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Legal Issues in Multinational Business Strategy: To Play the Game, You Have To Know the Rules

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Executive Overview

For corporations intent on developing an effective worldwide strategy, ultimate success may hinge on the company's mastery of the legal environment. This article identifies and discusses key legal questions confronting multinational firms. Given the complexities presented by the various legal systems throughout the world, this article will neither provide specific answers to every legal question nor attempt to address each rule and regulation country by country. However, specific instances will be used to illustrate the diverse legal environment across countries and geographic regions.

The methods of actually transacting business globally can range from a hands-off approach to one that requires a high degree of involvement. Each method has benefits and costs for the firm.

Introduction

There have been radical changes in the business paradigm in recent decades. As Brian O'Reilly comments, "A fundamental shift is underway in how and where the world's work gets done. . . . Interviews with executives around the globe reveal that increasingly sophisticated work is indeed being parceled out to faraway nations, whose labor forces are exceedingly capable."[1] As the limited perspectives of the past give way to new global viewpoints, the competitive changes create great hardships for some companies and great benefits to firms capable of seizing new opportunities. In this article, we will explore basic legal issues confronting multinational firms.

CONTRACTUAL AND LEGAL FORMS OF BUSINESS ENGAGEMENT

There are a number of ways in which a business may undertake its operations within a foreign country, each with differing legal consequences. The methods of actually transacting business globally can range from a hands-off approach to one that requires a high degree of involvement. Each method has benefits and costs for the firm. (See Exhibit 1.)

Direct Sales

A firm can market its goods or services directly to foreign purchasers or users, retaining complete control of the product or service and the form in which it is marketed. Payment may be difficult because the local mechanisms to ensure payment of contracts are not always reliable. The seller should therefore require an irrevocable letter of credit that the buyer has obtained from a local bank. The bank promises to pay the seller the amount of the contract after the goods have been shipped or the service performed. The bank is concerned with conformity to the credit terms, not with whether the goods or services confirm to the

Exhibit 1
Transacting Business in a Global Environment

Business Forms	Benefits	Potential Problems
Direct Sales	Complete control of product/ service	Payments uncertain
Agents, Representatives and Distributorships	Agents can enter into contracts; Distributors can remove sales risk	Agents can create inappropriate contracts
Joint Ventures	Complete investment may not be required	Possible loss of managerial control
Branches	Maintain managerial control	No local identity; Can subject company to extra liability; Income must be reported by parent company
Subsidiaries	Parent firm may not be liable for acts of subsidiary; Subsidiary's income remains on its balance sheet and not parent firm's	Possible repatriation of profits or expropriation of property; Full investment required
Licensing	Limits investment	Possible loss of control over product/ service
Acquisitions	Reduces start up costs; Obtains goodwill	Restrictive regulations on foreign investment can exist

contract. The bank may not revoke the letter of credit without the consent of both the buyer and the seller.

Agents and Representatives
Firms can do business in another country through sales agents or representatives. A sales agent may enter into contracts on the domestic employer's behalf; a representative may solicit and take orders, but does not have the authority to bind the company to a contract. Employing an agent may be more efficient, but the agent may bind the firm to inappropriate contract terms. Nor are agents always an option; in Algeria, for example, agents are not permitted to act on behalf of foreign sellers.[2] Other countries impose citizenship requirements or other restrictions on agents. Some countries view agency affiliations as employment relationships, which subjects the corporate-agent relationship to the employment laws of those countries.

Distributors
A distributor purchases items from an American firm and agrees to resell them in the foreign country, accepting all the risks involved. As a result, the American manufacturer loses control of the items, except when specific terms are included in the contract. Exclusive distributorships, prohibited to some extent in the United States under antitrust laws, are also prohibited by the European Community countries.

Joint Ventures
A joint venture, an entity created by two or more firms, enables an American firm to test a foreign market and obtain market presence through a connection with an established local partner. Host countries frequently require that foreign companies establish joint ventures as a condition of entry. Restrictions on joint ventures vary significantly across countries. In Japan, any amount up to and

including 100 percent of foreign ownership is allowed, while in China a foreign investor in a joint venture must contribute at least 25 percent of the registered capital. (Although no upper limit has been set, more than 50 percent is discouraged.) In India, a foreign investor may own only up to 40 percent of an Indian industrial company, while in Korea the percentage interest allowed a foreign investor depends on the sector of the economy involved.

