11e

Global Business Today

Charles W. L. Hill | G. Tomas M. Hult

McGraw Hill Education

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For my mother June Hill, and the memory of my father, Mike Hill

—Charles W. L. Hill

For Gert & Margareta Hult, my parents

—G. Tomas M. Hult

about the authors

Charles W. L. Hill
University of Washington

Charles W. L. Hill is the Hughes M. and Katherine Blake Professor of Strategy and International Business at the Foster School of Business, University of Washington. Professor Hill has taught in the MBA, Executive MBA, Technology Management MBA, Management, and PhD programs at the University of Washington. During his time at the University of Washington, he has received over 25 awards for teaching excellence, including the Charles E. Summer Outstanding Teaching Award. The Foster School is consistently ranked as a Top-25 business school. Learn more about Professor Hill at http://foster.uw.edu/faculty-research/directory/charles-hill.

A native of the United Kingdom, Professor Hill received his PhD from the University of Manchester, UK. In addition to the University of Washington, he has served on the faculties of the University of Manchester, Texas A&M University, and Michigan State University.

Professor Hill has published over 50 articles in top academic journals, including the *Academy of Management Journal, Academy of Management Review, Strategic Management Journal*, and *Organization Science*. Professor Hill has also published several textbooks, including *International Business* (McGraw-Hill) and *Global Business Today* (McGraw-Hill). His work is among the most widely cited in international business and strategic management.

Beginning in 2014, Dr. Hill partnered with Dr. Tomas Hult in a formidable co-authorship of the International Business franchise of textbooks (*International Business* and *Global Business Today*).This brought together two of the most cited international business scholars in history.

Professor Hill works on a private basis with a number of organizations. His clients have included Microsoft, where he has been teaching in-house executive education courses for two decades. He has also consulted for a variety of other large companies (e.g., AT&T Wireless, Boeing, BF Goodrich, Group Health, Hexcel, Microsoft, Philips Healthcare, Philips Medical Systems, Seattle City Light, Swedish Health Services, Tacoma City Light, Thompson Financial Services, WRQ, and Wizards of the Coast). Professor Hill has also served on the advisory board of several start-up companies.

For recreation, Professor Hill enjoys skiing and competitive sailing!

G. Tomas M. Hult

Michigan State University

Dr. Tomas Hult is Professor of Marketing, Byington Endowed Chair, and Director of the International Business Center in the Department of Marketing in the Eli Broad College of Business at Michigan State University. He also teaches for the Broad College's Department of Supply Chain Management and Department of Management. Learn more about Professor Hult at http://broad.msu.edu/facultystaff/hult.

A native of Sweden, Dr. Hult received a mechanical engineer degree in Sweden before obtaining Bachelor and MBA degrees in the United States, followed by a PhD at The University of Memphis. In addition to Michigan State University, he has served on the faculties of Florida State University and the University of Arkansas at Little Rock. Dr. Hult holds visiting professorships in the International Business Group of his native Uppsala University, Sweden, and the International Business Division of Leeds University, United Kingdom. Michigan State, Uppsala, and Leeds are all ranked in the top 10 in the world in international business research.

Dr. Hult serves as Executive Director and Board Member of the Academy of International Business (AIB), President and Board Member of the Sheth Foundation, and serves on the U.S. District Export Council. Tomas Hult hosts the radio show globalEDGE Business Beat on the Michigan Business Network.

Hult is one of the world's leading academic authorities (citations, publications) in marketing strategy, international business, international marketing, strategic management, global supply chains, and complex multinational corporations. He is one of only about 100 Elected Fellows of the Academy of International Business, an accolade achieved by only the elite international business scholars. Dr. Hult was also selected in 2016 as the Academy of Marketing Science/CUTCO-Vector Distinguished Marketing Educator.

He regularly speaks at high profile events (e.g., European Commission, Swedish Entrepreneurship Forum, United Nation's Conference on Trade and Development, U.S. Department of Education, World Investment Forum) and publishes influential op-ed articles (e.g., *Time, Fortune, Fortune, World Economic Forum, The Conversation*). Tomas has developed a large clientele of the world's top corporations (e.g., ABB, Albertsons, Avon, BG, Bechtel, Bosch, BP, Defense Logistics Agency, Domino's, FedEx, Ford, FreshDirect, General Motors, GroceryGateway, HSBC, IBM, Michigan Economic Development Corporation, Masco, NASA, Raytheon, Shell, Siemens, State Farm, Steelcase, Tech Data, and Xerox).

In addition to co-authoring with Charles W. L. Hill the market-share leading textbooks in international business (*Global Business Today*, now in its 11th edition, and *International Business*, now in its 12th edition), Dr. Hult has written several popular business trade books (e.g., *Second Shift; Global Supply Chain Management; Extending the Supply Chain*; and *Total Global Strategy*).

Tennis, golf, and traveling are his favorite recreational activities.

brief contents

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the proven choice for international business

Current. Application Rich, Relevant. Accessible and Student Focused.

Global Business Today (GBT), the worldwide market leader among international business products, has set a new standard for international business teaching. We have focused on creating resources that

- Are comprehensive, state of the art, and timely.
- Are theoretically sound and practically relevant.
- Focus on applications of international business concepts.
- Tightly integrate the chapter topics throughout.
- Are fully integrated with results-driven technology.
- Take full and integrative advantage of globalEDGE.msu.edu—the Google-ranked #1 web resource for "international business resources."

International Business (now in its 12th edition, 2019), also co-authored by Charles W. L. Hill and G. Tomas M. Hult, is a more comprehensive and case-oriented version that lends itself to the core course in international business for those that want a deeper focus on the global monetary system, structure of international business, international accounting, and international finance.

GBT has always endeavored to be current, relevant, application rich, accessible, and student-focused. Our goal has always been to cover macro and micro issues equally and in a relevant, practical, accessible, and student-focused approach. We believe that anything short of such a breadth and depth of coverage is a serious deficiency. Many of the students in these international business courses will soon be working in global businesses, and they will be expected to understand the implications of international business for their organization's strategy, structure, and functions in the context of the global marketplace. We are proud and delighted to have put together this international business learning experience for the leaders of tomorrow.

Over the years, and now through 11 editions, Dr. Charles Hill has worked hard to adhere to these goals. Since the ninth edition, Charles' co-author, Dr. Tomas Hult, has followed the same approach. In deciding what changes to make, we have been guided not only by our own reading, teaching, and research but also by the invaluable feedback we received from professors and students around the world, from reviewers, and from the editorial staff at McGraw-Hill Education. Our thanks go out to all of them.

Comprehensive and Up-to-Date

To be relevant and comprehensive, an international business package must

- Explain how and why the world's cultures, countries, and regions differ.
- Cover economics and politics of international trade and investment.
- Tackle international issues related to ethics, corporate social responsibility, and sustainability.
- Explain the functions and form of the global monetary system.
- Examine the strategies and structures of international businesses.
- Assess the special roles of the various functions of an international business.

Relevance and comprehensiveness also require coverage of the major theories. It has always been a goal to incorporate the insights gleaned from recent academic scholarship into the book.

Consistent with this goal, insights from the following research, as a sample of theoretical streams used in the book, have been incorporated:

- New trade theory and strategic trade policy.
- The work of Nobel Prize–winning economist Amartya Sen on economic development.
- Samuel Huntington's influential thesis on the "clash of civilizations."
- Growth theory of economic development championed by Paul Romer and Gene Grossman.
- Empirical work by Jeffrey Sachs and others on the relationship between international trade and economic growth.
- Michael Porter's theory of the competitive advantage of nations.
- Robert Reich's work on national competitive advantage.
- The work of Nobel Prize–winner Douglass North and others on national institutional structures and the protection of property rights.
- The market imperfections approach to foreign direct investment that has grown out of Ronald Coase and Oliver Williamson's work on transaction cost economics.
- Bartlett and Ghoshal's research on the transnational corporation.
- The writings of C. K. Prahalad and Gary Hamel on core competencies, global competition, and global strategic alliances.
- Insights for international business strategy that can be derived from the resource-based view of the firm and complementary theories.
- Paul Samuelson's critique of free trade theory.
- Conceptual and empirical work on global supply chain management—logistics, purchasing (sourcing), operations, and marketing channels.

In addition to including leading-edge theory, in light of the fast-changing nature of the international business environment, we have made every effort to ensure that this product is as up-to-date as possible. A significant amount has happened in the world since we began revisions of this book. By 2016, almost $4 trillion per day were flowing across national borders. The size of such flows fueled concern about the ability of short-term speculative shifts in global capital markets to destabilize the world economy.

The world continued to become more global. As you can see in Chapter 1 on Globalization, trade across country borders has almost exponentially escalated in the last few years. Several Asian economies, most notably China and India, continued to grow their economies at a rapid rate. New multinationals continued to emerge from developing nations in addition to the world's established industrial powers.

Increasingly, the globalization of the world economy affected a wide range of firms of all sizes, from the very large to the very small. We take great pride in covering international business for small- and medium-sized enterprises (SMEs), as well as larger multinational corporations. We also take great pride in covering firms from all around the world. Some sixty SMEs and multinational corporations from all six core continents are covered in the chapters' opening cases, closing cases, and/or Management Focus boxes.

And unfortunately, global terrorism and the attendant geopolitical risks keep emerging in various places globally, many new and inconceivable just a decade ago. These represent a threat to global economic integration and activity. Plus, with the United Kingdom opting to leave the European Union (Brexit), which has implications past 2019, the election of President Donald Trump in the United States (who espouses views on international trade that break with the long established consensus), and several elections around the world, the globe—in many ways—has paid more attention to nationalistic issues over trade. These topics and many more are integrated into this text for maximum learning opportunities.

WHAT'S NEW IN THE 11TH EDITION The success of the first ten editions of *Global Business Today* (and its longer, more in-depth textbook option and companion, *International Business*, now in the 12th edition) was based in part on the incorporation of leading-edge research into the text, the use of the up-to-date examples and statistics to illustrate global trends and enterprise strategy, and the discussion of current events within the context of the appropriate theory. Building on these strengths, our goals for the 11th edition have focused on the following:

1. Incorporate new insights from scholarly research.
2. Make sure the content covers all appropriate issues.

3. Make sure the text is up-to-date with current events, statistics, and examples.
4. Add new and insightful opening and closing cases in most chapters.
5. Incorporate value-added globalEDGE™ features in every chapter.
6. Connect every chapter to a focus on managerial implications.

As part of the overall revision process, changes have been made to every chapter in the book. All statistics have been updated to incorporate the most recently available data. As before, we provide the only textbook in International Business that ensures that all material is up-to-date on virtually a daily basis. The copyright for the book is 2020, but you are likely using the text somewhere between the years 2019 to 2022. We keep the textbook updated to each semester you use the text in your course! We do this by integrating Connect and globalEDGE™ features in every chapter.

Specifically, combining McGraw Hill's Connect platform with the Google number-one-ranked globaledge.msu.edu site (for "international business resources"), we can add up-to-date materials and exercises to each chapter to add value to the material and provide relevant data and information. This keeps chapter material constantly and dynamically updated for teachers who want to infuse Connect and globalEDGE™ material into the chapter topics, and it keeps students abreast of current developments in international business.

