state against violations of international law by another state. Trade sanctions are also associated with the term *retorsion*, defined as *trade embargo* is an example of a sanction, and refers to governmental orders to prevent trade with a specific state. Basic variants of the trade embargo are the *export embargo, import embargo* and *capital embargo* (e.g. blockage of payments or prohibition of asset transfers) (Cavusgil/Knight/Riesenberger 2014, p. 212).

Restricting Foreign Direct Investment

Besides establishing actual barriers to trade (export or import), a government can deter foreign investments. Foreign direct investment (FDI) occurs when a company invests in a foreign subsidiary or joint venture with a partner firm in a foreign country, takes over a foreign company (acquisition/merger) or has a share in a foreign company. Foreign direct investment entails some degree of control, in contrast to “pure” financial investment. Besides *ownership restraints*, such as, foreign ownership being restricted to, e.g., 25%, *operation requirements* (e.g. local content) are another important instrument which influences foreign direct investment decisions. They are controls over the behaviour of the local subsidiary, such as a minimum level of local participation in top management.

Government Policy Instruments and FDI

Global Integration

Trade Liberalisation

The most important institution which has opened up new markets in almost all regions of the world has been GATT – the *General Agreement on Tariffs and Trade*. Founded in 1947, its objective was to liberalise international trade by eliminating tariffs, subsidies, import quotas, and the like. According to this multilateral agreement, the international trading system should be as follows (WTO 2014a):

GATT Rules

- *without discrimination* – a country should not discriminate between its trading partners (giving them equally “*most-favoured-nation*” or MFN status) and it should not discriminate between its own and foreign products, services or nationals (giving them “*national treatment*”)
- *freer* – barriers coming down through negotiation
- *predictable* – foreign companies, investors and governments should be confident that trade barriers (including tariffs and non-tariff barriers) are not raised arbitrarily
- *more competitive* – discouraging “unfair” practices such as export subsidies and dumping products at below cost to gain market share
- *more beneficial for less developed countries* – giving them more time to adjust, greater flexibility, and special privileges.

Eight *rounds of trade negotiations* have led to significant reductions in tariffs and non-tariff barriers. The eighth round of negotiations, the *Uruguay Round*, created the *World Trade Organization* (WTO), which operates as an umbrella

Uruguay Round

organisation that encompasses the GATT along with new bodies, including one on services and one on intellectual property rights. Since 1 January 1995, the WTO has been responsible for monitoring the *trade policies* of member countries and arbitrating *trade disputes* among member countries.

GATS and TRIPS

The Uruguay Round led to liberalisation in both trade in services (GATS – *General Agreement on Trade in Services*) as well as agricultural goods, improvements in the protection of intellectual property rights (TRIPS – *Agreement on Trade-Related Aspects of Intellectual Property Rights*) and *anti-dumping rules*, prohibiting sales in foreign countries below cost.

Doha Development Round

The latest round, the *Doha Development Round*, which began in 2001, collapsed in July 2008. The Trade Negotiations Committee failed to agree on blueprint agreements in agriculture and industrial products. Eventually, the talks broke down over the *special safeguard mechanism* (SSM). The SSM was intended to allow developing countries to raise tariffs temporarily to deal with import surges and price falls. Most topics on the agenda had seen positions converge satisfactorily.

Bali Package

After the Ministerial Meeting in New Delhi in 2009 and the World Economic Forum in Davos in 2011, both of which failed, the first important success of the Doha Round could be reported in December 2013. At the Ninth Ministerial Conference, held in Bali, the “*Bali Package*”, a selection of issues from the broader Doha Round negotiations, was created. It focuses on trade facilitations, i.e. the simplification of customs procedures by reducing costs, improving speed and efficiency. Other important issues are for instance food security in developing countries, the reduction of export subsidies in agriculture or duty-free and quota-free market access for least-developed countries. Intellectual property aspects and trade in services were not taken into account. The “*Bali Package*” was planned being adopted by the General Council in July 2014. India did not adopt the protocol on the Trade Facilitation Agreement (TFA) – a part of the “*Bali Package*” – therefore the negotiations collapsed and the signature of the “*Bali Package*” was postponed indefinitely.

