

INTERNATIONAL FINANCIAL CRISIS & BUSINESS STRATEGIES

M.KARTHIKEYAN

Assistant Professor Dept of Management Studies, Vel Tech Multi Tech Engg College, Chennai

Abstract

International business strategies are affected by economic conditions, although the resource-based view would suggest that company resources are a more significant factor. This paper identifies differences in the international strategy behaviors of companies located in countries which, as a result of the GFC, entered either a deep recession, a shallow recession or no recession at all. Empirical evidence is provided for companies with home country markets with each of these conditions. The ability of international strategy theories to explain these behaviors is considered. Based on observations of international businesses with home country markets in each of these categories, it is suggested that determinants of international strategy during financial crises (and immediately after) are influenced by the strength of the home country market, foreign market government protectionist behavior, international exchange rate variations and local levels of rivalry.

1. INTRODUCTION

What are international businesses doing as domestic and global economies begin to recover? The answer is fairly complex. Some economies, such as those of India and China, have not experienced a recession and whilst there has been a downturn in their international business activity particularly in the areas of development and internationalization - the downturn has not occurred within the context of a recession in the company's home country. In other countries, notably the US and particularly, Iceland, the depth of the recession in the home country has had a more profound effect on international businesses. In these countries, the GFC has led to the collapse of major international businesses such as Lehman Bros and government decisions to bail out major international manufacturers such as GM (which would otherwise have collapsed).

A third category includes countries such as Australia and Singapore which briefly entered a recession, but not a deep recession. The recessions they experienced were predominantly forced upon them by the increased cost of capital and the collapse of trade with trading partners who had entered deep recessions. Aggressive responses by their governments, greater inherent comparative advantages, larger central bank and commodity reserves and more robust financial and capital markets in those countries led to their economies rapidly returning to near normal trading conditions. As a result, the impact on international businesses was much less. In some cases, the reduction in

international competition allowed businesses to increase their global market share to higher levels than

prior to the GFC. For example, following Australia's return to economic growth, all four major Australian banks moved into the category of the 20 largest global banks.

This paper will examine the research question, "Did the international strategies of international businesses change in response to the GFC?". To answer this question, the specific impacts of the GFC and the strategic responses of international businesses with home countries falling into each of the three following categories will be considered:

1. international businesses based in home countries which did not experience recession
2. international businesses based in home countries which did experience recession, but had strong financial and capital markets leading to rapid recovery
3. international businesses based in home countries which experienced a deep recession

2. LITERATURE REVIEW

Little research exists regarding frameworks of international business strategic behaviours during and immediately after recession environments. Economic theory predicts a reduction in internationalisation when the cost of capital is higher, as experienced in the recent global financial crisis (Ricardo 1963). This prediction has been supported by a global reduction in foreign direct investment (FDI) of 30 % (UNCTAD, 2009).

Empirical evidence from the 1991-1992 world recession (which was not as deep as the 2008-2009 global recession) identified reduction of internal costs as a post-

recession international business response. This was primarily achieved by flattening hierarchies and outsourcing operations to lower-cost countries. Outsourcing has become much more attractive as low labour cost countries develop their technical and resource capacity to provide activities such as IT, accounting, basic manufacturing and call centre work in response to demands from international businesses based in developed countries (Sharpe, 1997). The flattening of hierarchical structures resulted from the removal of layers of middle management and the horizontal narrowing of organisational structures by outsourcing. This led to more efficient domestic business operations. International comparative advantage theory predicts a reduced attractiveness for international activities resulting from increased levels of domestic efficiency. From an organisational design perspective, the reduction in management resources makes strategic planning for internationalisation more difficult, and reduces the rate at which companies internationalise (Jennings, 1997; Lei and Hitt, 1995).

