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Editorial Commentary

WITH THIS EDITION WE ARE STARTING a new series of lead articles that raise insightful and thought-provoking questions in an attempt to engage the AIB community in fruitful conversations that we hope will advance our field. The first article in this series, authored by AIB Fellow Jean Boddewyn, raises the question of *whether your international business research is truly “international.”* In a focused *AIB Insights* issue titled “Defining a Domain for International Business Study” (Volume 13, Issue 1), we published a set of articles that reflected on the nature of our field and explored a number of questions about what characteristics, features, boundaries, and benchmarks define the field of IB, what a legitimate curriculum for the teaching of IB globally would comprise, and to what purpose we study international business. Along this line of insightful questions that are relevant to our field in general, Jean Boddewyn’s article attempts to stimulate IB scholars to actively think about whether their individual research is truly international, and share their thoughts. To facilitate this effort, we have added an interactive “Comments” feature onto the AIB Insights website at <https://aib.msu.edu/publications/insights> through which you can respond to this question and receive a reply from Jean Boddewyn and fellow colleagues in the AIB community. We are planning to post a summary of this interactive dialogue on the *AIB Insights* website and also publish the best comments and discussions in a future *AIB Insights* issue.

When juxtaposing “intranational” and “international” research, Jean Boddewyn refers to the work by Phil Rosenzweig (1994) regarding the generalizability of research findings from a “domestic” to a “foreign” setting and notes that “truly international research focuses on variables whose relationships differ from country to country on account of differences among specific features of their external environments in the context of ‘open’ social systems” (p. 4). The second article in this issue, co-authored by Andrey Mikhailitchenko and Sanjay Varshney, provides a discussion about the unique external business environment of Russia, one of the world’s largest emerging markets. Based on in-depth interviews with owners and managers of small textile companies in the Moscow region that are engaged in international trade, the authors discuss the idiosyncrasies of the political environment and recent changes in the country and their impact on the local investment climate and entrepreneurial activities. In so doing, the authors provide food for thought for researchers interested in studying the unique institutional environment of Russia, and so examine variables whose relationships are specific to this market context when compared to other market contexts and, thus, conduct “true” international research.

The remaining three articles in this issue are particularly valuable for international pedagogy. The article by AIB Fellow Farok Contractor explores the current and controversial topic of tax evasion by multinational corporations and emphasizes the importance of incorporating international tax issues in IB pedagogy, research, and strategy. The article sketches out seven common (and legal) tax-avoidance methods used by MNCs and encourages a discussion on their ethical implications. The article by James Nebus presents five reasons for why IB educators should introduce international tax issues in the classroom, and it provides a valuable step-by-step blueprint for how to do so. The article also shares additional teaching resources to facilitate further discussions on the topic. The final article, authored by Tim Rogmans, provides an interesting account of technology-based international business simulations and discusses six suggestions for the effective use of simulations based on his experience and academic research on the topic. We believe that this set of articles constitutes a valuable addition to the teaching repertoire of IB educators interested in covering international tax issues in the classroom, and using international business simulations in their courses.

Reference

Rosenzweig, P. M. 1994. When can management science research be generalized internationally? *Management Science*, 40(1): 28-39.



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Is Your “IB” Research Truly “International”?

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IT IS RELATIVELY EASY TO DEFINE “international business” (IB) as those trading and investing activities—plus their management—that “cross borders.” However, *when is a piece of research truly “international”?*

If you replied, “When it covers two or more countries,” your answer would have been thought incorrect according to the criteria developed by the brilliant but late management scholar Graham Astley at a workshop organized by the International Division of the Academy of Management at its August 1990 meeting in San Francisco where he discussed “The Theoretical Uniqueness of IB Studies” (for an account of his presentation, see Boddewyn & Iyer, 1999: 173-181).

International versus Universal

Your answer would be incorrect because, according to Astley, the inclusion of two or more countries in a study does not automatically amount to “international” research; this status ultimately depends on the nature of the investigated phenomenon and of the variables being related to it. For that purpose, Astley relied on a fourfold classification of types of research.

1. Universal theories applied to foreign samples rather than to domestic ones

Classical examples are international trade theory and transaction cost economics, whose propositions apply to *all* places and times—namely, that economic activities gravitate to where factors of production and markets are more favorable, and that firms internalize the market until the benefits of common governance are exhausted. Such propositions can be tested by comparing Paris and Tokyo as well as France and Japan—this is what makes them “universal” because any two or more locations—whether neighborhoods, cities, counties, provinces, states, countries and regions—can provide the sites for such testing.

In the same vein, you may test such a proposition as: “The greater the cultural differences among countries, the greater the decentralization of decision making,” where the independent variable is “international” since the testing requires data from several countries. However, this proposition is really derived from theories that are *universal* in nature since they could be as well be tested between two U.S. states (e.g., California and Mississippi) located in the same country but with different sub-cultures.

In other words, it is not enough to include two or more countries to make a study “international.”

2. Theories whose dependent variable is distinctly international but whose independent variables are not

Astley gave as an instance the structuring of international joint ventures (IJVs) between firms of different nationalities (the dependent and truly international variable) being affected by technological intensity (the independent variable)—the latter again a “universal” type of variable whose impact on a joint venture could also be studied within a single country.

This misclassification applies to some of our basic creeds. For example, to what extent are Coase-type theories of the multinational enterprise (MNE) truly “international” explanations of its existence, operation, and performance? Coase (1937) demonstrated that MNEs exist, operate, and perform only because of market failures which lead these firms to internalize the market institution by replacing cross-border transactions with lower-cost ones performed within the MNE hierarchy. Yet, to think of it, Coase’s theorem, as applied to MNEs and FDI, is really a “universal” one of Astley’s second type because the independent variable—that is, market failures—can be found at every type of location, not just at the country level.

Even the work of Stephen Hymer (1960/1976), who helped found international business as a new research field (Dunning & Rugman, 1985; Teece, 1985), is questionably “international”! Hymer claimed that the pursuit of profits by growing firms already established in developed nations leads them to consider foreign operations such as exporting, licensing, franchising, and foreign direct investment (FDI). All of these modalities present advantages and disadvantages but, on balance, FDI is superior in terms of the control it affords to MNEs. This superior control allows these firms to deal with international rivalry—in order to reduce it as well as to better exploit their own monopolistic advantages by leveraging them in-house instead of through the open market (Pitelis & Boddewyn, 2009).

The benefits from this leveraging of advantages are related to market failures (e.g., the high cost of market transactions) as well as to such firm-specific advantages as the speed and efficiency of transferring intra-firm those advantages which have the characteristic of a “public good” and/or involve tacit knowledge (Dunning & Pitelis, 2008). FDI also offers

the benefit of risk diversification, although, for Hymer, this is a lesser motive because it does not require control (Hymer, 1976: 25). Overall, the benefits of FDI from rivalry reduction, advantage exploitation, and risk diversification explain both the existence of the MNE as well as why MNEs are able to compete with locally-based rivals in foreign countries despite some inherent disadvantages of being foreign on account of “the liability of foreignness” (Hymer, 1976: 46).

However, *it is arguable that most of the major categories which Hymer developed and leveraged in order to explain FDI do not pass the Astley test of a true “international” theory.* For example, rivalry reduction, advantage exploitation, and risk diversification are universal categories equally applicable to expansion within one country such as the United States. Thus, a company operating in a particular state (say, Ohio) can develop advantages (such as an innovative new product) that can be leveraged in another U.S. state (say, Louisiana). If this firm faces rivalry in its own state and the intra-firm exploitation of innovation is perceived to be more profitable by the firm, it may decide to invest in Louisiana so as to capture value from its advantages and deal with rivalry (actual or potential) in both Ohio and Louisiana. *Therefore, Hymer’s theory is not truly international because it is applicable to both domestic and foreign situations alike.* For example, if we replace Louisiana with France, we obtain a foreign rather than a domestic investment but all we have is a “foreign sample” (Astley’s case No. 1).

It is important to observe that the first two research instances identified by Astley are where IB researchers have encountered their major competition from economists and management strategists who have found it relatively easy to venture into foreign waters by extending their “domestic” research models—really “universal” ones—to foreign settings. The next two cases, however, are where IB researchers should find their true domain because of their hopefully greater knowledge of foreign settings at once physical, economic, political, social, and cultural.¹

3. Theories with dependent and independent variables that are both distinctly international

Astley’s example was foreign direct investment—the international dependent variable—being affected by transaction costs that are truly international—for example, those related to foreign culture and regulation. Thus, when a country’s economy operates under very bureaucratic rules applying to foreign direct investment (say, France), there will be additional transaction costs uniquely due to this country’s regulatory system which an investor would not encounter within a more “free-trade” nation (e.g., the United States)—hence, the truly “international” character of this independent variable.