In any case, as a result of the activities of GATT/WTO, and also because of *regional economic cooperation*, discussed later in this Chapter, world trade increased from 2,034 billion USD in 1980 to 18,784 billion USD in 2013 (see Table 7.1).

Increase in World Trade between 1980 and 2013 (in billion USD)

Year	World	Europe	Asia
1980	2,034	897	324
2013	18,784	6,636	6,285

Source: WTO World Trade Report 2014.

Table 7.1

Investment Liberalisation

The liberalisation of trade is accompanied by a policy of the WTO members gradually allowing *foreign direct investment*, such as the establishment of subsidiaries and joint ventures or the takeover of companies. The TRIMS agreement (*Trade-Related Investment Measures Agreement*) in the Uruguay Round is an important step towards eliminating national regulations on FDI. “To this end, an illustrative list of TRIMs agreed to be inconsistent with these articles is appended to the agreement. The list includes measures which require particular levels of local procurement by an enterprise (local content requirements) or which restrict the volume or value of imports such an enterprise can purchase or use to an amount related to the level of products it exports (trade balancing requirements)” (WTO 2014b).

For example, some important steps in the timeline of relations between India and the WTO are illustrated in Table 7.2. India has become one of the most popular destinations for foreign direct investment, attracting nearly 26.6 billion USD in 2013 (Reserve Bank of India 2014).

TRIMS

Table 7.2

India's Steps to Open the Market

Year	Event
January 1997	India allows foreign direct investments (FDI) in cash & carry (wholesale) with 100% ownership.
2001	India liberalises the insurance sector. Investment through FDI can be a maximum of 26%.
May 2001	The Indian Government opens the defence industry to the private sector. It permits 100% equity with a maximum of 26% FDI component.
March 2002	The Cabinet of India allows 100% FDI in the advertising and film industry, up from the present limit of 74%.
June 2002	The Indian Government first allows 26% FDI in news and current affairs in print media.
February 2006	The Indian Government opens up the retail sector by permitting FDI up to 51% in single-brand retail trading companies.
March 2011	Up to 100% FDI are permitted in certain agricultural activities (inter alia floriculture, horticulture, apiculture, cultivation of vegetables and mushrooms under controlled conditions, animal husbandry, pisciculture, aquaculture, tea production).
November 2011	India allows up to 51% FDI in multi-brand retail trading and 100% FDI in single-brand retail trading subject to 33% purchases from domestic sources.
September 2012	The Indian Government permits foreign airlines to make up to 49% FDI in scheduled and non-scheduled air transport services.
July 2013	The Indian Government rescinds the limit of 74% on foreign ownership in mobile services operations and allows these companies to be wholly owned by foreign investors.
August 2013	The Indian Government approved 100% FDI in the telecom sector.
January 2014	The Reserve Bank of India relaxes FDI regulations to facilitate great FDI inflows into the country.

Source: Financial Express 2002; People's World 2002; The Hindu 2011; Cedar Consulting 2012; The Economic Times 2012; The Metropolitan Corporate Counsel 2012; CIO 2013; Indian Defence Review 2013; The Economic Times 2013; India TV News 2014; The Economic Times 2014.

Regional Integration

One important exception to the *most-favoured-nation principle*, discussed in the context of the *GATT* rules, are comprehensive *trade agreements* that promote economic integration.

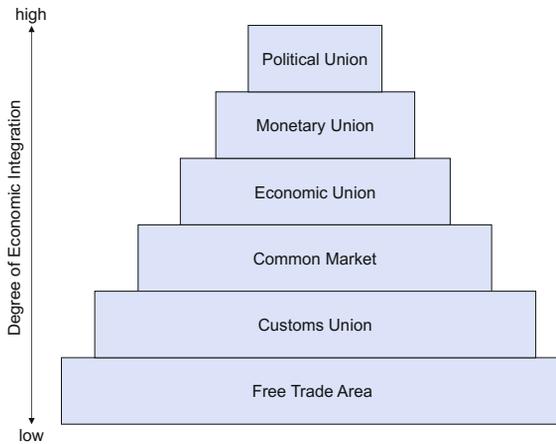
Trade and foreign investment liberalisation are reinforced by economic cooperation among countries, mostly within a geographical region. Economic cooperation can take the form of *bilateral agreements* or *multilateral agreements*, ranging from simple contracts on tariff reduction to political integration.