A corporate strategy level perspective suggests that focusing on core activities also has the effect of directing an organisation's strategies away from diversification. Internationalisation is a form of geographical diversification. Supplying markets outside that of the home country requires the introduction of variations in products and services to suit local conditions, and variations in the structure and operations of the local

subsidiaries to match local work practices, regulations and conditions. Even companies producing global products and services (such as airlines and book publishers) found that the level of organisational structure variation between that of the home country and subsidiaries in other countries necessary to sustain the business was a large barrier to internationalisation for companies based in home countries recently recovered from a recession (Birkinshaw and Morrison, 1995). Markets in host countries then became less attractive than the company's home country market as, having survived the recession, the organisations had become more efficient and more profitable in their home country markets.

Porter's theory of national competitive advantage points out that a destination country's features, such as government and local industry supports, are important factors in considering whether to internationalise to that country (Porter, 2000). Post-recession, almost every

government's policies (perhaps with the exception of China) have become more mercantile and focused on ensuring the continuation of local industry. One of the main drivers of mercantile policy is supporting the needs of the home country in the face of uncertainty of supply from other countries (Zhou and Vertinsky, 2002). Porter's theory predicts the empirical observations above, in that less attractive government policy and a weakening of supporting industries (including capital markets) in almost every country as a result of the GFC, meant that internationalisation should be less attractive until the potential host countries have fully recovered from the impact of the recession.

Another of Porter's models, the five forces for industry attractiveness, predicts that, where the powers of suppliers and the levels of rivalry are high, markets will be less attractive (Porter, 1979). This correctly supports the identified internationalisation of production to low labour cost countries. Critical suppliers such as capital markets, finance and supporting industries will have high levels of power over their customers (i.e., international business subsidiaries) because of their rarity, whilst rivalry in markets will have increased due to a reduction in local demand resulting from local recessions.

The exchange-rate theoretical perspective suggests that the highly dynamic nature of international exchange rates, coupled with the high level of uncertainty of the value of the US dollar (a currency frequently used for international trade transactions), increase the level of risk associated with international negotiations (Leung and Cheung, 2007). Whilst currency hedging can be used to reduce the impact of currency variations, the cost of hedging (to provide the same level of risk as was possible prior to the GFC) has increased in response to the large currency exchange rate variations in the global market. In addition, just as it has become increasingly difficult to attract the capital necessary for large-scale international transactions, it has also become much more difficult to acquire sufficient hedging for large-scale international transactions. The cost and difficulty of hedging international operations to the same level of certainty as existed prior to the GFC, predicts a reduction in international transactions and internationalisation until such time as international exchange rate variations reduce.

Dunning's eclectic theory suggests that advantages such as prior internationalization experience or technological competency, predict a greater level of

internationalization and a more proactive internationalization strategy (Dunning et al., 2007). Other factors, such as strong returns cash flows from local subsidiaries and access to local country specializations (such highly productive diamond mines in the case of South African, or low labour costs in the case of India), also are predictors of a more proactive internationalisation strategy, according to Dunning's theory. The aggressive internationalisation strategies apparent during the economic boom preceding the GFC were therefore supported by Dunning's eclectic theory. Dunning's theory also suggests that, when local market conditions are depressed as a result of a recession, the attractiveness of operating in those environments is also reduced. Demand conditions in many markets became less attractive as a result of the GFC and local business environments had less advantages to offer international businesses. This was due to the increased cost of capital in these countries and their governments focus on ensuring the survival of local industry. For example, manufacturing in the US for automotive manufacturers based in other countries would have become less attractive during the GFC because of the US government's moves to support the survival of the domestic US automotive industry. Dunning's eclectic theory therefore predicts reduced internationalization in the wake of a global recession.

The political theory perspective suggests that internationalization, particularly into countries with unstable and risky political environments, will be negatively affected. The impact of the GFC appears to be reduced political activity levels in many countries and increased international and cooperative foreign affairs activity between fully-developed countries (Ewing, 2009; McMillan and Powles, 2009). In poorly-developed countries and some partially-developed countries, such as some African and Middle Eastern countries, the impact of the global downturn appears to have been to increase political instability. Therefore, political theory predicts a shift towards internationalization between moderately-developed and fully-developed countries with stable political environments as a result of the GFC.

