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FIFTH EDITION

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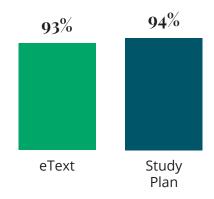


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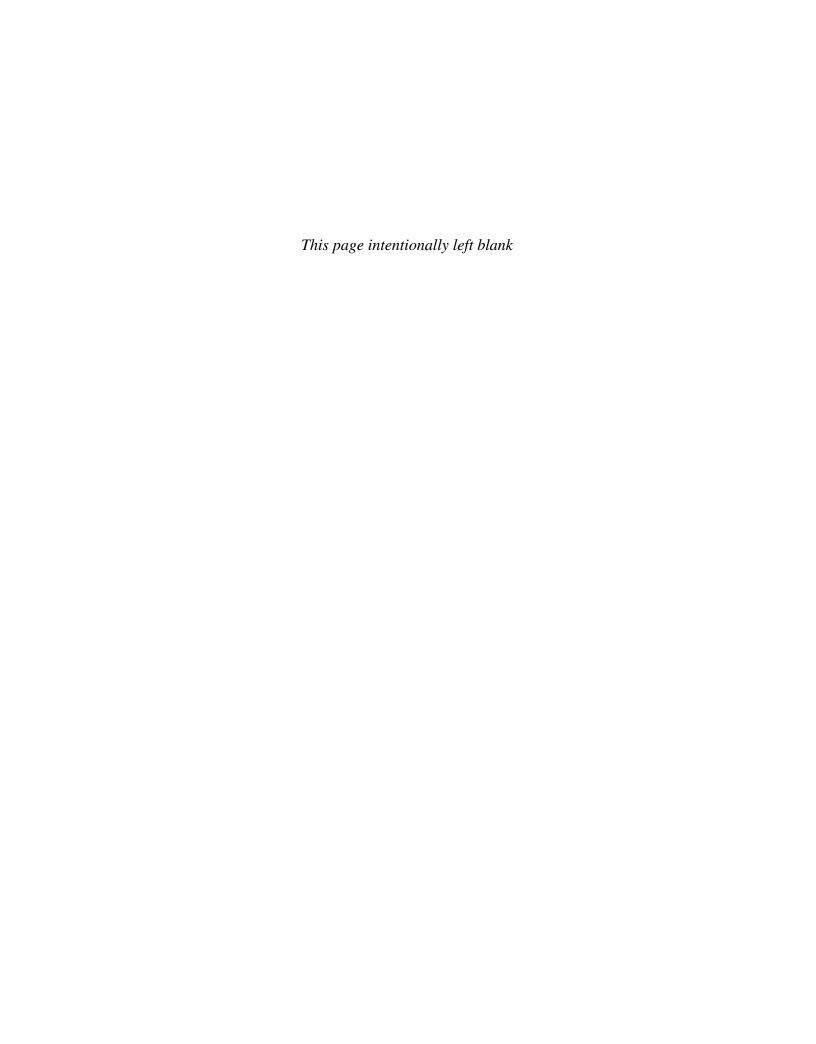
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# **International Business**

# **The New Realities**

Fifth Edition



# **International Business**

## **The New Realities**

Fifth Edition

### S. Tamer Cavusgil

Fuller E. Callaway Professorial Chair, Georgia State University

### **Gary Knight**

Helen Simpson Jackson Chair in International Management, Willamette University

### John R. Riesenberger

President, Consilium Partners Thunderbird School of Global Management (retired)



Vice President, Business, Economics, and UK Courseware: Donna Battista

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Full Service Project Management: Marianne Peters-Riordan, Integra Software Services

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#### Dedicated to...

This book is dedicated to all those who feel passionate about cross-border business, our readers around the world. I trust that this edition will inspire and help you discover the magic of international business. Since any journey is much more rewarding when you are accompanied by others, I also dedicate this edition to my students of four decades whom I had the opportunity to mentor over the years.

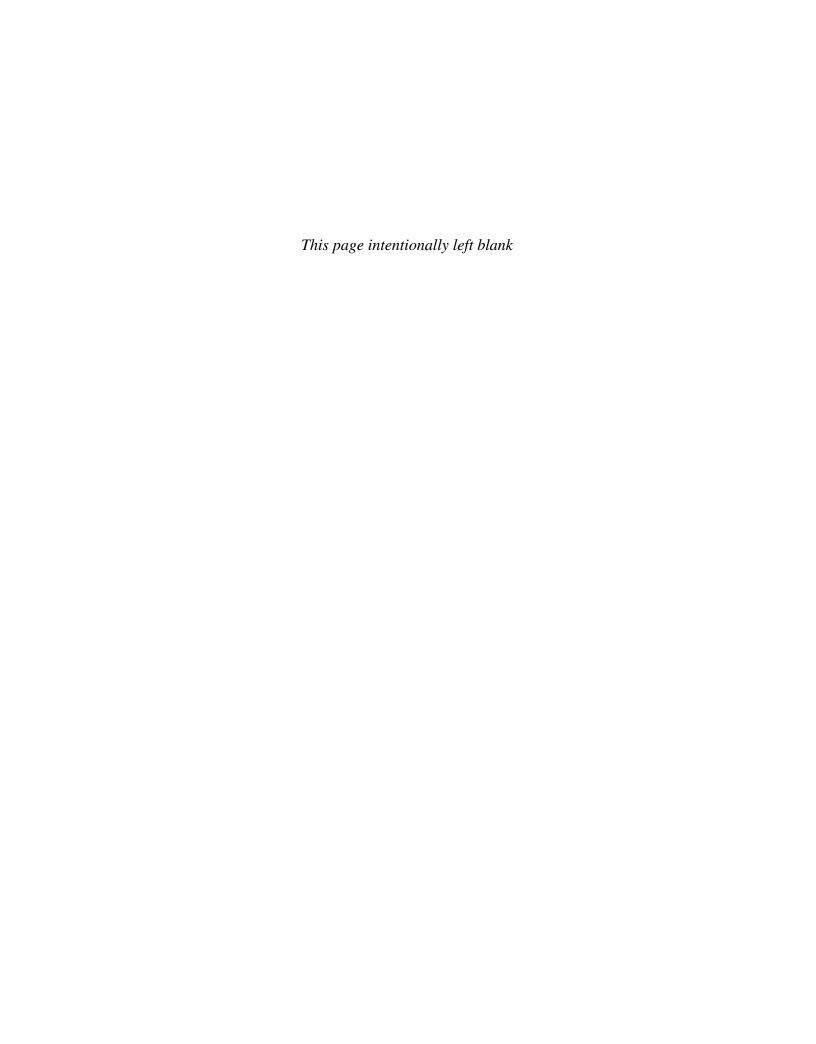
# **S. Tamer Cavusgil** Atlanta, Georgia

This book is dedicated to my wife, Mari, for her intellect, patience, and adventurous spirit; to Bill and Audrey, and to Hiroshi and Hisako, for being great parents and role models; and to the many students I have had the good fortune to influence over the years.

#### **Gary Knight** Salem, Oregon

This book is dedicated to my parents, Richard and Marie Riesenberger, for their example, many sacrifices, and love. To my wife and best friend, Pat, for her enthusiasm and loving support. To my daughters, Chris and Jen, of whom I am so very proud and thankful. To Byron, Ann-Marie and Terry, who enrich my life. To my amazing grandchildren, Ryan, Paige, Ethan, and Emma—the future of the New Realities.

#### John R. Riesenberger Scottsdale, Arizona



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### **Preface**

#### **New to This Edition**

Our aim is to keep the text fully up-to-date and at a reasonable length. Thus, we have dropped some items and added new ones. From Chapter 1, we dropped the Opening Case on Facebook. From Chapter 4, we dropped the Closing Case on Bribery and Corruption at Siemens. From Chapter 4, we dropped the Closing Case on Bribery and Corruption at Siemens. From Chapter 5, we dropped the Closing Case on Hyundai and the Global Auto Industry. From Chapter 6, we dropped the Opening Case on Risks in Russia's Political and Legal Systems. From Chapter 9, we dropped the Closing Case on Financial Contagion and the Global Financial Crisis. From Chapter 17, we dropped the Opening Case on International Human Resource Management at Johnson & Johnson.

To replace the above dropped items and maintain currency, we have created new or greatly revised opening and closing cases in the fifth edition of Cavusgil, Knight, and Riesenberger (CKR 5e) as follows:

- Chapter 1: A new Opening Case on Instagram: A Global Phenomenon
- Chapter 2: A heavily revised Opening Case on Spotify and the Rise of Born Global Firms
- Chapter 4: A new Closing Case on the recent Scandal at Volkswagen
- Chapter 5: A new Closing Case on Unilever's Comparative and Competitive Advantages
- Chapter 6: A new Opening Case on *Odebrecht and Risks in Brazil's Political and Legal Systems*
- Chapter 7: A heavily revised Closing Case on Government Intervention at Airbus and Boeing
- Chapter 8: A heavily revised Closing Case on Tata Group: India's Top Global Challenger
- Chapter 9: A new Closing Case on Tesco, the European Debt Crisis, and Brexit
- Chapter 15: A heavily revised Closing Case on Subway and the Challenges of Franchising in China
- Chapter 16: A heavily revised Opening Case on Michael Kors: The Global Affordable Luxury Market
- Chapter 17: A new Opening Case on International Human Resource Management at Google

In addition, for our feature *You Can Do It: Recent Grad in IB*, we have added new biographies of young graduates with careers in international business. In Chapter 1, we added *Mary Lyles*, who works in global sourcing for Starbucks; and in Chapter 15, we added *Juanita Velez*, who works in international social media at Delta Air Lines.

In various chapters, we also added several new exhibits and significant new material on such contemporary topics as preparing for international travel, the rise of digital technologies, the trade and GDP growth relationship, the meaning of colors worldwide, workplace harassment, Brexit and the UK, populism, national governance, blockchain and cryptocurrencies, carbon taxes, cross-national project management, the Global Connectedness Index, global sourcing for smartphones, reshoring and nearshoring, the best global companies to work for, and women in international business, among numerous others.

### **Solving Teaching and Learning Challenges**

Today's students—often called Generation Z, Post Millennials, or the iGen—have grown up in a constantly connected world. To address the unique wants, needs and learning style of Generation Z students, we have designed CKR 5e to emphasize the following features:

- *Visual learning*. CKR 5e emphasizes interactive media and videos as well as exhibits, maps, and other visual learning aids. The MyLab Management provides access to a wide variety of additional visual resources.
- Relevant knowledge and job-related skills. CKR 5e includes more relevant examples and activities, concise foundational course content, Intangible Soft Skills, and Tangible Process Skills that prepare Generation Z students for the work world.

- Contemporary issues that matter to Generation Z. CKR 5e emphasizes the new international business environment, in-depth coverage of contemporary international business topics such as emerging markets, developing economies, growth of the service sector, risks in international business, digital technologies, women in international business, and other important trends.
- Meaningful content. CKR 5e provides substantial content on ethics, corporate social responsibility, and sustainability in international business.
- **Digital platform.** Generation Z learners prefer content that they can read or access digitally at a time and place of their choosing. Digital learning enhances engagement, self-pacing, and the ability to customize content to individual needs. Digital platforms help ensure timely, up-to-date content and the ability to collaborate with peers. In these and other ways, CKR 5e provides such digital options. To improve Generation Z students results, we recommend pairing the text content with MyLab Management, which is the teaching and learning platform that empowers you to reach every student. By combining trusted author content with digital tools and a flexible platform, MyLab personalizes the learning experience and will help your students learn and retain key course concepts while developing skills that future employers are seeking in their candidates. From Mini Sims to Personal Inventory Assessments, MyLab Management helps you teach your course, your way. Learn more at www.pearson.com/mylab/management.

Some of the main features of the textbook and MyLab are as follows:

HIGHLY ACCESSIBLE WRITING AND EXPLANATIONS THAT ENGAGE STUDENTS. Opening and closing cases appeal to students, featuring firms and subjects such as Apple, IKEA, Harley-Davidson, H&M, Instagram, born global firms, social media in China, and the global movie industry. The content stimulates student desire to learn more about international business.

#### Constantly fluctuating exchange rates require international managers to keep in mind three facts:

- . The prices the firm charges can be quoted in the firm's currency or in the currency of each foreign customer.
- · Because several months can pass between placement and delivery of an order, fluctuations in the exchange rate during that time can cost or earn the firm money.
- The firm and its customers can use the exchange rate as it stands on the date of each transaction, or they can agree to use a specific exchange rate.