In addition to updating all statistics, figures, and maps to incorporate most recently published data, a chapter-by-chapter selection of changes for the 10th edition include the following:

CHAPTER 1: GLOBALIZATION

- New opening case: GM and Its Chevrolet Supercar, The Corvette ZR1
- New materials on international trade, trade agreements, world production, and world population
- Explanations of differences in cross-border trade and in-country production; the value of trade agreements; and population implications related to resource constraints
- Revised Management Focus: Boeing's Global Production System
- Revised Management Focus: Wanda Group
- New closing case: Globalization of BMW, Rolls-Royce, and the MINI

CHAPTER 2: NATIONAL DIFFERENCES IN POLITICAL, ECONOMIC, AND LEGAL SYSTEMS

- New opening case: Transformation in Saudi Arabia
- New Country Focus: Putin's Russia
- Updated data on corruption
- Updated Country Focus: Corruption in Brazil
- New closing case: The Decline of Zimbabwe

CHAPTER 3: NATIONAL DIFFERENCES IN ECONOMIC DEVELOPMENT

- New opening case: Brazil's Struggling Economy
- Updated statistics and discussion in section Differences in Economic Development
- Updated Country Focus: Property Rights in China
- Updated statistics and discussion in section States in Transition
- New closing case: Economic Development in Bangladesh

CHAPTER 4: DIFFERENCES IN CULTURE

- New opening case: China, Hong Kong, Macau, and Taiwan
- Deeper treatment of culture, values, and norms
- Revised the foundation that most religions are now pro-business
- Updated the Hofstede culture framework with new research
- New Country Focus: Determining Your Social Class by Birth
- New Country Focus: Turkey, Its Religion, and Politics
- New Management Focus: China and Its *Guanxi*
- New closing case: The Swatch Group and Cultural Uniqueness

CHAPTER 5: ETHICS, CORPORATE SOCIAL RESPONSIBILITY, AND SUSTAINABILITY

- New opening case: Sustainability Initiatives at Natura, the Bodyshop, and Aesop
- Deeper focus on corporate social responsibility and sustainability at the country, company, and customer levels
- New Management Focus: "Emissionsgate" at Volkswagen
- New closing case: Woolworths's Corporate Responsibility Strategy

CHAPTER 6: INTERNATIONAL TRADE THEORY

- New opening case: "Trade Wars Are Good and Easy to Win"
- Discussion of President Donald Trump's approach to international trade
- Updated Country Focus: Is China Manipulating Its Currency in Pursuit of a Neo-Mercantilist Policy?
- New closing case: The Trans Pacific Partnership (TPP) Is Dead; Long Live the CPTPP!
- Updated Appendix: International Trade and the Balance of Payments with new data and revised discussion

CHAPTER 7: GOVERNMENT POLICY AND INTERNATIONAL TRADE

- New opening case: U.S. and South Korea Strike a Revised Trade Deal
- New section: The World Trading System Under Threat, which discusses the potential ramifications of Brexit and the trade policies of the Trump administration
- New Closing Case: Boeing and Airbus Are in a Dogfight over Illegal Subsidies

CHAPTER 8: FOREIGN DIRECT INVESTMENT

- New opening case: Geely Goes Global
- Updated statistics and discussion in the section Foreign Direct Investment in the World Economy
- New Management Focus: Burberry Shifts Its Entry Strategy in Japan
- New closing case: FDI in the Indian Retail Sector

CHAPTER 9: REGIONAL ECONOMIC INTEGRATIONS

- New opening case: NAFTA 2.0?
- Extended discussion of Brexit and its ramifications
- New section The Future of NAFTA, which discusses the renegotiation of NAFTA by the Trump administration
- New closing case: Free Trade in Africa: TFTA and CFTA

CHAPTER 10: THE FOREIGN EXCHANGE MARKET

- New opening case: The Fluctuating Value of the Yuan Gives Chinese Business a Lesson in Foreign Exchange Risk
- New closing case: The Mexican Peso, the Japanese Yen, and *Pokemon Go*

CHAPTER 11: THE INTERNATIONAL MONETARY SYSTEM

- New opening case: Can Dollarization Save Venezuela?
- Updated statistics discussion of floating exchange rates through to early 2018
- New Country Focus: China's Exchange Rate Regime
- New Closing Case: Egypt and the IMF

CHAPTER 12: THE STRATEGY OF INTERNATIONAL BUSINESS

- New opening case: Red Bull, a Leader in International Strategy
- Deeper discussion of the rise of regionalism
- Integration of global strategy thoughts
- New Management Focus: IKEA's Global Strategy
- New Management Focus: Unilever's Global Organization
- New closing case: Sony Corporation: An International Innovator?

CHAPTER 13: ENTERING DEVELOPED AND EMERGING MARKETS

- New opening case: IKEA Entering India, Finally!
- New scope of the chapter to include entering developed and emerging markets, as well as aspects of less developed markets
- New closing case: Cutco Corporation—Sharpening Your Market Entry

CHAPTER 14: EXPORTING, IMPORTING, AND COUNTERTRADE

- New opening case: Spotify and SoundCloud
- New material on company readiness to export and import material
- New and revised material on globalEDGE™ Diagnostic Tools, with a focus on Company Readiness to Export (CORE)
- New Management Focus: Embraer and Brazilian Importing
- New Management Focus: Exporting Desserts by a Hispanic Entrepreneur
- New Management Focus: Two Men and a Truck
- New closing case: Tata Motors and Exporting

CHAPTER 15: GLOBAL PRODUCTION AND SUPPLY CHAIN MANAGEMENT

- New opening case: Procter & Gamble Remakes Its Global Supply Chains
- Revised and new material on global logistics, global purchasing, and global operations
- Revised sections Strategic Roles for Production Facilities, Make-or-Buy Decisions, and Global Supply Chain Functions
- New material in the sections Role of Information Technology, Coordination in Global Supply Chains, and Interorganizational Relationships
- New Management Focus: IKEA Production in China
- New Management Focus: Amazon's Global Supply Chains
- New closing case: Alibaba and Global Supply Chains

CHAPTER 16: GLOBAL MARKETING AND BUSINESS ANALYTICS

- New opening case: Fake News and Alternative Facts
- Revised section Globalization of Markets and Brands
- New section on Business Analytics; reordered with International Marketing Research to provide a better flow of the chapter material
- Revised section International Marketing Research
- Inclusion of more social media topics throughout
- Revised positioning of the Product Development and R&D section
- New Management Focus: Global Branding, Marvel Studios, and Walt Disney Company
- New Management Focus: Burberry's Social Media Marketing
- New closing case: ACSI and Satisfying Global Customers

CHAPTER 17: GLOBAL HUMAN RESOURCE MANAGEMENT

- New opening case: Global Mobility at Shell
- New section: Building a Diverse Global Workforce, which looks at the benefits, challenges, and policies for building a diverse global workforce in a multinational enterprise
- New Closing Case: Sodexo: Building a Diverse Global Workforce

Beyond Uncritical Presentation and Shallow Explanation

Many issues in international business are complex and thus necessitate considerations of pros and cons. To demonstrate this to students, we have adopted a critical approach that presents the arguments for and against economic theories, government policies, business strategies, organizational structures, and so on.

Related to this, we have attempted to explain the complexities of the many theories and phenomena unique to international business so the student might fully comprehend the statements of a theory or the reasons a phenomenon is the way it is. We believe that these theories and phenomena are explained in more depth in this work than they are in the competition, which seem to use the rationale that a shallow explanation is little better than no explanation. In international business, a little knowledge is indeed a dangerous thing.

Practical and Rich Applications

We have always believed that it is important to show students how the material covered in the text is relevant to the actual practice of international business. This is explicit in the later chapters of the book, which focus on the practice of international business, but it is not always obvious in the first half of the book, which considers macro topics. Accordingly, at the end of each chapter in Parts Two, Three, and Four—where the focus is on the environment of international business, as opposed to particular firms—there is a section titled **Focus on Managerial Implications**. In this section, the managerial implications of the material discussed in the chapter are clearly explained. Additionally, most chapters have at least one **Management Focus box**. The purpose of these boxes is to illustrate the relevance of chapter material for the practice of international business.

A **Did You Know?** feature in each chapter challenges students to view the world around them through the lens of international business (e.g., Did you know that sugar prices in the United States are much higher than sugar prices in the rest of the world?). The authors recorded short videos explaining the phenomenon.

In addition, each chapter begins with an **opening case** that sets the stage for the chapter and ends with a **closing case** that illustrates the relevance of chapter material for the practice of international business.

To help students go a step further in expanding their application-level understanding of international business, each chapter incorporates two **globalEDGE™ research tasks** designed and written by Tomas Hult. The exercises dovetail with the content just covered.

Integrated Progression of Topics

A weakness of many texts is that they lack a tight, integrated flow of topics from chapter to chapter. This book explains to students in Chapter 1 how the book's topics are related to each other. Integration has been achieved by organizing the material so that each chapter builds on the material of the previous ones in a logical fashion.

PART ONE Chapter 1 provides an overview of the key issues to be addressed and explains the plan of the book. Globalization of markets and globalization of production is the core focus.

PART TWO Chapters 2 through 4 focus on country differences in political economy and culture, and Chapter 5 on ethics, corporate social responsibility, and sustainability issues in international business. Most international business textbooks place this material at a later point, but we believe it is vital to discuss national differences first. After all, many of the central issues in international trade and investment, the global monetary system, international business strategy and structure, and international business functions arise out of national differences in political economy and culture.

PART THREE Chapters 6 through 9 investigate the political economy of global trade and investment. The purpose of this part is to describe and explain the trade and investment environment in which international business occurs.

PART FOUR Chapters 10 and 11 describe and explain the global monetary system, laying out in detail the monetary framework in which international business transactions are conducted.

PART FIVE In Chapters 12 and 13, attention shifts from the environment to the firm. In other words, we move from a macro focus to a micro focus at this stage of the book. We examine strategies that firms adopt to compete effectively in the international business environment.

PART SIX In Chapters 14 through 17, the focus narrows further to investigate business functions and related operations. These chapters explain how firms can perform their key functions—exporting, importing, and countertrade; global production; global supply chain management; global marketing; global research and development (R&D); human resource management—to compete and succeed in the international business environment.

Throughout the book, the relationship of new material to topics discussed in earlier chapters is pointed out to the students to reinforce their understanding of how the material comprises an integrated whole. We deliberately bring a management focus to the macro chapters (Chapters 1 through 11). We also integrate macro themes in covering the micro chapters (Chapters 12 through 17).

