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# Financial Performance of the International Business Planning: Localization and Trade in Theory of Krugman's "New Economic Geography" (NEG)

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## ABSTRACT

With regard to content, my thesis will compare the theoretical and practical findings used by practical schools of economics, which appear to be completely different to each other, to the Krugman's theories used by (regionalist) schools of theoretical economics. The founding point of my thesis is localization and trade. According to Krugman, a significant part of the industry is geographically concentrated, which provides an important source of international specialization and trade. The comparison between countries and regions does not correspond to the market competition between companies. In contrast, applied-economics (business-management) schools see the basis for competitiveness, innovation and profitability in business planning and in the business plan, such as a sub-branch of controlling. Today, findings in the most recent literature break through Krugman's earlier theses. By overwriting theoretical economics regionalistic dogmas, corporate finance and business planning see the way out of the crisis through the doctrines of the extension of the territorial units.

**Keywords:** *business plan, business planning, financial instruments, international business planning*

## 1. INTRODUCTION

With regard to content, my thesis will compare the theoretical and practical findings used by practical schools of economics, which appear to be completely different to each other, to the Krugman's theories used by (regionalist) schools of theoretical economics. The starting point of my thesis is localization and trade. According to Krugman, a significant part of the industry is geographically concentrated, which provides an important source of international specialization and trade. The comparison between countries and regions does not correspond to the market competition between companies. In contrast, applied-economics (business-management) schools see the basis for competitiveness, innovation and profitability in business planning and in the business plan, such as a sub-branch of controlling. Today, the most recent literature break through Krugman's earlier thesis. By overwriting theoretical economics regional dogmas, corporate finance and business planning see the way out of the crisis through the doctrines of the extension of the territorial units.

## 2. POINTS OF IMPACT

Based on the following, I will examine six subjects, taking both sides into consideration:

### 2.1 Geographical Differences

On the grounds of Krugman's theory suggests that „differences in economic development are at the very least associated with location: countries close to the equator tend to be poorer than those in temperate zones, and per capita income within Europe seems to follow a downward gradient from the northwest corner of the continent.”<sup>1</sup> Table 1. shows Krugman's one of centripetal forces, one of centrifugal forces.

<sup>1</sup> Krugman, Paul (1999): The Role of Geography in Development. *International Regional Science. Review* 22, 2.

August 1999. 142.p.  
<http://irx.sagepub.com/content/22/2/142.full.pdf>  
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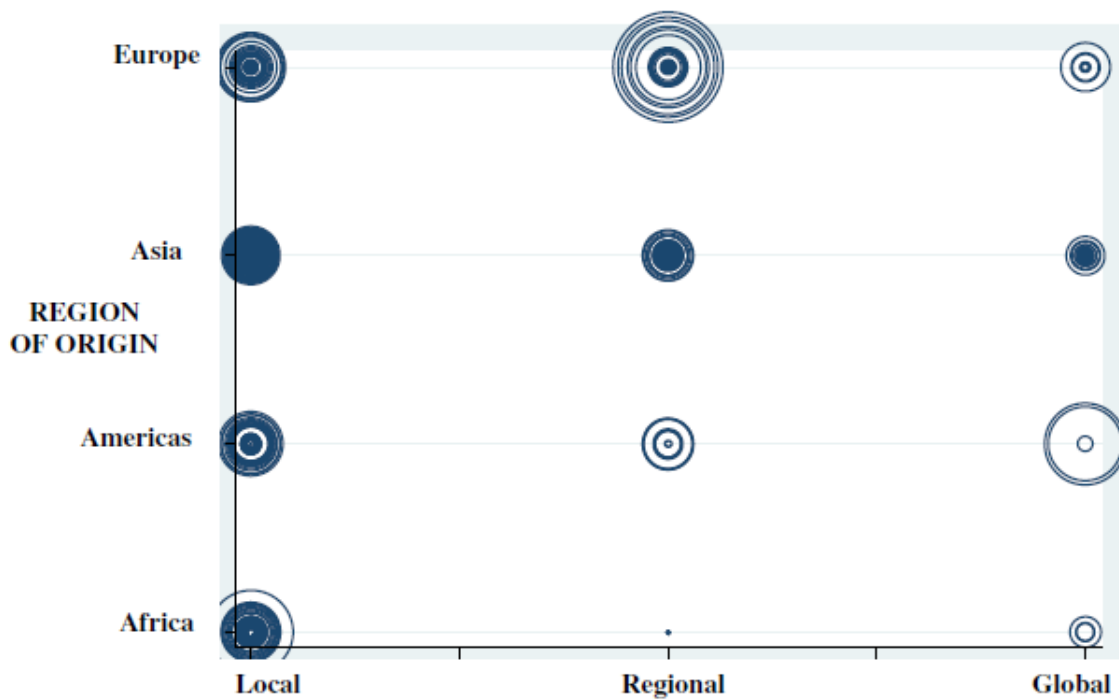
**Table 1:** Source: Krugman, Paul (1999): The Role of Geography in Development. International Regional