MORE EXERCISES AND ACTIVITIES THAT ENABLE STUDENTS TO ACQUIRE CRITICAL THINKING AND PROBLEM-SOLVING SKILLS. CKR 5e contains 174 exhibits (about three times more than leading competitors). Students like exhibits because they help clarify complex material and facilitate reading the chapters.

**TANGIBLE PROCESS TOOLS.** They are designed to simulate real-world decision making that will help increase effectiveness in the workplace.

GROUP PROJECT ON INTERNATIONAL CORPORATE SOCIAL **RESPONSIBILITY.** CKR 5e contains a comprehensive activity in which students debate corporate social responsibility (CSR) in international business. In this extended exercise, located in the *Instructor's Manual*, students debate the merits and consequences of CSR as executives, consumers, or activists.

YOU CAN DO IT-RECENT GRAD IN IB BIOGRAPHIES. CKR 5e offers eleven biographies of actual university graduates who have embarked on fascinating careers in international business. These biographies include comments concerning the specific intangible soft skills that have helped them be successful in work.

# You Can Do It

#### RECENT GRAD IN IB

#### TERRANCE ROGERS

Terrance's Majors: Finance and international busine national perspective, self-awareness, career growth and learning about foreign markets

Internships during college: Deutsche Bank

- Internships during college: Deutsche Bank
  Jobs held since graduating:

  Business analyst at Deutsche Bank, New York

  Management associate at Deutsche Bank, New York

  Executive management ortation at Deutsche Bank, New York

  Executive management associate at Deutsche Bank, London and New York

**LEARNING CATALYTICS™**. With this tool, you'll hear from every student when it matters most. You pose a variety of questions that help students recall ideas, apply concepts, and develop critical-thinking skills. Your students respond using their own smartphones, tablets, or laptops.





**NEW MINI SIMS.** Mini Sims put students in professional roles and give them the opportunity to apply course concepts and develop decision-making skills through real-world business challenges.

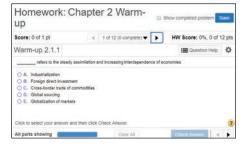
The simulations use each student's decisions to create various scenario paths that help them understand the impact their decisions can have on an organization.

These branching Mini Sims strengthen a student's ability to think critically, help students understand the impact of their decisions, engage students in active learning, and provide students with immediate feedback on their decisions.

Each decision point remediates to the Learning Objective in the eText.

**CHAPTER WARM-UP.** These questions help you hold your students accountable for learning key concepts in each chapter before coming to class.





**VIDEOS EXERCISES.** Engaging Videos explore a variety of business topics related to the theory students are learning in class.

Exercise Quizzes assess students' comprehension of the concepts in each video.

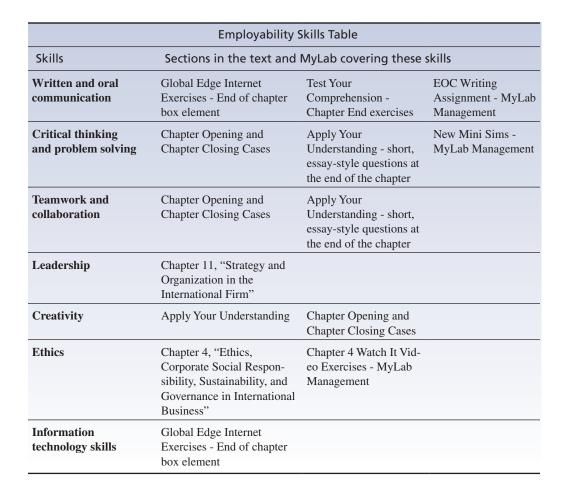
#### **Developing Employability Skills**

The Association to Advance Collegiate Schools of Business (AACSB) International increasingly advocates a more skills-oriented, practical approach in business books, which this text provides, rather than a theory-based approach.

For students to succeed in a rapidly changing job market, they should be aware of their career options and how to develop various critical skills. In this book and MyLab Management, we focus on developing these skills.

The CKR 5e Career Preparation Kit<sup>TM</sup> incorporates CKR Tangible Process Tools<sup>TM</sup> as well as CKR Intangible Soft Skills<sup>TM</sup>, which constitute guidelines of the Association to Advance Collegiate Schools of Business (AACSB). CKR Intangible Soft Skills focus on the skills employers have identified as needed for employability and success in the marketplace today. The CKR Tangible Process Tools will help students increase their effectiveness in the workplace.

The Employability Skills Table below provides students with a guide to features that support the development of skills employers are looking for in today's business graduates, helping students to see from the start of class the relevance of the course to their career goals. This table identifies which features and end-of-chapter materials will help students to develop these skills.



**OPENING CASE.** Each chapter begins with a brief case study that illustrates chapter topics and asks key questions about real-world companies and situations covered in the case.



**CLOSING CASE.** Every chapter closes with an extensive case study that addresses the learning objectives highlighted in the chapter. The cases help students build managerial skills by applying chapter material to a situation faced by real-world managers. Questions accompany the case for assignment as homework. Class discussion helps students sharpen their analytical and decision-making skills.

#### CLOSING CASE Internationalization at Harley-Davidson

Considered an American icon by many, Harley-Davidson (Harley) is a U.S. motorcycle manufacturer founded in 1903 and offers 32 models through a network of about 1,500 dealers. Its global motorcycle revenue was about 35 billion in 2017, continuing a three-year downward trend. Total sales have been relatively flat since 2012, with U.S. sales declaining and international sales rising. Harley earns about two-thirds of its total sales in the United States, where it also manufactures almost all list bisites to support its brand image and quality control. The firm is embarked on a course to build the next generation of Harley referrational sales sare crucial to the firm's survival and growth. The CEO recently annunced a bold goal to grow international sales to 50 percent of annual volume by 2027.
Harley is the only U.S.-based global motorcycle manufacturer and makes four distinctive groups of models:

- Standard: Practical bikes used for low-cost commuting
   Performance: Sleek, sport-style racing bikes built for sp
- Touring: Long-distance, large-capacity, comfort bikes that typically include cruise control, stereos, and luggage racks

#### International Expansion

Harley management resolved that future success would come from expansion into foreign markets. The firm had established a distribution network and local subsidiary in Japan, and by 2016, it was selling more than 16,000 motorcycles annually. It continued to sell heavyweight motorcycles in Japan at a price of more than \$20,000. substantially more than Honda's standard lightweight model. Har

ley's foreign saw a sustained growth.

Harley also made inroads in Europe, a vast marketplace and home to dozens of countries with diverse needs and tastes. Europe, performance bikes are the top seller by far, accounting for

**TEST YOUR COMPREHENSION.** A list of 6 to 12 short questions assesses student learning of chapter learning objectives and other chapter concepts.

APPLY YOUR UNDERSTANDING. An additional collection of three short, essay-style questions aims to have students apply chapter material to real-world international business practice.



Access globalEDGE<sup>TM</sup> at www.globalEDGE.msu.edu

AACSB and CKR Intangible Soft Skills to improve employability and success in the workplace: Information Technology, Application of Knowledge, Diverse and Multicultural Work Environments, Written and Oral Communication, Analytical Thinking and Reflective Thinking

#### Knowledge Portal

globalEDGETM is a leading knowledge portal for professionals in international business. It is a gateway to specialized knowledge on countries, international business transactions, culture, and of Controles, international unless trained training states, and firm practice. globalEDGE™ was developed at Michigan State University under the direction of Professor S. Tamer Cavusgil. Consult the globalEDGE™ portal to complete the Internet exercises at the end of each chapter.

1-20. You can gain valuable insights into international business by examining how countries compare to each other. Various research groups and international agencies systematically examine economic, political, and other features of nations. Visit globalEDGE™ Tools and Data, scroll down, and click Interactive Rankings. Select Countries. You will and click interactive failkings. Select Countries. You will find dozens of criteria ranking countries based on GDP per capita; Education—literacy rate; People—population total; People—population density; Health—mortality rate; Energy-electricity production; Infrastructure-mobile cel Illular subscriptions; Infrastructure—roads, total network; Trade and Investment—foreign direct investment net in-flows; and many other factors. Choose the ranking criteria that interest you most, and then examine the following three countries: Germany, India, and South Africa. Based on your analysis, explain why they rank where they do. Do

their relative positions make sense to you? Does each country seem like a good place to do business? Why or why not? **Hint:** Evaluate countries on a per-capita basis by divid-

- ing each criterion by the country's population.

  1-21. In this chapter, we reviewed the four major risks that firms face in international business: cross-cultural risk, country risk, currency risk, and commercial risk, Identify one balEDGE™ and research the countries to uncover examples of each of the four types of risks. For example, China is characterized by various cultural differences and a national government that tends to intervene in business. Research by entering the country name in the search engine. Visit Global Insights and Market Potential Index. Illustrate each risk with examples.
- 1-22. You have recently been hired by a smaller firm that is beginning to expand internationally. When first starting out, most firms choose exporting as their main foreign market entry strategy. However, no one in your firm knows how to conduct exporting. Therefore, your boss has given you an assignment: Prepare a presentation for your coworkers on how to engage in exporting. Using globalEDGE™, find and review Guide to Exporting, which you can use to cr your presentation

GLOBALEDGE INTERNET EXERCISES. GlobalEDGETM (https:// globaledge.msu.edu) was developed by CKR author S. Tamer Cavusgil and is the leading knowledge portal for professionals in international business. It provides a gateway to specialized knowledge on countries, crossborder ventures, culture, and company practice. Each chapter provides several globalEDGE exercises as the basis for student assignments and projects.

**CKR TANGIBLE PROCESS TOOLS™.** These practical exercises familiarize students with key managerial challenges and decision making that professionals typically encounter in international business. By completing CKR Tangible Process Tools<sup>TM</sup> exercises, students can acquire realworld skills that will help them perform better in their careers.

#### **CKR Tangible Process Tools™**

#### What is a CKR Tangible Process Tool Exercise?

CKR Tangible Process Tools consist of practical exercises and work processes designed to familiarize you with key managerial challenges and decisions that professionals typically encounter in international business. Completing CKR Tangible Process Tool exercises in this text enables you to acquire practical, real-world work processes that will improve employability and success in the workplace. Each exercise presents a managerial challenge in a real-world scenario, the skills you will acquire in solving the exercise, and a methodology and the resources to use in solving it. The second half of the exercise is provided at the Pearson MyLab Management website (www.pearson.com/mylab/management).

AACSB TAGGING. This book and MyLab Management support AACSB international accreditation. In every chapter, after each section of questions, specific AACSB tagging is provided to help instructors identify which AACSB Intangible Soft Skills that activity supports. AACSB tagging is also part of all questions in the Test Item File that accompanies the book.

### **Instructor Teaching Resources**

At the Instructor Resource Center, www.pearsonhighered.com, instructors can easily register to gain access to a variety of instructor resources available with this text in downloadable format. If assistance is needed, our dedicated technical support team is ready to help with the media supplements that accompany this text. Visit https://support.pearson.com/getsupport for answers to frequently asked questions and toll-free user support phone numbers.