Stages of Economic Integration

A *preliminary stage* of economic integration is bilateral or multilateral agreements between countries concerning the reduction or abolition of tariffs or other barriers to trade in one or a few product groups (*free trade agreements*). The different stages of economic integration are summarised in Figure 7.2. From the least integrated level to the most integrated level they are: free trade area, customs union, common market, economic union, monetary union, and political union.

Different Levels of Economic Integration

Figure 7.2



A *free trade area* is characterised by the fact that all formal barriers, especially tariffs, are abolished between the member states for a broad group of products or for all products (and services). Examples of existing free trade areas are:

- *European Free Trade Association (EFTA)*, focussing on free trade in industrial goods, including Iceland, Liechtenstein, Norway and Switzerland.
- *North American Free Trade Agreement (NAFTA)*, including Canada, Mexico and the USA, which led to 80% of all the trade of Canada and Mexico occurring within the NAFTA countries, while for the USA, its trade with NAFTA countries accounts for 33,5% (in 2012).

The *Transatlantic Trade and Investment Partnership (TTIP)* is a trade agreement that is presently being negotiated between the European Union and the United States. It aims at removing trade barriers in a wide range of economic sectors to make it easier to buy and sell goods and services between the EU and the US. The negotiations could ultimately lead to a *Trans-Atlantic Free Trade Area (TAFTA)*.

Presently, there is a major discussion, initiated primarily by *nongovernmental organisations (NGOs)*, but also by representatives of industrial companies, that there could be a “*race to the bottom*”, because the agreement could undermine social and ecological standards established in the EU through the need for harmonisation.

Free Trade Area

Customs Union

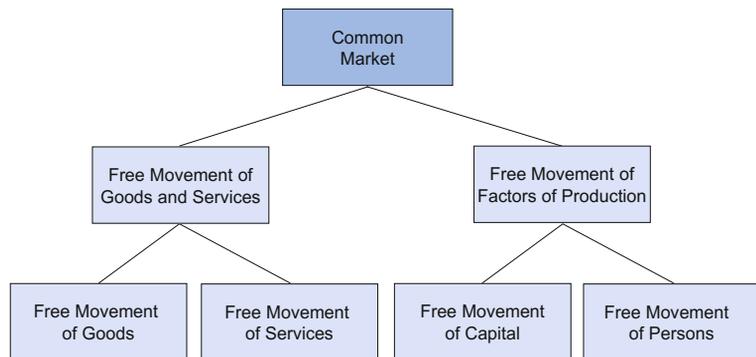
While the individual member countries of a free trade area maintain their independent external trade policy with regard to non-members, in a *customs union*, the member countries are committed to eliminating trade barriers corresponding to the free trade area, and adopting a common external trade policy. The most familiar and most important example of a customs union is the *European Union* (EU), although similar efforts exist in other regions too, such as MERCOSUR (*Mercado Común del Sur*) in the Southern part of Latin America. With regard to transaction costs, a customs union has a great advantage compared with free trade areas: *Certificates of origin* are not needed in intra-trade transactions. In free trade areas, there is always the possibility of realising *arbitrage effects* by importing goods into a “low tariff” country and then transferring them to “high tariff” countries within the area. To avoid these arbitrage businesses, certificates of origin are necessary.

Common Market

A common market has abolished internal tariffs and non-tariff barriers, standardised external tariffs and allows the free movement of factors of production (see Figure 7.3). The only existing common market is the *European Union* (EU), already mentioned as a customs union.

Figure 7.3

Characteristics of a Common Market

**Economic Union**

In an *economic union*, the next level of economic integration is that the member states harmonise their tax and subsidy policies in order to unify their fiscal policy. In this type of union, all member nations are fully integrated economically. The European Union intends to realise this stage of economic integration (*Maastricht Treaty*, *Amsterdam Treaty*, *Nice Treaty*). However, the implementation process is subject to political and economic difficulties.

Despite these difficulties, a common currency (EUR) was implemented, as of 1 January 1999. Since January 2014, 18 countries are members of the “Eurozone”. The dramatic debt crisis in Greece and other countries like Spain, Portugal, Ireland and Italy, revealed deep problems in the Eurozone and it became evident that the monetary union needs to be modified to prevent future economic crises. In Figure 7.2., it is pointed out that an economic union should precede a monetary union. The current proposals from France and Germany point in this direction. A “closer economic policy coordination” as well as “binding contracts with the European Commission to implement further reforms” are required (Spiegel Online 2013).