3. METHODOLOGY

The public business media and research literature were reviewed to identify evidence of strategic behaviours amongst companies based in home countries that

experienced a strong recession, a limited recession or no recession during the GFC. Evidence supporting the economic theory, international comparative advantage, organisational design, corporate strategy, national competitive advantage, industry attractiveness, exchange rates perspective, Dunning's eclectic theory and political theory was identified from empirical evidence available in the literature. The literature search covered the period 2008-2009.

4. FINDINGS AND DISCUSSION

The empirical data collected from the literature that related to each of the theories discussed in the literature review was compiled to provide evidence of changes in the international strategy of companies with home country markets that: (a) never entered a recession, (b) briefly entered a recession, and (c) deeply entered a recession, as identified in the introduction to this paper. This evidence will now be considered under the three home country categories.

Companies in Home Country Markets that Experienced Deep Recession

International businesses based in countries such as Iceland, Japan and Ireland are continuing to display all-time low levels of internationalization and no medium-term plans to increase this activity.

Japan - Toyota Toyota Motor Corporation's profitability was badly affected by the GFC, resulting in a fall from record profits to record losses over 12 months (Greimel, 2009). Whilst Toyota's industry rivals such as Honda Motor Co. and Nissan Motor Co. have been able to cut back operations, Toyota's Japanese operations were dependent on its export market and attractive exchange rates (Greimel, 2009). In response, Toyota is planning to curtail expenditure and return to its original focus on quality. In reaction to global currency fluctuations, the lower value of currencies in countries such as the US, and the possible mercantile behaviours of the governments of some of its host country markets, it has decided to increase the percentage of local production in the products it sells in its foreign markets (Bennett and Terlep, 2009). This will be balanced by a reduction in production activity in Japan (Automotive News, 2009). It is also moving towards making its subsidiary in each country more independent of Toyota Head Office (Toyoda, 2009).

Iceland - Banking Industry Leading up to the GFC, FDI by Iceland had been quite substantial, including (in some cases) Icelandic companies acquiring foreign organisations larger than themselves. This internationalisation strategy was principally driven by the objectives of increasing economies of scale to globally competitive levels and gaining access to foreign markets (Óladóttir, 2009). This internationalisation behaviour ended when Iceland entered a depression (OECD Economic Surveys, 2009), precipitated by the collapse of the banking industry (Country Monitor, 2009a).

Ireland - All Industries All international development activity in Ireland ceased as a result of weakness in the Irish economy which is in depression. For example, one of its major banks has already had to be nationalised to enable it to stay in operation, and it is quite likely that most of the other Irish banks will also have to be nationalised to stop them from going out of business (Country Monitor, 2009b).

US - Exxon Mobil In response to the GFC, Exxon Mobil reduced costs by outsourcing IT operations to lower-cost Indian IT service providers (EmergingMarketsNOW 2009a). It also moved into related diversification such as research and development into biofuels. Interestingly, Exxon's website does not mention the GFC. As a result of the demand for energy in industries based in countries not in recession, Exxon Mobil has been able to maintain some internationalisation, but only using funds from international markets in the same regions. For example, it was able to finance a new liquefied natural gas project in Papua New Guinea with funding support from the International Finance Corporation, the Asian Development Bank, the Italian credit agency Servizi Assicurativi del Commercio Estero, and the Japan Bank for International Cooperation (Power Finance & Risk 2009).

These behaviours are strongly predicted by Porter's theory of national competitive advantage in that the increased cost of capital in foreign markets (a supporting industry) is an effective barrier to internationalisation. In addition, weak domestic exchange rates for countries still in significant recession will increase the cost of internationalisation, as predicted by international exchange rates theory. The political theory predicts this behaviour by suggesting that home country governments' initiatives will be focused on domestic business

development, reducing the effective home country government's support for internationalisation. Dunning's theory provides some explanation of this behaviour because those organisations operating in home countries which are in deep recession, are less likely to possess the specific strengths which a company can use in foreign markets, as they contract their core business in an effort to survive.

Companies in Home Countries that Briefly Experienced a Recession

Countries such as Australia and Singapore experienced recession for only a few quarters and quickly returned to economic growth because of the strength in their domestic financial and capital markets, and the aggressive stimulatory behaviours of their governments. Companies from these home country markets quickly returned to internationalisation activities and maintained aggressive international strategies, but with some differences.