Supplements available to instructors at www.pearsonhighered.com/irc	Features of the Supplement
Instructor's Resource Manual authored by Marta Szabo White, S. Tamer Cavusgil, Gary Knight, and John Riesenberger	<ul> <li>Chapter-by-chapter summaries</li> <li>Examples and activities not in the main book</li> <li>Teaching outlines</li> <li>Teaching tips, including openers to help launch lectures</li> <li>Solutions to all questions and problems in the book</li> </ul>
Test Bank authored by John Capela	<ol> <li>1,600 multiple-choice, true/false, short-answer, and essay questions with the following annotations:</li> <li>Difficulty level (1 for straight recall, 2 for some analysis, 3 for complex analysis)</li> <li>Type (multiple-choice, true/false, short-answer, essay)</li> <li>Learning objective</li> <li>AACSB learning standard (Written and Oral Communication, Ethical Understanding and Reasoning, Analytical Thinking, Information Technology, Interpersonal Relations and Teamwork, Diverse and Multicultural Work Environments, Reflective Thinking, and/or Application of Knowledge)</li> </ol>
TestGen® Computerized Test Bank	TestGen allows instructors to:  Customize, save, and generate classroom tests  Edit, add, or delete questions from the Test Item Files  Analyze test results  Organize a database of tests and student results
PowerPoints Presentations authored by S. Tamer Cavusgil, Gary Knight, and John Riesenberger	<ul> <li>Cover all concepts, explanations, and major examples in each chapter</li> <li>Include all exhibits in the textbook</li> <li>Meet accessibility standards for students with disabilities. Features include, but not limited to:         <ul> <li>Keyboard and Screen Reader access</li> <li>Alternative text for images</li> <li>High color contrast between background and foreground colors</li> </ul> </li> </ul>
Image Library	A collection of photos and other images for use in enhancing PowerPoints and other teaching materials related to CKR 5e

# **Acknowledgments**

#### **Our Reviewers**

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Hamid Ali, Chicago State University
Allen Amason, University of Georgia
Gary Anders, Arizona State University
Robert Armstrong, University of North
Alabama

Mathias Arrfelt, Arizona State University Bulent Aybar, Southern New Hampshire University

Nizamettin Aydin, Suffolk University Peter Banfe, Ohio Northern University Eric Baumgardner, Xavier University Mack Bean, Franklin Pierce University Lawrence Beer, Arizona State University Enoch Beraho, South Carolina State University

David Berg, University of Wisconsin–Milwaukee

Jean Boddewyn, Baruch College, City University of New York

Henry Bohleke, Owens Community College Santanu Borah, University of Northern Alabama

Darrell Brown, Indiana University, Purdue University, Indianapolis

Linda Brown, Scottsdale Community College
Diana Bullen, Mesa Community College
Nancy Bush, Wingate University
Kirt Butler, Michigan State University
Michael Campo, Regis University
Tom Cary, City University, Seattle
Erin Cavusgil, University of Michigan–Flint
Kalyan Chakravarty, California State
University, Northridge

Aruna Chandra, Indiana State University Kent Cofoid, Seminole State College Tim Curran, University of South Florida Madeline Calabrase Damker, California S

Madeline Calabrese Damkar, California State University–East Bay

Donna Davisson, Cleveland State University Seyda Deligonul, St. John Fisher College Peter Dowling, Latrobe University, Australia Juan España, National University Bradley Farnsworth, University of Michigan, Ann Arbor

Aysun Ficici, Southern New Hampshire University

John Finley, Columbus State University Ian Gladding, Lewis University Jorge Gonzalez, University of Texas-Pan American

Tom Head, Roosevelt University Bruce Heiman, San Francisco State University

David Hrovat, Northern Kentucky University Douglas Johansen, Jacksonville University Paul Jones, Regis University

Ali Kara, Pennsylvania State University— University Park

Bruce Keillor, Youngstown University
Daekwan Kim, Florida State University
Ki Hee Kim, William Patterson University
Konghee Kim, St. Cloud State University
Ahmet Kirca, Michigan State University
Leonard Kloft, Wright State University
Peter Knight, Santa Clara University
Anthony Koh, University of Toledo
Stephanie Kontrim-Baumann, Missouri
Baptist University

Tatiana Kostova, University of South Carolina
Chuck Kwok, University of South Carolina
Ann Langlois, Palm Beach Atlantic University
Romas Laskauskas, Stevenson University
Yikuan Lee, San Francisco State University
Bijou Lester, Drexel University
Phil Lewis, Eastern Michigan University
Charles Main, Northern Arizona University
Minghua Li, Franklin Pierce University
Peter Liesch, University of Queensland
Bob McNeal, Alabama State University
Montgomery

Bulent Menguc, Kadir Has University Janis Miller, Clemson University Barbara Moebius, Waukesha County Technical College

Bruce Money, Brigham Young University Bill Murray, University of San Francisco Paul Myer, University of Maine Matthew B. Myers, University of Tennessee Max Grunbaum Nagiel, Daytona State College

Kuei-Hsien Niu, Sacramento State University Bernard O'Rourke, Caldwell College Braimoh Oseghale, Fairleigh Dickinson University

Jeffrey W. Overby, Belmont University Susan Peterson, Scottsdale Community College

Iordanis Petsas, University of Scranton Zahir Quraeshi, Western Michigan University Roberto Ragozzino, University of Central Florida

Brandon Randolph-Seng, Texas Tech University

Michelle Reina, Wisconsin Lutheran College Elizabeth Rose, University of Otago Michael Rubach, University of Central Arkansas

Carol Sanchez, Grand Valley State University Hakan Saraoglu, Bryant University Jeff Sarbaum, University of North Carolina at Greensboro

Amit Sen, Xavier University Deepak Sethi, Old Dominion University Karen Sneary, Northwestern Oklahoma State

Kurt Stanberry, University of Houston– Downtown

University

John Stanbury, George Mason University William Streeter, Olin Business School, Washington University in Saint Louis Philip Sussan, University of Central Florida Charles Ray Taylor, Villanova University Deanna Teel, Houston Community College Gladys Torres-Baumgarten, Ramapo College of New Jersey

Kimberly Townsend, Syracuse University Thuhang Tran, Middle Tennessee State University

Joseph Trendowski, Old Dominion University Sameer Vaidya, Texas Wesleyan University Chandu Valluki, St. Mary's University of Minnesota

Cheryl Van Deusen, University of North Florida

Linn Van Dyne, Michigan State University
Davina Vora, State University
of New York–New Paltz
William Walker, University of Houston
Paula Weber, St. Cloud State University
Mindy West, Arizona State University
Sidney Wheeler, Embry-Riddle Aeronautical
University

Marta Szabo White, Georgia State University
Richard Wilson, Hofstra University
Yim-Yu Wong, San Francisco State University
Jennifer Woolley, Santa Clara University
Alan Wright, Troy University
Alex Xu, University of Michigan–Flint
Attila Yaprak, Wayne State University
Betty Yobaccio, Bryant University
Pierre Yourougou, Whitman School of Management, Syracuse University

Bashar Zakaria, California State University— Sacramento Anatoly Zhuplev, Loyola Marymount

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Choton Basu, University

of Wisconsin-Whitewater

Eric Baumgardner, Xavier University

Mark Bean, Franklin Pierce College Enoch Beraho, South Carolina State

University

Paula Bobrowski, Auburn University Teresa Brosnan, City University, Bellevue

Darrell Brown, Indiana University, Purdue

University-Indianapolis

Nichole Castater, Clark Atlanta University Aruna Chandra, Indiana State University

Mike C. H. (Chen-Ho) Chao, Baruch College,

City University of New York

David Chaplin, Waldorf College

Dong Chen, Loyola Marymount University Chen Oi Chin, Lawrence Technological

University

University

Patrick Chinon, Syracuse University

Farok J. Contractor, Rutgers University

Angelica Cortes, University of Texas-Pan Michael Deis, Clayton State University Les Dlabay, Lake Forest College Gary Donnelly, Casper College Gideon Falk, Purdue University-Calumet Marc Fetscherin, Rollins College Charles Fishel, San Jose State University Frank Flauto, Austin Community College Georgine K. Fogel, Salem International University Frank Franzak, Virginia Commonwealth University Debbie Gilliard, Metropolitan State College Robert Goddard, Appalachian State University Andy Grein, Baruch College, City University of New York Andrew C. Gross, Cleveland State University David Grossman, Goucher College Seid Hassan, Murray State University Wei He, Indiana State University Xiaohong He, Quinnipiac University Christina Heiss, University of Missouri-Kansas City Pol Herrmann, Iowa State University Guy Holburn, University of Western Ontario Anisul Islam, University of Houston-Downtown Basil Janavaras, Minnesota State University Raj Javalgi, Cleveland State University Ruihua Jiang, Oakland University Yikuan Jiang, California State University-East Bay James Kennelly, Skidmore College Ken Kim, University of Toledo Leonard Kloft, Wright State University Anthony C. Koh, The University of Toledo Ann Langlois, Palm Beach Atlantic

Francis
Romas A. Laskauskas, Villa Julie College
Shaomin Li, Old Dominion University
Ted London, University of Michigan
Peter Magnusson, University of Alabama
Charles Mambula, Suffolk University
David McArthur, Utah Valley State College
Ofer Meilich, Bradley University

Michael La Rocco, University of Saint

University

Lauryn Migenes, University of Central Mortada Mohamed, Austin Community College Robert T. Moran, Thunderbird Carolyn Mueller, Stetson University Kelly J. Murphrey, Texas A&M University Lilach Nachum, Baruch College, CUNY William Newburry, Florida International University Stanley Nollen, Georgetown University Augustine Nwabuzor, Florida A&M University Bernard O'Rourke, Caldwell College David Paul, California State University-East Bay Christine Cope Pence, University of California Riverside Heather Pendarvis-McCord, Bradley University Kathleen Rehbein, Marquette University Liesl Riddle, George Washington University John Rushing, Barry University Mary Saladino, Montclair State University Carol Sanchez, Grand Valley State University Camille Schuster, California State University-San Marcos Eugene Seeley, Utah Valley State College Deepak Sethi, Old Dominion University Mandep Singh, Western Illinois University Rajendra Sinhaa, Des Moines Area Community College John E. Spillan, Pennsylvania State University–DuBois Uday S. Tate, Marshall University Janell Townsend, Oakland University Sameer Vaidya, Texas Wesleyan University Robert Ware, Savannah State University Marta Szabo White, Georgia State University Steve Williamson, University of North Florida Lynn Wilson, Saint Leo University Attila Yaprak, Wayne State University Rama Yelkur, University

of Wisconsin-Eau Claire

University

Minyuan Zhao, University of Michigan

Christopher Ziemnowicz, Concord

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Bryan Jean, National Cheng-Chi University

Raj Javalgi, Cleveland State University Destan Kandemir, Bilkent University Ilke Kardes, Georgia State University George Kaufman, The Upjohn Company Ihsen Ketata, Georgia State University Irem Kiyak, Michigan State University Tunga Kiyak, Michigan State University Yener Kandogan, University of Michigan-Flint Tuba Koc, Georgia State University Phillip Kotler, Northwestern University David Kuhlmeier, Valdosta State University John Lavaca, Pearson Prentice Hall Tiger Li, Florida International University Karen Loch, Georgia State University Mushtaq Luqmani, Western Michigan University Robert McCarthy, The Upjohn Company Myron Miller, Michigan State University (ret.) Vincent Mongello, The Upjohn Company Robert T. Moran, Thunderbird Graduate School of Management G.M. Naidu, University of Wisconsin-Whitewater (ret.) John R. Nevin, University of Wisconsin Sushil Nifadkar, Georgia State University Gregory Osland, Butler University Erkan Ozkaya, California Polytechnic University-Pomona Aysegul Ozsomer, Koc University Ayse Ozturk, Georgia State University Morys Perry, University of Michigan-Flint Penny Prime, Georgia State University Hussain Rammal, University of South Australia Vivas Reyes, Georgia State University Alex Rialp, Universidad Autonoma de Barcelona, Spain Tony Roath, University of Bath Carol Sanchez, Grand Valley State University Hakan Saraoglu, Bryant University Michael Savitt, The Upjohn Company Peter Seaver, The Upjohn Company Oktay Sekercisoy, Binghamton University Linda Hui Shi, University of Victoria Rudolf R. Sinkovics, The University of Manchester

Carl Arthur Solberg, Norwegian School of

Elif Sonmez-Persinger, Eastern Michigan

Management, Norway

University

Douglas Squires, The Upjohn Company of Canada

Barbara Stoettinger, Wirtschaftuniversität, Wien, Austria

Detmar Straub, Georgia State University Berk Talay, University of Massachusetts— Lowell

Cherian Thachenkary, Georgia State University

David Tse, University of Hong Kong Mithat Uner, Gazi University Nukhet Vardar, Yeditepe University Marta Szabo White, Georgia State University Joachim Wolf, University of Kiel
Peter Wright, University of Melbourne
Fang Wu, University of Texas–Dallas
Shichun (Alex) Xu, University
of Michigan–Flint
Goksel Yalcinkaya, University
of New Hampshire
Attila Yaprak, Wayne State University
Ugur Yavas, East Tennessee State University
Sengun Yeniyurt, Rutgers University
Poh-Lin Yeoh, Bentley College
Eden Yin, University of Cambridge
Chun Zhang, University of Vermont
Shaoming Zou, University of Missouri

#### **Contributors**

Mamoun Benmamoun, St. Louis University Susan Leshnower, Midland College Marta Szabo White, Georgia State University

#### **Our Pearson Team**

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### **About the Authors**

### S. Tamer Cavusgil

Georgia State University, Fuller E. Callaway Professorial Chair Executive Director, Center for International Business Education and Research (CIBER), J. Mack Robinson College of Business

Professor Tamer Cavusgil has been mentoring students, executives, and educators in international business for the past four decades. A native of Turkey, his professional work has taken him to numerous other emerging markets.