The most advanced form of economic integration is a *political union*. In a political union, a body coordinates the economic, social, and foreign policy of its member states. This objective was the basic element of the *Maastricht Treaty* in 1992. In anticipation of this step, the former *European Community* agreed to rename itself the *European Union*, a truly optimistic sign.

Effects of Economic Cooperation

The effects of economic cooperation are diverse. For example, the macroeconomic effects of the implementation of a common market (within the European Community, EC) can be observed. According to the so-called *Cecchini Report* (Cecchini 1988, p. 97), the following macro-effects had been expected:

- relaunch of economic activity, adding on average 4.5% to GDP
- deflation of consumer prices by an average of 6.1%
- improving the balance of public finances by an average equivalent to 2.2% of GDP
- boosting the EC’s external position by around 1% of GDP
- creating 1.8 million new jobs.

An *interim balance* (a report entitled “20 Years of the European Single Market: Together for new growth”) identifies many important advantages which could be attributed to economic integration (European Commission 2012, p. 2):

- The GDP of the EU-27 in 2008 was 2.13% or 133 billion EUR higher than it would have been without the Single Market. This can be equated to an average additional income of 500 EUR per EU citizen.
- During the period from 1992 to 2008, 2.77 million new jobs have been created.

- Trade between EU countries rose from 800 billion EUR in 1992 to 2,800 billion EUR in 2011.
- Exports to third countries (non-member) have increased from 500 billion EUR in 1992 (8% of EU GDP) to 1,500 billion EUR in 2011 (12% of EU GDP).
- The Single Market has become much more attractive for foreign investors. The flow of foreign direct investment (FDI) between EU countries rose from 64 billion EUR in 1992 to 260 billion EUR in 2010.

Intra-EU Trade

The effects of the common market with regard to trade within the European Union (*intra-EU trade*) are shown in Table 7.3. The majority of member states of the EU-27 had an intra-EU trade share in 2013 of at least 60%.

Table 7.3

Shares of Intra-EU Trade for the EU Member States (EU-27) 2013 (in %)

State	Quote	State	Quote
Austria	69	Latvia	66
Belgium	70	Lithuania	57
Bulgaria	60	Luxembourg	81
Cyprus	58	Malta	42
Czech Republic	81	Netherlands	76
Denmark	63	Poland	75
Estonia	71	Portugal	70
Finland	55	Romania	69
France	59	Slovakia	83
Germany	57	Slovenia	69
Greece	46	Spain	63
Hungary	76	Sweden	58
Ireland	59	United Kingdom	44
Italy	53		

Source: EUROSTAT 2014.

Impact of Economic Integration on Firms

New Markets and Cross Border Value Creation

The political efforts of GATT/WTO to liberalise trade and foreign direct investment and the different regional alliances eliminating trade barriers, adopting a common external trade policy and allowing factors of production to move freely between members, have led to new markets with regard to sourcing, and selling and to new sites for production, logistics and so on (see Part V). Firms can reduce their production costs by capturing *economies of scale* when expanding their customer base within the trading bloc. The lower

cost structure will also promote the firm's *international competitiveness* outside the trading blocs. "However, elimination of trade barriers also exposes a firm's home market to competition from firms located in other member countries, thus threatening less efficient firms" (Griffin/Pustay 2013, p. 288).

Conclusion and Outlook

The remarkably high level of world trade and foreign direct investment can be attributed to the political efforts of *GATT/WTO* and to the fact that regional integration has extended and intensified. This results in far-reaching liberalisation within regional cooperation, but also in discrimination vis-à-vis third countries, which is at first glance in conflict with free trade worldwide ("*most-favoured-nation status*").

In the next few years, there will be strong efforts to create new regional cooperation or to intensify the stage of integration, for example initiated by the European Union and the United States, Russia in Eurasia, or in North and South America and Asia. This offers many opportunities for companies with regard to exports and imports, for outsourcing, offshoring, strategic alliances, and greenfield and brownfield investments. If *regional agreement areas* gradually merge, regional economic cooperation will ultimately lead to far more free trade worldwide.