Since certain countries regulate the capital and earnings that a foreign firm can take back home, repatriation can be significant issue in a firm's overall strategic plan. In Argentina, for instance, registered capital may be repatriated only three years after the investment is made.

The form of joint ventures is influenced by host country regulations. Austria, for example, has complicated administrative procedures for foreign investment, as well as burdensome policies on foreign ownership of real estate and environmental restrictions on land use. More extreme examples of governmental restrictions are provided in Qatar and the Czech Republic, where only nationals are allowed to own real estate.[3] By engaging in a joint venture, a foreign firm may benefit from a local firm's experience with what may be overly burdensome restrictions.

Some companies conclude that the chauvinism of the host market argues for a joint venture with a domestic firm. Intel (United States) entered into a joint venture in Japan with Sharp (Japan) because of the potential benefits from Sharp's semiconductor expertise, but also because of its belief that the nationalistic Japanese market favors the partner of a Japanese firm.[4]

Branches

An American firm may enter a foreign market by establishing a wholly-owned branch in the host country. Some countries welcome branch offices and require only registration of the office with a local ministry. Other countries, wanting to support domestic firms, forbid foreign-owned branch offices. In Poland, foreign businesses interested in investing in certain strategic areas, such as airports or port facilities, must apply for a permit from the State Agency for Foreign Investment (SAFI). SAFI denies investments that threaten the economic interest or security of the state. In Austria, by contrast, foreign firms receive the same treatment as domestic firms, with all firms required to apply for business licenses. A foreign firm seeking a service business license, however, must establish a branch office or a joint venture to comply with Austrian residence requirements.

Because the branch office of a foreign firm is a direct extension of the parent corporation, the branch office may subject the corporation to liability in the host country according to that country's laws. The corporation, however, maintains complete control over the operations of the branch office, which may outweighs the risk of liability.

Subsidiaries

An American corporation may decide to open a subsidiary in a host country. The subsidiary may be wholly or partly owned by the parent corporation, but it is considered an entity separate from the parent company and must be established in the host country in the same way as any new firm. Problems can occur in the repatriation of the subsidiary's profits. Some developing countries, for example, have no foreign exchange. These countries may encourage foreign investment, but dividends paid or funds returned to an American parent company reduce the dollars the local country uses to buy American goods for defense, development, or consumption. Since certain countries regulate the capital and earnings that a foreign firm can take back home, repatriation can be significant issue in a firm's

overall strategic plan. In Argentina, for instance, registered capital may be repatriated only three years after the investment is made.

Expropriation is another problem faced by subsidiaries. Some countries may take over a foreign firm's facilities without compensating the firm in exchange. International law is not clear as to the form of compensation required for such a takeover. Many developing countries compensate foreign firms; others believe no compensation is required where they treat the property of citizens and foreigners alike.

Licensing
An American company, instead of developing an overseas manufacturing plant or distributorship, can license the rights to produce a product or a service to a foreign company. The license may be in the form of a right to market or sell a patented or copyrighted item or service, in which case the American firm loses all control of the use of the license once the right has been granted, except pursuant to the terms of the specific contract. The license may also be in the form of a franchise where the franchisor maintains more control over how the business is run.

Acquisition
An American firm can also choose to acquire an existing company in a foreign country. This reduces startup costs and allows for direct acquisition of the company's goodwill and reputation. However, some countries have relatively restrictive regulations on foreign investments. In Japan, industries such as water supply, postal services, and industrial alcohol are closed to private enterprises altogether. Venezuela restricts foreign ownership to 20 percent of the capital stock in television and radio broadcasting, in the Spanish language press, and in professional, consulting and advisory services. Taiwan prohibits foreign ownership in 53 different industries and has restrictions on foreign ownership in 54 others. While some foreign restrictions seem harsh, the United States itself allows the President to prohibit foreign investment in U.S. businesses for national security reasons.

In many countries, an acquiring firm must first obtain approval or clearance that varies depending on the structure of the acquisition. In France, for instance, a foreign firm acquiring shares in a French company must get approval from the French Treasury Department; but a firm acquiring shares in a non-French holding company that owns shares in a French company need only notify the Treasury after the close of the transaction. Government approval is so critical in some countries that the parties may make the closing of the transaction contingent on procuring permission.