Tamer serves as Fuller E. Callaway Professorial Chair at Georgia State University's Robinson College of Business. He is also a visiting professor at Leeds University Business School, U.K. and at the University of South Australia. He is also a Trustee of Sabanci University in Istanbul.

Previously, Tamer served as Senior Fulbright Scholar to Australia and taught at Monash University. Tamer also served as a visiting professor at Manchester Business School and held the Gianni and Joan Montezemolo Visiting Chair at the University of Cambridge, United Kingdom, where he is also an Honorary Fellow of Sidney Sussex College. At Michigan State University, where he served for 21 years, he was the inaugural holder of the John Byington Chair in Global Marketing and founding director of CIBER.

Tamer is an elected fellow of the Academy of International Business (AIB), a distinction earned by a select group of intellectual leaders in international business. He also served as vice president of the AIB and on the Board of Directors of the American Marketing Association.

Tamer has authored several dozen books and some 200 refereed journal articles. His work is among the most cited contributions in international business. Various reviews have listed him as one of the most influential and prolific authors in international management. Google Scholar indicates more than 36,000 citations as of 2018 (h-index of 82) and lists him among the top five scholars in the world in international business, international marketing, emerging markets, and export marketing.

Tamer was awarded an honorary doctorate, *Doctor Honoris Causa*, by The University of Hasselt, Belgium, in May 2014 and an honorary doctorate from the University of Southern Denmark in October 2017. In 2018, Tamer was named an honorary professor by Atilim University in Ankara, Turkey.

Tamer was named International Trade Educator of the Year in 1996 by the National Association of Small Business International Trade Educators (NASBITE).

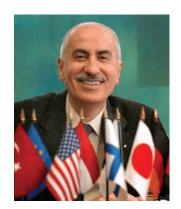
Tamer holds a bachelor of science degree in business and economics from the Middle East Technical University in Ankara, Turkey. He earned his MBA and PhD degrees in business from the University of Wisconsin.

### **Gary Knight**

Willamette University, Professor of Global Management and Helen Simpson Jackson Chair in International Management

Professor Gary Knight has been teaching international business for 25 years. A native of the United States, he has lived and worked in many countries around the world.

Gary has been Helen Simpson Jackson Chair in International Management at Willamette University since 2012. He was a professor at Florida State University for 15 years, where he directed the school's International Business Program. He also has been a visiting professor at the University of Southern Denmark and Nihon University in Japan.





Gary has been an invited speaker at institutions worldwide and developed study abroad programs in Asia, Europe, and Latin America. He has won several awards, including the Jerry Hudson Award for Excellence in Teaching, Willamette University, and Best Teacher in the MBA Program, Florida State University.

Gary has coauthored six books and more than 100 refereed articles in academic journals and conference proceedings. His research emphasizes international business strategy, international services, emerging markets, and internationalization of small and medium-sized firms.

Gary won the Hans Thorelli Best Paper Award for his article "Entrepreneurship and Strategy: The SME Under Globalization." Along with S. Tamer Cavusgil, he won the 2014 Decade Award at the *Journal of International Business Studies* for their article on born global firms.

Gary is ranked in the top 5 percent of scholars who have published in the *Journal of International Business Studies* since 1995, based on number of articles published. He is ranked among the top five scholars in the United States and top 15 worldwide in international business research impact based on Google Scholar citation data. He is on the editorial review boards of several international journals. He has provided expert testimony on global commerce and small business to the U.S. House of Representatives.

Gary is chair of the Academy of International Business, Western United States Chapter. Prior to joining academia, he was export manager of a medium-sized enterprise, directing the firm's operations in Canada, Europe, Japan, and Mexico and supervising some 50 distributors. He enjoyed a brief career in banking and as a teacher in Japan.

Gary earned his MBA at the University of Washington and PhD at Michigan State University, both in international business. Earlier degrees were in finance and modern languages. He also attended the University of Paris in France and Sophia University in Japan and is fluent in French and Japanese.



### John R. Riesenberger

President, Consilium Partners

Thunderbird School of Global Management, Clinical Professor of Executive Development, Corporate Learning Group (retired)

Professor Riesenberger's teaching activities centered on leadership and global project management at the Thunderbird School of Global Management, Corporate Learning Group. His passion is to help students and young professionals develop the managerial skills frequently required of new graduates entering careers in international business.

John is an accomplished author, consultant, and international executive with senior executive positions in major pharmaceutical firms, biotechnology firms, and pharmaceutical agencies. John's international business career spans more than three decades in the global pharmaceutical industry. He has conducted business transactions in 22 countries.

Currently, he also serves as the president of Consilium Partners, Inc., a pharmaceutical consulting firm with clients in pharmaceutical, biotechnology, and pharmaceutical agency firms.

He worked for 30 years with Pharmacia & Upjohn and The Upjohn Company as a senior international executive. His experience covered a diverse range of divisional, geographic, and functional accountabilities. His most recent position was as vice president of Global Business Management. He also served as corporate vice president and chief commercialization officer for a biotechnology firm and as the executive vice president of a pharmaceutical science agency.

John serves as a member of the board of directors of the Ontario Institute for Cancer Research. He was a member of the Global Advisory Board of the American Marketing Association. He served as an executive in residence at the Michigan State University Center for International Business Education and Research. He served on the editorial review board of the *Journal of International Marketing*. He served as chairman of the Industry Advisory Board's Value of Marketing Program, SEI Center for the Advanced Studies in Management at the Wharton School of

the University of Pennsylvania. He is the former chairman of the Pharmaceutical Manufacturing Association Marketing Practices Committee. Professor Riesenberger is the coauthor, with Robert T. Moran, of *The Global Challenge: Building the New Worldwide Enterprise* (McGraw-Hill, London).

John holds a bachelor of science degree in economics-business and an MBA in management from Hofstra University. He attended the Harvard Business School's International Senior Management Program.

## **Part 1** | Foundation Concepts



# Introduction: What Is International Business?

**Learning Objectives** *After studying this chapter, you should be able to:* 

- **1.1** Describe the key concepts in international business.
- 1.2 Understand how international business differs from domestic business.
- **1.3** Identify major participants in international business.
- **1.4** Describe why firms internationalize.

- **1.5** Appreciate why you should study international business.
- 1.6 Learn the CKR Intangible Soft Skills™ and the CKR Tangible Process Tools™ to improve your employability and success in the workplace.

### Instagram: A Global Phenomenon

lobalization refers to ongoing economic integration and growing interdependency of countries worldwide. It implies rising economic, political, and personal interconnectedness among countries, companies, and consumers. Widespread adoption of smartphone apps like Facebook and Instagram exemplifies globalization and converging lifestyles around the world. The number of smartphone users worldwide has reached 3 billion, about 40 percent of world population. Smartphone ownership is common in the advanced economies—especially in Australia, Europe, and North America—where 65 percent of residents own such devices. The phones are increasingly popular in emerging markets—countries such as Chile, China, Poland, and Russia-where the ownership rate is more than 50 percent. Developing economies—countries such as Bangladesh, Nigeria, Pakistan, and Ukraine—have low smartphone penetration rates, mainly due to lower incomes and underdeveloped infrastructure.

Founded in 2010, Instagram is a photo- and videosharing network that smartphone owners use to share photos and short videos with others. The site has more than 700 million active monthly users, the majority of whom are women, and most are under age 35. Instagram was acquired by Facebook in 2012 for about US\$1 billion.

Available in 33 languages, Instagram has a dual identity—a for-profit business and a vehicle for our personal lives. Instagram is the sixth most popular social media platform worldwide, after Facebook, Twitter, LinkedIn, YouTube, and Google+. Instagram emphasizes sharing photographs and enjoys a very enthusiastic following from visually oriented social media users. The app is popular worldwide, especially in countries like Russia,



Source: Dmytro Kosmenko/123rf

Brazil, Turkey, the United Kingdom, Poland, and the United States.

Instagram is a truly global platform—more than 80 percent of users are outside the United States, where the app is based. Management has used foreign direct investment to establish offices around the world. The most photographed countries among Instagram users are Italy, Japan, Indonesia, Kuwait, Thailand, and France. Tourist destinations such as Rome, Kyoto, Dubai, Paris, and the Grand Canyon are popular subjects. Pizza is the most Instagrammed food, followed by sushi.

The Instagram platform allows people to take and share high-quality photographs using low-resolution phones, which appeals to users in less-developed economies. Users in such countries often cannot afford sophisticated phones or access fast cellular networks that allow conveniently downloading the Instagram app. Many lack enough phone storage to easily download the

app. To get around these problems, Instagram launched an expanded web version that allows users to skip the app's wait time, data costs, and storage needs while still providing basic functionality.

Retailers and other companies leverage Instagram to market their products and services at low cost. Instagram first launched advertising, along with its photo feed, to subscribers in Australia, Canada, and the United Kingdom in 2014. Most of the world's top brands—for example, Apple, BMW, and Sony—have established Instagram pages, and many actively share photos or videos every week. Today, Instagram earns more than \$5 billion in annual advertising revenue worldwide.

German sportswear company Puma contracts with Instagrammers who have many followers to capture photos that showcase the firm's products. The Danish brewing company Carlsberg launched a marketing strategy called "Happy Hour" that offers half-priced beers in

exchange for Instagram posts. In Japan, Instagram's most popular influencer is a dog, Marutaro, who promotes pet food, real estate, and other ventures through the app. Sports teams use Instagram to promote themselves in Brazil. The Instagram phenomenon illustrates how converging lifestyles, communications technology, and imaginative entrepreneurship are facilitating the emergence of global enterprises.

AACSB and CKR Intangible Soft Skills to improve employability and success in the workplace: Written and Oral Communication, Reflective Thinking and Application of Knowledge

#### Questions

- **1-1.** What advantages does Instagram obtain from doing business in international markets?
- **1-2.** What attributes of Instagram have allowed it to gain rapid acceptance in countries around the world?
- **1-3.** How do companies use Instagram to market their products and services?

SOURCES: B. Ahmadinejad and H. Asli, "E-business through Social Media: A Quantitative Survey (Case Study: Instagram)," International Journal of Management, Accounting and Economics, 4, No. 1 (2017), www.ijmae.com; S. Aslam, "Instagram by the Numbers: Stats, Demographics & Fun Facts," Omnicore, August 10, 2017, www.omnicoreagency.com; J. Constine, "Instagram Launches Mobile Web Sharing to Pursue Global Growth," Techcrunch, May 8, 2017, https://techcrunch.com; E. Hamburger, "Instagram Shoots for Global Expansion with Big Android Update," The Verge, March 11, 2014, www.theverge.com; E. Hancock, "The 23 Most Instagrammed Countries of All Time," Business Insider, December 1, 2016; J. Hempel and A. Nyantakyi, "Instagram Is Ready to Take Its Shot," Fortune International (Europe), July 21, 2014, pp. 72–77; S. Joseph, "Carlsberg Offers Drinkers Half-Priced Beers in Exchange for Instagram Posts," Marketing Week, March 17, 2014, www.marketingweek.com; Newzoo, "Top 50 Countries by Smartphone Users and Penetration," April 2017, http://newzoo.com; M. Swant, "This Instagram Timeline Shows the App's Rapid Growth to 600 Million," Adweek, December 15, 2016, www.adweek.com.

#### International business

Performance of trade and investment activities by firms across national borders.

As revealed in the opening case, international business touches our daily experiences. **International business** refers to firms' performance of trade and investment activities across national borders. Because it emphasizes crossing national boundaries, we also refer to international business as *cross-border business*. Firms organize, source, manufacture, market, and conduct other value-adding activities on an international scale. They seek foreign customers and engage in collaborative relationships with foreign business partners. Although international business is performed mainly by individual firms, governments and international agencies also conduct international business activities. Firms and nations exchange many

#### **CKR Career Preparation Kit™**

In this textbook, *International Business: The New Realities*, by Cavusgil, Knight, and Riesenberger ("CKR"), we will present guidance on how best to prepare for a career in international business, the CKR CAREER PREPARATION KIT<sup>TM</sup>.

#### The Unmet Need

Numerous surveys of employers, educators, and students suggest that today's graduates are not adequately prepared for the job market. Students need to acquire intangible soft skills and tangible process tools to improve their employability and succeed in the workplace.

#### The Solution

*International Business: The New Realities CKR CAREER PREPARATION KIT* has been specifically designed to integrate and advance your learning of intangible soft skills and tangible process tools.