4. Theories whose central propositions are distinctly international

For instance, the proposition² that the existence, volume, and forms of foreign direct investment (the international dependent variable) depend on the permeabilities of sovereign states that either accept,

modify, reject, or annul (e.g., through expropriation) such IB activities by *fiat*—the latter a truly “international” independent variable because only nation-states are fully sovereign (e.g., Boddewyn & Brewer, 1994). It is solely in these last two areas that IB researchers do have or should have a competitive advantage vis-à-vis domestic scholars because these projects require in-depth knowledge of foreign locales—not just secondary data available for several countries.

From “Domestic” to “Universal”

Independently from Astley, Rosenzweig (1994: 30) raised the related question of: *When can a theorized or observed relationship among variables in a “domestic” setting be generalized to “foreign” ones, and thus become “universal” because the relations among the focal variables are identical (i.e., “invariant”) across nation-states?* Under this perspective, truly international research focuses on variables whose relationships differ from country to country on account of differences among specific features of their external environments in the context of “open” social systems:

Theories [involving closed technical systems] have external validity across countries, since they are affected neither by differences in social behavior, such as cultural differences, nor by differences in the external environment, such as different legal systems or social institutions. By contrast, open social systems . . . are severely restricted in their international generalizability, and are valid only as far as key relationships among focal variables obtain *and* essential elements of the external environment are present. (Rosenzweig, 1994: 31-32)

What Rosenzweig called “international generalizability” is what Astley meant by “universal” on account of the invariant nature of the relationships between the dependent and independent variables. In a reverse fashion, one may inquire about the applicability of “IB” models and theories to “domestic” situations, thereby implicitly looking for “universal” ways of interpreting business situations whether located at home or abroad.

The Relativity of “International” Theories

Rosenzweig (1994) also remarked that theories which seem internationally or universally applicable may reflect *national* values of the types identified by Hofstede (1991). Thus, in the case of transaction cost economics, its central concept that hierarchies arise when market mechanisms are not efficient on account of opportunism, information-impactedness, and small-number bargaining does assume that the market is the theoretical point of departure while hierarchy is the fallback position when markets fail. However, a French theorist raised in a country marked by high power distance might take the existence of hierarchy as the base mode and therefore explain the use of market mechanisms as the product of a failure of hierarchy (Rosenzweig, 1994: 36, quoting Hofstede, 1991: 149)! Therefore, we must make sure that

even truly “international” studies do apply theories with a deep and accurate understanding of their applicability to different contexts.

Now, the big question: Do you agree with Astley’s arguments about what constitutes “true ‘international’ research”? Where does your current or recent IB research stand in rapport with his reasoning? Please submit your answers and relevant comments through the online commenting feature on the *AIB Insights* website at <https://aib.msu.edu/publications/insights> by June 30, 2016. I will respond through this commenting feature and we are also planning to publish the best comments and dialogues in a subsequent issue of *AIB Insights*.

Thank you very much for your interest in this question. We plan to offer other ones in future issues of *AIB Insights* about a variety of interesting IB problems to be generated by top IB scholars!

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Endnotes

- 1 Raymond Vernon (1994) thought that knowledge of “national business systems” was essential for significant IB research—compared to these studies that exude only a “slight foreign accent” (p. 217).
- 2 By using “propositions” rather than “variables” in this fourth category, Astley was elevating the discussion from “models” to “constructs,” that is, to more generalized statements of relationships between “approximated units” which, by their very nature cannot be observed directly (e.g., centralization or culture), compared to “observed units” which can be empirically operationalized by measurement (Bacharach, 1989: 498).

Jean Boddewyn (Jean.Boddewyn@Baruch.cuny.edu) spent more than 40 years reading, teaching and researching “international business.” He retired in 2006 as Emeritus Professor from Baruch College (CUNY) after teaching at NYU (1964-1973) and the University of Portland (OR) (1957-1964) while his Ph.D. was obtained at the University of Washington (WA) in 1964. He served as AIB President (1992-1994), Dean of the AIB Fellows (2005-2008), Chair of the International Management Division of the Academy of Management (1975-1976) and Founding Editor of *International Studies of Management & Organization* (1971-2006).

Russian Foreign Trade under a New Wave of Political Pressure: A Glance from the Inside

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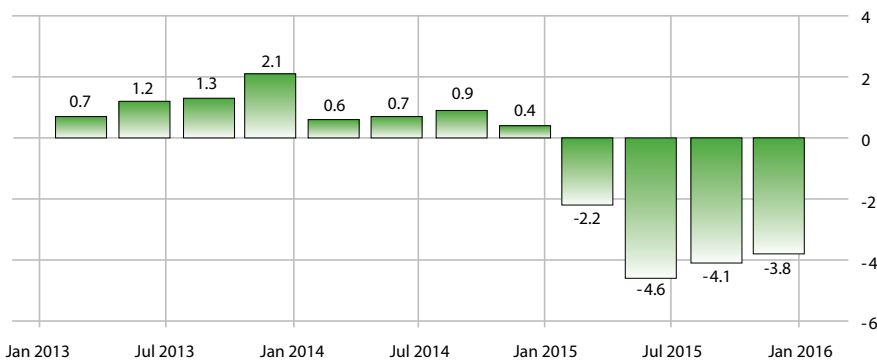
Introduction

It has been a little over two years since a new era in Russia's foreign policy dawned (its annexation of Crimea, suspension from G8, and first round of Western sanctions) in February 2014. The changes and ramifications that followed in Russia, both political and economic, are both extremely drastic and fundamental. The real GDP has plunged, the currency has been significantly devalued, inflation has spiked, and the economy has continued to contract at a rapid rate finally regressing into a recession in 2015 (Figure 1).

Foreign Trade Changes

Provided below is an overview of the Russian small business climate based on in-depth interviews with owners and managers of a pool of Russian companies working in the Moscow region in the textiles sector and involved in foreign trade activities. The interview results suggest that the most recent foreign trade changes that have the strongest impact on small businesses can be grouped into three major categories: (1) administrative regulations and practices, (2) "grey" customs market development, (3) political restrictions on foreign trade.

Figure 1. Russian Real GDP Percent Change



Source: Trading Economics (2015)

New Customs Regulations and Enforcement Practices

The Russian government's regulation of its foreign trade is limited by tariff commitments and other international obligations that the country has to follow as a member of the World Trade Organization (WTO). However, during the period between the middle of 2014 and the beginning of 2016, a set of new policies de facto revising the existing import tariffs was implemented as a result of newly imposed internal customs rules and practices. While formally not violating any international import tax agreements, these customs rules and practices are creating additional barriers for imports.

While Russian international relations, foreign policy, geo-political developments, and mainstream macroeconomic trends (oil price decline, inflation growth, economic crisis) are quite visible to foreign investors and observers, the changes in government regulations of the Russian economy (both official and covert) as well as their influence on the small business sector are often overlooked or not obvious. These changes are even more pivotal and impactful than those that occur at the macro level. It is noteworthy that it is the microeconomic trends (in contrast to macroeconomic and political) that determine the investment climate in a country and its attractiveness for entrepreneurial activity. The small business sector is the lifeblood and backbone of any major economy, often responsible for creating many more net new jobs on the margin, and countries that have thriving small businesses tend to be more economically successful.

The most impactful measure that directly increases the amount of duties to be paid by importers, thereby increasing the costs of imported goods, is the so-called "customs risk management system." This system exists in the internal rules and regulations (letters, orders, and instructions) of the Federal Customs Service (FCS) that are communicated to the local customs offices responsible for clearance of customs declarations. These regulations are critical when the imported goods are subject to payments of duties and import VAT calculated as a percentage of the declared value of the imported goods (product value and the freight and insurance costs). In these cases, Customs has the option to agree with the value of the goods declared by the importer and release the merchandise with payment of regular duties, or disagree and initiate the procedure of declared value investigation.

Before June 2015, the system of internal customs regulations generally allowed normal customs clearing procedures based on the actual

contract prices of the goods. For example, knitted fabrics (Harmonized System (HS) code 60019200) were allowed to be normally cleared if the declared cost at the Russian border did not go below \$2.55 per kg, which generally corresponds to the international market prices for this type of goods. However, on June 26, 2015, in an internal customs order (11/10000/25062015/03202, version 10) the “risk value” for this item was increased up to \$6.00/kg for goods imported from China, \$8.50/kg for most other countries, and \$10 for the group of countries that includes USA, Canada, Japan, and most of the EU members. Local customs offices were informed that if the declared amount for the goods in this HS code is less than levels mentioned above, the criterion of rejection and further investigation should be stated as “submitted customs documents contain not sufficient or contradictory information or information causing suspicion in its truthfulness” (Russia Federal Customs Service, 2015).

As part of further investigation, the declarant has to provide a long list of supplementary documents such as price list of the trade partner, foreign partner’s export customs declaration, accounting documents, etc. The barrier is high and often impossible to overcome given the amount of accompanying conditions, such as verification by the Chamber of Commerce of the foreign country, legal notarization, and presence of information that may constitute the commercial secret of a supplier (e.g., technological breakdown of the product costs that is also required by the customs).