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Numerous people deserve to be thanked for their assistance in preparing this book. First, thank you to all the people at McGraw-Hill Education who have worked with us on this project:

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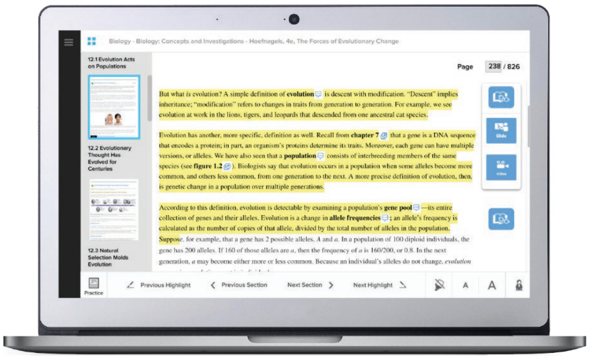

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- Jordan Cunningham,
Eastern Washington University

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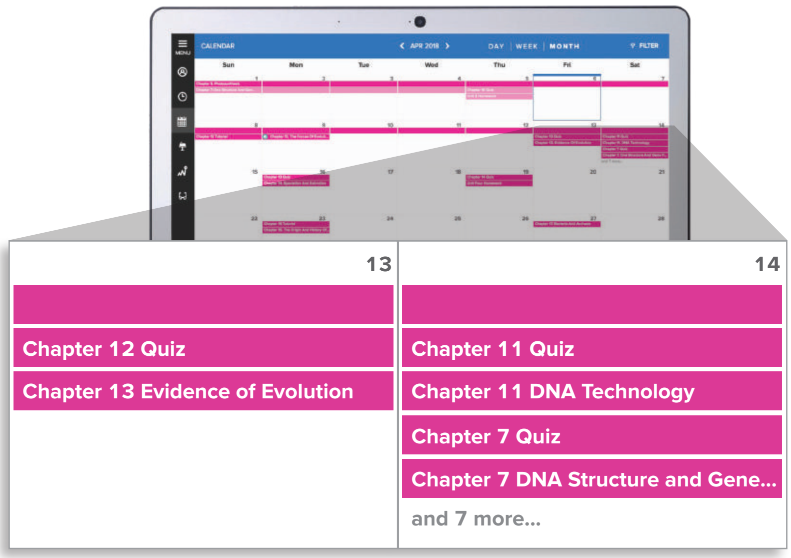

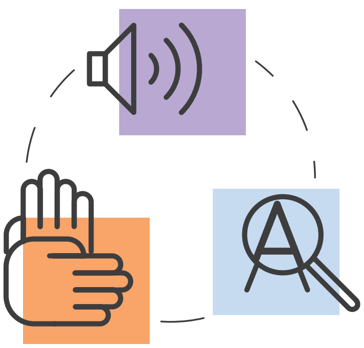

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contents

Global Business Today

Part 1 Introduction and Overview

Globalization

1

Learning Objectives

After reading this chapter, you will be able to:

LO1-1 Understand what is meant by the term *globalization*.

LO1-2 Recognize the main drivers of globalization.

LO1-3 Describe the changing nature of the global economy.

LO1-4 Explain the main arguments in the debate over the impact of globalization.

LO1-5 Understand how the process of globalization is creating opportunities and challenges for management practice.

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GM and Its Chevrolet Supercar, the Corvette ZR1

opening case

The General Motors Company (gm.com), commonly abbreviated as GM (which is also the company's symbol on the New York Stock Exchange), is an American multinational corporation headquartered in Detroit, Michigan, that designs, manufactures, markets, and distributes vehicles and vehicle parts. GM was founded in Flint, Michigan, on September 16, 1908. In addition, to support its auto operations, GM Financial is a wholly owned captive finance subsidiary of General Motors, albeit headquartered in Fort Worth, Texas (and not at the main headquarters location in Detroit).

Interestingly, GM is a large conglomerate with a one-industry focus on automobiles that operates as a holding company for various vehicle brands. Consequently, there are no General Motors, or GM, branded cars. But the company has been around for more than 100 years making vehicles. Today, there are eight distinctive automotive brands under the General Motors umbrella: Chevrolet, Buick, GMC, Cadillac, Holden, Baojun, Wuling, and Jiefang. At one point the company owned more than 20 automobile brands (e.g., Hummer, McLaughlin, Oakland, Oldsmobile, Opel, Pontiac, Saab, Saturn, and Vauxhall).

Within its current brand umbrella, GM is served by about 180,000 employees who speak some 70 different languages, and operate on five continents across 23 time zones. GM delivers about 9 million vehicles via 12,450 dealers in 125 countries annually. China has become critical to GM's operations as one of the company's top markets in recent years, now accounting for about 5 million of the 9 million vehicles sold globally on an annual basis. To support this heavy Chinese focus, GM is building an additional five new manufacturing plants in the country (adding to its already strong Chinese presence of 10 joint ventures and two wholly owned enterprises and more than 58,000 employees).

Within GM, the Chevrolet brand, or vehicle line, occupies a distinctive position for its range of car makes. Amazingly, a Chevrolet is sold somewhere in the world every 8.33 seconds! Louis Chevrolet and then ousted GM founder William C. Durant started Chevrolet in 1911 as the Chevrolet Motor Car Company, and it became part of the General Motors Company in 1918. As of today, Chevrolet-branded vehicles are sold in all markets worldwide. Until 2017, Oceania had been an exception since GM had been represented in that part of the world since the 1980s by its Australian subsidiary, Holden. However, GM has also decided to focus its India manufacturing on producing vehicles for export only and will transition its South Africa manufacturing to Isuzu Motors. Consequently, GM's Chevrolet brand was phased out of both country markets by the end of 2017.

What is not phased out is the Corvette! Chevrolet's sports car, Corvette, has been around since it was introduced at the GM Motorama at the New York Auto Show in 1953. Myron Scott is credited for naming the sports car after a relatively small, maneuverable warship called a corvette. As any automobile brand,

continued

the "Vette" or "Chevy Corvette," has several different brand designations, and the car models are priced from a low of about $60,000 to a high of $160,000. Uniquely, the Corvette ZR1 was again introduced in 2019 (produced from mid-year 2018). This particular Corvette designation, ZR1, had been in production from 1969–1971, 1990–1995, and 2009–2013 before it again made a comeback in 2019.

"ZR1 has returned to the throne to push the Corvette legacy to its highest point ever. It's a supercar that's at once luxurious and overwhelmingly capable, delivering the icon's fastest, most powerful, most advanced performance in a production Corvette to date. Drivers, hail the new King." In much of the world, the Chevrolet Corvette is an instantly recognizable sports car. The pinnacle of its lineup is the ZR1, an extraordinary engine and performance pack that dates back to the 1969 model. But for the 2019 model and on, only 2,000 to 3,000 ZR1s are expected to be produced each year. The car has 755 horsepower, does zero to 60 miles per hour (about 97 kmh) in under 2.85 seconds, and has a top speed of 212 mph (about 341 kmh).

The 2019 ZR1's aerodynamics benefited in design from Corvette's racing teams that compete in races around the world (e.g., the annual 24 Hours of Le Mans endurance race in France). The new version has more carbon fiber parts than any Corvette before it. This includes an optional high wing rising from the rear deck that generates such a powerful downforce that it had to be mounted on the Vette's frame since the trunk would buckle under the pressure. The wing is needed to help keep the car planted solidly on the road at speeds where it might otherwise leave the ground.

Given its periodic dormant production within the Chevrolet Corvette product family, the Corvette ZR1 is a global phenomenon. It is the top of the line Corvette, produced in small numbers, and produced only periodically (and not every year as most other cars). The Corvette is a globally recognizable brand that inspires true passion, engagement, and commitment from its owners.

The global branding and a testament to its staying power are nicely exemplified by the first 2019 Corvette ZR1 having been sold for $925,000 at a Barrett-Jackson auction in Scottsdale, Arizona. It was sold to Rick Hendrick, Chairman of Hendrick Automotive Group and owner of the Hendrick Motorsports NASCAR team. The price was a hefty markup paid to be first to get the new 2019 version of ZR1, since the Corvette ZR1 starts at about $120,000. However, the full sales price benefited the Stephen Siller Tunnel to Towers Foundation—a charitable foundation—and so the high sticker price went to a good cause. ●

Sources: "Corvette ZR-1: Consider the Pace Set," Chevrolet, www.chevrolet.com/performance/corvette-zr1-supercar (accessed April 16, 2018); Hannah Elliott, "GM Takes On Ferrari and Lamborghini with the 2019 Corvette ZR1," *Bloomberg BusinessWeek*, November 29, 2017; Bradley Brownell, "The First Corvette ZR1 Just Sold For $925,000," *Jalopnik,* January 21, 2018; Mark Phelan, "First Look: 2019 Chevy Corvette ZR1 Convertible Is Faster and More Powerful than Ever," *Detroit Free Press*, November 29, 2017; David Hollister, Ray Tadgerson, David Closs, and Tomas Hult, "Second Shift: The Inside Story of the Keep GM Movement," McGraw-Hill Professional, 2016; and Chris Davies, "2019 Corvette ZR1: 5 Fast Facts About Chevy's New Supercar," *Slash Gear*, November 13, 2017.

Introduction

Over the past five decades, a fundamental shift has been occurring in the world economy. We have been moving away from a world in which national economies were relatively self-contained entities, isolated from each other by barriers to cross-border trade and investment; by distance, time zones, and language; and by national differences in government regulation, culture, and business systems. As we will see later on in this chapter and throughout the text, international trade across country borders has become the norm, with an almost exponential increase in trade during the last decade.

We are moving toward a world in which barriers to cross-border trade and investment are declining; perceived distance is shrinking due to advances in transportation and telecommunications technology; material culture is starting to look similar the world over; and national economies are merging into an interdependent, integrated global economic system. The process by which this transformation is occurring is commonly referred to as *globalization*. At the same time, recent political world events (e.g., increase of terrorism in many parts of the world, the United Kingdom leaving the European Union, and elections globally of nationalistic politicians) create tension and uncertainty regarding the future of global trade activities. These political swings usually temper, or even out, over time in democratic societies, and long-term indications generally are for stability in the marketplace. We are unlikely to backtrack on globalization and global companies' willingness to satisfy the needs and wants of global customers.

For example, as described in the opening case, General Motors and its Chevrolet brand are an illustration of the trend toward the unique opportunities that globalization can present to a company. It is pretty amazing to think that a Chevrolet is sold somewhere in the world every 8.33 seconds! However, it is clear that within GM's global product portfolio (Chevrolet, Buick, GMC, Cadillac, Holden, Baojun, Wuling, and Jiefang), the Chevrolet brand occupies a distinctive position. People in the U.S. know Chevrolet along with GM's other core brands (Buick, GMC, and Cadillac) well but have not been exposed so much to Holden, Baojun, Wuling, and Jiefang. GM uses Holden to focus on Oceania and also manufactures and sells numerous Baojun, Wuling, and Jiefang vehicles in the important Chinese market. As we've mentioned, five million of GM's nine million annual vehicle sales are in the Chinese market.

Proponents of increased global trade argue that cross-cultural engagement and trade across country borders is the future and that returning back to a nationalistic perspective is the past. On the other hand, the nationalistic argument rests in citizens wanting their country to be sovereign, self-sufficient as much as possible, and basically in charge of their own economy and country environment. As with any debate, both sides of the argument have merit. We will explore many aspects of today's global marketplace in this text's 17 integrated and topical chapters.

Globalization now has an impact on almost everything we do. For example, an American medical doctor—let's call her Laurie—might drive to work at her pediatric office in a sports utility vehicle (SUV) that was designed in Stuttgart, Germany, and assembled in Leipzig, Germany, and Bratislava, Slovakia, by Porsche from components from parts suppliers worldwide, which in turn were fabricated from Korean steel and Malaysian rubber. Laurie may have filled her car with gasoline at a Shell service station owned by a British-Dutch multinational company. The gasoline could have been made from oil pumped out of a well off the coast of Africa by a French oil company that transported it to the United States in a ship owned by a Greek shipping line. While driving to work, Laurie might talk to her stockbroker (using a hands-free, in-car speaker) on an Apple iPhone that was designed in California and assembled in China using chip sets produced in Japan and Europe, glass made by Corning in Kentucky, and memory chips from South Korea. Perhaps on her way Laurie might tell the stockbroker to purchase shares in Lenovo, a multinational Chinese PC manufacturer whose operational headquarters is in North Carolina and whose shares are listed on the New York Stock Exchange.

This is the world in which we live. In many cases we simply do not know or perhaps even care where a product was designed and where it was made. Just a couple of decades ago, "Made in the USA" or "Made in Germany" (or "Made in the United Kingdom" for Charles W. L. Hill, the first author of this textbook, or "Made in Sweden" for G. Tomas M. Hult, the second author of this textbook) had strong meaning and referred to something. The U.S. often stood for quality and Germany often stood for sophisticated engineering. Now the country of origin for a product has given way to, for example, "Made by BMW," and the company is the quality assurance platform, not the country. In many cases, it goes even beyond the company to the personal relationship a customer has developed with a representative of the company, and so we focus on what has become known as CRM (Customer Relationship Management).