Other Alternatives
Certain countries allow additional forms of doing business. For example, in Latin American countries, a business may operate as a limited liability company or as a company with variable capital.

Further Considerations
Where to transact business may be as crucial a question as how. For example, the legal protection of intellectual property may be a critical factor influencing location. Another factor could be the import taxes assessed against a firm, which may be higher or lower depending on the country where the product was made.

OPERATIONS AND THE LAW

Legal issues involving product liability, communication and government regulation affect operations in foreign nations.

Product Liability

With increasingly large awards being given to victims of defective products, corporations need to be cognizant of significant, rapidly changing product liability regulations. In the United States, product liability is defined in terms of strict tort liability, which imposes a duty on all who introduce products into the market. Strict product liability exists where (1) an article has a defect that renders it unreasonably dangerous, (2) the article is placed on the market by the manufacturer with knowledge that it is to be used without inspection for defects, and (3) the defect causes an injury to a human being.[5] Where these factors are present, traditional defenses, such as the exercise of due care, are not available to the manufacturer.

The European Common Market countries are bound by the Directive of the European Community (EC) Council on The Approximation of The Laws, Regulations, and Administrative Provisions of the Member States Concerning Liability for Defective Products, enacted in 1985.[6] For the directive to become binding within the EC member states, each state must implement a product liability plan in its national legislation. Although the directive required compliance within three years, France, Ireland and Spain have yet to comply.[7] Norway and Austria, while not members of the Common Market, have adopted liability principles similar to those presented in the directive.

Because juries in civil suits and contingency fees for lawyers are not available in the EC, the enormous liability of firms in the United States will not be duplicated overseas.

In Europe before the directive—except in France, Belgium and Luxembourg—product liability had been based on the concept of negligence. To recover damages, a victim has to prove that a defective product was the result of the manufacturer's failure to exercise sufficient care over its manufacture. Once the directive is fully implemented, manufacturers will be held strictly liable for any damage resulting from a defective condition. No proof of negligence or lack of care will be required.[8]

Manufacturers' liability is tempered in several ways. Under the directive, the manufacturer must protect only against what is known or should have been known, based on the state of relevant scientific and technological knowledge at the time of sale—the so-called developmental risk. Luxembourg, Belgium and Italy do not allow this specific defense on the part of the manufacturer. Germany, Greece, Portugal, and, possibly, Spain, maintain financial ceilings to manufacturer liability for personal injury. The EC directive also provides that where the consumer has contributed to the damage, the amount of the claim allowed is decreased. Because juries in civil suits and contingency fees for lawyers are not available in the EC, the enormous liability of firms in the United States will not be duplicated overseas. Alleged victims must also file suit within three years from the date when they became or should have become aware of the defect, but no more than ten years from the date when the product entered into commerce.

In Canada, strict liability takes a back seat to traditional theories of negligence and comparative fault.[9] Thus, a court will look to whether the defendant attempted to prevent the harm and to what extent the injured party contributed to the resulting damage. Because these cases are tried before a judge instead of a jury, damage awards are seldom as large as those in the United States.

Japan, in stark contrast, has no concept of strict liability. Eric Rose provides the following observation of the Japanese legal system in relation to product liability:

> . . . when the injured party finds one of only 12,000 Japanese attorneys willing to represent him/her after payment of a bar-established advance retainer, and after subsequent payments to the lawyer of other court fees and attorneys' fees, and after the claimant proves to the judge (no juries in Japan) that the defendant was negligent, then the injured party may recover his/her out-of-pocket damages, plus court costs and attorneys' fees, and have some time to live with the stigma of being a litigious person.[10]

Fewer than 200 liability lawsuits have been successfully litigated on the part of consumers in Japan since World War II.[11]

Business Communication

The laws and regulations of foreign countries pertaining to corporate communication by international firms are moving targets requiring constant vigilance. American companies expanding overseas need to pay special attention to securities law obligations and to the transfer of information within the company.

Securities Laws

The U.S. Securities Act of 1933 and the Securities and Exchange Act of 1934 provide a comprehensive structure for controlling security trades. U.S. companies that become multinational enterprises must make full disclosure of all material facts to investors through filings with the Securities and Exchange Commission. Failure to do so may result in financial penalties. For a geographically dispersed company, identifying and communicating relevant knowledge of all material matters is a complex task.