Before these documents are provided, the goods can be released only under the condition of full pre-payment of all duties and taxes based on the assumption of the declared value stipulated in the customs order. For instance, if the actual value of a 40’HQ container is around \$30K, the amount of duties to be paid is 7% and VAT of 18%, resulting in a total amount around \$7.8K. However, based on the “customs risks” order, the importer cannot get the goods released without paying \$15K to \$19K, depending on the judgment of a local customs officer.

The procedure of reimbursement of the overpaid duties and taxes takes several months and is multi-level, i.e., after the documents are considered in the local customs office, the application for overpaid duties return should be resubmitted to the regional customs office and again considered there. During this process the importer can still be subject to additional document requests and verification requirements and can be subjected to the procedure of “customs cost correction” without any return of payments made. Formally, the importers can try to protect themselves through a lawsuit, but given the time, resources, and high degree of courts’ dependence upon administrative authorities, the questionable outcome of such a trial makes most of the importers not consider this option at all.

As a result, in 2015 customs control departments made 4,782 customs investigations among which 3,972 resulted in fines and penalties. The total amount of additionally charged and collected duties, penalties, and fines during that period was 12.7 billion rubles (187 million USD), 24.5% higher than in 2014 (Russia Federal Customs Service, 2016).

“Grey” Customs Clearing System

Additionally, a parallel “grey” system of customs clearing exists, resulting in a strong impulse for developing and getting new clients after June 2015, as a result of the new “risks level” imposed by FCS. Definite firms (apparently affiliated with high-level customs officers and other representatives of administrative power) are offering customs clearing without providing legal customs declaration, but with substantially lower amount of expenses paid than official import duties and taxes. The 40’HQ container mentioned above could be cleared through the “grey” customs market for \$10-12K. That is still higher than actual legal duties, but lower than what would be paid if the importer went through customs clearing without this intermediary. As a result, the payment is actually split: a certain amount goes to the budget, while part of it is channeled elsewhere as unofficial cash. Given the choice between the expensive “grey” and super-expensive “white” customs clearing, most of importers prefer to go with the “grey” option.

Based on the opinion of most interviewees, the system of “customs risks management” as it has been enforced since summer 2015 is aimed at two major goals: (1) to attempt to fix budget holes by increasing the burden on importers, primarily in the small business sector and (2) to create another channel of unofficial cash inflow for administrators on different levels. Combined with the crisis conditions in the Russian economy (fall of Russian ruble, decline in living standards, and buying capacity, etc.) these new regulations have forced most importers either to temporarily stop their foreign trade operations or to completely withdraw from the business. Those who are still continuing their operations do not have any reasonable choice other than to seek “grey” intermediaries’ help.

Additional Political Restrictions

Another new area of hidden customs regulations that has a direct impact on Russian small business is political restrictions. In addition to limitations on the import of agricultural products, raw materials, and food products from EU countries that have existed since summer 2014, a new wave of embargoes, both official and unofficial, was imposed in November 2015 on goods imported from Turkey after the incident with the shooting down of a Russian bomber aircraft near the Syria–Turkey border on November 24, 2015. The list of banned import items mostly includes different types of agricultural products. Additionally, except for the direct embargo, other different internal customs regulations have been introduced and implemented as well.

The instruction 55/10000/24112015/60113, sent from FCS to local customs offices, contains the requirement to make all products either originated or shipped from Turkey, or transported by Turkish carriers, the subject of the special procedures. These procedures include 100% inspection of the merchandise with full unloading of the containers, weighing of the items, taking samples, and their subsequent verification regarding declared customs value. As a result, not only the agricultural products that were listed in the official government ruling (Russian

Federation Government, 2015) but also all others either produced or shipped through Turkey have become the subject of newly constructed customs barriers (Platonova, Romanova, & Kalachihina, 2015).

One example is textiles, which are roughly 18% of total imports from Turkey to Russia. Most of the Russian companies that purchase textile products (fabrics, yarn, accessories, etc.) from Turkey are small businesses. One of the interviewees, an owner of a textile trading company importing terry fabrics from Turkey, said: "Our containers got stuck in the port Novorossiysk. Every day that they are held by customs brings us huge losses, both direct and indirect. And there is no way to expect that they will be released in the foreseeable future. We paid for this shipment way before the accident with the Russian plane, so it is not our Turkish suppliers but we, Russian businesses, who are suffering. Why and what are we punished for?"

New Corruption Opportunities

The political restrictions on imports from Turkey immediately resulted in expanded offerings by "grey" and "black" customs clearing markets. The new ways to work around the limitations, like in the case of sanctions against agricultural products from EU countries, are mostly related to transit through countries belonging to the Eurasian Economic Union (EEU) such as Belarus and Kazakhstan. The corruption schemes offered on the market include delivering the merchandise to one of the EEU countries, unloading the container, and then transporting the goods by truck as originated in some other country.

In order to prevent the possibility of re-export under the practice, the FCS established Mobile Inspection Complexes, tasked with patrolling borders with Kazakhstan and Belarus and preventing any illegal transit. However, companies advertising their transit services undertake obligations to resolve problems with customs officials on these complexes for a fee. Importing from Turkey as a result became more expensive (average increase of transit costs by more than \$3K per 40'HQ container) and susceptible to corruption.

Another opportunity advertised by "grey" freight forwarders through social networks and other channels is transportation to Finland (port Kotka), reloading of the merchandise from container to truck, and transporting to the territory of Russia by parts as loose cargo received from China. Using this scheme adds around \$5K to the cost of container transportation. In general, as it often happens with restrictive regulations in Russia, illegal imports are not prevented, but rather create new corruption opportunities.

Macroeconomic Impact

Attempts to squeeze more taxes from import and restrictive customs measures were key factors leading to the decline in Russia's international trade, especially imports. According to the data released by the Russia Federal State Statistics Service, external trade turnover in 2015 declined by 34.3% in comparison to 2014 (from 806.1 to 534.4 billion USD), while imports declined by 37.0% (from 308.1 to 194.1 billion USD) (Russia Federal State Statistics Service, 2016a). Such a downfall in foreign trade

Figure 2. Russia's Import and Export Dynamics (% to December 2013)

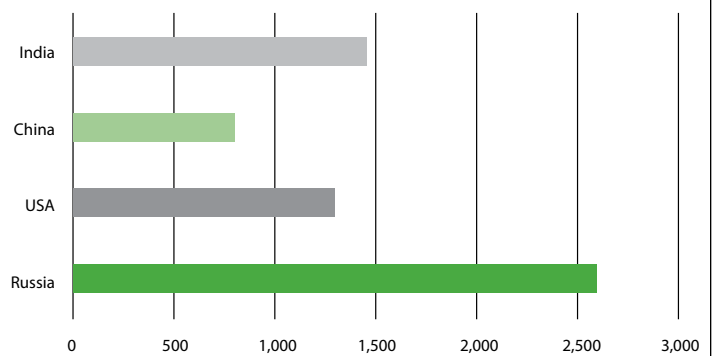


Source: Russia Federal State Statistics Service (2016b)

and imports in particular creates the likelihood for further weakening of the Russian ruble, shrinking demand, and overall economic decline.

For potential investors and foreign trade partners, recent measures imply further increased transaction costs of doing international trade business in Russia. Currently, according to the World Bank Investments Strategy Group, the transaction costs for exporting one container of goods from Russia are 2.0 times higher than from the U.S. and 3.2 times higher than from China (Figure 3). With the restrictive measures from recent months, the gaps will definitely widen.

Figure 3. Cost to Import One Container



Source: World Bank(2014)

Institutional Changes

In terms of wider impact on the Russian political system as a whole, the latest restrictions have definitely contributed to the traditional challenges in the Russian economy: “manual” type of management at all levels of the administrative pyramid, and the minimal rule of law. This point of influence can be characterized as the institutional impact. According to Robinson and Acemoglu (2012), while strong “inclusive” political and economic institutions nurture market competition, property rights, and depth in financial markets, countries with “extractive” institutions, in contrast, do not sustain growth, concentrate political power in the hands of a narrow elite, and extract resources from the rest of society for the benefit of this elite.

The crisis in Russian foreign policy and subsequent sanctions, followed by the economic recession and budget deficit, is one more sign of the lack of “inclusive” institutions in the country. The situation with the new wave of politically driven customs regulations that harms first of all Russia’s own small businesses plays in favor of empowering “extractive” institutions in the governance mechanism at all levels and conserves the current hyper-centralized and corrupted political system.

Currently Russia ranks 143rd on the 2015 Index of Economic Freedom with an overall economic freedom score of 52.1, and it is included in the category of Mostly Unfree countries (with scores in the range of 50–60) (Heritage Foundation, 2015). However, the latest events in the Russian economy and government regulations of business, especially in the areas of foreign trade and the small business sector, clearly demonstrate the declining trend, with the strong possibility of further downgrading in this list in the foreseeable future. Overall, the latest economic events provide further evidence of Russia’s challenges and show that the transformation has been anything but positive.