Trading Blocs
vs.
Free Trade

Further Reading

GRIFFIN, R.; PUSTAY, M. (2013): *International Business: A Managerial Perspective*, 7th ed., Upper Saddle River, New Jersey, Pearson.

HILL, C.W.L. (2013): *Global Business Today*, 8th ed., Boston, McGraw-Hill, pp. 249-273.

RUGMAN, A.M.; COLLINSON, S. (2012): *International Business*, 6th ed., Harlow, Pearson, pp. 175-187.

WOYKE, W. (2002): *The European Union after Nice. A Community Facing a New Century*, in: SCHOLZ, C.; ZENTES, J. (Eds.): *Strategic Management: A European Approach*, Wiesbaden, Gabler, pp. 3-21.

Case Study: Mazda*

Profile, History, and Status Quo

Since its foundation, *Mazda* has developed into an internationally known automobile brand. Its origins date back to 1920, when *Toyoko Cork Kogyo Co. Ltd.* was floated by Jujiro Matsuda in Hiroshima, Japan. In 1984, the company was renamed the *Mazda Motor Corporation*, derived from its founder on the one hand and *Ahura Mazda*, the god of wisdom, intelligence and harmony of the earliest civilisations in West Asia on the other hand.

In its early stages, the company produced machine tools and three-wheel trucks. After the critical incident in Hiroshima during World War II, the headquarters was used as a military hospital. Production could be resumed in 1949 by manufacturing three-wheel trucks again which were exported to India. Due to the fact that these vehicles were tax-exempt driver's licences were not required, they were highly demanded. The first four wheel light truck was produced in 1958. In the 1960s, new product lines like the R360 Coupe, the first *Mazda* two door passenger car, were launched. In 1967, the *Mazda Cosmo Sports* (110S) was ushered in, the company's first rotary engine vehicle.

Mazda pursued an international approach very early in its history. The company started to export vehicles to China in 1932 and took up its export activities in 1949, exporting vehicles to India. The first assembly sites abroad were opened in South Korea (1962), South Africa (1963) and Malaysia (1968). This was followed by the opening of production facilities all over the world: Indonesia (1971), Philippines (1974), Thailand (1975), Colombia (1983), and the US (1985). In addition, *Mazda* established full-scale exports and sales companies in numerous regions. At the end of the 1960s, the European, Australian and Canadian markets were cultivated in this way, followed by the US in 1970. Till this day further sales companies are being opened, e.g. in Thailand (2005), Russia, Ireland (2006), and South Africa (2013).

Throughout its history, *Mazda* has shown an interest in *cooperation*. It founded the *Mazda Motor Manufacturing Corporation* in the mid-1980s. In 1992, this corporation was changed into the *AutoAlliance International, Inc.*, an equal partnership between *Mazda* and *Ford*. Three years later, the partners decided to establish the *AutoAlliance Company Ltd.* in Thailand, which produces vehicles for the Asian-Pacific and European market. In 2006, *Mazda* and *Mitsubishi Corporation* collaborated in the context of an energy supply company for Japan operations. For developing and producing sports cars, the

* Sources used for this case study include the website www.mazda.com, various company reports and explicitly cited sources.

company started a co-operative program with *Fiat* in 2012. This led to the agreement of collectively producing the new *Alfa Romeo* roadster in 2013.

Today, the company employs approximately 38,000 people, generating net sales about 2,205 billion Yen in 2013, where the largest share is apportioned to the North American region (see Table 7.4)

Consolidated Financial Statements of Mazda Motor Corporation and Consolidated Subsidiaries

Table 7.4

	2009	2010	2011	2012	2013
Net Sales (in billion Yen)	2,535.9	2,163.9	2,325.6	2,033.0	2,205.2
Net Sales - Domestic (in billion Yen)	620.3	575.0	541.5	560.2	588.0
Net Sales – North America (in billion Yen)	697.6	574.6	631.3	575.6	651.2
Net Sales - Europe (in billion Yen)	653.4	477.3	427.4	347.3	347.9
Net Sales – Other areas (in billion Yen)	564.6	537.0	725.5	549.9	618.1
Global Sales Volume (thousand of units)	1,261	1,193	1,273	1,247	1,235
Number of Employees	39,852	38,987	38,117	37,617	37,745

Source: Mazda 2014.