Whether it is still the quality associated with the country of origin of a product, or the assurance given by a specific company regardless of where they manufacture their product, we live in a world where the volume of goods, services, and investments crossing national borders has expanded faster than world output for more than half a century. It is a world in which international institutions such as the World Trade Organization and gatherings of leaders from the world's most powerful economies continue to work for even lower barriers to cross-border trade and investment. The symbols of material culture and popular culture are increasingly global, from Coca-Cola and Starbucks, to Sony PlayStation, Facebook, Netflix video streaming service, IKEA stores, and Apple iPads and iPhones. Vigorous and vocal groups protest against globalization, which they blame for a list of ills from unemployment in developed nations to environmental

Will the United States Produce Just Services?

The United States has the largest and most technologically powerful economy in the world, with a per capita GDP (gross domestic product) of $57,466. The country's overall GDP is valued at $18.57 trillion. Most of the labor force (80 percent) is employed in the services sector, with 19 percent employed in manufacturing industries, and only 1 percent in the agricultural area. China, India, and the European Union have labor forces larger than that of the United States. Data show that the United States has become much more of a service economy over the years. Will the United States continue to increase its service sector at the cost of manufacturing and agriculture?

Source: U.S. Central Intelligence Agency, *World Factbook*, 2019. www.cia.gov.

degradation and the Westernization or Americanization of local cultures. These protesters come from environmental groups, which have been around for some time, but more recently also from nationalistic groups focused on their countries being more sovereign.

For businesses, the globalization process has many opportunities. Firms can expand their revenues by selling around the world and/or reduce their costs by producing in nations where key inputs, including labor, are cheap. The global expansion of enterprises has been facilitated by generally favorable political and economic trends. This has allowed businesses both large and small, from both advanced nations and developing nations, to expand internationally. As globalization unfolds, it is transforming industries and creating anxiety among those who believed their jobs were protected from foreign competition. Advances in technology, lower transportation costs, and the rise of skilled workers in developing countries imply that many services no longer need to be performed where they are delivered. As best-selling author Thomas Friedman has argued, the world is becoming "flat."[1] People living in developed nations no longer have the playing field tilted in their favor. Increasingly, enterprising individuals based in India, China, or Brazil have the same opportunities to better themselves as those living in Western Europe, the United States, or Canada.

In this text, we will take a close look at these issues and many more. We will explore how changes in regulations governing international trade and investment, when coupled with changes in political systems and technology, have dramatically altered the competitive playing field confronting many businesses. We will discuss the resulting opportunities and threats and review the strategies that managers can pursue to exploit the opportunities and counter the threats. We will consider whether globalization benefits or harms national economies. We will look at what economic theory has to say about the outsourcing of manufacturing and service jobs to places such as India and China and look at the benefits and costs of outsourcing, not just to business firms and their employees but to entire economies. First, though, we need to get a better overview of the nature and process of globalization, and that is the function of this first chapter.

What Is Globalization?

LO 1-1
Understand what is meant by the term *globalization*.

globalization
Trend away from distinct national economic units and toward one huge global market.

globalization of markets
Moving away from an economic system in which national markets are distinct entities, isolated by trade barriers and barriers of distance, time, and culture, and toward a system in which national markets are merging into one global market.

As used in this text, **globalization** refers to the shift toward a more integrated and interdependent world economy. Globalization has several facets, including the globalization of markets and the globalization of production.

THE GLOBALIZATION OF MARKETS

The **globalization of markets** refers to the merging of historically distinct and separate national markets into one huge global marketplace. Falling barriers to cross-border trade and investment have made it easier to sell internationally. It has been argued for some time that the tastes and preferences of consumers in different nations are beginning to converge on some global norm, thereby helping create a global market.[2] Consumer products such as Citigroup credit cards, Coca-Cola soft drinks, Sony video games, McDonald's hamburgers, Starbucks coffee, IKEA furniture, and Apple iPhones are frequently held up as prototypical examples of this trend. The firms that produce these products are more than just benefactors of this trend; they are also facilitators of it. By offering the same basic product worldwide, they help create a global market.

A company does not have to be the size of these multinational giants to facilitate, and benefit from, the globalization of markets. In the United States, for example, according to the International Trade Administration, more than 300,000 small- and medium-size firms with fewer than 500 employees export, accounting for 98 percent of the companies that export. More generally,

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exports from small- and medium-size companies account for 33 percent of the value of U.S. exports of manufactured goods.[3] Typical of these is B&S Aircraft Alloys, a New York company whose exports account for 40 percent of its $8 million annual revenues.[4] The situation is similar in several other nations. For example, in Germany, a staggering 98 percent of small and midsize companies have exposure to international markets, via either exports or international production. Since 2009, China has been the world's largest exporter, sending more than $2 trillion worth of products and services last year to the rest of the world.

Despite the global prevalence of Citigroup credit cards, McDonald's hamburgers, Starbucks coffee, and IKEA stores, for example, it is important not to push too far the view that national markets are giving way to the global market. As we shall see in later chapters, significant differences still exist among national markets along many relevant dimensions, including consumer tastes and preferences, distribution channels, culturally embedded value systems, business systems, and legal regulations. Uber, for example, the fast-growing ride-for-hire service, is finding that it needs to refine its entry strategy in many foreign cities in order to take differences in the regulatory regime into account. Such differences frequently require companies to customize marketing strategies, product features, and operating practices to best match conditions in a particular country.

The most global of markets are not typically markets for consumer products—where national differences in tastes and preferences can still be important enough to act as a brake on globalization—but markets for industrial goods and materials that serve universal needs the world over. These include the markets for commodities such as aluminum, oil, and wheat; for industrial products such as microprocessors, DRAMs (computer memory chips), and commercial jet aircraft; for computer software; and for financial assets from U.S. Treasury bills to Eurobonds and futures on the Nikkei index or the euro. That being said, it is increasingly evident that many newer high-technology consumer products, such as Apple's iPhone, are being successfully sold the same way the world over.

In many global markets, the same firms frequently confront each other as competitors in nation after nation. Coca-Cola's rivalry with PepsiCo is a global one, as are the rivalries between Ford and Toyota; Boeing and Airbus; Caterpillar and Komatsu in earthmoving equipment; General Electric and Rolls-Royce in aero engines; Sony, Nintendo, and Microsoft in video-game consoles; and Samsung and Apple in smartphones. If a firm moves into a nation not currently served by its rivals, many of those rivals are sure to follow to prevent their competitor from gaining an advantage.[5] As firms follow each other around the world, they bring with them many of the assets that served them well in other national markets—their products, operating strategies, marketing strategies, and brand names—creating some homogeneity across markets. Thus, greater uniformity replaces diversity. In an increasing number of industries, it is no longer meaningful to talk about "the German market," "the American market," "the Brazilian market," or "the Japanese market"; for many firms, there is only the global market.

globalization of production

Trend by individual firms to disperse parts of their productive processes to different locations around the globe to take advantage of differences in cost and quality of factors of production.

factors of production

Inputs into the productive process of a firm, including labor, management, land, capital, and technological know-how.

Did You Know?

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THE GLOBALIZATION OF PRODUCTION

The **globalization of production** refers to the sourcing of goods and services from locations around the globe to take advantage of national differences in the cost and quality of **factors of production** (such as labor, energy, land, and capital). By doing this, companies hope to lower their overall cost structure or improve the quality or functionality of their product offering, thereby allowing them to compete more effectively. For example, Boeing has made extensive use of outsourcing to foreign suppliers. Consider Boeing's 777: eight Japanese suppliers make parts for the fuselage, doors, and wings; a supplier in Singapore makes the doors for the nose landing gear; three suppliers in Italy manufacture wing flaps; and so on.[6] In total, some 30 percent of the 777, by value, is built by foreign companies. And for its most recent jet airliner, the 787, Boeing has pushed this trend even further; some 65 percent of the total value of the aircraft is outsourced to foreign companies, 35 percent of which goes to three major Japanese companies.

Part of Boeing's rationale for outsourcing so much production to foreign suppliers is that these suppliers are the best in the world at their particular activity. A global web of suppliers yields a better final product, which enhances the chances of Boeing winning a greater share of total orders for aircraft than its global rival, Airbus. Boeing also outsources some production to foreign countries to increase the chance that it will win significant orders from airlines based in that country. For a more detailed look at the globalization of production at Boeing, see the accompanying Management Focus.

Early outsourcing efforts were primarily confined to manufacturing activities, such as those undertaken by Boeing and Apple. Increasingly, however, companies are taking advantage of modern communications technology, particularly the Internet, to outsource service activities to low-cost producers in other nations. The Internet has allowed hospitals to outsource some radiology work to India, where images from MRI scans and the like are read at night while U.S. physicians sleep; the results are ready for them in the morning. Many software companies, including Microsoft, now use Indian engineers to perform test functions on software designed in the United States. The time difference allows Indian engineers to run debugging tests on software written in the United States when U.S. engineers sleep, transmitting the corrected code back to the United States over secure Internet connections so it is ready for U.S. engineers to work on the following day. Dispersing value-creation activities in this way can compress the time and lower the costs required to develop new software programs. Other companies, from computer makers to banks, are outsourcing customer service functions, such as customer call centers, to developing nations where labor is cheaper. In another example from health care, workers in the Philippines transcribe American medical files (such as audio files from doctors seeking approval from insurance companies for performing a procedure). Some estimates suggest the outsourcing of many administrative procedures in health care, such as customer service and claims processing, could reduce health care costs in America by more than $100 billion.

The economist Robert Reich has argued that as a consequence of the trend exemplified by companies such as Boeing, Apple, and Microsoft, in many cases it is becoming irrelevant to talk about American products, Japanese products, German products, or Korean products. Increasingly, according to Reich, the outsourcing of productive activities to different suppliers results in the creation of products that are global in nature, that is, "global products."[7] But as with the globalization of markets, companies must be careful not to push the globalization of production too far. As we will see in later chapters, substantial impediments still make it difficult for firms to achieve the optimal dispersion of their productive activities to locations around the globe. These impediments include formal and informal barriers to trade between countries, barriers to foreign direct investment, transportation costs, issues associated with economic and political risk, and the sheer managerial challenge of coordinating a globally dispersed supply chain (an issue for Boeing with the 787 Dreamliner, as discussed in the Management Focus). For example, government regulations ultimately limit the ability of hospitals to outsource the process of interpreting MRI scans to developing nations where radiologists are cheaper.

Nevertheless, the globalization of markets and production will probably continue. Modern firms are important actors in this trend, their very actions fostering increased globalization. These firms, however, are merely responding in an efficient manner to changing conditions in their operating environment—as well they should.

management FOCUS

Boeing's Global Production System

Executives at the Boeing Corporation, America's largest exporter, say that building a large commercial jet aircraft like the 787 Dreamliner involves bringing together more than a million parts in flying formation. Half a century ago, when the early models of Boeing's venerable 737 and 747 jets were rolling off the company's Seattle-area production lines, foreign suppliers accounted for only 5 percent of those parts on average. Boeing was vertically integrated and manufactured many of the major components that went into the planes. The largest parts produced by outside suppliers were the jet engines, where two of the three suppliers were American companies. The lone foreign engine manufacturer was the British company Rolls-Royce.