As a result of the relative stability of their home country environment, exchange rate instability and the reduction in attractiveness of foreign markets, companies with these home countries reduced their rate of internationalisation.

Australia - BHP Billiton In response to the global financial crisis, BHP has reduced its international activities in the markets that have been most affected by the crisis (and in which demand for resources has been most affected). It is looking towards Asia, and particularly China, for the greatest opportunities and these are the markets where it will focus more of its attention (Argus 2009). BHP Billiton has also reduced its internationalisation in two regions where significant local development has been required. For example, it withdrew from negotiations with the Suriname Government to mine alumina because of the lack of a local market (Mendes de Paula 2009).

Where BHP Billiton has continued internationalisation behaviours, it has attempted to use its size and position to create a more attractive market. For example, the joint venture (JV) between BHP Billiton Ltd. and Rio Tinto PLC in iron ore mining in Western Australia will give the partnership an enormous bargaining power over the price of the iron ore that it sells to one of its major markets. Twenty percent of BHP Billiton's sales are made in China (Argus 2009). Coupled with an iron ore pricing agreement which has also been established between Rio Tinto and

Japan's Nippon Steel, these measures will create a more certain market for BHP Billiton.

Australia - ANZ Banking Group In an approach similar to that of BHP, ANZ has continued to internationalized into non-recession markets, such as those of Asia, because of its access to stronger home country capital markets and growing customer demand in those foreign markets (Sibillin 2009). In an approach again similar to BHP, ANZ attempted to make its foreign markets more attractive. In particular, ANZ aimed to become one of the top foreign banks in China by 2012 (Euroweek 2009a), using a number of different approaches. For example, ANZ influenced the Chinese commercial banking industry to significantly increase the levels of corporate governance in that industry, to enable it to meet its corporate governance objectives (Ngee 2009). ANZ also invested in attractive acquisitions in non-recession markets from competitors with home country markets in deep recession and capital shortages. For example, ANZ purchased the Royal Bank of Scotland's retail and commercial operations in Asia (MarketWatch 2009).

ANZ has also applied to the China Banking Regulator Commission for approval to set up a wholly-owned local subsidiary and a rural bank in a West China province (Euroweek 2009a). These investments were funded with capital from its non-recession foreign markets as well. For example, ANZ raised one billion Australian dollars from the sale of bonds into Asian capital markets (Morrow 2009).

Singapore - Singtel SingTel, too, acquired interests in businesses located in attractive markets, such as 30% of the telecommunication operator Warid Telecom in Pakistan (Global Telecoms Business 2009a). It also negotiated with the Australian Government to acquire a percentage of a proposed national broadband network (Venkat et al. 2009). In the same period, it entered into an international business partnership with Google and four other telecom companies to construct a high-speed communications cable between Los Angeles and Chikura in Japan (Global Telecoms Business 2009b), showing that it still has a longer-term interest in both the US and Japanese markets. It also diversified its interests in its home country market by acquiring the rights to show English Premier League football matches and other sport content there (Media 2009). SingTel also sourced capital from non-recession

markets, negotiating a US\$713.3m loan with seven local banks (Euroweek 2009b).

In these countries, government intervention has made the home country markets more attractive and has caused international businesses to switch some of their development investment to their home country market rather than to foreign markets. International businesses with home markets such as Australia, which are located in geographical regions experiencing continued high economic growth, such as parts of Asia, and which had significant prior experience, still tended to internationalize into high economic growth rate foreign markets. Porter's Five Forces theory predicts a return to internationalization activities in higher economic growth rate host countries because the threat of new entrants (from other developed countries) is reduced. Internal rivalry in these countries is also lower because of the rapid rate of growth which means that companies can achieve growth on the basis of the country's economic growth rate without having to compete to increase their market share.

Exchange rate theory also predicts this behavior because, although the initial internationalization investment outlay may be higher, interest rates in those home countries were generally at an all-time low, and the higher foreign market currency exchange rates, resulting from the high levels of economic growth, would result in greater profits to repatriate to the home country.