Implications for Future Research and Business Practice

This analysis and results have strong implications for further research, business practices, the state of public policy, and more importantly, changes needed therein. Russia, once a star emerging market (part of BRICS) that was considered a major growing economic power, seems to have lost its luster amid declining consumer and business confidence and corrupt and unstable practices. Much reform is needed on both the economic and political fronts to allow Russia to be once again considered a major player among world economies that has a positive impact on the global landscape. Our analysis and insights will hopefully add to this discussion.

We see at least two key areas of research that are worthy of close attention in the foreseeable future: (1) Russian economic resources in turbulent environments and the current state of its critical sectors and (2) short-term impact and long-term consequences of economic sanctions against Russia and its counter-sanctions on the European and world economies. The dynamics of the changes in Russia as a whole and in its foreign trade in particular have increased drastically during the last two years, and in the worst case scenario, the situation could culmi-

nate in an uncontrollable state at some point. Thus, close monitoring of the external and internal economic processes and regular analysis are needed more than ever before to keep the economic environment in Russia and around it understandable and predictable on all stages of the crisis development.

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Tax Avoidance by Multinational Companies: Methods, Policies, and Ethics

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Why an Acquaintance with International Tax Issues Is Essential for Scholarship, Teaching, and Strategy

To most international business (IB) scholars and educators, global taxation may appear to be an obscure topic. But actually, it is central to global decision-making: most foreign direct investment (FDI) and global operations are biased by tax considerations. The numbers are huge. For instance, with around US\$10 trillion worth of world trade being intrafirm and a similar portion being intermediate (as opposed to finished products or services), the multinational firm can decide internally what unit price it will type on its export invoices. No “arms-length” equivalent benchmarks are easily available.

Because of a US tax provision, between US\$2.1 and \$3 trillion in accumulated profits from US multinational foreign affiliates have not been repatriated (a firm is classified as an FDI “affiliate” if at least 10% of its shares are held by a foreign owner; a “subsidiary” is also an affiliate, but denotes majority or full ownership by a foreign entity or owner.) I conservatively estimate that out of the million-odd foreign affiliates of all multinationals listed in the United Nations Conference on Trade and Development (UNCTAD) 2015 database, between 300,000 and 400,000 are shell or dummy companies (firms that have no economic activity except for a part-time accountant or a lawyer behind a shining brass nameplate). The entire FDI statistics of major nations such as China and India, for example, are biased by the “round-tripping” of *local* investment masquerading as *foreign* investment.

Global strategists and IB scholars grapple with a key dilemma – the tension between a world divided into 190-odd territorial and tax jurisdictions versus the desire of multinational corporation (MNC) executives to view the planet as a single economic space within which to optimize shareholder (or private corporate) value by shifting taxable profits, operations, and finance from one country to another. Awareness of and sensitivity to international tax avoidance are growing, exemplified by the EU’s introduction of a “Tax Avoidance Package” in early 2016 and by strident voices on both sides of the American political aisle. US presidential candidate Bernie Sanders describes tax avoidance as a “scam.” Donald Trump has labeled corporate inversions “disgusting.”

An Overview of Tax-Avoidance Methods and Their Relative Importance

The seven tax-avoidance methods summarized below, starting with the one that has the biggest impact, are legal because they use provisions and loopholes granted by the countries involved.

1. Exemption/Deferral of Foreign Affiliate Income (The “Biggest Break”)

Most advanced nations typically tax the profits generated by multinationals’ home-country operations, but not their foreign affiliates’ profits (Markle, 2015). Others, including the US, treat their multinationals’ worldwide income as taxable. However, the US offers a gigantic loophole: after paying each country’s taxes, MNCs can defer additional US taxes on foreign affiliates’ profits indefinitely by simply not remitting those profits back to the US. Instead, the funds are parked in tax havens (like Bermuda) and reinvested in other foreign operations (Contractor, 2015a). Unrepatriated profits of US multinationals’ foreign subsidiaries—which have legally escaped US taxation—are estimated at US\$2.1 to US\$3 trillion.

2. Transfer Pricing

In international supply chains, multinationals ship goods and services with unit values often biased by tax considerations. Consider two affiliates, A and B, both owned by the same MNC. Affiliate A has been exporting 1,000 items per year to Affiliate B, invoiced at US\$1.30 each. Initial pre-tax profits are \$1,000 in A and \$2,000 in B. But if these items are invoiced at US\$1.80 each, B would then pay A US\$500 more annually. Firm A’s profit would increase, and B’s would decrease—but the MNC *as a whole* would increase its after-tax income from US\$2,250 to US\$2,325. The idea is simple: pay higher amounts to affiliates where taxes are lower, and report lower values where taxes and/or tariffs are higher (See Figure 1 and Table 1).

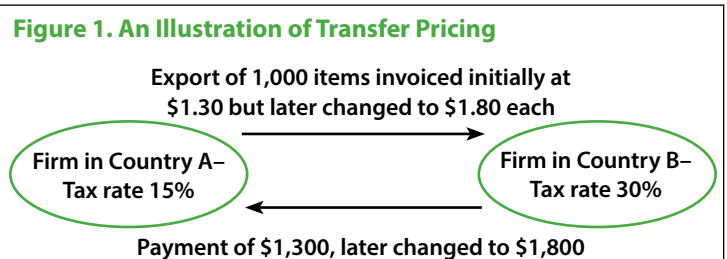


Table 1. Export of 1,000 Items – Payment of \$1,300 Changed to \$1,800

	Before Change in Transfer Price (Export Shipment Invoiced at \$1.30 Each)		After Change in Transfer Price (Export Shipment Invoiced at \$1.80 Each)	
	Firm A	Firm B	Firm A	Firm B
	Tax Rate 15%		Tax Rate 30%	
Pretax Profit	1,000	2,000	1,500	1,500
Tax	150	600	225	450
After-tax Profit	850	1,400	1,275	1,050
Total MNC After-tax Profit	\$850 + \$1,400 = \$2,250		\$1,275 + \$1,050 = \$2,325	

No real change has occurred, and production cost does not change. However, one simple keystroke changes the invoiced unit price from US\$1.30 to US\$1.80 and so allows the MNC to increase global after-tax profits. This is only one example. Millions of shipments are made annually—a great many where the exporter and importer are the same MNC, which can decide the invoice value depending on the tax differential between the import and export nations. Intrafirm trade is huge, estimated between 42 and 55% of world trade (around US\$23 trillion). Moreover, much international trade is in intermediate (not finished) products, some with unique designs and embedded proprietary technology. So with no comparative arms-length valuations, the MNCs themselves declare their shipments' value (Lanz & Miroudot, 2011).

In the example above, if Firm A's country's tax rate were higher than Firm B's, or if Country A levied an import tariff, then the situation would be reversed: the MNC could under-value the shipment from A to B to reduce its total worldwide tax and tariff liability.

3. Royalty Payments

Tax avoidance through interfirm royalty payments occurs because:

1. Typically, MNCs are technology-intensive. Most value resides in proprietary technologies or intangible assets.
2. Even if research and development (R&D) costs have been incurred by Firm A (located in the home country of the MNC), current rules allow the transfer of the patents or brands to a holding company or affiliate (in a low-tax country, such as Ireland) or a shell company (in a zero-tax country, such as Bermuda), which then charges royalties to headquarters and other affiliates (Dischinger & Riedel, 2008).

3. Most governments allow deductions for royalty payments, which reduces the tax liability of the licensee—even if the licensee is part of the same MNC, and even if no R&D was performed in the licensee's nation.

In Table 2, a Japanese company conducting R&D in Japan establishes a subsidiary in the US. In Scenario 1, the US subsidiary pays no royalty

for the Japanese technology. In Scenario 2, nothing has changed except that the Japanese parent has signed an additional side agreement with its US subsidiary, which will pay a 5% royalty to its parent. Under US rules, despite the US operation being the fully-owned "child" of its Japanese "parent," the royalty payments are a tax deductible expense. US tax liability is legally reduced from US\$90 to US\$75. And the total remittance (after taxes) to Japan increases from US\$210 to US\$225. True, less re-investible profits are left in the US operation, and more go to Japan. But this benefits the MNC overall if the effective tax rate in Japan (say 20%) is less than the US tax rate of 30%.

More aggressively, it is even better for the Japanese MNC to transfer the patent rights to another subsidiary in a low-tax nation, such as Ireland. By making the Irish subsidiary the licensor, royalties collected there would be taxed at an even lower corporate rate—perhaps as low as 10% instead of the Japanese rate of, say, 20% (Mutti & Grubert, 2009).

Further, the Japanese patents could be transferred to a Bermuda or Cayman Islands shell company—as Google, Apple, and many pharmaceutical firms have done—with royalties collected there at near-zero tax liability.