Fast-forward to the modern era, and things look very different. In the case of Boeing's super-efficient 787 Dreamliner, 50 outside suppliers spread around the world account for 65 percent of the value of the aircraft. Italian firm Alenia Aeronautica makes the center fuselage and horizontal stabilizer. Kawasaki of Japan makes part of the forward fuselage and the fixed trailing edge of the wing. French firm Messier-Dowty makes the aircraft's landing gear. German firm Diehl Luftahrt Elektronik supplies the main cabin lighting. Sweden's Saab Aerostructures makes the access doors. Japanese company Jamco makes parts for the lavatories, flight deck interiors, and galleys. Mitsubishi Heavy Industries of Japan makes the wings. KAA of Korea makes the wing tips. And so on.

Why the change? One reason is that 80 percent of Boeing's customers are foreign airlines, and to sell into those nations, it often helps to be giving business to those nations. The trend started in 1974 when Mitsubishi of Japan was given contracts to produce inboard wing flaps for the 747. The Japanese reciprocated by placing big orders for Boeing jets. A second rationale was to disperse component part production to those suppliers who are the best in the world at their particular activity. Over the years, for example, Mitsubishi has acquired considerable expertise in the manufacture of wings, so it was logical for Boeing to use Mitsubishi to make the wings for the 787. Similarly, the 787 is the first commercial jet aircraft to be made almost entirely out of carbon fiber, so Boeing tapped Japan's Toray Industries, a world-class expert in sturdy but light carbon-fiber composites, to supply materials for the fuselage. A third reason for the extensive outsourcing on the 787 was that Boeing wanted to unburden itself of some of the risks and costs associated with developing production facilities for the 787. By outsourcing, it pushed some of those risks and costs onto suppliers, who had to undertake major investments in capacity to ramp up to produce for the 787.

So what did Boeing retain for itself? Engineering design, marketing and sales, and final assembly are done at its Everett plant north of Seattle, all activities where Boeing maintains it is the best in the world. Of major component parts, Boeing made only the tail fin and wing to body fairing (which attaches the wings to the fuselage of the plane). Everything else was outsourced.

As the 787 moved through development, it became clear that Boeing had pushed the outsourcing paradigm too far. Coordinating a globally dispersed production system this extensive turned out to be very challenging. Parts turned up late, some parts didn't "snap together" the way Boeing had envisioned, and several suppliers ran into engineering problems that slowed down the entire production process. As a consequence, the date for delivery of the first jet was pushed back more than four years, and Boeing had to take millions of dollars in penalties for late deliveries. The problems at one supplier, Vought Aircraft in North Carolina, were so severe that Boeing ultimately agreed to acquire the company and bring its production in-house. Vought was co-owned by Alenia of Italy and made parts of the main fuselage.

There are now signs that Boeing is rethinking some of its global outsourcing policy. For its next jet, a new version of its popular wide-bodied 777 jet, the 777X, which will use the same carbon-fiber technology as the 787, Boeing will bring wing production back in-house. Mitsubishi and Kawasaki of Japan produce much of the wing structure for the 787 and for the original version of the 777. However, recently Japan's airlines have been placing large orders with Airbus, breaking with their traditional allegiance to Boeing. This seems to have given Boeing an opening to bring wing production back in-house. Boeing executives also note that Boeing has lost much of its expertise in wing production over the last 20 years due to outsourcing, and bringing it back in-house for new carbon-fiber wings might enable Boeing to regain these important core skills and strengthen the company's competitive position.

Sources: M. Ehrenfreund, "The Economic Reality Behind the Boeing Plane Trump Showed Off," *The Washington Post*, February 17, 2017; K. Epstein and J. Crown, "Globalization Bites Boeing," *Bloomberg Businessweek*, March 12, 2008; H. Mallick, "Out of Control Outsourcing Ruined Boeing's Beautiful Dreamliner," *The Star*, February 25, 2013; P. Kavilanz, "Dreamliner: Where in the World Its Parts Come From," *CNN Money*, January 18, 2013; S. Dubois, "Boeing's Dreamliner Mess: Simply Inevitable?" *CNN Money*, January 22, 2013; and A. Scott and T. Kelly, "Boeing's Loss of a $9.5 Billion Deal Could Bring Jobs Back to the U.S.," *Business Insider*, October 14, 2013.

The Emergence of Global Institutions

As markets globalize and an increasing proportion of business activity transcends national borders, institutions are needed to help manage, regulate, and police the global marketplace and to promote the establishment of multinational treaties to govern the global business system. Over the past half-century, a number of important global institutions have been created to help perform these functions, including the **General Agreement on Tariffs and Trade (GATT)** and its successor, the World Trade Organization; the International Monetary Fund and its sister institution, the World Bank; and the United Nations. All these institutions were created by voluntary agreement between individual nation-states, and their functions are enshrined in international treaties.

The **World Trade Organization (WTO)** (like the GATT before it) is primarily responsible for policing the world trading system and making sure nation-states adhere to the rules

General Agreement on Tariffs and Trade (GATT)
International treaty that committed signatories to lowering barriers to the free flow of goods across national borders and led to the WTO.

World Trade Organization (WTO)
The organization that succeeded the General Agreement on Tariffs and Trade (GATT) as a result of the successful completion of the Uruguay Round of GATT negotiations.

Can the International Court of Justice Be Effective?

The International Court of Justice (www.icj-cij.org) is the principal judicial organ of the United Nations (UN). Of the six principal organs of the UN, it is the only one not located in New York (United States); instead, the seat of the Court is at the Peace Palace in The Hague (Netherlands). The court's role is to settle, in accordance with international law, legal disputes submitted to it by countries and to give advisory opinions on legal questions referred to it by authorized United Nations organs and specialized agencies. But how effective can the UN International Court of Justice really be in the global marketplace with its many legal systems?

Source: www.icj-cij.org/en/court.

laid down in trade treaties signed by WTO member states. As of 2017, 164 nations that collectively accounted for 98 percent of world trade were WTO members, thereby giving the organization enormous scope and influence. The WTO is also responsible for facilitating the establishment of additional multinational agreements among WTO member states. Over its entire history, and that of the GATT before it, the WTO has promoted the lowering of barriers to cross-border trade and investment. In doing so, the WTO has been the instrument of its member states, which have sought to create a more open global business system unencumbered by barriers to trade and investment between countries. Without an institution such as the WTO, the globalization of markets and production is unlikely to have proceeded as far as it has. However, as we shall see in this chapter and in Chapter 7 when we look closely at the WTO, critics charge that the organization is usurping the national sovereignty of individual nation-states.

International Monetary Fund (IMF)
International institution set up to maintain order in the international monetary system.

World Bank
International institution set up to promote general economic development in the world's poorer nations.

The **International Monetary Fund (IMF)** and the **World Bank** were both created in 1944 by 44 nations that met at Bretton Woods, New Hampshire. The IMF was established to maintain order in the international monetary system; the World Bank was set up to promote economic development. In the more than seven decades since their creation, both institutions have emerged as significant players in the global economy. The World Bank is the less controversial of the two sister institutions. It has focused on making low-interest loans to cash-strapped governments in poor nations that wish to undertake significant infrastructure investments (such as building dams or roads).

The IMF is often seen as the lender of last resort to nation-states whose economies are in turmoil and whose currencies are losing value against those of other nations. During the past two decades, for example, the IMF has lent money to the governments of troubled states including Argentina, Indonesia, Mexico, Russia, South Korea, Thailand, and Turkey. More recently, the IMF took a proactive role in helping countries cope with some of the effects of the 2008–2009 global financial crisis. IMF loans come with strings attached, however; in return for loans, the IMF requires nation-states to adopt specific economic policies aimed at returning their troubled economies to stability and growth. These requirements have sparked controversy. Some critics charge that the IMF's policy recommendations are often inappropriate; others maintain that by telling national governments what economic policies they must adopt, the IMF, like the WTO, is usurping the sovereignty of nation-states. We will look at the debate over the role of the IMF in Chapter 11.

United Nations (UN)
An international organization made up of 193 countries headquartered in New York City, formed in 1945 to promote peace, security, and cooperation.

The **United Nations (UN)** was established October 24, 1945, by 51 countries committed to preserving peace through international cooperation and collective security. Today, nearly every nation in the world belongs to the United Nations; membership now totals 193 countries. When states become members of the United Nations, they agree to accept the obligations of the UN Charter, an international treaty that establishes basic principles of international relations. According to the charter, the UN has four purposes: to maintain international peace and security, to develop friendly relations among nations, to cooperate in solving international problems and in promoting respect for human rights, and to be a center for harmonizing the actions of nations. Although the UN is perhaps best known for its peacekeeping role, one of the organization's central mandates is the promotion of higher standards of living, full employment, and conditions of economic and social progress and development—all issues that are central to the creation of a vibrant global economy. As much as 70 percent of the work of the UN system is devoted to accomplishing this mandate. To do so, the UN works closely with other international institutions such as the World Bank. Guiding the work is the belief that eradicating poverty and improving the well-being of people everywhere are necessary steps in creating conditions for lasting world peace.[8]

Group of Twenty (G20)
Established in 1999, the G20 comprises the finance ministers and central bank governors of the 19 largest economies in the world, plus representatives from the European Union and the European Central Bank.

Another institution in the news is the **Group of Twenty (G20)**. Established in 1999, the G20 comprises the finance ministers and central bank governors of the 19 largest economies in the world, plus representatives from the European Union and the European Central Bank. Collectively, the G20 represents 90 percent of global GDP and 80 percent of international global trade. Originally established to formulate a coordinated policy response to financial crises in developing nations, in 2008 and 2009 it became the forum through which major nations attempted to launch a coordinated policy response to the global financial crisis that started in America and then rapidly spread around the world, ushering in the first serious global economic recession since 1981.

How Important is the European Union Among the Group of Twenty (G20)?

There have been twelve G20 Leaders' Summits since they started in 2008. The Group of Twenty includes 19 prominent countries and the European Union (Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, United Kingdom, United States, and the European Union). G20 members represent about 85 percent of global GDP, 80 percent of global trade, and about two-thirds of the world's population. Now, is it really right for the G20 to include 19 countries and one union entity (the European Union), or should the European Union countries be selected individually (as some already are)?

Source: www.g20.org/en.

Drivers of Globalization

Two macro factors underlie the trend toward greater globalization.[9] The first is the decline in barriers to the free flow of goods, services, and capital that has occurred in recent decades. The second factor is technological change, particularly the dramatic developments in communication, information processing, and transportation technologies.

LO 1-2 Recognize the main drivers of globalization.

international trade Occurs when a firm exports goods or services to consumers in another country.

foreign direct investment (FDI) Direct investment in business operations in a foreign country.

DECLINING TRADE AND INVESTMENT BARRIERS During the 1920s and 1930s, many of the world's nation-states erected formidable barriers to international trade and foreign direct investment. **International trade** occurs when a firm exports goods or services to consumers in another country. **Foreign direct investment (FDI)** occurs when a firm invests resources in business activities outside its home country. Many of the barriers to international trade took the form of high tariffs on imports of manufactured goods. The typical aim of such tariffs was to protect domestic industries from foreign competition. One consequence, however, was "beggar thy neighbor" retaliatory trade policies, with countries progressively raising trade barriers against each other. Ultimately, this depressed world demand and contributed to the Great Depression of the 1930s.