#### **CKR Intangible Soft Skills™**

Surveys and the findings of the Association to Advance Collegiate Schools of Business (AACSB) identify the following Intangible Soft Skills as necessary for success in today's workplace:

- Written and oral communication
- Ethical understanding and reasoning
- Information technology
- Analytical thinking
- Diverse and multicultural work environments
- Reflective thinking
- Application of knowledge
- Interpersonal relations and teamwork

Each chapter of CKR has been specifically designed to integrate and advance your learning of these intangible soft skills. End-of-chapter exercises—Test Your Comprehension, Apply Your Understanding, and globalEDGE Internet Exercises—help you develop these critical skills.

#### **CKR Tangible Process Tools**™

Understanding and applying these tools will help you increase your effectiveness in the workplace. "Tangible Process Tools" appear at the end of selected chapters and consist of process tools that will enable you to address real-world challenges often encountered by managers in the workplace. Some of the tools consist of helpful checklists. Others will present a real-world management scenario, methodology, and the resources to solve it. Please visit the Pearson MyLab Management at www.pearson.com/mylab/management to access the "CKR: Travel Abroad Preparation Checklist™," which will assist you in gathering necessary documents, as well as tools and aids for health care, telecommunications, funds, customs, and other requirements for visiting different countries.

For a more detailed treatment of this topic, visit the Pearson MyLab Management website (www.pearson.com/mylab/management).

physical and intellectual assets, including products, services, capital, technology, know-how, and labor. In this book, we are mainly concerned with the international business activities of the individual firm.

International business is characterized by six major dimensions, as shown in Exhibit 1.1. Firms' growing international activities give rise to the globalization of markets. As they venture abroad, firms undertake international trade and investment activities. In doing so, they encounter various types of risks and challenges that occur to a lesser degree, or not at all, in the home country. Participants in international business are diverse and include firms, distribution channel intermediaries, and facilitators. When they expand abroad, firms employ such international market entry strategies as exporting and direct investment. We explore each of the six dimensions in detail in this chapter.

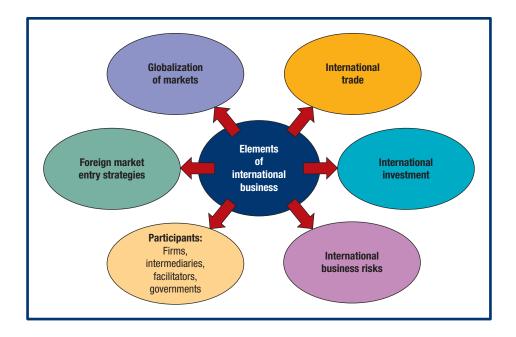
Although trading across borders has been around for centuries, contemporary international business has gained much momentum and complexity over the past few decades. Firms seek international market opportunities more than ever before. Like Instagram, international business affects the everyday lives of people worldwide. Daily activities such as shopping, listening to music, watching a movie, or surfing the Internet involve interactions and transactions that connect you to the global economy. Internationalization of business gives you access to products and services from around the world. It profoundly affects your quality of life and economic well-being.

Online platforms such as Amazon, Alibaba, Facebook, and Instagram are all expressions of ongoing economic integration and growing interdependency of countries worldwide, known as the **globalization of markets**. Globalization is a macro-trend of intense economic interconnectedness among the nations of the world. A parallel trend is the ongoing internationalization of countless firms and dramatic growth in the volume and variety of cross-border transactions in

### Globalization of markets

Ongoing economic integration and growing interdependency of countries worldwide.

#### Elements of International Business



#### Internationalization

The tendency of companies to deepen their international business activities systematically. goods, services, and capital flows. **Internationalization** refers to the tendency of companies to deepen their international business activities systematically. It has led to widespread diffusion of products, technology, and knowledge worldwide.

Globalization both compels and facilitates firms to expand abroad. Simultaneously, company internationalization has become easier than ever before. A few decades ago, international business was largely the domain of large, multinational firms. Recent developments have created a more level playing field that allows all types of firms to benefit from active participation in international business. In this book, you will read about the international activities of smaller firms and those of large, multinational enterprises. You will learn about companies in the services sector that are internationalizing in such industries as banking, engineering, insurance, and retailing.

## The globalization of markets is evident in several related trends.

- *Unprecedented growth of international trade*. In 1960, cross-border trade was modest—about \$300 billion per year. Today, it accounts for a substantial proportion of the world economy, with world exports alone amounting to some \$16 trillion annually—that is, \$16,000,000,000,000.000!
- Trade between nations, accompanied by substantial flows of capital, technology, data, and communications. In 2004, total cross-border bandwidth in digital data transfer and communications was practically zero. Today, total cross-border bandwidth flows now exceed 400,000 gigabits per second. Virtually every type of international transaction now includes a digital component.
- Development of highly sophisticated global financial systems and mechanisms that facilitate the cross-border flow of products, money, technology, and knowledge.
- Greater collaboration among nations through multilateral agencies such as the World Trade Organization (WTO, www.wto.org) and the International Monetary Fund (IMF, www.imf.org).

Source: McKinsey Global Institute, Digital Globalization: The New Era of Global Flows (2016), www.mckinsey.com; UNCTAD, World Investment Report, New York: United Nations (2017), www.unctad.org; World Trade Organization, World Trade Report, Geneva: World Trade Organization (2017), www.wto.org.

#### What Are the Key Concepts in International Business?

International trade describes the exchange of products (merchandise) and services (intangibles) across national borders. Exchange can occur through **exporting**, the sale of products or services to customers located abroad from a base in the home country or a third country. Exchange also can take the form of **importing or global sourcing**—the procurement of products or services from suppliers located abroad for consumption in the home country or a third country. While exporting represents the outbound flow of products and services, importing is an inbound activity. Both finished products and intermediate goods (for example, raw materials and components) can be imported and exported.

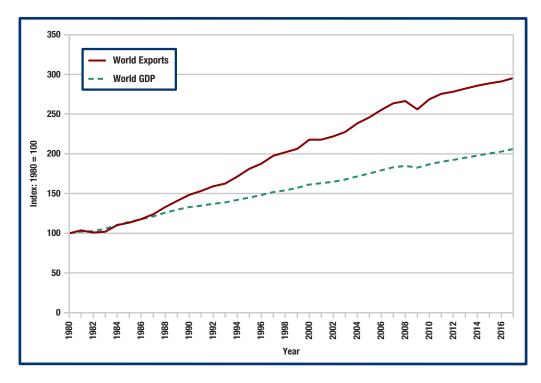
**International investment** refers to the transfer of assets to another country or the acquisition of assets in that country. Economists refer to such assets as *factors of production*; they include capital, technology, managerial talent, and manufacturing infrastructure. Trade implies that products and services cross national borders. By contrast, investment implies that the firm itself crosses borders to secure ownership of assets located abroad.

The two essential types of cross-border investment are international portfolio investment and foreign direct investment. **International portfolio investment** refers to the passive ownership of foreign securities such as stocks and bonds to gain financial returns. It does not entail active management or control over these assets. The foreign investor has a relatively short-term interest in the ownership of these assets.

Foreign direct investment (FDI) is an internationalization strategy in which the firm establishes a physical presence abroad through acquisition of productive assets such as land, plant, equipment, capital, and technology. It is a foreign-market entry strategy that gives investors partial or full ownership of a productive enterprise typically dedicated to manufacturing, marketing, or management activities. Investing such resources abroad is generally for the long term and involves extensive planning.

#### **The Nature of International Trade**

Overall, export growth has outpaced the growth of domestic production during the past few decades, illustrating the fast pace of globalization. Exhibit 1.2 contrasts the growth of total world exports with the growth of total world gross domestic product (GDP) since 1980. GDP is defined as the total value of products and services produced in a country in the course of a year. As reflected in the exhibit, world trade declined in 2009 due to the global recession, following a 27-year boom. Trade revived and returned to normal levels by 2012. Trade was a key factor in reducing the impact of the global recession.<sup>2</sup> What is remarkable is that throughout most of the



**1.1** Describe the key concepts in international business.

#### International trade

Exchange of products and services across national borders, typically through exporting and importing.

#### **Exporting**

Sale of products or services to customers located abroad from a base in the home country or a third country.

## Importing or global sourcing

Procurement of products or services from suppliers located abroad for consumption in the home country or a third country.

### International investment

The transfer of assets to another country or the acquisition of assets in that country.

### International portfolio investment

Passive ownership of foreign securities such as stocks and bonds to generate financial returns.

## Foreign direct investment (FDI)

An internationalization strategy in which the firm establishes a physical presence abroad through acquisition of productive assets such as capital, technology, labor, land, plant, and equipment.

#### **EXHIBIT 1.2**

## Comparing the Growth Rates of World GDP and World Exports

Source: Based on data from the International Monetary Fund, World Economic Outlook Database October 2017, www.imf.org.

past few decades, average annual growth rate in world exports has surpassed that of world GDP by a factor of almost two (5.3 versus 2.8 percent).

Three factors have been especially notable in explaining why trade growth has long outpaced GDP growth. First is the rise of emerging markets during the past three decades. These rapidly developing economies are home to swiftly growing middle-class households possessing substantial disposable income. Second, advanced (or developed) economies such as the United States and the European Union are sourcing many of the products they consume from such low-cost manufacturing locations as China, India, and Mexico. Third, advances in information and transportation technologies, decline of trade barriers, and liberalization of markets all have contributed to rapid growth of trade among nations.

Exhibit 1.3 identifies leading nations in exports of merchandise (and not services). Panel (a) shows the total annual value of merchandise exports and imports in billions of U.S. dollars. Panel (b) shows the annual value of products traded as a percentage of each nation's GDP. Total merchandise trade (exports plus imports) of the countries in panel (a) is nearly \$18,000 billion and accounts for about half of world merchandise trade. To get a better sense of the structure of international trade, Exhibit 1.4 presents the world's top trading countries. It reveals that China, the United States, Germany, and Japan are the world's leading international traders. China and the United States are close competitors in total trade, but trade accounts for about 31 percent of China's GDP as opposed to 19 percent for the United States. Merchandise trade is a much larger component of economic activity in countries such as the Netherlands (126 percent) and South Korea (69 percent). These percentages suggest that some countries depend very heavily on international trade relative to the value of all goods and services they produce domestically.

In some cases, countries' total trade surpasses 100 percent of the nation's GDP. How can this be? The answer is that countries such as Singapore, Hong Kong, and the Netherlands are known as entrepôt economies. *Entrepôt* is from the French for "intermediate depot." Such countries import a large volume of products, some of which they process into higher value—added products and some of which they simply re-export to other destinations. They often arise in locations that enjoy especially advantageous access to larger, adjacent markets. For example, Singapore is a major entrepôt for Southeast Asia, e.g., for transshipping petroleum products that it receives from the Middle East. Hong Kong is an entrepôt for China. The Netherlands is an entrepôt for the greater European Union.

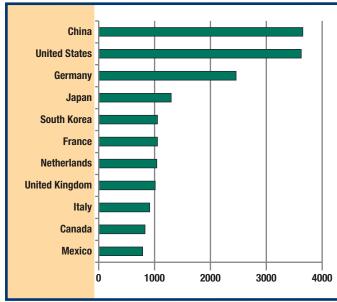
#### **The Nature of International Investment**

Of the two types of investment flows—portfolio investment and foreign direct investment—we are concerned primarily with foreign direct investment (FDI) in this text because it is the ultimate form of internationalization and encompasses the widest range of international business

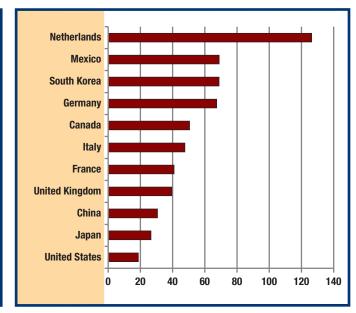
#### **EXHIBIT 1.3**

## Leading Countries in International Merchandise Trade

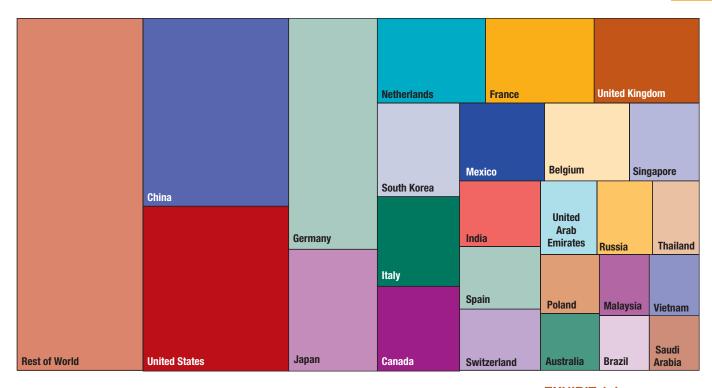
Sources: Based on data from the World Bank, World Development Indicators, Washington, DC: World Bank (2017), www.worldbank.org; World Trade Organization, Statistics Database, Geneva: World Trade Organization (2017), www.wto. org; UNCTAD, World Investment Report, New York: United Nations (2017), www.unctad.org.