Trade Liberalisation in the Mexican Automotive Industry

Since 1962, regional integration between the US and Mexico has been shaped by a series of decrees. In 1990, four years before NAFTA, content requirements were reduced and imports of cars were allowed for the first time, due to the *Decree for the Development and Modernisation of the Automotive Industry*. In 1994, the *North American Free Trade Agreement* (NAFTA) came into effect, including the US, Mexico, and Canada. All states obligated themselves to remove all duties and quantitative restrictions, as scheduled in 2008 (Office of the United States Trade Representative 2014). In Article 102 Paragraph 1 of the North American Free Trade Agreement its objectives were registered as follows:

NAFTA

- a) eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties;
- b) promote conditions of fair competition in the free trade area;

- c) increase substantially investment opportunities in the territories of the Parties;
- d) provide adequate and effective protection and enforcement of intellectual property rights in each Party's territory;
- e) create effective procedures for the implementation and application of this Agreement, for its joint administration and for the resolution of disputes; and
- f) establish a framework for further trilateral, regional and multilateral cooperation to expand and enhance the benefits of this Agreement."

Bilateral Free Trade Agreements

In addition to NAFTA, Mexico negotiated "10 FTAs [Free Trade Agreements] with 45 countries, 30 Reciprocal Investment Promotion and Protection Agreements (RIPPAs) and 9 trade agreements (...) within the framework of the Latin American Integration Association (ALADI)" (Secretariat of Economy 2013).

Mexico's Automotive Industry

Mexico has a long history of vehicle production. It began in 1925 when *Ford* established the first manufacturing plant in Mexico City. In the mid-1930s *Ford*, *GM* and *Autamax* (later *Chrysler*) produced in Mexico, in 1952 *Volkswagen*, 1959 *Nissan* and 1985 *Honda* entered the Mexican market (PWC 2013, p. 9). In 1962, a decree established local content requirements, so that a 60% minimum of national inputs in auto part manufacturers was specified (Fernandez 2005). As a result, *Mercedes Benz*, *Fiat*, *Citroën*, *Peugeot*, and *Volvo* left Mexico, because they did not agree with the policy. The 1970s were characterised by several decrees which influenced exports negatively. From 1989 onwards, a more liberate approach aiming at the deregulation and economic liberalisation was pursued. In 2005, *Mazda* followed its competitors and entered the Mexican market.

Between 1985 and 2012, Mexico raised its exports of light vehicles from 600,000 to 2.4 million units. 1.1 million units of vehicles produced in Mexico are for auto producers with headquarters overseas, which equals a hundred-fold increase in comparison to 1985 (Global Economic Intersection 2013). By the end of 2013, the production of light vehicles reached 2.93 million units, of which 2.42 million were exported (AMIA 2014). In 2012, 63.9% of all exported vehicles went to the US, 6.8% to Canada, 15.5% to Latin America, 1.5% to Africa, 2% to Asia, 9% to Europe, and 1.3% to other regions (PWC 2013, p. 5). Mexico developed into the *fourth largest exporter* of cars behind Germany, Japan, and South Korea and the eighth largest vehicle manufacturer worldwide (Reuters 2014) (see Table 7.5).

With the realisation of NAFTA, the inflow of FDI was increased. In Mexico, the automotive sector represented 21% of the total FDI; the auto parts sector reached a total of 1,770 million USD in 2012 (Promexico 2012). Approximately 3% of GDP, 14% of manufacturing output, 23% of all exports and about 500,000 employees can be attributed to the automotive sector (KPMG 2012, p. 4). This shows the enormous relevance of Mexico's most important industry within manufacturing.

Top 10 World Motor Vehicle Producing Countries 2008-2013 (in thousand of units)

Table 7.5

Top 10 (2013)	2008	2009	2010	2011	2012	2013
China	9,299	13,791	18,265	18,419	19,272	22,117
United States	8,694	5,731	7,763	8,662	10,329	11,046
Japan	11,576	7,934	9,629	8,399	9,943	9,630
Germany	6,046	5,210	5,906	6,311	5,649	5,718
South Korea	3,827	3,513	4,272	4,657	4,562	4,521
India	2,332	2,642	3,557	3,927	4,145	3,881
Brazil	3,216	3,182	3,382	3,408	3,343	3,740
Mexico	2,168	1,561	2,342	2,681	3,002	3,052
Thailand	1,394	999	1,645	1,458	2,429	2,533
Canada	2,082	1,490	2,068	2,135	2,464	2,380

Source: OICA 2014.