Global companies frequently place their stocks on the exchanges of host countries whose securities laws and accounting systems may differ in inventory valuation, principles of revenue recognition, depreciation, good will, consolidation of subsidiaries, currency translation, disclosure requirements, and voluntary loss reserves. The degree of disclosure required in corporate reporting may also vary drastically from country to country. Switzerland, for example, has a famous and time-honored tradition of guarding the confidentiality of business transactions, and Swiss disclosure requirements are more narrowly defined than those of the United States.

Transfer of Information

Several nations limit the transfer of information between various headquarters or divisions. Sweden was the first to enact national data protection in 1973, followed soon after by Germany, France, Denmark, Norway, Luxembourg, and Austria.[12] The Council of Europe's 1981 Convention for the Protection of Individuals with Regard to Automatic Processing of Personal Data required signatories to safeguard personal data. EC countries extend these protections not only to European citizens but to all persons, regardless of citizenship.[13] Since European privacy laws apply to both the public and private sectors—unlike the Privacy Act in the United States—U.S. multinationals are consistently subject to the European data inspection ministers, who monitor the dissemination of information, at times impeding operations. Service sector companies, which

depend on the unimpeded flow of information, are most hampered by data regulations.

Many European countries have conflicting laws relating to document management. An Italian company operating in France, for example, was not allowed to transfer to Italy personnel information about its French employees because the French felt Italian data protection laws were deficient. To deal with such situations, additional proposals on information transfer are being considered by the EC. Since the United States is less rigid about the transfer of data than most European countries, American companies could be restricted from transferring data back to the U.S. if these proposals are approved. (They include a provision that individuals have an automatic right to information and to correct any misinformation or mistakes.)

Government Regulation

Every country or geographic region has legislation regulating the terms and conditions of employment. A significant human resource responsibility of a multinational company is compliance with local employment regulations. Several human resource areas are of particular concern:

Compensation and Benefits

Compensation and benefits regulations vary across country borders. An employee hired by a U.S. company and stationed overseas has no legal right under the laws of the United States to the same benefits of the company's domestic employees, except where the company violates the antidiscrimination provisions of Title VII of the Civil Rights Act of 1964.[14] Companies are required to obey local regulations governing benefits to employees employed within a country. Italy requires that employees receive a government-sponsored pension plan, a relocation allowance, and insurance coverage reimbursing medical expenses. All employees in large and medium-sized companies in Spain are statutorily entitled to an appropriate health and safety policy developed by a company health and safety committee. In Austria and the United Kingdom, there is no minimum wage; wages are instead tied to annual collective bargaining agreements. In the U.K., employment contracts are required for most positions and workers have the right not to be fired without cause after a specified period of time.

Companies are required to obey local regulations governing benefits to employees employed within a country. Italy requires that employees receive a government-sponsored pension plan, a relocation allowance, and insurance coverage reimbursing medical expenses.

Once bonuses are paid to employees in Brazil, they become legally required. Laws in Brazil and Peru require that employers pay year-end bonuses equivalent to one month's salary. In Peru, bonuses must be paid twice each year, along with a small monthly allowance for each child under fourteen years of age. A foreign enterprise in China must make payments to a social welfare fund to cover employee medical expenses, labor insurance, welfare, retirement, and continuing education. These payments are often as high as 50 percent of an employee's wages. India requires employers in some states to provide workers with a rent allowance and a termination payment of fifteen days' salary for each year worked.

In Mexico, the Federal Labor Board and various state boards have been granted jurisdiction over businesses holding federal charters or operating within federal or state zones. These boards—made up of representatives from government, management, and labor—regulate minimum benefits (including six paid vacation days per year, a 25 percent vacation pay premium, seven paid federal holidays, and fifteen days' salary as a Christmas bonus), profit sharing plans,

and an employer-funded payroll tax that supports a federal day care program. Mexican employees are tenured after one year of work, after which they may be dismissed only for specified causes set forth by the Mexican labor law. Most dismissals are reviewed by the Labor Board in order to determine their validity. When a strike is declared, all employees, including management, must strike and must be compensated.[15]

Standard employment practices also vary across countries. In Japan, many employees consider a position theirs for life. Culturally or nationally accepted holidays will also vary. Mexico celebrates its independence (September 16), its Dia de la Raza (October 12) and All Souls' Day (November 2).