<b>Forces Affecting Geographical Concentration</b>	
<i>Centripetal forces</i>	<i>Centrifugal forces</i>
Market size effects (linkages)	Immobile factors
Thick labor markets	Land rents
Pure external economies	Pure external diseconomies

Science. Review 22, 2. August 1999. 143.p.

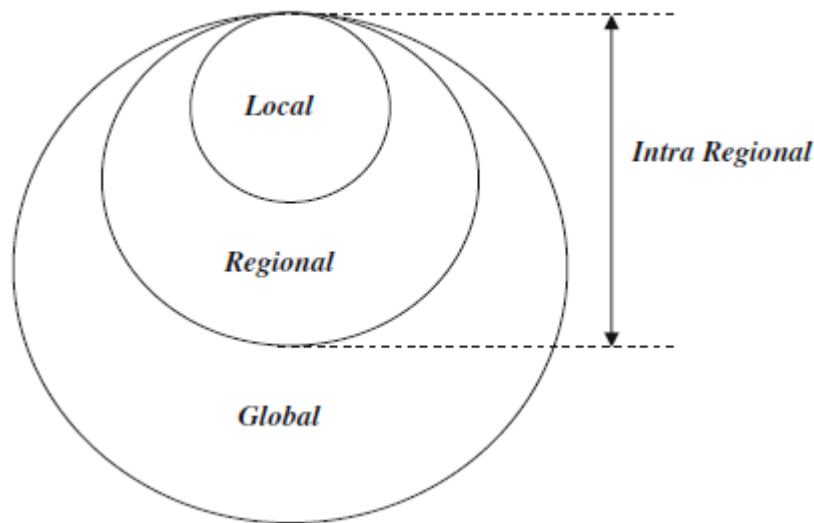
<http://irx.sagepub.com/content/22/2/142.full.pdf>  
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In spite of Krugman’s centripetal forces and his centrifugal forces, Banalieva, Elitsa R. and Santoro, Michael D. illustrates in terms of Region of Origin and the Geographic Orientation.



**Fig 1:** Source: Banalieva, Elitsa R.; Santoro, Michael D. (2009): Local, regional, or global? Geographic orientation and relative financial performance of emerging market multinational enterprises. European Management Journal, Volume 27, Issue 5, October 2009, 349.p.

Furthermore, Banalieva, Elitsa R. and Santoro, Michael D. Figure 1 shows the Organizing Framework of Multinationals Geographic Orientations.



**Fig 2:** Source: Banalieva, Elitsa R.; Santoro, Michael D. (2009): Local, regional, or global? Geographic orientation and relative financial performance of emerging market multinational enterprises. *European Management Journal*, Volume 27, Issue 5, October 2009, 345.p.

## 2.2 Transportation Costs

Heart of the NEG theory is the transportation costs. Fundamentally, „a fraction of any good shipped simply “melts away” in transit, so that transport costs are in effect incurred in the good shipped. In the NEG’s „models melting is usually assumed to take place at a constant rate per distance covered—for example, 1 percent of the cargo melts away per mile.”<sup>2</sup> Allowing for Krugman’s theory, it is to be noted that „the transport cost between any two locations is always a constant fraction of the f.o.b. (free on board) price, the constant elasticity of demand is preserved.”<sup>3</sup> Taking into account Peter J Buckley and Pervez N Ghauri (2004) works, it is expected to keep decelerating the multinational enterprises are a vertically-horizontally, integrated firm.<sup>4</sup>

Peter J Buckley and Pervez N Ghauri’s (2004) table shows the global and local operations.

<sup>2</sup> Krugman, Paul (1999): The Role of Geography in Development. *International Regional Science. Review* 22, 2. August 1999. 146.p.  
<http://irx.sagepub.com/content/22/2/142.full.pdf>  
(Download Time: 22.10.2012.)