The main assemblers in Mexico's consolidated automotive sector are *Nissan*, *Volkswagen*, and the Big Three – *Ford*, *General Motors* and *Chrysler*, which covered over 93% of total production and 94% of internal sales between January and May 2014. In the same period, *Nissan* was the market leader with almost 50%, followed by *General Motors* with approximately 24% and *Volkswagen* with about 13% of internal sales, while *Mazda* was responsible for only approximately 1%, which can be ascribed to the circumstance that the production plant had just been opened (AMIA 2014). As shown in Table 7.6, *Mazda* was ranked No. 8 in units sold in Mexico.

Table 7.6 Top 10 Manufacturers in Mexico Based on Units Sold in 2013

Rank	Manufacturer	Sold Units
1.	Nissan	263,477
2.	General Motors	201,604
3.	Volkswagen	156,313
4.	Ford	85,721
5.	Chrysler	78,974
6.	Toyota	60,740
7.	Honda	58,381
8.	Mazda	33,348
9.	Seat	21,189
10.	Renault	21,187

Source: Autoblog 2014.

Mexico has a tight net of car production plants. Especially the centre and Northern regions of the country reveal a concentrated manufacturing presence. The activities of manufacturers are not only confined to assembly. In fact, some companies also maintain design and engineering centres.

Due to the positive situation in Mexico, car manufacturers are still investing large amounts of money (see Table 7.7). Besides new automakers which are planning to build factories, established manufacturers want to expand their investments in favour of higher capacity.

Table 7.7 Selection of Projects of Automobile Manufacturers in Mexico in 2014

Manufacturer	Project
Audi	1.3 billion USD: new production plant for Q5 model
Chrysler	164 million USD: expansion for Tigershark engines
Daimler	19 million USD: bus-assembly plant expansion
General Motors	349 million USD: new transmission plant
Honda	7 million USD: CR-V vehicles plant expansion
Mazda	770 million USD: new production plant
Mercedes-Benz	20 million USD: new assembly line expansion
Nissan	14 million USD: diesel engines
Volkswagen	118 million USD: new engine configuration

Source: Mexiconow 2014.

Entry and Operating Strategy of Mazda in Mexico

In December 2004, *Mazda Motor de Mexico* was established. This was followed by *Mazda's* market entry in 2005. Since then, the company could sell approximately 180,000 vehicles in Mexico, and about 33,000 units only in 2013 alone. In this period of time, the brand's image in Mexico was improved so, that today it is highly regarded.

The next step in the Mexican history of *Mazda* took place in 2011. The company had to face different difficulties in its home country. Besides an earthquake, consequences on the supply chain and the catastrophe in Fukushima, even the global economic crisis forced the company to reflect on the possibility of relocating production. In addition, the development of the strong Yen endangered the company's success, because of the carmaker's reliance on exports from Japan. While, in 2008, a record profit of 162.1 billion Yen was generated, *Mazda* experienced a large profit decline in the following years. Consequently, the company was forced to take extensive steps. In January 2011, *Mazda* announced that it planned to produce automobiles in Mexico.

One of the most important reasons for establishing production plants in Mexico can be seen in numerous *free trade agreements*. Substantial FTAs in the automotive sector are the NAFTA, MEFTA, ACE-55, and the AAE. FTAs eliminate barriers like tariffs or quotas and allow duty-free trade within the member states, what can lead to demand-side effects, especially in the often high-priced automotive sector. In this context, local content requirements often constitute important conditions. They fix a certain share of local production of vehicles or auto parts. Within NAFTA, a local content of 62.5% is required to be covered from the exemption from customs duties. For duty-free export to Japan, a local content share of 65% is postulated (see Table 7.8).