(b) Total annual value of products trade (exports + imports) as a percentage of nation's GDP



involvement. FDI is the foreign entry strategy practiced by the most internationally active firms. Companies usually undertake FDI for the long term and retain partial or complete ownership of the assets they acquire. In the process, the firm establishes a new legal business entity in the host country, subject to the regulations of the host government.

FDI is especially common among large, resourceful companies with substantial international operations. For example, many European and U.S. firms have invested in China, India, and Brazil to establish plants to manufacture or assemble products, taking advantage of low-cost labor or natural resources in these countries. At the same time, companies from these rapidly developing economies have begun to invest in Western markets. In 2012, for example, the Haier Group from China acquired New Zealand's appliance manufacturing company Fisher & Paykel. Then, in 2016, Haier purchased General Electric's appliance division for \$5.4 billion.<sup>3</sup>

Exhibit 1.5 illustrates the dramatic growth of FDI since the 1980s. The exhibit reveals that the dollar volume of FDI has grown immensely since the 1980s, especially in developed (advanced) economies such as Japan, Europe, and North America. FDI inflows to the developing economies began to surpass those to the advanced economies in about 2010. FDI inflows were interrupted in 2001 as investors panicked following the September 11 terrorist attacks in the United States. The inflows were interrupted again in 2008 by the global recession but then rose sharply in subsequent years. These dips underscore the importance of maintaining stability in the world economy. Despite these setbacks, the overall trend remains strong and growing over time. Particularly significant is the growth of FDI into developing economies, much of which results from their need for modern industrial infrastructure. It reflects the importance of developing economies and emerging markets as target markets and sourcing bases.

#### Services as Well as Products

Historically, international trade and investment were mainly the domain of companies that make and sell products—tangible merchandise such as clothing, computers, and motor vehicles. Today, firms that produce *services* (intangibles) are key international business players as well. Services are deeds, performances, or efforts performed directly by people working in banks, consulting firms, hotels, construction companies, retailers, and countless other firms in the services sector. International trade in services accounts for about one-quarter of all international trade and is growing rapidly.

#### **EXHIBIT 1.4**

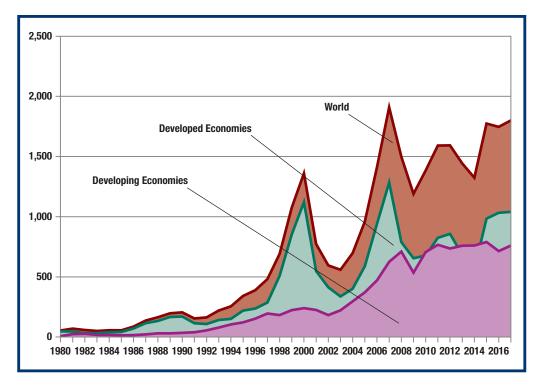
## The Top 25 Countries in International Merchandise Trade

Sources: Based on data from the World Bank, World Development Indicators, Washington, DC: World Bank (2017), www.worldbank.org; World Trade Organization, Statistics Database, Geneva: World Trade Organization (2017), www.wto. org; UNCTAD, World Investment Report, New York: United Nations (2017), www.unctad.org.

Note: The exhibit reflects the value of each country's combined exports and imports as a percentage of total world trade.

#### Foreign Direct Investment (FDI) Inflows into World Regions (in Billions of U.S. Dollars per Year)

Sources: UNCTAD, UNCTADSTAT Database, Inward FDI Flows, Annual (2017); OECD, FDI Flows (2017), https://data.oecd.org/fdi/fdi-flows.htm; World Bank, Foreign Direct Investment, Net Inflows (BoP, Current US\$) (2017), http://data.worldbank.org.

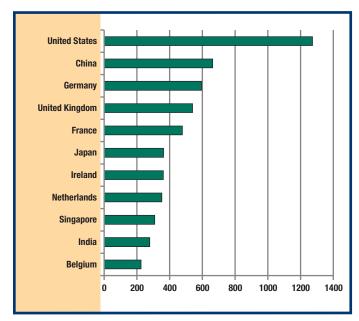


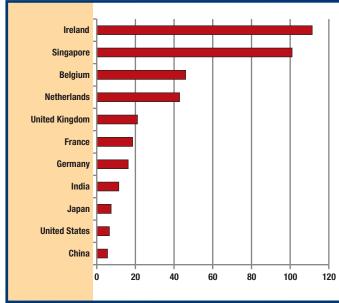
Instagram in the opening case is a leading services firm that has internationalized rapidly. If you own a house, your mortgage might be underwritten by the Dutch bank ABN Amro. Perhaps you eat lunch in a cafeteria owned by the French firm Sodexho, which manages the food and beverage operations on numerous university campuses. Recently, Riot Games expanded its operations into Germany, Ireland, China, Turkey, and numerous other countries to meet rapidly rising demand for its online video games. Demand for the firm's *League of Legends* game has spread rapidly, prompting the need to establish offices at gamer locations worldwide. The 2017 League of Legends World Championship attracted fans from around the world for two weeks of competition and more than 100 hours of live content broadcast in more than 20 languages.<sup>4</sup>

Exhibit 1.6 identifies countries leading in total international services trade. Panel (a) shows the total annual value of services exports and imports in billions of U.S. dollars. Panel (b) shows the total annual value of services trade as a percentage of each nation's GDP. As with products, larger advanced economies account for most world services trade. This is expected because services typically comprise more than two-thirds of the GDPs of these countries. Recently, the emerging markets of China and India have gained strong reputations in this area. Ireland has emerged as the leader in world services trade as a percentage of GDP. Compare the value of merchandise trade in Exhibit 1.3 with the value of services trade in Exhibit 1.6 for each country. Although services trade is growing rapidly, the value of merchandise trade is still much larger. One reason is that services face greater challenges and barriers in cross-border trade than merchandise goods.

Not all services can be exported. Examples are repair work done on your bicycle or the experience of eating a meal in a restaurant. Although some services can be digitized and moved across borders, most service providers can operate internationally only by establishing a physical presence abroad through direct investment. Firms invest abroad to set up restaurants, retail stores, and other physical facilities through which they sell billions of dollars' worth of services every year.

There are numerous industries in the services sector with strong potential for internationalization. The giant Internet retailer eBay earned about \$9 billion in 2017, of which more than 50 percent came from international sales. The company expects that most future revenue growth will come from abroad. When developing its business in India, eBay acquired the Mumbai-based e-retailer Baazee, which followed eBay's expansion into China, Korea, and Europe. Vendors in Russia now constitute a big portion of eBay's business.<sup>5</sup>





(a) Total annual value of services trade (exports + imports) in billions of U.S. dollars

(b) Total annual value of services trade (exports + imports) as a percentage of nation's GDP

A recent development in the services sector is the rise of the *sharing economy*, in which firms and individuals undertake online peer-to-peer exchange of all types of goods and services. Uber and Airbnb are examples of a growing number of global firms that allow people to borrow or rent assets from others. Uber lets people bypass taxis to go places, and Airbnb allows them to book rooms in private homes around the world. Uber is based in San Francisco and operates in more than 600 cities worldwide. The firm has faced controversy in various nations, as municipal authorities deal with legal issues related to driver qualifications, licensing, and fares. In Australia, people use Freelancer to hire needed workers. Streetbank is a UK-based firm that helps neighbors share tools, appliances, and other household items and has expanded to Australia, Canada, and numerous other countries.<sup>6</sup>

Exhibit 1.7 illustrates the diversity of service industries that are internationalizing, extending their reach beyond the countries where they are based. If you are considering a career in international business, keep these industries in mind.

#### The International Financial Services Sector

International banking and financial services are among the most internationally active service industries. Explosive growth of investment and financial flows since about 2000 has led to the emergence of capital markets worldwide. It resulted from two main factors: the internationalization of banks and the massive flow of money across national borders into pension funds and portfolio investments

In the developing economies, meanwhile, banks and other financial institutions have fostered economic activity by increasing the availability of local investment capital, which stimulates the development of financial markets and encourages locals to save money.

International banking is primarily conducted by very large banks. Governments around the world have imposed many new regulations in the banking industry following the global financial crisis that arose in 2007–2008. Consumers and local businesses generally prefer to deal with local banks, obtaining financial services from homegrown "brick-and-mortar" branches and personnel who understand local conditions. Smaller, local banks usually work with larger, international banks to process cross-national payments, exchange currencies, and fulfill other international functions. Banks in Asia and North America have seen the most growth in recent years in their home markets. China is now home to three of the world's five largest banks, specifically ICBC, China Construction Bank, and the Agricultural Bank of China. London long has been the banking hub of Europe, a status bolstered by the United Kingdom's membership in the European Union (EU). However, the 2016 vote to exit the EU may reduce London's competitive advantages in banking and may result in a growing role for Dublin, Frankfurt, and Paris as leading European banking centers.<sup>7</sup>

#### **EXHIBIT 1.6**

#### Countries Leading in International Services Trade

Sources: Based on data from the World Bank, World Development Indicators, Washington, DC: World Bank (2017), www.worldbank. org; World Trade Organization, Statistics Database, Geneva: World Trade Organization (2017), www. wto.org; UNCTAD, "International Trade in Goods and Services," UNCTADSTAT (2017), www. unctad.org.

#### Service Sector Industries That Are Rapidly Internationalizing

Source: Based on International Trade Administration, Service Industries (Washington, DC: U.S. Department of Commerce, 2018).

Industry	Representative Activities	Representative Companies
Architectural, construction, and engineering	Construction, power utilities, design, engineering services, for airports, hospitals, dams	ABB, Bechtel Group, Kajima, Philip Holzman, Skanska AB
Banking, finance, and insurance	Banks, insurance, risk evaluation, management	Bank of America, CIGNA, Barclays, HSBC, Ernst & Young
Education, training, and publishing	Management training, technical training, language training	Berlitz, Kumon Math & Reading Centers, NOVA, Pearson, Elsevier
Entertainment	Movies, recorded music, Internet-based entertainment	Time Warner, Sony, Virgin, MGM
Information services	E-commerce, e-mail, funds transfer, data interchange, data processing, computer services	Infosys, Google, Hitachi, Qualcomm, Cisco
Professional business services	Accounting, advertising, legal, management consulting	Leo Burnett, EYLaw, McKinsey, A.T. Kearney, Booz Allen Hamilton
Transportation	Aviation, ocean shipping, railroads, trucking, airports	Maersk, Santa Fe, Port Authority of New Jersey, SNCF (French railroads)
Travel and tourism	Transportation, lodging, food and beverage, aircraft travel, ocean carriers, railways	Carlson Wagonlit, Marriott, British Airways

## **1.2** Understand how international business differs from domestic business.

## **How Does International Business Differ from Domestic Business?**

Firms operate in countries characterized by distinctive economic, cultural, and political conditions. For example, the economic environment of Colombia differs sharply from that of Canada, the legal environment of Saudi Arabia does not resemble that of Japan, and the cultural environment of China is very distinct from that of Kenya. Not only does the firm find itself in unfamiliar surroundings, it encounters many *uncontrollable variables*—factors over which management has little control. These factors introduce new or elevated business risks. As exemplified by Instagram in the opening case, distinctive conditions in each country require firms to adapt their products and approaches from country to country.

#### The Four Risks in Internationalization

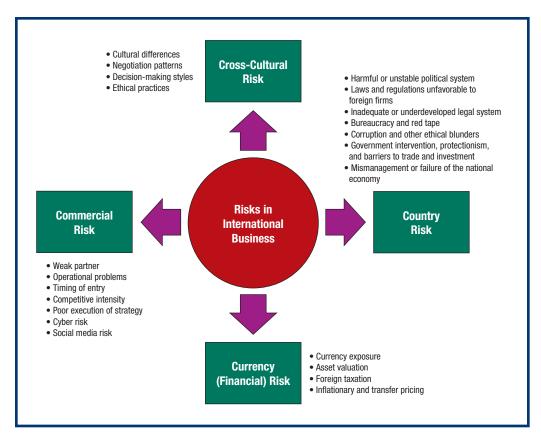
Globalization is not without risks. When companies undertake international business, they are routinely exposed to four major types of risk, as illustrated in Exhibit 1.8. These are cross-cultural risk, country risk, currency risk, and commercial risk. The firm must manage these risks to avoid performance breakdowns, reputation loss, or other adverse consequences.