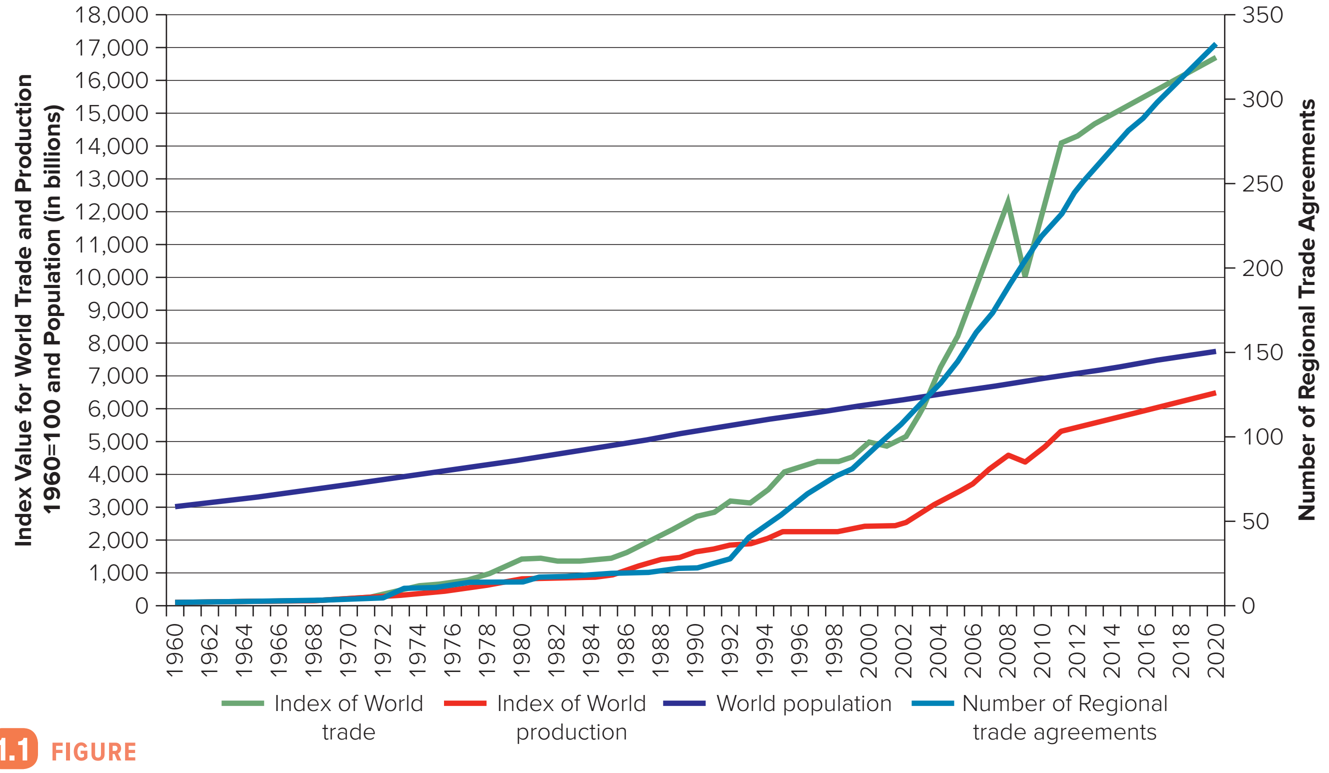
Having learned from this experience, the advanced industrial nations of the West committed themselves after World War II to progressively reducing barriers to the free flow of goods, services, and capital among nations.[10] This goal was enshrined in the General Agreement on Tariffs and Trade. Under the umbrella of GATT, eight rounds of negotiations among member states worked to lower barriers to the free flow of goods and services. The first round of negotiations went into effect in 1948. The most recent negotiations to be completed, known as the Uruguay Round, were finalized in December 1993. The Uruguay Round further reduced trade barriers; extended GATT to cover services as well as manufactured goods; provided enhanced protection for patents, trademarks, and copyrights; and established the World Trade Organization to police the international trading system.[11] Table 1.1 summarizes the impact of GATT agreements on average tariff rates for *manufactured* goods among several developed nations. As can be seen, average

1.1 TABLE

Average Tariff Rates on Manufactured Products as Percentage of Value

	1913	1950	1990	2017
France	21%	18%	5.9%	1.9%
Germany	20	26	5.9	1.9
Italy	18	25	5.9	1.9
Japan	30	—	5.3	2.1
Netherlands	5	11	5.9	1.9
Sweden	20	9	4.4	1.9
United Kingdom	—	23	5.9	1.9
United States	44	14	4.8	3.0

Sources: The 1913–1990 data are from "Who Wants to Be a Giant?" The Economist: A Survey of the Multinationals, *June 24, 1995, pp. 3–4. The 2017 data are from the* World Development Indicators, *World Bank.*



1.1 FIGURE

Index value of world trade and world production (1960=100), world population (billions), and number of regional trade agreements.

Sources: World Bank, 2018; World Trade Organization, 2018; United Nations, 2018.

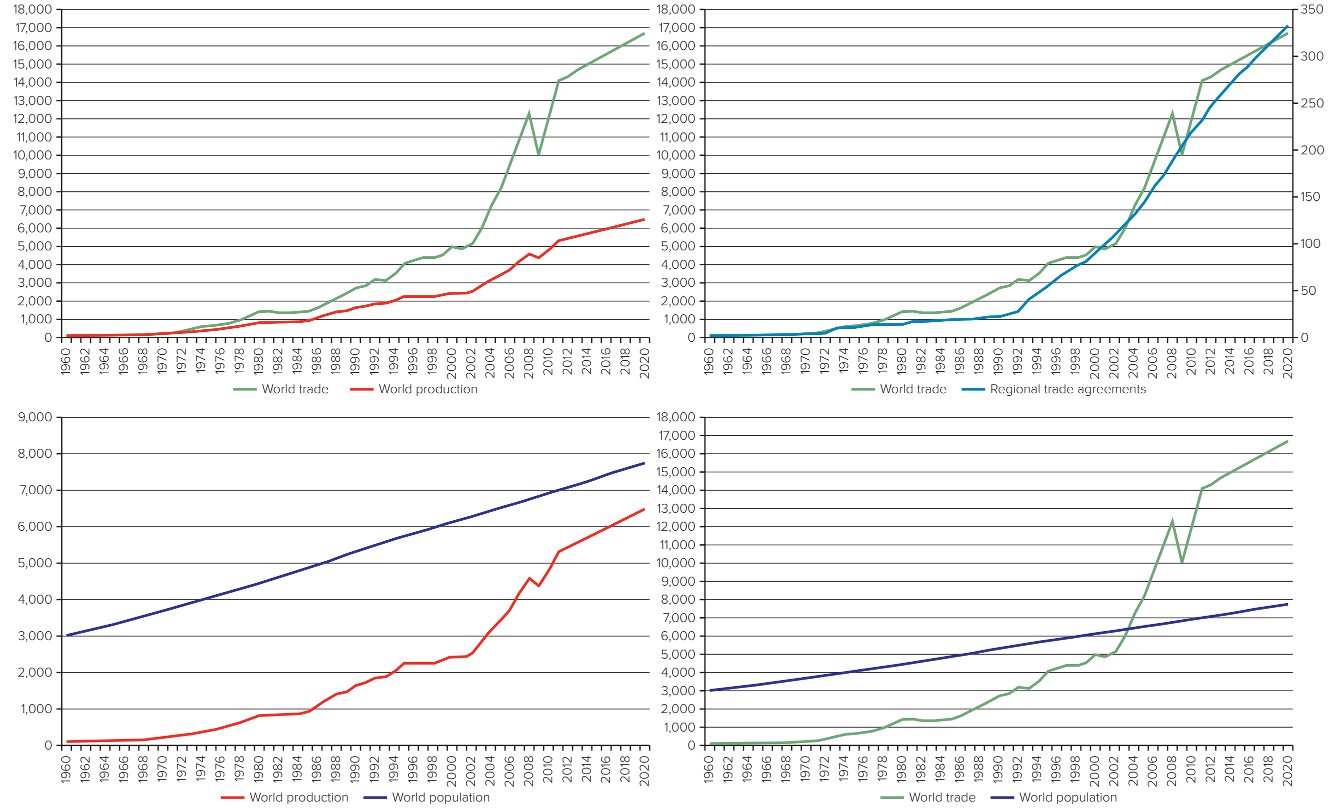
tariff rates have fallen significantly since 1950 and now stand at about 2.0–3.0 percent. Comparable tariff rates in 2017 for China and India were about 8 percent. However, it should be noted that while the long term trend has been towards lower tariff rates, it is possible that recent increases in tariff rates imposed by the Trump Administration in the U.S. could signify a reversal of this trend.

Knowledge Society and Trade Agreements

Figure 1.1 reports on the value of world trade, world production, and active regional trade agreements in the world along with the world population from 1960 to 2020 (the last three years being forecast data). Trade and production are indexed to 100 in 1960 (the index calculation is based on current prices and not adjusted for inflation). The figure illustrates some interesting changing globalization trends. For example, according to the World Trade Organization, the value of world trade in merchandised goods has grown consistently faster than the world economy since 1960, and the chart shows that this growth has been markedly higher since the turn of the century (note that the index values in the chart are based on current prices, and are not adjusted for inflation).

As a consequence, when adjusted for inflation, by 2020 the value of world trade is expected to be around 21 times larger than it was in 1960, whereas the world economy will be around 9.3 times larger. This trend has continued into the modern era. Between 2000 and 2017, the value of world trade increased 98 percent whereas the world economy has increased by 74 percent in real terms (adjusted for inflation). The forecast is that world trade will continue to increase more rapidly than world production for the foreseeable future.

The difference in the growth rates of world production and world trade is why studying international business is so important. While we produce more goods and services today compared with before, a far greater proportion of that production is being traded across national borders than at any time in modern history. Moreover, the knowledge society that we live in has resulted in consumers knowing more than ever about goods and services being produced worldwide. From a customer perspective, this is driving demand for internationally traded goods. Thus, the larger the difference between the growth rates of world trade and world production, the greater the extent of globalization and the more important it becomes to understand international business.



1.2 FIGURE

Comparisons of index of world trade and world population; index of world trade and number of regional trade agreements; world population and index of world production; and world population and index of world trade (index 1960 = 100).

Sources: World Bank, 2019; World Trade Organization, 2018; United Nations, 2018.

Additionally, despite the recent wave of nationalism around the world (e.g., Brexit, the 2016 U.S. presidential election), many countries have been progressively removing restrictions to foreign direct investment over the past 20 years. According to the United Nations, some 80 percent of the 1,440 changes made worldwide since 2000 in the laws governing foreign direct investment created a more favorable environment for FDI. Basically, the pressure from customers to make available any goods and services anywhere for their needs and wants has been facilitated by country governments removing restrictions on imports to their countries.

Such customer pressures and restrictions removal by countries have been driving both the globalization of markets and the globalization of production. The lowering of barriers to international trade enables firms to view the world, rather than a single country, as their market. The lowering of trade and investment barriers also allows firms to base production at the optimal location for that activity. Thus, a firm might design a product in one country, produce component parts in two other countries, assemble the product in yet another country, and then export the finished product around the world.

Another important facilitator of trade across country borders is the increased number of trade agreements that have been implemented in the world. Figure 1.1 reports on regional trade agreements in force today (more than two countries involved), with another roughly 300 bilateral trade agreements between two countries also active worldwide. There is no doubt that trade at least between the countries in a trade agreement has been a strong reason for the increase overall in world trade. Figure 1.1 illustrates the almost 1:1 match of the trade agreement and world trade curves on the chart. That is, as regional trade agreements in force increase year-by-year, so does world trade across country borders at the same pace.