The EC may prohibit elected company officers and other insiders from trading their company's stock, which will have unprecedented effects on the executive compensation decisions of global corporations.[16] On the other hand, perquisites are much more prevalent in EC countries than in the United States. Common among them are company cars, personal loans, meal allowances, housing allowances, and supplemental benefits.

Working Conditions

There are varied perspectives across borders on how work gets done. Consider the example of a Chicago-based manufacturer that decided internationalization was the most effective means for carrying out its strategy for long-term growth. The firm began by acquiring an existing European firm with a distinct manufacturing presence throughout Europe. Later, as potential business opportunities for even more growth were evaluated, the apparent benefits of doing business in Belgium induced the corporation to build a new tile plant in Allonge, Belgium. After the plant began operating, the parent firm learned that in Belgium all firms are placed in a joint committee organized by trade and bound by the collective bargaining agreement reached by the committee representatives. These agreements define minimum employment standards similar to those established by the U.S. Fair Labor Standards and National Labor Relations Acts. However, the Belgian accords tend to provide much greater regulation. For example, no work is to be performed in Belgium on Sunday, a government-regulated day of rest. To ensure compliance with the maze of local statutes and rules, the Chicago-based firm eventually had to hire local legal counsel.

The status of various employees also differs from country to country. In France, Greece and Italy, the duration of all employment must be in a written contract, in contrast to the United States, where oral contracts are permitted for work that can be performed within one year. Italian employees must also have written permission from the Italian Labor Office in the district of employment. Spain, in another contrast to U.S. practice, restricts overtime to a specified number of hours per day.

In the Netherlands, any company with more than thirty-five employees must have a works council, which must be consulted by any firm considering a transfer of control within a Netherlands company or a merger of a Netherlands company. If the council does not approve the transfer of control or the merger, and the action goes forward, the council may appeal the decision.

Discriminatory Practices

Discrimination laws and their enforcement also differ widely across countries. Exhibit 2 summarizes the various forms of discrimination prohibitions in a selected group of countries. The United States is included as a comparison.

Exhibit 2
Types of Discrimination Prohibited Within Selected Countries

Country	Age	Sex	National Origin	Race	Religion	Marital Status
United States	Yes	Yes	Yes	Yes	Yes	No
France	Some	Yes	Yes	Yes	Yes	Yes
Greece	No	Yes	No	Yes	Yes	Yes
Great Britain	No	Yes	Yes	Yes	No	No
Venezuela	No	No	No	No	No	No
Canada	Yes, except Yukon	Yes	Yes	Yes	Yes	Yes
Hong Kong	No	No	No	No	No	No
Japan	No	Yes	Yes	Yes	Yes	No
Italy	Yes	Yes	Some	Yes	Yes	No
Spain	No	Yes	Yes	Yes	Yes	Yes
Belgium	Some	Yes	Yes	Yes	Yes	Yes
Netherlands	No	Yes	Yes	Yes	Yes	Yes

While both the United States and the EC markets have legislation requiring equal pay for equal work between men and women, only the EC has gone so far as to also require equal pay for comparable work.

Section 702c of Title VII of the Civil Rights Act of 1964 prohibits U.S. firms from discriminating against their employees both on United States soil and in foreign countries. Foreign companies doing business in the United States are also subject to Title VII. There are notable differences in views of discrimination around the world. Women in Belgium are not allowed to work at night. Therefore, a firm with a revolving shift system cannot employ women for night shifts. Discrimination on the basis of race is prohibited by Belgium law. Discrimination based on age is allowed in France, but is prohibited in the United States by the Age Discrimination in Employment Act. West Germany has no existing specific antidiscrimination legislation, but its constitution states that all people are equal. In Spain, the government sanctions discrimination only where it has resulted from a strict affirmative action program. Discrimination is illegal in Greece if it is based on sex, race, religion or marital status, but not when based on age or national origin. Antidiscrimination laws exist in Pakistan, but because middle eastern tradition holds that a woman may not command the same respect as a man, an employer may use gender as a qualification for a supervisory job. Venezuela and Hong Kong do not have any of the traditional discrimination prohibitions.