Table 2. Japanese MNC's US Subsidiary Royalties —Scenario 1–No Royalty vs. Scenario 2–5% Royalty

Scenario 1: Japanese MNC's US Subsidiary Pays No Royalty		Scenario 2: Japanese MNC's US Subsidiary Pays 5% Royalty	
Sales by Japanese subsidiary in USA	1,000	Sales by Japanese subsidiary in US	1,000
Total costs (no royalties involved)	700	Royalty (at 5% on sales)	50
Profit before tax	300	Total costs (excluding royalties)	700
US tax (at 30%)	90	Profit before tax	250
Profit after US tax	210	US tax (at 30%)	75
Total remittance to Japanese parent	\$210	Profit after US tax	175
		Royalty remittance to Japanese parent	50
		Total remittance to Japanese parent	\$225

4. Intracorporate Loans

Governments generally allow companies to deduct interest payments on loans as an expense. But if the lender and borrower are companies

within the same MNC, albeit located in different nations, then the MNC can reduce taxes in high-tax jurisdictions (e.g., by making its lower-taxed affiliates extend loans to affiliates in higher-tax nations, thus enjoying a juicier tax deduction on the interest payment).

FDI flows consist of three components: New Equity + Retained Earnings + Net Intracorporate Loans. Although we lack comprehensive data on the magnitude of worldwide intracorporate loans, they would conservatively exceed three quarters of a trillion US dollars (UNCTAD, 2015). We have no comprehensive idea of how many loans are motivated by tax avoidance, and even less about the extent to which the intracorporate interest rate deviates from the actual cost of capital to a lending affiliate or parent. In recent years, “a number of countries have imposed restrictions on the tax deductibility of interest” (DeMooij, 2011); but the enforcement of rules is lacking, especially in developing nations (Faccio, Lang & Young, 2010).

5. Other Central MNC/Parent Overheads and Costs

For reasons scholars have not fully understood, MNC R&D expenditures remain highly concentrated in the parent nation, or at least in far fewer countries than the number of territories in which the fruits of the R&D are derived (Belderbos, Leten & Suzuki, 2013). Some fraction of centralized MNC R&D costs and overheads logically have to be charged to each foreign affiliate (Sikka & Willmott, 2010).

Charging royalties to each affiliate for centrally-developed technology is one technique. Other categories of overheads (e.g., the costs of maintaining brand equity, other headquarters administrative costs involving global information technology, supply-chain management, and human resources) should not be borne entirely by the parent firm, but spread over the various subsidiaries and foreign operations that enjoy the benefits of the MNC’s central administration overheads.

In principle, this sounds fair, but how does the MNC carve up slices of its central overheads pie and proportionally allocate/charge a slice to each foreign affiliate? This is difficult because the allocation will vary depending on the weight of each country affiliate (in the planetary total) – the weighting for each country varying by numbers of employees, versus value added in the nation, versus assets, and so on. An obvious further complication is that exchange rates fluctuate, affecting the share of each affiliate in the worldwide total pie from year to year.

But, of course, MNCs are not tax-unbiased. They face a clear temptation, *ceteris paribus*, to allocate a larger slice of the overheads pie to operations in higher-tax nations and *vice versa*. There is no standard methodology. The EU has been attempting, since 2000, to formulate relevant rules for a combined pan-European system for the future; however, each formula has its problems and detractors (Picciotto, 2012; Altshuler, Shay & Toder, 2015).

6. “Round-tripping” and Shell Companies

In 2011, 70.1% of Chinese outbound FDI went to Hong Kong or Caribbean affiliates (OECD, 2013). Much of this Chinese money made a round trip, returning to mainland China under the guise of “foreign invest-

ment” in order to take advantage of the still better tax treatment, cheaper land or loans available to “foreign” as opposed to purely “domestic” investors. Another driver is evading capital controls (Contractor, 2015b), since Chinese renminbi (RMB) cannot be converted into dollars or euros without a written justification, such as FDI.

UNCTAD (2011) reported an implausible 434,248 Chinese foreign affiliates out of a worldwide total of 892,114 for *all* MNCs. Conclusion? A large number are shell companies, with no economic activity or purpose other than round-tripping or evasion of capital controls.

In Europe, shell companies account for over 80% of FDI into Luxembourg and Holland, over 50% in Hungary, and over 30% in Austria and Iceland (OECD, 2015). A third of FDI into India emanates from Mauritius because the two countries have a tax treaty. US multinationals use tax haven subsidiaries as “parking spots” for un-repatriated foreign affiliate profits and as licensors to collect royalties charged to other affiliates globally (Contractor, 2015a).

Considering these facts, I conservatively estimate that 30–40% of all FDI affiliates worldwide in the UNCTAD World Development Reports or World Bank databases are shell companies—a sobering thought for scholars using these data.

7. Inversions

An inversion involves a company shifting its corporate headquarters to a lower-tax jurisdiction by acquiring/merging with a foreign firm in a lower-tax country. The intended tax savings of the Pfizer (US)–Allergan (Ireland) merger were estimated at \$150 billion since US taxes can be 35% while Irish taxes are 12.5% at most. Other examples since 2012 include Mylan moving to the Netherlands and Burger King to Canada, which have lower tax rates than the US.

The numbers of inversions have actually been few. For the US, only 44 occurred since 2000, and six in 2015, though each is typically huge (Contractor, 2016). As long as MNCs conclude that home nation taxes are higher than in other nations, inversions will continue in the future.

Ethical Pros and Cons

Pros

Many executives argue that taxes in nations like the US are already too high and that firms suffer a competitive disadvantage if higher taxes mean less after-tax income is reinvested in R&D and/or smaller dividends are distributed to shareholders. Some argue that if government rules allow loopholes, it is the company’s fiduciary duty toward shareholders to take advantage of loopholes to (legally) avoid taxes.

Cons

Critics aver that tax avoidance may be legal, but loopholes in tax provisions have been written by corporate lobbyists. Multinationals enjoy all the tax-avoidance methods outlined in this article. Consequently, the much-trumpeted US corporate tax rate of 35% is actually only

the *marginal rate*, with *actual effective* rates variously estimated to be between 19.4%¹ and 27%² putting the US tax burden in the middle of the OECD advanced-nation group (Contractor, 2016).

It is true that if a MNC pays higher tax, less money is left over for shareholder dividends or to replenish the R&D budget. But critics argue that the gains from tax avoidance may not go to R&D or dividends, but instead can be diverted into fatter bonuses and stock options for top executives.

Conclusion

No decision in large MNCs is made these days without assessing tax implications. The magnitude of the international tax-avoidance phenomenon—the extent to which global operations, supply chains, and location decisions are affected by tax considerations—places this issue at the heart of global strategy. In large companies, executives consider tax angles concurrently with strategy, rather than as an afterthought. Vanishingly few IB and strategy papers take taxes into consideration. Consequently, an acquaintance with this topic is unquestionably critical to IB scholarship, teaching, and practice.

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Irish-Dutch Sandwiches, Corporate Inversions, and Arm's Length Transactions: International Tax for IB Courses

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Introduction

Looking for a good reason to introduce international tax into your IB course? Let me give you five. First, every IB course includes a unit whose purpose is to have students appreciate how doing business differs when traversing borders—tax is certainly a practical example of this. Second, all MNEs must submit tax returns, and therefore managers must understand, at least at a high level, the general classes of tax systems and principles that countries employ. Third, international tax is a provocative, controversial topic which will engage students academically and often emotionally. Students read in the practitioner press about large MNEs that pay little or no tax, and students want to know: How do they do it? Why are they getting away with it? Fourth, tax is a relevant example by which to discuss MNE–government bargaining and relations. A discussion of tax includes the ability of MNEs to play countries against each other. Fifth, tax is an issue area that can be used as a context when teaching global governance. Actions to assure that each MNE pays its “fair share” of tax require broad international support and exchange of information among countries, MNEs, and supranational organizations. Given this premise, it is not surprising that international tax reforms are complex and slow in developing.

“Debates are a particularly effective way of both engaging students and teaching both sides of the issues. No one is without an opinion on tax avoidance, tax arbitrage, and tax havens.”

There is no shortage of materials and methods that are available to IB instructors that facilitate introducing international tax into your IB course. These include cases, videos, simulations, academic book chapters on tax theory, as well as numerous articles in the practitioner press and by multinational organizations which reflect a variety of different perspectives and agendas. Debates are a particularly effective way of both engaging students and teaching both sides of the issues. No one is without an opinion on tax avoidance, tax arbitrage, and tax havens.

Teaching International Tax

Prior to the class lecture on tax, I introduce the topic by asking students

to watch an investigative reporting piece, available online, that provides both the MNE and government perspectives on the international tax issue. The 60 Minutes piece (CBS, 2011) is a few years old but gives students a high-level introduction and an appreciation for the subject as a contemporary, relevant issue and conveys the frustration of both MNE CEOs and governments with the current tax system. I also assign an article from the practitioner press (*Economist*, 2013, 2014) on MNEs that pay little or no tax, along with a current headline story in a financial newspaper, such as the Pfizer-Allergan merger (Hoffman, 2015). These assignments (module ① in Figure 1) “set the hook” and students come into class eager to learn more details.