Two additional implications can be gleaned from the data in Figure 1.1 that could become important for the global marketplace. These are illustrated in separate charts in Figure 1.2. The first implication relates to sustainability—a topic we will cover much more in Chapter 5. In 2000,

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the United Nations established the Millennium Development Goals to reduce the number of people who live in extreme poverty by 2015. Subsequently, in September 2015, the United Nations and its 193 member countries ratified the Sustainable Development Goals that set targets to end poverty, protect the planet, and ensure prosperity for all countries by 2030 as part of a new sustainability agenda.[12] The urgency of delivering on the UN's Sustainable Development Goals can be traced to the difference between the world production and population data. As world production approaches the total population curve, we can infer that resource availability for all of our needs and wants in the world's 260 countries and territories will potentially be drastically constrained.

The chart in Figure 1.1 also indicates that our needs worldwide are still rather "spiky" and not as flat as Tom Friedman projected in 2004. Trading across country borders is significantly more pronounced today than ever before, growing at a rate above the population growth of the world. These two curves are likely to not intersect any time soon, and coupled with the large difference between world trade and world production, especially in the last 20 years, we will see a world consumer market where localized needs and wants are still very much unique in a large set of industries and product categories. Overall, though, the fact that the volume of world trade has been growing faster than world GDP implies several things.

The fact that the volume of world trade has been growing faster than world GDP implies several things. First, more firms are doing what Boeing does with the 777 and 787: dispersing parts of their production process to different locations around the globe to drive down production costs and increase product quality. Second, the economies of the world's nation-states are becoming ever more intertwined. As trade expands, nations are becoming increasingly dependent on each other for important goods and services. Third, the world has become significantly wealthier in the last two decades. The implication is that rising trade is the engine that has helped pull the global economy along.

Evidence also suggests that foreign direct investment is playing an increasing role in the global economy as firms increase their cross-border investments. The average yearly outflow of FDI increased from $14 billion in 1970 to about $1.5 trillion today, audited by the United Nations Conference on Trade and Development (UNCTAD).[13] As a result of the strong FDI flow, the global stock of FDI is about $28 trillion. More than 80,000 parent companies had more than 800,000 affiliates in foreign markets that collectively employed more than 75 million people abroad and generated value accounting for about 11 percent of global GDP. The foreign affiliates of multinationals had $36 trillion in global sales, higher than the value of global exports of goods and services, which stood at close to $23.4 trillion.[14]

The globalization of markets and production and the resulting growth of world trade, foreign direct investment, and imports all imply that firms are finding their home markets under attack from foreign competitors. This is true in China, where U.S. companies such as Apple, General Motors, and Starbucks are expanding their presence. It is true in the United States, where Japanese automobile firms have taken market share away from General Motors and Ford over the past three decades, and it is true in Europe, where the once-dominant Dutch company Philips has seen its market share in the consumer electronics industry taken by Japan's Panasonic and Sony and Korea's Samsung and LG. The growing integration of the world economy into a single, huge marketplace is increasing the intensity of competition in a range of manufacturing and service industries.

However, declining barriers to cross-border trade and investment cannot be taken for granted. As we shall see in subsequent chapters, demands for "protection" from foreign competitors are still often heard in countries around the world, including the United States. Although a return to the restrictive trade policies of the 1920s and 1930s is unlikely, it is not clear whether the political majority in the industrialized world favors further reductions in trade barriers. Indeed, the global financial crisis of 2008–2009 and the associated drop in global output that occurred led to more calls for trade barriers to protect jobs at home. If trade barriers decline no further, this may slow the rate of globalization of both markets and production.

ROLE OF TECHNOLOGICAL CHANGE

The lowering of trade barriers made globalization of markets and production a theoretical possibility. Technological change has made it a tangible reality. Every year that goes by comes with unique and oftentimes major advances in communication, information processing, and transportation technology, including the explosive emergence of the "Internet of Things."

Communications

Perhaps the single most important innovation since World War II has been the development of the microprocessor, which enabled the explosive growth of high-power, low-cost computing, vastly increasing the amount of information that can be processed by individuals and firms. The microprocessor also underlies many recent advances in telecommunications technology. Over the past 30 years, global communications have been revolutionized by developments in satellite, optical fiber, wireless technologies, and of course the Internet. These technologies rely on the microprocessor to encode, transmit, and decode the vast amount of information that flows along these electronic highways. The cost of microprocessors continues to fall, while their power increases (a phenomenon known as **Moore's law**, which predicts that the power of microprocessor technology doubles and its cost of production falls in half every 18 months).[15]

Moore's law
The power of microprocessor technology doubles and its costs of production fall by half every 18 months.

The Internet

The explosive growth of the Internet since 1994, when the first web browser was introduced, has revolutionized communications and commerce. In 1990, fewer than 1 million users were connected to the Internet. By 1995, the figure had risen to 50 million. By 2017, the Internet had 3.8 billion users, or 51 percent of the global population.[16] Thus, 2017 marked the first year that more than half of the world's population were Internet users. It is no surprise that the Internet has developed into the information backbone of the global economy.

In North America alone, e-commerce retail sales will surpass $520 billion in 2020 (up from almost nothing in 1998), while global e-commerce sales surpassed $2 trillion for the first time in 2017.[17] Viewed globally, the Internet has emerged as an equalizer. It rolls back some of the constraints of location, scale, and time zones.[18] The Internet makes it much easier for buyers and sellers to find each other, wherever they may be located and whatever their size. It allows businesses, both small and large, to expand their global presence at a lower cost than ever before. Just as important, it enables enterprises to coordinate and control a globally dispersed production system in a way that was not possible 25 years ago.

Transportation Technology

In addition to developments in communications technology, several major innovations in transportation technology have occurred since the 1950s. In economic terms, the most important are probably the development of commercial jet aircraft and superfreighters and the introduction of *containerization*, which simplifies transshipment from one mode of transport to another. The advent of commercial jet travel, by reducing the time needed to get from one location to another, has effectively shrunk the globe. In terms of travel time, New York is now "closer" to Tokyo than it was to Philadelphia in the colonial days.

Containerization has revolutionized the transportation business, significantly lowering the costs of shipping goods over long distances. Because the international shipping industry is responsible for carrying about 90 percent of the *volume* of world trade in goods, this has been an extremely important development.[19] Before the advent of containerization, moving goods from one mode of transport to another was very labor intensive, lengthy, and costly. It could take days and several hundred longshore workers to unload a ship and reload goods onto trucks and trains. With the advent of widespread containerization in the 1970s and 1980s, the whole process can now be executed by a handful of longshore workers in a couple of days. As a result of the efficiency gains associated with containerization, transportation costs have plummeted, making it much more economical to ship goods around the globe, thereby helping drive the globalization of markets and production. Between 1920 and 1990, the average ocean freight and port charges per ton of U.S. export and import cargo fell from $95 to $29 (in 1990 dollars).[20] Today, the typical cost of transporting a 20-foot container from Asia to Europe carrying more than 20 tons of cargo is about the same as the economy airfare for a single passenger on the same journey.

Implications for the Globalization of Production

As transportation costs associated with the globalization of production have declined, dispersal of production to geographically separate locations has become more economical. As a result of the technological innovations discussed earlier, the real costs of information processing and communication have fallen dramatically in the past two decades. These developments make it possible for a firm to create and then manage a globally dispersed production system, further facilitating the globalization of production. A worldwide communications network has become essential for many international businesses. For example, Dell uses the Internet to coordinate and control a globally dispersed production system to such an extent that it holds only three days' worth of inventory at its assembly locations. Dell's Internet-based system records orders for computer equipment as they are submitted by customers via the company's website and then immediately transmits the resulting orders for components to various suppliers around the world, which have a real-time look at Dell's order flow and can adjust their production schedules accordingly. Given the low cost of airfreight, Dell can use air transportation to speed up the delivery of critical components to meet unanticipated demand shifts without delaying the shipment of final product to consumers. Dell has also used modern communications technology to outsource its customer service operations to India. When U.S. customers call Dell with a service inquiry, they are routed to Bangalore in India, where English-speaking service personnel handle the call.

Implications for the Globalization of Markets

In addition to the globalization of production, technological innovations have facilitated the globalization of markets. Low-cost global communications networks, including those built on top of the Internet, are helping create electronic global marketplaces. As noted earlier, low-cost transportation has made it more economical to ship products around the world, thereby helping create global markets. In addition, low-cost jet travel has resulted in the mass movement of people between countries. This has reduced the cultural distance between countries and is bringing about some convergence of consumer tastes and preferences. At the same time, global communications networks and global media are creating a worldwide culture. U.S. television networks such as CNN and HBO are now received in many countries, Hollywood films are shown the world over, while non-U.S. news networks such as the BBC and Al Jazeera also have a global footprint. In any society, the media are primary conveyors of culture; as global media develop, we must expect the evolution of something akin to a global culture. A logical result of this evolution is the emergence of global markets for consumer products. Clear signs of this are apparent. It is now as easy to find a McDonald's restaurant in Tokyo as it is in New York, to buy an iPad in Rio as it is in Berlin, and to buy Gap jeans in Paris as it is in San Francisco.

Despite these trends, we must be careful not to overemphasize their importance. While modern communications and transportation technologies are ushering in the "global village," significant national differences remain in culture, consumer preferences, and business practices. A firm that ignores differences among countries does so at its peril. We shall stress this point repeatedly throughout this text and elaborate on it in later chapters.

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LO 1-3

Describe the changing nature of the global economy.

The Changing Demographics of the Global Economy

Hand in hand with the trend toward globalization has been a fairly dramatic change in the demographics of the global economy over the past decades. Half a century ago, four facts described the demographics of the global economy. The first was U.S. dominance in the world economy and world trade picture. The second was U.S. dominance in world foreign direct investment. Related to this, the third fact was the dominance of large, multinational U.S. firms on the international business scene. The fourth was that roughly half the globe—the centrally planned economies of the communist world—was off-limits to Western international businesses. All four of these facts have changed rapidly.

THE CHANGING WORLD OUTPUT AND WORLD TRADE PICTURE

In the early 1960s, the United States was still by far the world's dominant industrial power. In 1960, the United States accounted for 38.3 percent of world output, measured by gross domestic product (GDP). By 2018, the United States accounted for 24 percent of world output, with China now at 15.2 percent of world output and the global leader in this category (see Table 1.2). The United States was not the only developed nation to see its relative standing slip. The same occurred to Germany, France, Italy, the United Kingdom, and Canada—as just a few examples. These were all nations that were among the first to industrialize globally.

Of course, the change in the U.S. position was not an absolute decline because the U.S. economy grew significantly between 1960 and 2018 (the economies of Germany, France, Italy, the United Kingdom, and Canada also grew during this time). Rather, it was a relative decline, reflecting the faster economic growth of several other economies, particularly China as well as several other nations in Asia. For example, as can be seen from Table 1.2, from 1960 to today, China's share of world output increased from a trivial amount to 15.2 percent, making it the world's second largest economy in terms of its share in world output (the U.S. is still the largest economy overall). Other countries that markedly increased their share of world output included Japan, Thailand, Malaysia, Taiwan, Brazil, and South Korea.

By the end of the 1980s, the U.S. position as the world's leading trading nation was being challenged. Over the past 30 years, U.S. dominance in export markets has waned as Japan, Germany, and a number of newly industrialized countries such as South Korea and China have taken a larger share of world exports. During the 1960s, the United States routinely accounted for 20 percent of world exports of manufactured goods. But as Table 1.2 shows, the U.S. share of world exports of goods and services has slipped to 8.2 percent, significantly behind that of China.