In comparison to the European Union, which is a customs union, NAFTA does not restrict its member states concerning the negotiation of FTAs with other countries. The member states keep their degrees of freedom in reference to its trade policy. Consequently, none of the member states of NAFTA needs permission if it wants to conclude a new bilateral free trade agreement with another country. In contrast, customs unions have common tariffs on external countries.

Mazda's major sales markets are, among others, the US, Japan, China, Europe, Australia, the ASEAN member states, Canada and Mexico. Compared to Mexico's existing FTAs, almost all relevant markets are covered. Mazda had to introduce a production plant in Mexico to fulfil the local content requirements that were anchored in the FTAs, on order to participate in duty-free sales. As a result, the production plant in Salamanca, Mexico was

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established, that serves as a hub for exports. In February 2014, the official opening of the engine and vehicle assembly plant took place.

Table 7.8 Selected Free Trade Agreements of Mexico

Agreement	Member States	Duty-free Trade in the Automotive Sector	Local Content Requirement
North American Free Trade Agreement (NAFTA)	Mexico, USA, Canada	since 01.01.2004	62.5%
Middle East Free Trade Area (MEFTA)	Mexico, European Union	since 01.01.2007	50%
Mercosur/ACE-55	Mexico, Argentina, Brazil	since 01.01.2007/ 19.03.2012	60% Argentina and Brazil, 35% Mexico
Economic Partnership Agreement (AAE, by its initials in Spanish)	Mexico, Japan	since 01.04.2011	65%

Source: AHK Mexiko 2012, p. 25.

The facility is a joint venture by *Mazda* and the Japanese trading company *Sumitomo Corporation*. It was the first time that *Mazda* went overseas without another automotive partner (Entrada Group 2013). While *Sumitomo* owns 30%, *Mazda* is a 70% shareholder of the 770 million USD plant (Automotive News 2014b). In Salamanca, *Mazda* employs 4,500 people. Besides the production of *Mazda 2* and *Mazda 3*, the facility will be producing engines from October 2014. Thus, the number of locally produced parts will increase and local content requirements will be adhered more easily. At the end of 2016, the plant is supposed to have an annually capacity of 230,000 units. Additionally, from 2015 on 50,000 *Toyota*-branded cars should be produced there.

Vehicles produced in Salamanca are sold to Canada, Mexico, Central and South America, as well as Europe; even other regions in the world are not excluded. In its first months of operation until May 2014, 18,700 vehicles were produced in total. While only a fraction was sold in the Mexican market, over 75% went to the US (AMIA 2014).

Structural Reform Plan

In February 2012, the *Structural Reform Plan* was established. This plan was formulated in order to achieve the company's mid- to long-term objectives and to strengthen business in emerging markets. The aim was to reach an operating income of 150 billion Yen by 2016. Another target is to increase the share of vehicles produced outside Japan from 30% in 2012 to 50% in 2016. The establishment of the Mexican plant is one step to achieve these targets. Yamanouchi, the CEO of *Mazda Motor Corporation*, made clear that "*Mazda's Structural Reform Plan*, upon which the very future of the company hinges, positions this plant as [the] most important global strategic base" (Automotive News 2014a).

For achieving objectives of the Structural Reform Plan, *Mazda* follows the approach of producing abroad to circumvent market barriers like customs regulations. Besides Mexico, the company also established a production plant in Thailand, which is an ASEAN member state. Within ASEAN, companies that fulfil the requirement of 40% local content are eligible to benefit from the 0-5% preferential tariff rate. *Mazda* operates in all ten ASEAN member states, even Myanmar, which was under international economic sanctions until recently. Only in 2011, were import restrictions imposed by the military government loosened (Reuters 2013).

Questions

1. *Mazda* and other carmakers use Mexico as a production country. Summarise the advantages that accrued for the Mexican automotive industry through the country's access to the NAFTA. Except the evasion of market barriers, which benefits are there in the context of producing vehicles in Mexico?
2. Compare the possibility of relocating a production facility to Mexico with the advantages and disadvantages an automotive manufacturer could have shifting its production to the ASEAN region.
3. Define different types of market barriers and show their effect on the market entry mode. Explain different strategies a company can use to deal with entry barriers in the context of the internationalisation of its business. Give some examples.

Hints

1. See Gachúz Maya 2011.
2. See Ball et al. 2012, pp. 63-93, as well as Kotabe and Helsen 2014, pp. 30-59.

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