Tax Basics

When introducing international tax, I suggest you think of the topic as comprised of two categories: transfer pricing and corporate tax on foreign sourced income (② in Figure 1). That way, if you don't have time to address both, you can teach either one somewhat independently of the other. Intracompany transfer pricing is, in theory, based on the principle of arm's length transactions, in which intracompany prices are set as if the transferred product is an intercompany sale (Eden, 1998, 2015).

The effect of different transfer prices on MNE subsidiary and overall corporate profits is relatively straightforward for students when discussing physical products. However,

transfer pricing enters a “grey area” when you introduce intangible assets and MNE income shifting activities and structures. One example of this tax avoidance structure is the “double Dutch-Irish sandwich” (Figure 2), in which a parent company's IP is transferred at a low value to an Irish incorporated subsidiary located in a tax haven, who in turn licenses the IP under a royalty agreement to an operating company in Ireland, and the Irish operating company then funnels royalty payments back to the Irish subsidiary through an intermediate company in the Netherlands (Fuest, Spengel Finke, Heckemeyer, & Nusser, 2013; UNCTAD, 2015). The intermediate company is inserted as the Netherlands does not impose withholding taxes on royalty payments. Students are first curious to know how this works, and then shocked that MNEs can do this to avoid tax.

Figure 1. Taxation Course Module Sequence

① Homework Assignments Prior to First Class on Int'l Tax
<p>I assign students to read, or watch, the following:</p> <ol style="list-style-type: none">1. One overview article from the business press (e.g., parts of Economist, 2013)2. One video that shows how the tax issue draws emotional reactions from both country governments and MNE CEOs (e.g., CBS, 2011)3. A news article that conveys the issue's contemporary relevance (Hoffman, 2015)
② First Class on Int'l Tax - Lecture on Concepts, Laws, Tax Analysis
<ol style="list-style-type: none">1. Transfer pricing (TP)<ul style="list-style-type: none">• What is a TP? Why is it required? Who sets it? TP and arm's length transactions• How TP affects subsidiary profits and MNE overall worldwide profit• Potential issues with intangible assets2. Corporate Taxation of Foreign Sourced Income<ul style="list-style-type: none">• Country maximum corporate tax rates versus effective tax rates• Territorial tax systems versus Worldwide tax systems (US)• Credits for Foreign Tax Paid; Interest and R&D Allocations against Income• Repatriation timing issues and taxation consequences• Tax policy that incents MNE investment and job creation outside home country• Excess credit versus Deficit credit firms and influence on investment decisions3. Corporate Inversions and Tax Havens<ul style="list-style-type: none">• What is a tax haven? What is an inversion?• What are the incentives to do an inversion? Pre and post inversion profit analysis• Recent laws to attempt to stop inversions
③ Homework Assignments Prior to Second Class on Int'l Tax
<ul style="list-style-type: none">• All students read the case "Corporate inversions: Stanley works and the lure of tax havens" (Desai et al., 2002)• First group of students is assigned to present case analysis to class• Second group of students is asked to prepare a presentation on the view of country governments in answering the questions: Are MNE's paying their fair share? If not, who is to blame? What should be done about it?• Third group of students is asked to prepare the MNE's view on these questions
④ Second Class on Int'l Tax – Presentations, Debate, Conclusion
<ul style="list-style-type: none">• First student group presents their case analysis• Second and third groups present their viewpoints, followed by debate, discussion• I summarize and conclude by pointing to areas of blame on both sides
⑤ Ongoing Simulation with Transfer Pricing Decisions
<p>A component of my IB course is the Cesim Global Challenge Simulation. Students make weekly decisions on running an MNE including setting transfer prices from product source to destination countries given subsidiary profits and country tax rates.</p>

Another tool I use for teaching transfer pricing is simulation (module ⑤ in Figure 1). While examples of transfer pricing of physical goods between MNE units in two countries are easy to understand, they do not enable students to appreciate the complexity involved in deciding on a set of transfer prices from units in several source countries to several destination countries. The Cesim Global Challenge simulation (Cesim, 2015) requires students to make these transfer pricing decisions, with the goal of optimizing overall MNE profit, for three destination countries that may sell up to four products from two possible source countries, given each country's corporate tax rate and tariff and transportation costs among them.

I start out the topic of corporate tax by distinguishing between country maximum corporate tax rates and country effective tax rates. Students often fixate on the US having the highest maximum corporate tax rate. However, the US's effective tax rate is less than a country like Brazil, which has a lower maximum corporate tax rate but has fewer deductions as well as higher state taxes and a social contribution tax. Next, I explain the differences between tax laws in countries which have a territorial tax regime, in which tax is calculated only on income earned in that country, versus worldwide tax systems, in which all of a home country MNE's income is taxed, including income generated in other countries. However, in worldwide tax systems such as the US, foreign income is only taxed when it is repatriated and then a tax credit is given on taxes paid to other countries.

Worldwide tax systems have several perverse effects, such as home country MNEs not repatriating profits to avoid taxes and instead reinvesting profits outside the home country. This has, for example, resulted in many US high technology MNEs having more assets and employees outside the US than in it. In an economic climate where there is much emphasis on job creation, US students are typically perplexed and dismayed that archaic US tax laws are an incentive for US MNEs to create more jobs outside the US than in it. It is also important to explain that in some worldwide tax system countries as the US, MNEs must allocate some expenses, such as interest payments and R&D expenses, based on percent of total assets abroad, even though these expenses were incurred in the home country. Finally, it is instructive to differentiate between excess credit firms, whose foreign tax rate is greater than the home country tax rate, and deficit credit firms. These two MNE tax credit positions result in FDI target countries providing different investment incentives. Primers by Reiling (2006) and Desai (2005) are recommended reading as background material for instructors not familiar with MNE taxation.

Tax Avoidance

After these basics of corporate income tax law, I turn the students' attention to what MNEs do to avoid taxes. This leads to an explanation of "corporate inversions," an MNE from a worldwide tax system home country "changing" its home country by moving its headquarters to a tax haven. The net tax effect of an inversion is that now taxes paid

to what was previously the home country are based only on income earned in that country. The MNE now does not have to pay taxes to what was previously its home country on the income of the its foreign subsidiaries, and the tax haven has no corporate taxes. After the first class, I assign the case "Corporate Inversions: Stanley Works and the Lure of Tax Havens" (Desai, Hines, & Veblin, 2002) to help students compare the before and after effects of a corporate inversion (③ in Figure 2). This case also has an excellent teaching note. My case analysis assignment asks students to calculate the tax before and after the inversion and argue whether the firm should do the inversion or not. At the undergraduate level, I keep students on track by providing spreadsheet templates for calculations with data from the exhibits.

For the next class (④ in Figure 1), I ask half the class to prepare to take the position of MNEs and the other half to take the position of governments and ask them to debate these questions: Who is to blame for MNEs not paying their "fair share"? What should be done about it? This is usually a raucous, finger-pointing affair, but it is rewarding to see students teach each other in the process.

At the end, I point out that in reality there is plenty of blame to go around on both sides. I explain that while economists can prescribe changes to tax law that will simultaneously force MNEs to pay their "fair share," increase government tax revenues, and create jobs in the home country in the long run, these prescriptions often have the side effect of tax revenue shortfalls in the short run. For example, reducing corporate taxes on repatriated income for US MNEs will increase MNE investment in the US and create more jobs in the US, both of which will increase tax revenues in the long run. However, there will be a lag, perhaps as much as five years, between the time the tax law passes and the time the resulting new investments are paying enough tax to more than compensate for the tax rate reduction. In the meantime, the consequence of the law will be an immediate tax revenue shortfall as the taxes paid by existing MNEs is decreased. I explain that while the "long term" to an economist might be a decade or two, the long term to a politician is the next election.

The statement of previous EU Council president Claude Juncker regarding politicians and the debt problem equally applies to the tax problem: "We all know what to do [economically], we just don't know how to get re-elected after we've done it." Therefore, because of a reluctance to overhaul the tax code, we observe a continuous cycle of (1) MNEs exploit a loophole in the tax code to reduce taxes, (2) governments pass tax legislation to plug the loophole, (3) MNE tax lawyers find another loophole in the tax code, and (4) go to step 1.

Discussion and Conclusion

In my view, there are several reasons why fewer students, aside from those in tax specialty masters programs, are exposed to international tax in business schools. First, IB professors are quick to delegate the tax topic to their accounting departments, while most accounting departments, at least in the US, focus on the details of domestic tax

law. Second, less tax research finds its way into classrooms as IB professors who are interested in tax research find it difficult to publish in IB journals. This is because our IB/strategy journals find articles on tax policy to be atheoretical and more oriented for a practitioner than for an academic audience. Ironically, many of these same journals, which might be considered to have a disproportionate emphasis on academic writing at the expense of practical impact, then have special issues which ask the question: Why aren't business practitioners listening to business academics? This is unfortunate as a conversation on alternative tax regimes in our literature could make a significant contribution to renovating tax policy, thereby breaking the aforementioned cycle of legislative band aids on tax loopholes.