Cross-cultural risk occurs when a cultural misunderstanding puts some human value at stake. Cross-cultural risk arises from differences in language, lifestyles, mind-sets, customs, and religion. Values unique to a culture tend to be long-lasting and transmitted from one generation to the next. Values influence the mind-set and work style of employees and the shopping patterns of buyers. Foreign customer characteristics can differ significantly from those of buyers in the home market

Language is a critical dimension of culture. In addition to facilitating communication, language is a window on people's value systems and living conditions. For example, Inuit (Eskimo) languages have various words for snow, whereas the South American Aztecs used the same basic word stem for snow, ice, and cold. When translating from one language to another, it is often

#### **Cross-cultural risk**

A situation or event in which a cultural misunderstanding puts some human value at stake.



## The Four Risks of International Business

difficult to find words that convey the same meanings. For example, a one-word equivalent to aftertaste does not exist in many languages. Such challenges impede effective communication and cause misunderstandings. Miscommunication due to cultural differences gives rise to inappropriate business strategies and ineffective relations with customers. Cross-cultural risk most often occurs in encounters in foreign countries. However, the risk also can occur domestically, as when management meets with customers or business associates who visit company headquarters from abroad.

Country risk (also known as *political risk*) refers to the potentially adverse effects on company operations and profitability caused by developments in the political, legal, and economic environment in a foreign country. Country risk includes the possibility of foreign government intervention in firms' business activities. For example, governments may restrict access to markets, impose bureaucratic procedures on business transactions, and limit the amount of income that firms can take home from foreign operations. The degree of government intervention in commercial activities varies from country to country. Singapore and Ireland are characterized by substantial economic freedom—that is, a fairly liberal economic environment. By contrast, the Chinese and Russian governments regularly intervene in business affairs. Country risk also includes laws and regulations that potentially hinder company operations and performance. Critical legal dimensions include intellectual property protection, product liability, and taxation policies. Nations also experience potentially harmful economic conditions, often due to high inflation, national debt, and unbalanced international trade.

Currency risk (also known as *financial risk*) refers to the risk of adverse fluctuations in exchange rates. Fluctuation is common for *exchange rates*—the value of one currency in terms of another. Currency risk arises because international transactions are often conducted in more than one national currency. For example, when U.S. fruit processor Graceland Fruit Inc. exports dried cherries to Japan, it is normally paid in Japanese yen.

When currencies fluctuate significantly, the value of the firm's earnings can be reduced. The cost of importing parts or components used in manufacturing finished products can

#### **Country risk**

Potentially adverse effects on company operations and profitability caused by developments in the political, legal, and economic environment in a foreign country.

#### **Currency risk**

Risk of adverse fluctuations in exchange rates.

#### Commercial risk

Firms' potential loss or failure from poorly conceived or executed business strategies, tactics, or procedures.

increase dramatically if the value of the currency in which the imports are denominated rises sharply. Inflation and other harmful economic conditions experienced in one country may have immediate consequences for exchange rates due to the interconnectedness of national economies.

Rising value of the U.S. dollar during 2015 and 2016 relative to most currencies has cut into revenues of U.S. multinational firms such as Apple, Caterpillar, and Pfizer. Procter and Gamble's Duracell battery business experienced a 31 percent decline in profits due to weaker currencies in its foreign markets.<sup>9</sup>

Commercial risk is encountered by all firms, whether operating domestically or internationally. It refers to the firm's potential loss or failure from poorly conceived or executed business strategies, tactics, or procedures. Managers may make poor choices in such areas as the selection of business partners, timing of market entry, pricing, creation of product features, and promotional themes. Although such failures also exist in domestic business, the consequences are usually costlier when committed abroad. For example, in domestic business, a company might terminate a poorly performing distributor simply with advance notice. In foreign markets, however, terminating business partners can be costly due to regulations that protect local firms. Marketing inferior or harmful products, falling short of customer expectations, or failing to provide adequate customer service can also damage the firm's reputation and profitability. Furthermore, commercial risk is often affected by currency risk because fluctuating exchange rates can affect various types of business deals.

In recent years, two types of commercial risk have become an important source of concern for firms—cyber risk and social media risk. Both are the result of vulnerabilities in affected organizations. *Cyber risk* results from attacks on, or breaches of, the firm's information systems. Cyber risk arises from failures in the firm's information technology systems. Recent data breaches have afflicted such companies as eBay, Uber, Tesco Bank, and Sony Playstation Network. Even government organizations are vulnerable to data breaches. <sup>10</sup>

Social media risk refers to rapid and widespread circulation of unfavorable "buzz" about the firm. Such negative news is accelerated and amplified by social media. In 2015, for example, regulators announced that Volkswagen had installed software in its vehicles aimed at evading environmental regulations intended to reduce engine pollutants. When the scandal went viral on Twitter, Facebook, and other sites, Volkswagen's brand image was damaged. By late 2015, Volkswagen's buzz score had descended to its lowest point in several years. A single negative post about corporate events can travel globally at lightning speed and damage stakeholder trust in the firm's brand even before management has time to react. <sup>11</sup>

The four types of international business risks are omnipresent; the firm may encounter them around every corner. Some international risks, such as global financial disruptions, are extremely challenging. In Greece, the nation's debt crisis has lingered for several years and affects not only the European Union but creditors elsewhere. 12

Although risk cannot be avoided, it can be anticipated and managed. Experienced international firms constantly assess their environments and conduct research to anticipate potential risks, understand their implications, and take proactive action to reduce their effects. This book is dedicated to providing you, the future manager, with a solid understanding of these risks as well as managerial skills and strategies to counter them effectively.

#### Who Participates in International Business?

International business requires numerous organizations, with varying motives, to work together as a coordinated team, contributing different types of expertise and inputs. There are four major categories of participants.

A focal firm is the initiator of an international business transaction; it conceives, designs, and produces offerings intended for consumption by customers worldwide. Focal firms take center stage in international business. They are primarily large multinational enterprises (MNEs; also known as multinational corporations, or MNCs) and small and medium-sized enterprises (SMEs). Some are privately owned companies; others are public, stock-held firms; and still others are state enterprises owned by governments. Some focal firms are manufacturing businesses; others are in the service sector.

**1.3** Identify major participants in international business.

#### Focal firm

The initiator of an international business transaction, which conceives, designs, and produces offerings intended for consumption by customers worldwide. Focal firms are primarily MNEs and SMEs.

- A distribution channel intermediary is a specialist firm that provides various logistics
  and marketing services for focal firms as part of international supply chains, both in the
  focal firm's home country and abroad. Typical intermediaries include independent distributors and sales representatives, usually located in foreign markets where they provide distribution and marketing services to focal firms on a contractual basis.
- A facilitator is a firm or an individual with special expertise in banking, legal advice, customs clearance, or related support services that helps focal firms perform international business transactions. Facilitators include logistics service providers, freight forwarders, banks, and other support firms that assist focal firms in performing specific functions. A freight forwarder is a specialized logistics service provider that arranges international shipping on behalf of exporting firms, much like a travel agent for cargo. Facilitators are found in both the home country and abroad.
- Governments, or the public sector, are also active in international business as suppliers, buyers, and regulators. State-owned enterprises (SOEs) account for a substantial portion of economic value added in many countries, even rapidly liberalizing emerging markets such as Russia, China, and Brazil. Governments in advanced economies such as France, Australia, and Sweden have significant ownership of companies in telecommunications, banking, and natural resources. The recent global financial crisis led governments to step up their involvement in business, especially as regulators.

The activities of firms, intermediaries, and facilitators in international business overlap to some degree. The focal firm performs certain activities internally and delegates other functions to intermediaries and facilitators when their special expertise is needed. In other words, the focal firm becomes a client of intermediaries and facilitators who provide services on a contractual basis.

Whereas focal firms, intermediaries, and facilitators represent the supply side of international business transactions, customers or buyers make up the demand side. Customers consist of:

- Individual consumers and households.
- Retailers—businesses that purchase finished goods for the purpose of resale.
- Organizational buyers—businesses, institutions, and governments that purchase goods and services as inputs to a production process or as supplies needed to run a business or organization. Governments and nonprofit organizations such as CARE (www.care.org) and UNICEF (www.unicef.org) also often constitute important customers around the world.

#### **Focal Firms in International Business**

Imagine a typical theatrical production. It has script writers, stage managers, lighting technicians, musicians, set directors, business managers, and publicity staff in addition to performing actors. Each participant contributes in different ways, and much coordination is required among them. Advanced planning, preparation, timeliness, and synchronization are critical to ultimate success. In the same way, international business transactions require the participation of many specialist organizations, exact timing, and precision.

Focal firms are the most prominent international players. They include well-known multinational enterprises and small and medium-sized exporting firms as well as contemporary organizations such as the born global firms. Let's learn more about each of these key actors in international business.

A multinational enterprise (MNE) is a large company with substantial resources that performs various business activities through a network of subsidiaries and affiliates located in multiple countries. Leading MNEs are listed in the *Fortune Global 500* (http://fortune.com). Examples include well-known companies such as Nestlé, Sony, Citibank, Unilever, Nokia, Ford, Barclays, DHL, Four Seasons Hotels, and Shell Oil. In recent years, the largest MNEs have been firms in the oil industry (such as Exxon-Mobil and Royal Dutch Shell) and the automotive industry (General Motors and Honda) as well as in retailing (Walmart). <sup>13</sup>

Although MNEs employ a range of foreign market entry strategies, they are best known for their foreign direct investment (FDI) activities. They operate in multiple countries, especially in Asia, Europe, and North America, by setting up production plants, marketing subsidiaries, and regional headquarters. MNEs such as Exxon, Honda, and Coca-Cola derive much of their total

## Distribution channel intermediary

A specialist firm that provides various logistics and marketing services for focal firms as part of international supply chains, both in the home country and abroad.

#### **Facilitator**

A firm or an individual with special expertise in banking, legal advice, customs clearance, or related support services that assists focal firms in the performance of international business transactions.

#### Freight forwarder

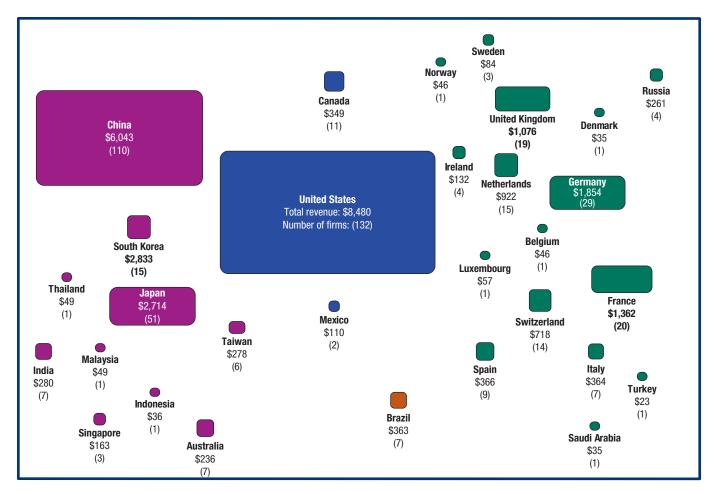
A specialized logistics service provider that arranges international shipping on behalf of exporting firms.

## State-owned enterprise (SOE)

A company that is founded and owned by a government in order to undertake commercial activities on the government's behalf.

#### Multinational enterprise (MNE)

A large company with substantial resources that performs various business activities through a network of subsidiaries and affiliates located in multiple countries.



## Geographic Distribution of the Headquarters of the World's 500 Largest MNEs

Sources: Scott Decarlo, "Global 500," Fortune (2017), http://fortune.com, pp. 18–19; Fortune, "Global 500," Special Section, July 21, 2014, pp. F1–F8.Note: The exhibit shows country name, total revenues of Global 500 firms in U.S. dollars, and total number of Global 500 firms.