An interesting distinction exists between the United States and the EC on the related issue of comparable worth. The EC requires that member states prohibit gender-based discrimination in systems of professional classification, working conditions, vocational training, professional advancement, and admission to professions. While both the United States and the EC markets have legislation requiring equal pay for equal work between men and women, only the EC has gone so far as to also require equal pay for comparable work. The EC requires that firms assess the value of various positions to ensure that positions of equal value offer equivalent remuneration of males and females. This concept has been specifically rejected by the U.S. courts, which refuse to make a similar determination of value. Companies, however, may conduct voluntary value determinations and comparisons.

Conclusion

This article has focused on the differing legal environments confronting businesses as they move into countries and regions throughout the world. The legal frameworks throughout the world determine the rules of the game. The effective global competitors are those companies that understand the rules.

Endnotes

[1] O'Reilly, Brian, "Your New Global Workforce," *Fortune*, December 14, 1992, p. 56.

[2] Unless otherwise cited, information about specific countries is drawn from: Price Waterhouse World Firm Ltd. publications: *Doing Business in Japan*, (1993); *Doing Business in China* (1988); *Doing Business in Poland—Update* (1994); *Doing Business in Argentina* (1993); *Doing Business in Venezuela* (1993); *Doing Business in Taiwan* (1993); *Doing Business in the United States* (1992); *Doing Business in France* (1993); *Doing Business in Spain* (1990); *Doing Business in Brazil* (1994); *Doing Business in Peru* (1994); *Doing Business in India* (1993); *Doing Business in the Netherlands* (1990); *Doing Business in Hong Kong* (1992); *Doing Business in Belgium* (1990); from U.S. International Trade Administration publications: "Algeria Market Reports," March 21, 1995; "China: Tax Regulations," Oct. 30, 1955; "Korea Market Reports," May 1, 1992; "Austria: Industrial Privitization Process," Mar. 21, 1995; "Poland National Market Report," March, 1992; "Japan Market Report," June 11, 1991; "Steel Dumping Report—IMI930128," 1993; "Market Report, Italy—Labor Relations," 1995; "Market Report, Austria—Country Marketing Plan FY94," 1993; and from Alan Gutterman's *Counseling Emerging Companies in Going International*, American Bar Association (1994).

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[4] Certo, Samuel C., *Modern Management*, 6th ed., Boston: Allyn & Bacon, 1994, p. 544.

[5] Greenman v. Yuba Power Products, Inc., 59 Cal.2d 57, Cal.Rptr. 697, 377 P.2d 897 (1963).

[6] 28 O.J. Dur. Comm. (No. L 210) 29 (1985) reprinted in 2 Common Mkt. Rep. (CCH) ¶3330 (1/2/86); Dielman, "The European Community's Council Directive on Products Liability," 20 *Int'lLaw* 1391 (1986).

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[8] The Directive states in Art. 1 "[t]he producer shall be liable for damage caused by a defect in the product."

[9] *Ives v. Clare Bros. Ltd., 1 O.R. 417 (1971); Buchan v. Ortho Pharmaceutical (Canada) Ltd., 54 O.R.2d 92 (1986); The Ontario Negligence Act*, R.S.O. 1980, Ch. 315.

[10] Rose, Eric, "International Contractual Developments in Product Liability," 1 *PLI/Lit EEC Strict Liability in 1992: The New Product Liability Rules* 175 (1989) (PLI Order No. H4-5064).

[11] Goozner, Merrill, "In Japan, Lax Liability Laws Shroud Blame," *Chicago Tribune*, Sec. 7, January 9, 1994, p. 1.

[12] Boyle, David and Cole, Patrick, "New Challenges to the U.S. Multinational Corporation in the European Economic Community: Data Protection Law," *NYU International Law & Policy Journal*, 893–941, 895 (1985).

[13] Boyle, David, "Proposal to Amend the United States Privacy Act," 22 *Cornell International Law Journal*, 285 (1989).

[14] EEOC v. Arabian American Oil Co., 111 S.Ct. 1227 (1991).

[15] Jarvis, Susan, "Preparing Employees to Work South of the Border," *Personnel* (June 1990) pp. 59–63.

[16] Hahn, Frederick, "Shaping Compensation Packages in Global Companies," *Journal of Compensation and Benefits*, Nov/Dec 1991, pp. 11–16.

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