In my view, the root cause underlying tax issues is that profit is the basis of taxation, and the profit metric is not transparent, can be easily shifted geographically, and is subject to creative accounting. A more objective and transparent tax metric, such as changes in stock price, which reflects profits but cannot be shifted geographically, would eliminate MNEs' motivation to locate in tax havens. Tax havens would simply dry up and go away. These alternative bases of taxation introduce another set of problems, but that is a discussion for another paper.

In the meantime, I strongly urge you to introduce international tax into your IB course. You might be rewarded, as I have, when a student stops you in the hallway the following semester and says "Hello, Professor. By the way I read an article in the financial newspaper last week about offshore financing, and I actually understood it!"

Appendix: Resources for Educators

There are a wide variety of international tax educational resources available. Short primers on international tax for IB instructors include Reiling (2006) and Desai (2005). For student analysis, presentation, and discussion, I use the Harvard case "Corporate Inversions: Stanley Works and the Lure of Tax Havens" (Desai, Hines, & Veblen, 2002), which has an accompanying teaching note (Desai, Veblen, & Luchs, 2005). Chapter 13 of Pratt and Kulsrud's (2016) taxation textbook is a well written introduction to international taxation.

For instructors who want a more detailed understanding, suggested textbooks dedicated to international tax include Bittker and Lokken (2014) and Doernberg (2012). More academic treatments of taxation can be found in Eden (1998, 2016) and Fuest et al. (2013). In addition, Webb (2006) presents an academic global governance perspective on international taxation. Chapter V of UNCTAD's 2105 *World Investment Report* contains a good discussion of the problems of present corporate tax law and its impact on the economic development of emerging economies.

In order to initially convey the tax issues and positions of stakeholders to students, I use the 13-minute video from the *60 Minutes* news reporting show by CBS (2011). Beyond that, the business press offers a number of overview articles (e.g., *Economist*, 2013) on the impact of corporate tax laws. In addition, the financial newspapers have a

constant stream of short reports on company and political news that illustrate the contemporary relevance of this topic (e.g., Hoffman, 2015). Finally, business simulations provide an engaging resource for students who actively learn by making weekly decisions while managing an MNE over the semester and then understanding the consequences of these decisions from their firms' results. The Cesim Global Challenge (2015) simulation requires students to set transfer prices and thereby appreciate their impact on an MNE with multiple product source and destination countries, each with different tax rates.

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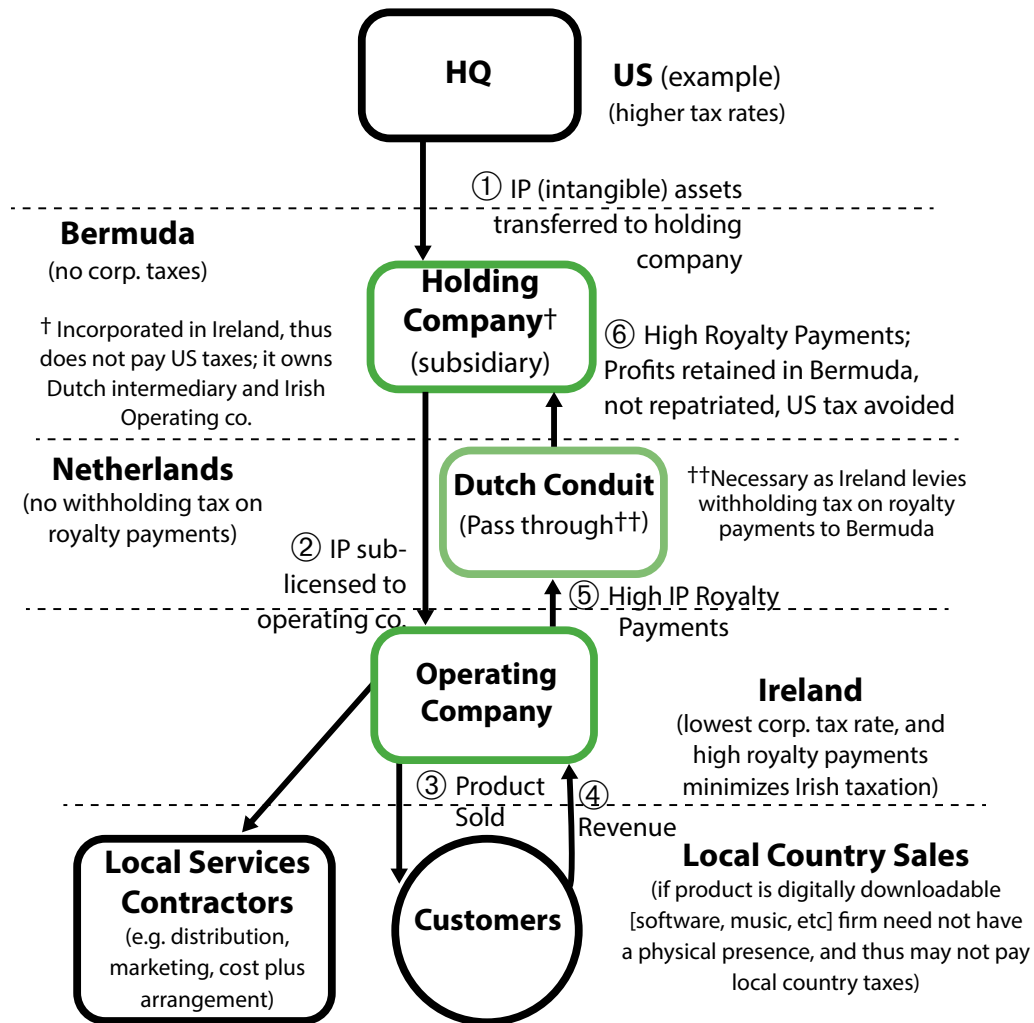
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Figure 2. Double Irish-Dutch Sandwich



Effective Use of Business Simulation Games in International Business Courses

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IN THE FIELD OF INTERNATIONAL BUSINESS (IB) and strategic management education, the most commonly used business simulation games are browser-based multiplayer simulations. Teams of students compete against each other by managing multinational enterprises over a number of rounds of play, with each round representing a financial year. IB simulation games enable students to make decisions and receive immediate feedback in a risk-free environment.

The growing use of business simulation games in the teaching of international business is supported by several trends. Technology, in the form of high-speed internet access and mobile computer devices, is increasingly available and affordable for students. In parallel, online and blended programs have grown rapidly. Instructors are realizing that online games can bring variety and energy to the classroom compared to traditional lectures or case discussions. In short, games have the potential to motivate and engage a new generation of students who are used to working and playing online.

The supply of high quality games with relevance to IB curricula continues to grow. Instructors can now choose among a range of multi-functional games with relevance to IB, including CESIM's Global Challenge, Capsim's Global DNA, and Glo-bus, which is marketed by McGraw-Hill. In addition, a wide range of function-specific games exist in the fields of cross-cultural management and negotiation, international marketing, and international financial management. A listing of simulations is available on the AIB website.¹ Most IB simulation games can be used by students at the undergraduate and graduate level, as well as by executives.

Despite this growth in business simulation games, many instructors are still reluctant to engage in their use. In order to use games effectively in the classroom, the instructor must undergo a learning process. The aim of this article is to accelerate this learning process so that instructors can begin to use business simulation games in IB courses with a greater level of confidence and generate successful learning outcomes more quickly.

Even after several decades of accumulated experience, effective teaching practices for the use of business simulation games have not yet been researched thoroughly, especially in the IB discipline. Schreier and Bassuray (1981) observed that "research in simulation and experiential learning has, for the most part, focused on evaluation of learning

outcomes, analysis of learning styles, and only to a very small extent, the behavior and attitudes of the instructor." Not much has changed since then. A search in the ABSEL journal *Developments in Business Simulation & Experiential Exercises* produces no results for articles on effective teaching practices, with most articles in this publication dealing with the development and use of individual games and their contribution to learning. In the *Journal of International Business Studies*, the only article that has simulation as a keyword dates from 1984 (Klein, 1984).

It seems that the practice of using business simulation games has outpaced research into effective teaching practices. Hence, the six suggestions for the effective use of simulation games in IB teaching in this article are derived mostly from practice rather than from academic research.

Align Game Use with Clearly Defined Learning Objectives

The most commonly used IB games can be regarded as both global strategy games and "capstone" experiences. A variety of corporate functions are represented in the decision-making elements of the game. Typically, students need to make decisions on a company's product portfolio, pricing, advertising, production, R&D, and financial structure. IB aspects of games include the management of foreign currency fluctuations, barriers to trade, differential tax rates between

“In order to use games effectively in the classroom, the instructor must undergo a learning process.”

countries, transport costs, and international cash management. Players also need to deal with national differences on multiple aspects, including consumer preferences, price sensitivity, production costs, market growth rates, business environment, and economic growth. Instructors need to choose which decisions to emphasize, downplay, or ignore, in line with the planned learning goals of the course.