Porter's theory of national competitive advantage predicts continued internationalization activities from international businesses with home country markets in countries with high economic growth rates, because the foreign market's government policy regarding FDI, and the likely growth in supporting industries as a result of that market's economic growth, make these regions attractive. For the same reasons, both Porter's Five Forces and national competitive advantage theories predict that companies with home markets recently emerged from recession and, therefore, more cautious than during boom times, will find foreign markets still in recession unattractive due to the protectionist measures of local government, the reduced size of the markets (reflecting reduced local spending power), and the increased levels of rivalry (due to reduced market size).

Companies with Home Country Markets that Did Not Experience a Recession

Not surprisingly, countries with high economic growth rates leading into the GFC, and which did not experience a recession, maintained strong levels of internationalization activity. The reduction in some of their foreign markets (particularly markets in countries that did enter a recession) meant that some international businesses were unable to maintain the same rate of internationalization or, in some cases, were unable to survive due to their dependence on foreign markets that had entered deep recessions. Some international businesses took advantage of the decline in the share prices of their overseas competitors, and attempted to acquire as many of them as possible as part of their internationalization strategy.

China - Sinopec Sinopec is one of China's largest petroleum companies. Local demand has ensured that it remained profitable during the GFC, actually experiencing a profit increase in 2009 off 50% (Country Monitor 2009c). Whilst Sinopec is investing heavily in establishing production facilities and in exploration in China, it is also investing heavily in acquisitions outside of China. One of these acquisitions was the Swiss Canadian petrochemical producer, Addax Petroleum Corp. It planned to make foreign investments of US\$20 million in 2010 and 2011 (Wall Street Journal Eastern Edition 2009). In addition, it established a partnership with the Japanese company, Mitsubishi Chemical (Tremblay 2009), as well as establishing partnerships with Indian petrochemical companies and aggressively investing in many other countries such as Kyrgyzstan. To fund its acquisitions, it formed partnerships with companies such as Kuwait Petroleum Corporation and released bonds into the Chinese bond market (Company Monitor 2009). Sinopec's international strategy is to meet increasing domestic demands through expansion of its direct access to oil and gas assets (King 2009).

India - Tata Motors took advantage of the weakness of competitors whose home country markets were in recession and acquired the UK Jaguar Land Rover company. It also introduced the world's cheapest car in 2009. It now carries a high level of debt which it needs to refinance (Economist 2009), showing it is still susceptible to some of the issues facing international businesses whose home country markets are in recession. Its consulting arm (Tata Consultancy Services) announced a net profit of US\$300 million and an increase in revenue of 25%, indicating that

business activity remains strong in its home country market (Sheth et al. 2009). It has also been increasing its internationalization in those Asian countries which have not experienced a deep recession (EmergingMarketsNOW 2009b). It has also strengthened its activities in its home market in response to the economic growth there. For example, it has entered into a partnership with Microsoft India to launch a centre of excellence to support the local Indian market (EmergingMarketsNOW 2009c).

The continuation of internationalization by international businesses with these home country markets is predicted by exchange rate theory. The weakening of the exchange rates in countries which have experienced a recession, relative to the home country currency of the international business, makes companies in those home country markets attractive acquisition targets. This advantage would have been moderated, however, by the reduced revenues generated in those markets when converted to the international business's home country currency.

This behavior is also predicted by Dunning's eclectic theory which notes that local conditions are attractive due to the reduced resources and capital available to local companies with which to compete against an international business acquiring local businesses. The international business's sustained competencies and access to capital would be valuable in these environments. This advantage would have also been moderated by the increased level of rivalry and possible protectionist behavior of the foreign country's government in reaction to takeover plans of larger local organizations.

Porter's Five Forces and national competitive advantage theories do not predict this international strategy behavior of acquisition of companies in weak foreign markets. Local levels of rivalry would be greater in markets in recession and the power of customers and possibly suppliers would be stronger due to their relative rarity (reduced spending power of customers and collapse of some suppliers). In addition, local government behavior and weakened supporting industries would have made these environments unattractive for investment.