<sup>3</sup> Krugman, Paul (1999): The Role of Geography in Development. *International Regional Science. Review* 22, 2. August 1999. 147.p.  
<http://irx.sagepub.com/content/22/2/142.full.pdf>  
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<sup>4</sup> Compare: Peter J Buckley; Pervez N Ghauri (2004): Globalisation, economic geography and the strategy of multinational enterprises. *Journal of International Business Studies* (2004) 35, 84.p.: Location and ownership strategies of multinational firms:„ In consequence, each division of the firm was locked into linkages with other divisions of the same firm. As global competition intensified, there was growing recognition of the costs of integration of this kind. Commitment to a

particular source of supply or demand of any product, intermediate good or service is relatively low cost in a high-growth scenario, since it is unlikely that any investment will need to be reversed. It is much more costly in a low-growth scenario, where production may need to be switched to a cheaper source of supply or sales diverted away from a depressed market. The desire for flexibility therefore discourages vertical integration – whether it is backward integration into production or forward integration into distribution. It is better to subcontract production and to franchise sales instead. The subcontracting of production is similar in principle to a ‘putting out’ arrangement, but differs in the sense that the subcontractor is now a firm rather than just a single worker.”

<http://www.ejournalofbusiness.org>**Table 2:** Source: Peter J Buckley; Pervez N Ghauri (2004): Globalisation, economic geography and the strategy of multinational enterprises. *Journal of International Business Studies* (2004) 35, 87.p.

Global and local operation	
<i>Global</i>	<i>Local</i>
Cost	Revenue
Efficiency	Responsiveness
Centralisation	Decentralisation
Standardisation	Adaptation
GLOCAL?	

Peter J Buckley; Pervez N Ghauri (2004) pay attention to the advantages of global operations. They focused that they are cost-based, and „maximising economies of scale and reducing duplication, thus achieving efficiency.”<sup>5</sup> Apart from, Peter J Buckley; Pervez N Ghauri (2004) state „the advantages of localisation are revenue based, allowing differentiation to reach all customer niches and achieving responsiveness. These are real gains that only the firm can achieve, as opposed to the financial gains from unrelated product diversification, which have proved disappointing in the past because they are best exploited through the diversification of individual share portfolios instead.”<sup>6</sup>

### 2.3 New Economic Geography Models

NEG's theory states that „ad hoc process of adjustment, in which factors of production move gradually toward locations that offer higher current real returns.”<sup>7</sup> As opposed to it neglects the role of expectations.<sup>8</sup> Krugman may be concluded that „geography as games in which actors choose locations rather than strategies—or rather, in which locations are strategies—in which case one is engaged not in old-fashioned static expectations analysis but

<sup>5</sup> Peter J Buckley; Pervez N Ghauri (2004): Globalisation, economic geography and the strategy of multinational enterprises. *Journal of International Business Studies* (2004) 35, 84.p

<sup>6</sup> Peter J Buckley; Pervez N Ghauri (2004): Globalisation, economic geography and the strategy of multinational enterprises. *Journal of International Business Studies* (2004) 35, 84.p

<sup>7</sup> Krugman, Paul (1999): The Role of Geography in Development. *International Regional Science. Review* 22, 2. August 1999. 147.p.  
<http://irx.sagepub.com/content/22/2/142.full.pdf>  
(Download Time: 22.10.2012.)

<sup>8</sup> Krugman, Paul (1999): The Role of Geography in Development. *International Regional Science. Review* 22, 2. August 1999. 147.p.  
<http://irx.sagepub.com/content/22/2/142.full.pdf>  
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rather in state-of-the-art evolutionary game theory.”<sup>9</sup> Krugman conclusion can be drawn that „the economy would spontaneously organize itself into a core-periphery geography.”<sup>10</sup>

### 2.4 Krugman's International Trade Theory

In Krugman's theory appears the international trade theory as „a world with just two discrete locations, themselves modeled as points.”<sup>11</sup> This seems to be pointing at Krugman's trade theory that „there are assumed to be transport costs between these points.”<sup>12</sup>

### 2.5 Natural Geography Exert

Having regard to Krugman's theory, it divides two part. One of them states „the geographical pattern of production depends on historical accidents”<sup>13</sup> and on the

<sup>9</sup> Krugman, Paul (1999): The Role of Geography in Development. *International Regional Science. Review* 22, 2. August 1999. 147.p.  
<http://irx.sagepub.com/content/22/2/142.full.pdf>  
(Download Time: 22.10.2012.)