#### Small and mediumsized enterprise (SME)

A company with 500 or fewer employees (as defined in Canada and the United States).

sales and profits, often more than half, from cross-border operations. Although there were fewer than 7,500 MNEs worldwide in 1970, today there are at least 75,000, a tenfold increase. <sup>14</sup>

Exhibit 1.9 displays the geographic distribution of the world's largest MNEs, drawn from *Fortune*'s Global 500 list. These firms are concentrated in the advanced economies. The United States was home to 132 of the top 500 MNEs in 2017, a number that has declined over time as firms from other countries increase in size. China has the second most MNEs (110 firms), and Europe is home to many top MNEs: Germany (29 firms), France (20 firms), and the United Kingdom (19 firms). <sup>15</sup>

In recent years, large MNEs have begun to appear in emerging market countries, such as China, Mexico, and Russia. China currently hosts 110 of the top 500 MNEs, a number that has increased from only 20 countries in the past decade. Nearly all of China's top firms are state enterprises—wholly or partly owned by the Chinese government—which provides them substantial advantages. <sup>16</sup>

The new global challenge firms from emerging markets are fast becoming key contenders in world markets. For example, the Mexican firm Cemex is one of the world's largest cement producers; in Russia, Lukoil has big ambitions in the global energy sector; and China Mobile dominates the cell phone industry in Asia. These companies make best use of home–country natural resources and low-cost labor to succeed in world markets. Thousands of firms from emerging markets have big global dreams and pose competitive challenges to companies from the advanced economies. <sup>17</sup>

#### **Small and Medium-Sized Enterprises**

Another type of focal firm that initiates cross-border business transactions is the SME. As defined in Canada and the United States, **small and medium-sized enterprises (SMEs)** are manufacturers or service providers with fewer than 500 employees. (In the European Union and

numerous other countries, they are defined as having fewer than 250 employees.) SMEs now make up the majority of companies active in international business. Nearly all firms, including large MNEs, started out small. Compared to large multinationals, SMEs can be more flexible and quicker to respond to global business opportunities. They are usually less bureaucratic, more adaptable, and more entrepreneurial and often sustain entrepreneurship and innovation in national economies.

Being smaller organizations, SMEs are constrained by limited financial and human resources. This explains why they usually choose exporting as their main strategy for entering foreign markets. Their limited resources prevent them from undertaking FDI, an expensive entry mode. As their operations grow, some gradually establish company-owned sales offices or subsidiaries in key target markets.

Due to their smaller size, SMEs often target specialized products to market niches too small to interest large MNEs. SMEs owe much of their international success to support provided by intermediaries and facilitators in foreign markets and to globe-spanning logistics specialists such as FedEx and DHL. Smaller firms also rely on information and communications technologies that allow them to identify global market niches and efficiently serve specialized buyer needs. SMEs are gaining equal footing with large multinationals in marketing sophisticated products around the world.

#### **Born Global Firms**

One type of contemporary international SME is the **born global firm**, a young entrepreneurial company that initiates international business activity very early in its evolution, moving rapidly into foreign markets. Despite the scarce resources typical of most small businesses, born globals usually internationalize within three years of their founding and may export to 20 or more countries, generating more than 25 percent of their sales from abroad.

One example is Logitech (www.logitech.com), a born global firm based in Switzerland specializing in accessories for mobile phones and personal computers. The firm is well known as a worldwide leader in mice and keyboards. Within a few years of founding, Logitech expanded it sales to countries around Asia, Europe, and North America. Today Logitech has more than 7,000 employees in some 30 countries.<sup>18</sup>

The born global phenomenon represents a new reality in international business. In countries like Australia, Denmark, Ireland, and the United States, born globals account for a substantial proportion of national exports. They use the Internet and communications technologies to facilitate early and efficient international operations. In many cases, born globals offer leading-edge products with strong potential to generate international sales.

The emergence of born globals is associated with *international entrepreneurship*, in which innovative, smaller firms pursue business opportunities everywhere, regardless of national borders. Communications and transportation technologies, falling trade barriers, and the emergence of niche markets worldwide have increased the ability of contemporary firms to view the whole world as their marketplace. Entrepreneurial managers are creative, proactive, and comfortable dealing with risk. They are usually quick to adapt company strategies as circumstances evolve. The widespread emergence of born globals implies that any firm, regardless of size or experience, can succeed in international business.<sup>19</sup>

## **Governments and Nongovernmental Organizations**

In addition to profit-seeking focal firms, governments are central participants in international trade and investment. Their role is so important that we

#### Born global firm

A young entrepreneurial company that initiates international business activity early in its evolution, moving rapidly into foreign markets.



Source: Iakov Filimonov/123rf

Born global firms are international from their founding. Vix Technology is an Australian born global that makes fare management equipment for public transit systems worldwide.



Source: Oksana Kuzmina/123rf

The British Wellcome Trust funds nongovernmental organizations (NGOs) and research initiatives to work in collaboration with private businesses to develop remedies for diseases in Africa and other less developed areas.

devote later chapters to government intervention, political systems, and other government-related topics. In addition, numerous nonprofit organizations conduct cross-border activities, including charitable groups and nongovernmental organizations (NGOs). They work on behalf of special causes, such as education, research, health care, human development, and the natural environment, operating internationally either to conduct their activities or to raise funds. Examples of nonprofit organizations include the Bill and Melinda Gates Foundation and the British Wellcome Trust, both of which support health and educational initiatives. CARE is an international nonprofit organization dedicated to reducing poverty. Many MNEs operate charitable foundations that support various initiatives. GlaxoSmithKline (GSK), the giant pharmaceutical firm, operates several small, country-based foundations in Canada, France, Italy, Romania, Spain, and the United States.

### **1.4** Describe why firms internationalize.

#### Why Do Firms Internationalize?

There are multiple motives for international expansion, some strategic in nature, others reactive. An example of a strategic, or proactive, motive is to tap foreign market opportunities or to acquire new knowledge. An example of a reactive motive is the need to serve a key customer that has expanded abroad. Specific motivations include the following:

- Seek opportunities for growth through market diversification. Substantial market potential exists abroad. Many firms—for example, Facebook, Gillette, Siemens, Sony, and Biogen—derive more than half of their sales from international markets.<sup>20</sup> In addition to offering sales opportunities that often cannot be matched at home, foreign markets can extend the marketable life of products or services that have reached maturity in the home market. One example is the internationalization of automatic teller machines (ATMs). The first ATMs were installed in London by Barclays Bank. The machines were adopted next in the United States and Japan. As growth of ATMs began to slow in these countries, they were marketed throughout the rest of the world. There were more than 3 million ATMs worldwide in 2017; a new one is installed somewhere every few minutes.
- Earn higher margins and profits. For many types of products and services, market growth in mature economies is sluggish or flat. Competition is often intense, forcing firms to get by on slim profit margins. By contrast, most foreign markets may be underserved (typical of high-growth emerging markets) or not served at all (typical of developing economies). Less intense competition, combined with strong market demand, implies that companies can command higher margins for their offerings. For example, compared to their home markets, bathroom fixture manufacturers American Standard and Toto (of Japan) have found more favorable competitive environments in rapidly industrializing countries such as Indonesia, Mexico, and Vietnam. Just imagine the demand for bathroom fixtures in the thousands of office buildings and residential complexes going up from Taiwan to Turkey!
- Gain new ideas about products, services, and business methods. International markets are
  characterized by tough competitors and demanding customers with various needs. Unique
  foreign environments expose firms to new ideas for products, processes, and business
  methods. The experience of doing business abroad helps firms acquire new knowledge for
  improving organizational effectiveness and efficiency. For example, Japan's Toyota refined
  just-in-time inventory techniques, which other manufacturers and foreign suppliers around
  the world then applied to manufacturing in their own countries.

- Serve key customers better that have relocated abroad. In a global economy, many firms
  internationalize to better serve clients that have moved into foreign markets. For example,
  when Nissan opened its first factory in the United Kingdom, many Japanese auto parts
  suppliers followed, establishing their own operations there.
- Be closer to supply sources, benefit from global sourcing advantages, or gain flexibility in product sourcing. Companies in extractive industries such as petroleum, mining, and forestry establish international operations where raw materials are located. One example is the aluminum producer Alcoa, which established operations in Brazil, Guinea, Jamaica, and elsewhere to extract aluminum's base mineral bauxite from local mines. Some firms internationalize to gain flexibility from a greater variety of supply bases. Dell Computer has assembly facilities in Asia, Europe, and the Americas that allow management to shift production quickly from one region to another. This flexibility provides Dell with competitive advantages over less agile rivals—a distinctive capability that allows Dell to outperform competitors and skillfully manage fluctuations in currency exchange rates.
- Gain access to lower-cost or better-value factors of production. Internationalization enables the firm to access capital, technology, managerial talent, and labor at lower costs, higher quality, or better value. For example, some Taiwanese computer manufacturers established subsidiaries in the United States to access low-cost capital. The United States is home to numerous capital sources in the high-tech sector, such as stock exchanges and venture capitalists, which have attracted many firms from abroad seeking funds. More commonly, firms venture abroad in search of skilled or low-cost labor. For example, the Japanese firm Canon relocated much of its production to China to profit from that country's inexpensive and productive workforce.
- Develop economies of scale in sourcing, production, marketing, and R&D. Economies of scale reduce the per-unit cost of manufacturing by operating at high volume. For example, the per-unit cost of manufacturing 100,000 cameras is much cheaper than the per-unit cost of making just 100 cameras. By expanding internationally, the firm greatly increases the size of its customer base, thereby increasing the volume of goods it produces. On a per-unit-of-output basis, the greater the volume of production, the lower the total cost. Economies of scale are also present in R&D, sourcing, marketing, distribution, and aftersales service.
- Confront international competitors more effectively or thwart the growth of competition in the home market. International competition is substantial and increasing, with multinational competitors invading markets worldwide. The firm can enhance its com
  - petitive positioning by confronting competitors in international markets or preemptively entering a competitor's home market to destabilize and curb its growth. One example is Caterpillar's entry in Japan to confront its main rival in the earthmoving equipment industry, Komatsu. Caterpillar's preemptive move hindered Komatsu's international expansion for at least a decade. Had it not acted proactively to stifle Komatsu's growth in Japan, Komatsu's home market, Caterpillar would certainly have had to face a more potent rival sooner.
- Invest in a potentially rewarding relationship with a foreign partner. Firms often have long-term strategic reasons for venturing abroad. Joint ventures or project-based alliances with key foreign players can lead to the development of new products, early positioning in future key markets, or other long-term, profit-making opportunities. For example, Black and Decker entered a joint venture with Bajaj, an Indian



Source: Coleman Yuen/Pearson Education Asia Ltd.

A vibrant workforce is driving economic development and buying power in emerging markets. Here consumers flock to a popular shopping street in Beijing, China. retailer, to position itself for expected long-term sales in the huge Indian market. The French computer firm Groupe Bull partnered with Toshiba in Japan to gain insights for developing the next generation of information technology.

At the broadest level, companies internationalize to enhance competitive advantage and find growth and profit opportunities. Throughout this book, we explore the environment within which firms seek these opportunities, and we discuss the strategies and managerial skills necessary for achieving international business success.



#### MyLab Management Watch It!

If your professor has assigned this, go to the Assignments section of **www.pearson.com/ mylab/management** to complete the video exercise titled MINI Globalization.

**1.5** Appreciate why you should study international business.

#### Why Study International Business?

There are many reasons to study international business. We examine them from the perspectives of the global economy, the national economy, the firm, and you as a future manager.

#### **Facilitator of the Global Economy and Interconnectedness**

International business is transforming the world as never before. In the past 50 years, international trade and investment have experienced unprecedented growth. Since the 1980s, *emerging markets* have provided new impetus to worldwide economic interconnectedness. These fast-growth developing economies—some 30 countries, including Brazil, Russia, India, and China, the so-called BRICs—are experiencing substantial market liberalization, privatization, and industrialization, which are fueling global economic transformation.

#### Contributor to National Economic Well-Being

International business contributes to economic prosperity, helps countries use their resources more efficiently, and provides interconnectedness to the world economy and access to a range of products and services. Consequently, governments have become more willing to open their borders to foreign trade and investment.

International trade is a critical engine for job creation. It is estimated that every \$1 billion increase in exports creates more than 20,000 new jobs. In the United States, cross-border trade di-

-20 -40 -50

Source: satina/123rf

International trade is encouraging faster diffusion of consumer products and brands around the world.

rectly supports at least 11 million jobs. One of every seven dollars of U.S. sales is made abroad. One of every three U.S. farm acres and one of every six U.S. jobs is producing for export markets. On average, exporting firms create jobs faster and provide better pay than nonexporting firms.<sup>21</sup>

#### A Competitive Advantage for the Firm

To sustain a competitive advantage in the global economy, firms must readily participate in cross-border business and acquire the necessary skills, knowledge, and competence. Procter & Gamble sells shampoo, disposable diapers, and other consumer products in more than 150 countries. MTV broadcasts its programming in some 140 countries. Nestlé sells its food and beverage products world-wide, obtaining nearly all its revenue from foreign operations. As these examples imply, going international offers countless opportunities for firms to grow and earn additional profits.