5. CONCLUSION

The research determined that international businesses did indeed change their international strategies in

response to the GFC. Three different international strategy responses to the GFC were identified. The identified international strategy behaviors were categorized on the basis of the level of the company's home country market recession experience. In all three cases, international strategy was affected by the GFC, dramatically reducing internationalization rates for countries with companies with home country markets that experienced deep recession; creating reduced, but highly-focused internationalization behaviors from international businesses with home country markets that experienced a shallow recession; and embarking on a greater level of acquisition as part of the international strategy from companies with home country markets that experienced no recession at all.

The findings suggest that two principal factors are dominant in determining international strategy during times of financial crisis - home country market conditions, and the level of domestic industry protection introduced by the foreign country government in response to the economic downturn. Other factors including the variability in relative exchange rates also influenced international strategy during financial crises.

The behaviors of international businesses under these conditions were accurately (but not completely) predicted by the exchange rate variation and Dunning's eclectic and political theory perspectives. Corporate strategy, Porter's Five Forces and Porter's theory of national competitive advantage correctly predicted some of the behaviors of international businesses with home country markets that experienced some level of recession, but they were not found to correctly predict the behaviors of international businesses with home country markets that did not experience a recession during the global financial crisis.

These findings suggest the model for international strategy responses to crises shown in Figure 1. In addition to the direct contribution of each of the four external forces, they are likely to influence one another in specific markets as well.

It can be seen, for example, that the protectionist behaviors of a local government would influence the exchange rate of that currency as well as its likely variability. The Chinese government's efforts to keep the Yuan/US dollar exchange rate low to support continued exports to the US is an example of this interaction which has had a very significant impact on international trade. In a similar manner, countries whose currency value is dropping relative

to major trading partners may relax protectionist behaviors because of the increasing ease of exports.

Foreign country government protectionist behaviors can be expected to have a significant effect on the nature of the home country markets and possibly also on the capital markets available in those countries. In addition, home country industries which are suffering, such as the banking industry in many countries at present, will cause governments to display protectionist behaviors (such as partially nationalizing banks in order to keep them operating) where those industries are considered to be critical and so support the markets they serve.

Local levels of rivalry will determine the conditions in the home country markets and may also influence the availability of capital markets in those countries. It is not clear whether the condition of home country markets will encourage or discourage levels of rivalry, except, perhaps, through the overall attractiveness (e.g. profitability) of a particular industry.

Local levels of rivalry in the market will probably be only mildly affected by international exchange-rate variations except where those markets are highly dependent on imported raw materials or are only viable where a significant component of export occurs. Exchange rates are unlikely to be significantly affected by the local levels of rivalry.

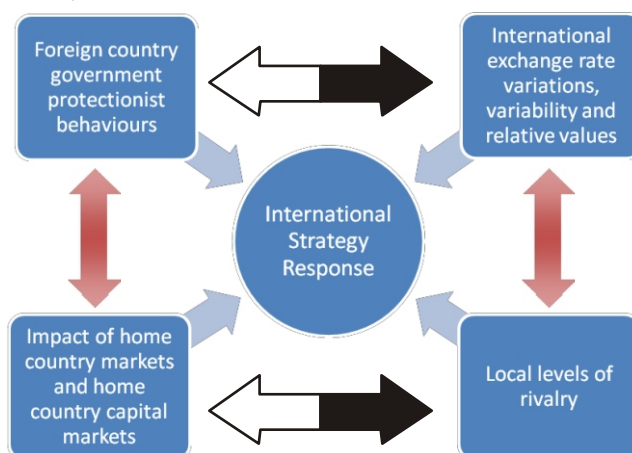


Figure 1. International Strategy Response to Crises

This research represents a starting point in understanding the strategic responses of international businesses at times of crisis. Detailed empirical research into the support for each of the theories examined would further extend the understanding of these behaviors. Ultimately, these

findings could be used to further develop the model presented in Figure 1 for determination of international strategy in times of financial crises. In particular, structural equation modeling of the relationship between each of the four contributing factors, and their impact upon one another would provide particularly informative insights for specific industries, such as the banking and finance industry.

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