<sup>10</sup> Krugman, Paul (1999): The Role of Geography in Development. *International Regional Science. Review* 22, 2. August 1999. 147.p.  
<http://irx.sagepub.com/content/22/2/142.full.pdf>  
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<sup>11</sup> Krugman, Paul (1999): The Role of Geography in Development. *International Regional Science. Review* 22, 2. August 1999. 151.p.  
<http://irx.sagepub.com/content/22/2/142.full.pdf>  
(Download Time: 22.10.2012.)

<sup>12</sup> Krugman, Paul (1999): The Role of Geography in Development. *International Regional Science. Review* 22, 2. August 1999. 151.p.  
<http://irx.sagepub.com/content/22/2/142.full.pdf>  
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<sup>13</sup> Krugman, Paul (1999): The Role of Geography in Development. *International Regional Science. Review* 22, 2. August 1999. 156.p.  
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other hand it is include „in natural geography exert powerful influences on economic development.”<sup>14</sup>

### 3. CONCLUSIONS

There is no getting away from study of Banalieva, Elitsa R.; Santoro, Michael D.<sup>15</sup> The main question of their study relates to how the differences in the firms geographic orientations affect their financial performance.<sup>16</sup> Their hypothesis are: „the higher the local orientation, the higher the relative financial performance”<sup>17</sup> and „the lower the global orientation,

the higher the relative financial performance.”<sup>18</sup> Study of Banalieva, Elitsa R.; Santoro, Michael D. used return on assets (ROA).<sup>19</sup> Not surprisingly, Banalieva, Elitsa R.; Santoro, Michael D.’s research reveal globally oriented companies had the lowest relative financial performance (3.80%) and which were locally oriented had the highest relative financial performance (0.6%)<sup>20</sup>, „providing preliminary evidence for the negative effect of global orientation on firm performance.”<sup>21</sup> Summ up and to conclude Banalieva, Elitsa R.; Santoro, Michael D. showed and confirmed that companies „market penetration strategies, the local orientation is the most prevalent, followed by the regional and finally global orientations.”<sup>22</sup> Companies „leapfrog and maintain both a local and a global orientation simultaneously by keeping their regional orientation low, they gain superior financial performance.”<sup>23</sup>

In spite of Krugman’s NEG, the theory of literature generally describes the samples and procedures that a business plan should contain. A fundamental definition in theoretical literature is that proper planning

<sup>14</sup> Krugman, Paul (1999): The Role of Geography in Development. *International Regional Science. Review* 22, 2. August 1999. 156.p.

<http://irx.sagepub.com/content/22/2/142.full.pdf>  
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Compare: Görg, Holger; Strobl, Eric (2002): Multinational companies and indigenous development: An empirical analysis. *European Economic Review*, Volume 46, Issue 7, July 2002, 1305-1322.p.:., Theoretically that multinational companies, through the creation of linkages with indigenous suppliers, can exert positive effects on the development of indigenous firms in the host country. Our paper examines this issue for the first time from an empirical perspective, thus complementing the theoretical analysis by Markusen and Venables and adding to the empirical literature on the impact of multinationals on the host country. Using data for the Irish manufacturing sector we find that such positive effects have, indeed, taken place in the Irish economy. Speciacally, we find that the presence of multinational companies has had a positive effect on the entry of indigenous firms. Even though we find a positive effect from the presence of foreign multinationals on indigenous entry, we must be cautious to point out that we are only measuring the incidence of entry. To conclude on a lasting positive effect of multinationals on indigenous development, one would also need to investigate whether new indigenous firms are able to survive in the industry. Furthermore, it would also be of interest to examine not only the number of firms entering the industry but also the levels of employment associated with this entry.”

<sup>15</sup> Banalieva, Elitsa R.; Santoro, Michael D.: Local, regional, or global? Geographic orientation and relative financial performance of emerging market multinational enterprises. Original Research Article. *European Management Journal*, Volume 27, Issue 5, October 2009, 344-355.p.

<sup>16</sup> Banalieva, Elitsa R.; Santoro, Michael D.: Local, regional, or global? Geographic orientation and relative financial performance of emerging market multinational enterprises. Original Research Article. *European Management Journal*, Volume 27, Issue 5, October 2009, 345.p.

<sup>17</sup> Banalieva, Elitsa R.; Santoro, Michael D.: Local, regional, or global? Geographic orientation and relative financial performance of emerging market multinational enterprises. Original Research Article. *European*

*Management Journal*, Volume 27, Issue 5, October 2009, 347.p.