In order to ensure alignment of learning objectives with a game, instructors should use a standard sequence of brief–play–debrief activities. In the briefing phase, the rules of the game and any required theory are explained. During play, students analyze the information they are given and make decisions. In the debrief phase, they analyze their results in a classroom setting and link the game playing process and their results back to the learning objectives of the course and to the real world of international business. This sequence can be used regardless of whether a game consists of one round or many rounds. In multi-round games, a debrief session should be held after every round

Introduce Complexity Step-by-Step

Some games are overwhelmingly rich and complex for students, particularly those in undergraduate programs. Once students feel they are lost, they find it difficult to re-engage with the exercise. In order to avoid confusion, instructors can delay the use of certain functions of the game for all students. In this way, each round of a game can have its own specific learning objectives. For example, the explanation of topics such as a company's financial structure, tax optimization, and dividend policy may be left until later in a game. The instructor may even decide to leave certain decision-making areas out for the entire game. Some games have optional modules that may be switched on or off by the instructor. By selectively choosing which decisions to emphasize, instructors can tailor the level and type of complexity of the simulation to any particular audience and the course learning objectives.

It is important that students don't feel they are losing out as a result of not knowing the basic rules of the game. Some of the more complex games offer the possibility to play practice rounds, enabling students to familiarize themselves with the game, build their team spirit, and formulate a strategy before the results start to count.

Get to Know the Game before Using It in Class

Instructors need to get to know a game before using it by consulting the student and instructor materials (documents and videos) and by playing the game before the course starts. If possible, the instructor should get to know the underlying model that is supporting the game. After having played a game, the instructor will have a better view about how to play the game in class. This insight will lead to decisions about which functions to keep in the game and, if possible, what changes to make to any of the coefficients in the model.

The instructor provides credibility to the game through explanation and guidance. If the instructor is seen to be not fully knowledgeable about the game, credibility will be impaired, student engagement will drop, and learning will suffer. The instructor is not expected to know the details of every single aspect of a rich simulation; if the instructor is lacking an answer to a question posed by students, it is best to check the available documentation or to communicate with the game supplier-before giving an answer.

Facilitate Learning

A business simulation game is an ideal opportunity to give students greater responsibility for their own process of discovery and learning, both individually and in teams. Throughout the process, but especially during the playing phase, the instructor should act as the "guide on the side" rather than "the sage on the stage" (King, 1993). Students need support, especially those who are analytically weaker than others. However, the instructor should be careful not to replace the students' own efforts and must refrain from giving inside information or specific advice on what decisions students should take. At best, the instructor can help students to think through what may be the consequences of certain decisions and link such analysis to the learning objectives of the course.

A thorough debrief after every round of play is necessary to make students reflect on their learning journey. Such a debrief starts with students observing and understanding the results of the various teams on multiple dimensions. They can then move on to explain their performance by drilling down on individual decisions they made and their consequences for the team's performance. Such discussions provide good opportunities for the instructor to link the game results back to the course learning objectives and the real world of international business.

Include the Game in Student Assessment

There are many ways to include the game in assessments that count toward a course grade. The most straightforward is to give points according to the student's performance in the game. For example, students in the winning team get 100 percent for this component of the course, the second placed team gets 90 percent, and so on. The advantage of such an approach is that the students get engaged in the game and will be highly motivated to do well. There is also objectivity, since the score of a team is determined by the software and not by the instructor.

The instructor should communicate the winning criteria at the start of the game. This may be one all-encompassing measure such as cumulative shareholder return or may combine several measures such as Return on Equity, profit growth, or market share. If the winning criteria are clear at the start, the instructor does not need to make personal judgments when declaring a winner at the end of the game.

The drawback of this approach is that competitive spirits may become too strong and inhibit an atmosphere of collaborative learning in the classroom, especially in more collectivist cultures. In addition, game performance may not always be a good reflection of learning and understanding. Sometimes the lower ranked teams have made far greater efforts, have learned more, and end up with superior understanding, as they have learned from mistakes made early in the game.

Other ways to include the game in assessments of students' learning include exams, essays, and group presentations. Exams can test

knowledge of the materials covered and can get students to apply newly developed skills. Essays and presentations typically address the questions of how the students made their decisions, what their results were, and reflections on what they learned. Learning diaries may be another way to assess the learning that is taking place.

Open up the Model to Students

Finally, it is important to discuss the assumptions and parameters of the underlying model with the students. The instructor should remember that “the model is always right,” in the sense that the leading games suppliers tend to deliver games without software bugs. Whenever there appears to be something inexplicable in the behavior of the game, an explanation can usually be found, sometimes after consulting with the game supplier.

On the other hand, “every model is wrong” in the sense that a model is necessarily a simplification of reality. It is precisely by removing complexity that the learner can focus on the behavior of a limited set of variables. Discussing with students how the model simplifies reality enables them to relate their game experience to the real world.

If the objective is to learn about the workings of a system, openness about the underlying model will facilitate learning. As John Sterman of MIT Sloan wrote in his classic work *Business Dynamics* (Sterman, 2000):

To learn in dynamically complex systems participants must have confidence that the model is an appropriate representation of the problem they care about. They must believe it mimics the relevant parts of the real world well enough that the lessons emerging from the virtual world apply to the real one. To develop such confidence the virtual world must be an open box whose assumptions can be inspected, criticized, and changed. To learn, participants must become modelers, not merely players in a simulation game.

Several strategy simulations published by MIT’s Learning Edge allow the instructor to change the coefficients and parameters in a model. Even if some IB simulations don’t provide this opportunity, instructors should discuss and challenge the apparent assumptions used in the model underlying the game.

Conclusion

In the context of IB education, learning opportunities from simulation games relate to a wide variety of topics including cross-cultural management, international expansion strategies, tax optimization, the role of import duties and transport costs, offshoring, currency fluctuations, and adaptation of products and prices to local consumer preferences. In addition, simulation games can help to build general skills related to

critical thinking, systems thinking, time management, decision making, and teamwork (Lovelace, Eggers, & Dyck, 2016). Having student teams composed of different nationalities compete against each other is an exercise in international business itself.

Simulation games can be used in IB courses at three levels. In the most simplistic sense, instructors can use a simulation game to introduce variety in the class and let students “play a game,” with a focus on the competitive elements of the experience. The danger of this approach is that serious concepts that are present in the game become gimmicks, students overestimate the luck factor in obtaining results, and the consequences for motivation, engagement, and learning may be counterproductive.

At a second level, the instructor facilitates learning by linking the impact of decisions made by students to the learning topics of the course. This is achieved through carefully planned briefing and debriefing, as well as by providing some support during the game play. In this way, learning can be enhanced through higher levels of student motivation and engagement.

“*Simulation games can help to build general skills related to critical thinking, systems thinking, time management, decision making, and teamwork.*”

Ultimately, instructors need to become model builders themselves and encourage students to become so too. Initially, this is done by building a deep understanding of the functioning of the model underlying the simulation game and by reviewing (and potentially changing) coefficients of the game. The instructor then needs to open up the model to the students for discussion and criticism and link the functioning of the model to observations in the real world. Students may begin by describing how they think the model works or compare it to theories or cases they have studied. Ultimately students may offer suggestions for improvement for the model to correspond better to how they see the world. In this way, students deepen their learning about the course concepts and their applications, and at the same time they develop modeling and critical thinking skills.

In conclusion, the opportunity to integrate the use of business simulation games in IB teaching will continue to grow. Such growth is driven by the falling cost of electronic devices and internet access, the increasing number of relevant games available, and greater awareness of the opportunity to enhance experiential learning through games. Simulation games have the potential to engage students, to introduce variety to the classroom, and to support online and blended learning. Games can help students reach new levels of critical thinking and insight. Over time, instructors can tailor the use of games to design learning experiences that are specific to the needs of their students. Ultimately, opening the model up to scrutiny by the students extends learning

from the use of games beyond any specific IB curriculum into modeling and systems thinking.

The most important obstacles to further growth in the use of simulation games in IB teaching appear to be individual and institutional barriers. General inertia, combined with the initial investment required by the instructor to learn and complex purchasing procedures, are potential factors at play. This may result in instructors not willing to make the effort to select and use a simulation game. Even students seem fearful of the unknown when they are confronted with a business simulation in their courses for the first time. Encouragement and support from senior management and a willingness to invest the required time and effort to prepare for using simulations are prerequisites. Knowledge sharing between instructors with varying levels of experience can also help to overcome resistance and anxiety.

Despite recent increases in their use, there is still a great deal of potential for growth in the benefits obtained from business simulation games in IB teaching. Teachers learn to become more effective in the use of IB simulation games through experience and experience sharing. Employing the effective practices described here can accelerate the learning curve for instructors and improve the student learning experience.

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Endnotes

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