<sup>18</sup> Banalieva, Elitsa R.; Santoro, Michael D.: Local, regional, or global? Geographic orientation and relative financial performance of emerging market multinational enterprises. Original Research Article. *European Management Journal*, Volume 27, Issue 5, October 2009, 347.p.

<sup>19</sup> Banalieva, Elitsa R.; Santoro, Michael D.: Local, regional, or global? Geographic orientation and relative financial performance of emerging market multinational enterprises. Original Research Article. *European Management Journal*, Volume 27, Issue 5, October 2009, 348.p.

<sup>20</sup> Banalieva, Elitsa R.; Santoro, Michael D.: Local, regional, or global? Geographic orientation and relative financial performance of emerging market multinational enterprises. Original Research Article. *European Management Journal*, Volume 27, Issue 5, October 2009, 350.p.

<sup>21</sup> Banalieva, Elitsa R.; Santoro, Michael D.: Local, regional, or global? Geographic orientation and relative financial performance of emerging market multinational enterprises. Original Research Article. *European Management Journal*, Volume 27, Issue 5, October 2009, 350.p.

<sup>22</sup> Banalieva, Elitsa R.; Santoro, Michael D.: Local, regional, or global? Geographic orientation and relative financial performance of emerging market multinational enterprises. Original Research Article. *European Management Journal*, Volume 27, Issue 5, October 2009, 355.p.

<sup>23</sup> Banalieva, Elitsa R.; Santoro, Michael D.: Local, regional, or global? Geographic orientation and relative financial performance of emerging market multinational enterprises. Original Research Article. *European Management Journal*, Volume 27, Issue 5, October 2009, 355.p.



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cannot be achieved in the absence of appropriate elements. This is the case with regards to so-called domestic business plans, but for international business plans based on the former, there is an extremely high probability that the lack of such a plan or design does not provide adequate support for the company's operations.

The research results of sampling procedures were essentially confirmed the theoretical ideas in general. In this case, almost all studies emphasised the importance of business planning, including the financial section. Thus in the investigation of certain Central and Eastern European countries, in the case of rapidly growing Slovenian companies (that wish to continue being active in the global economic market), the elaboration of business plans and financial sections is of utmost importance. Companies operating in Western European countries provided similar results in the main screening criteria. In most cases, business plans are used and their financial sections are also important factors. In the case of Eastern European countries, the published literature background indicated that there is no statistically significant difference between Western Europe companies in business planning. Overall, the United States of America concluded that the summary and the financial support (funding) are the two most important sections in business plans. In Australia, the results indicate that formally composed business plans bring significantly higher gross revenues and an increase in the sales part of the business plan. In China, the results indicate that informal business planning was useful for emerging enterprises. Here the elaboration of business plans reduces uncertainties that come from the external environment.

The comparison I made of the business plan of country's company proves all of this, goes beyond and grades all of these findings. This is basically due to isomorphism and the cultural characteristics of the peripheral causes.<sup>24</sup>

<sup>24</sup> Compare: Collinson, S. and Rugman, A. M. (2008): The regional nature of Japanese multinational business. *Journal of International Business Studies* 39(2), 215–230.p.; Delios, A. and Beamish, P. (2005): Regional and global strategies of Japanese firms. *Management International Review*, 19–36.p.; Elango, B. (2004): Geographic scope of operation by multinational companies: An exploratory study of regional and global strategies. *European Management Journal* 22(4), 431–441.p.; Geringer, J. M., Tallman, S. and Olsen, D. M. (2000): Product and international diversification among Japanese multinational firms. *Strategic Management Journal* 21(1), 51–80.p.; Hejazi, W. (2007): Reconsidering the concentration of US MNE activity: Is it global, regional, or national? *Management International Review* 47(1), 5–27.p.; Hennart, J.-F. (2007): The theoretical rationale for a multi-nationality-performance relationship. *Management International Review* 47(3), 423–452.p.; Hitt, M. A., Hoskisson, R. E. and Kim, H. (1997): International diversification: effects

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<http://www.handelsblatt.com/meinung/gastbeitraege/businessplan-fuer-die-eu-der-businessplan-fuer-europa/6897670-2.html> (Download Time: 22.08. 2012.)  
[http://www.rolandberger.com/media/news/2012-07-30-rbnc-news-Business\\_Plan\\_for\\_each\\_EU\\_country.html](http://www.rolandberger.com/media/news/2012-07-30-rbnc-news-Business_Plan_for_each_EU_country.html) (Download Time: 22.08. 2012.)

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