As emerging economies such as Brazil, Russia, India, and China—coined the BRIC countries—continue to grow, a further relative decline in the share of world output and world exports accounted for by the United States and other long-established developed nations seems likely. By itself, this is not bad. The relative decline of the United States reflects the growing economic development and industrialization of the world economy, as opposed to any absolute decline in the health of the U.S. economy.

Most forecasts now predict a continued rise in the share of world output accounted for by developing nations such as China, India, Russia, Indonesia, Thailand, South Korea, Mexico, and Brazil and a commensurate decline in the share enjoyed by rich industrialized countries such as the United Kingdom, Germany, Japan, and the United States. The United Kingdom, in particular, presents an interesting case study with Britain's exit from the European Union (Brexit) looming. Perhaps more important, if current trends continue, the Chinese economy could ultimately be larger than that of the United States on a purchasing power parity basis as well, while the economy of India will become the third largest by 2030.[21]

Overall, the World Bank has estimated that today's developing nations may account for more than 60 percent of world economic activity by 2025, while today's rich nations, which currently

Country	Share of World Output in 1960 (%)	Share of World Output Today (%)	Share of World Exports Today (%)
United States	38.3%	24.0%	8.2%
Germany	8.7	4.6	7.1
France	4.6	3.2	2.8
Italy	3.0	2.4	2.4
United Kingdom	5.3	3.3	2.3
Canada	3.0	2.0	2.2
Japan	3.3	6.0	3.6
China	NA	15.2	11.1

1.2 TABLE

Changing Demographics of World Output and World Exports

Sources: Output data from World Bank database, 2019. Trade data from WTO Statistical Database, 2019.

country FOCUS

India's Software Sector

Some 30 years ago, a number of small software enterprises were established in Bangalore, India. Typical of these enterprises was Infosys Technologies, which was started by seven Indian entrepreneurs with about $1,000 among them. Infosys now has annual revenues of $10.2 billion and some 200,000 employees, but it is just one of more than 100 software companies clustered around Bangalore, which has become the epicenter of India's fast-growing information technology sector. From a standing start in the mid-1980s, this sector is now generating export sales of more than $100 billion.

The growth of the Indian software sector has been based on four factors. First, the country has an abundant supply of engineering talent. Every year, Indian universities graduate some 400,000 engineers. Second, labor costs in the Indian software sector have historically been low. As recently as 2008, the cost to hire an Indian graduate was roughly 12 percent of the cost of hiring an American graduate (however, this gap is narrowing fast with pay in the sector now only 30–40 percent less than in the United States). Third, many Indians are fluent in English, which makes coordination between Western firms and India easier. Fourth, due to time differences, Indians can work while Americans sleep, creating unique time efficiencies and an around-the-clock work environment.

Initially, Indian software enterprises focused on the low end of the software industry, supplying basic software development and testing services to Western firms. But as the industry has grown in size and sophistication, Indian firms have moved up the market. Today, the leading Indian companies compete directly with the likes of IBM and EDS for large software development projects, business process outsourcing contracts, and information technology consulting services. Over the past 15 years, these markets have boomed, with Indian enterprises capturing a large slice of the pie. One response of Western firms to this emerging competitive threat has been to invest in India to garner the same kind of economic advantages that Indian firms enjoy. IBM, for example, has invested $2 billion in its Indian operations and now has 150,000 employees located there, more than in any other country. Microsoft, too, has made major investments in India, including a research and development (R&D) center in Hyderabad that employs 4,000 people and was located there specifically to tap into talented Indian engineers who did not want to move to the United States.

Sources: "Ameerpet, India's Unofficial IT Training Hub," *The Economist*, March 30, 2017; "America's Pain, India's Gain: Outsourcing," *The Economist*, January 11, 2003, p. 59; "The World Is Our Oyster," *The Economist*, October 7, 2006, pp. 9–10; "IBM and Globalization: Hungry Tiger, Dancing Elephant," *The Economist*, April 7, 2007, pp. 67–69; P. Mishra, "New Billing Model May Hit India's Software Exports," *Live Mint*, February 14, 2013; and "India's Outsourcing Business: On the Turn," *The Economist*, January 19, 2013.

account for more than 55 percent of world economic activity, may account for only about 38 percent. Forecasts are not always correct, but these suggest that a shift in the economic geography of the world is now under way, although the magnitude of that shift is not totally evident. For international businesses, the implications of this changing economic geography are clear: Many of tomorrow's economic opportunities may be found in the developing nations of the world, and many of tomorrow's most capable competitors will probably also emerge from these regions. A case in point has been the dramatic expansion of India's software sector, which is profiled in the accompanying Country Focus.

THE CHANGING FOREIGN DIRECT INVESTMENT PICTURE

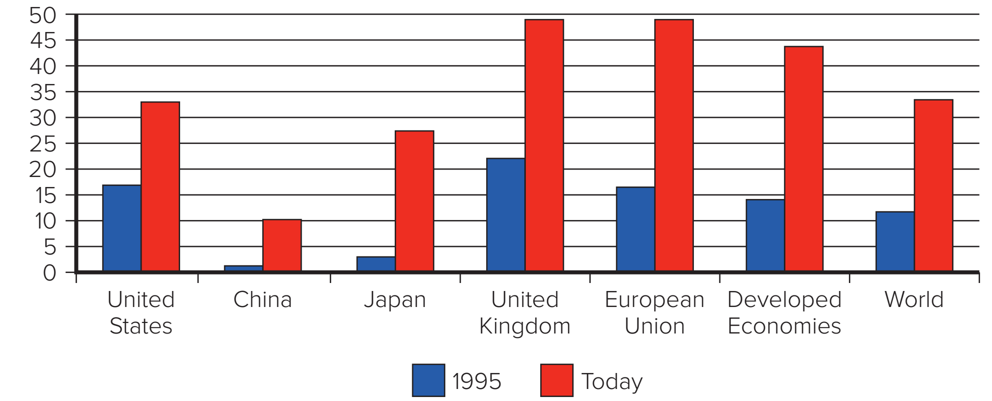
Reflecting the dominance of the United States in the global economy, U.S. firms accounted for 66.3 percent of worldwide foreign direct investment flows in the 1960s. British firms were second, accounting for 10.5 percent, while Japanese firms were a distant eighth, with only 2 percent. The dominance of U.S. firms was so great that books were written about the economic threat posed to Europe by U.S. corporations.[22] Several European governments, most notably France, talked of limiting inward investment by U.S. firms.

However, as the barriers to the free flow of goods, services, and capital fell, and as other countries increased their shares of world output, non-U.S. firms increasingly began to invest across national borders. The motivation for much of this foreign direct investment by non-U.S. firms was the desire to disperse production activities to optimal locations and to build a direct presence in major foreign markets. Thus, beginning in the 1970s, European and Japanese firms began to shift labor-intensive manufacturing operations from their home markets to developing nations where labor costs were lower. In addition, many Japanese firms invested in North America and Europe—often as a hedge against unfavorable currency movements and the possible imposition of trade barriers. For example, Toyota, the Japanese automobile company, rapidly increased its investment in automobile production facilities in the United States and Europe during the late 1980s and 1990s. Toyota executives believed that an increasingly strong Japanese yen would price Japanese automobile exports out of foreign markets; therefore, production in the most important foreign markets, as opposed to exports from Japan, made sense. Toyota also undertook these investments to head off growing political pressures in the United States and Europe to restrict Japanese automobile exports into those markets.

One consequence of these developments is illustrated in Figure 1.3, which shows how the stock of foreign direct investment by the United States, China, Japan, United Kingdom, European Union countries, Developed Economies, and the World changed between 1995 and today. (The **stock of foreign direct investment (FDI)** refers to the total cumulative value of foreign investments as a percentage of the country's GDP.) As expected, in all cases in Figure 1.3, we invest more today outside of our own country than we did in 1995. For example, in 1995 the stock of FDI held by U.S. firms was equivalent to 17.8 percent of U.S. GDP; today the figure is 34.4 percent. Collectively, the global stock of FDI is now equal to 34.6% of global GDP, an increase from 12.8% in 1995. Bottom line, the world is becoming more globalized in investment mentality and opportunities are no longer as restricted to the home country of a firm as they used to be even as recently as 1995.

stock of FDI
The total accumulated value of foreign-owned assets at a given time.

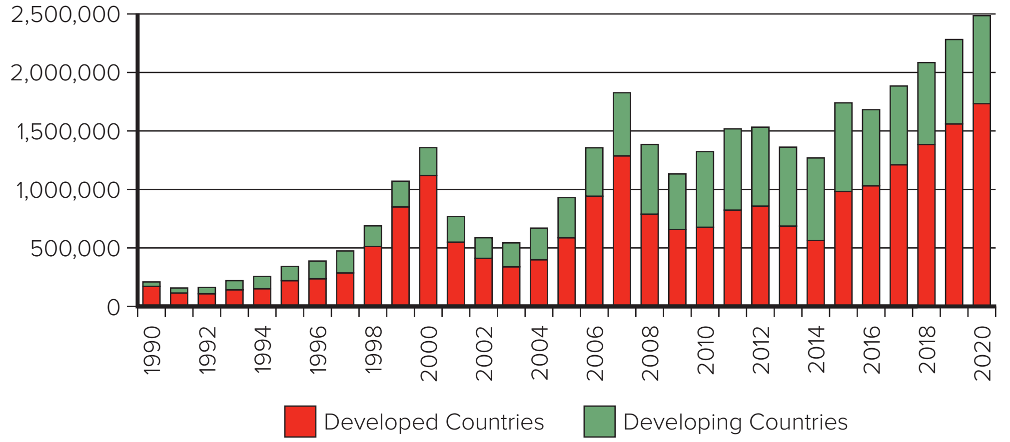
Figure 1.4 illustrates two other important trends—the sustained growth in cross-border flows of foreign direct investment that has occurred since 1990 and the increasing importance of developing nations as the destination of foreign direct investment. Throughout the 1990s, the amount of investment directed at both developed and developing nations increased dramatically, a trend that reflects the increasing internationalization of business corporations. A surge in foreign direct investment from 1998 to 2000 was followed by a slump from 2001 to 2004, associated with a slowdown in global economic activity after the collapse of the financial bubble of the late 1990s and 2000. The growth of foreign direct investment resumed at "normal" levels for that time in 2005 and continued upwards through 2007, when it hit record levels, only to slow again in 2008 and 2009 as the global financial crisis took hold. However, throughout this period, the growth of foreign direct investment into developing nations remained robust. Among developing nations,



1.3 FIGURE

Share of FDI outward stock as a percentage of GDP.

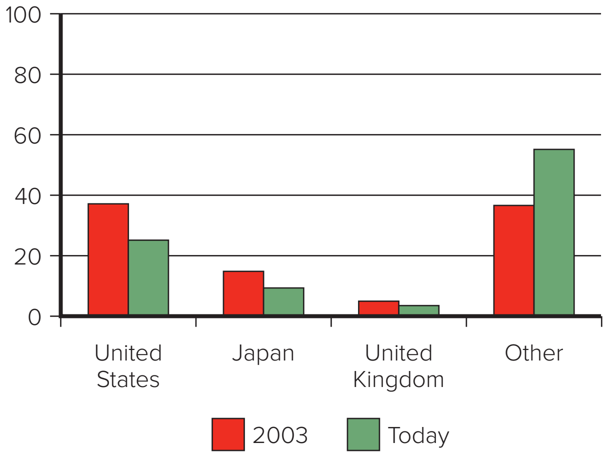
Sources: OECD data 2017, FDI stocks.



1.4 FIGURE

FDI inflows (in millions of dollars).

Source: United Nations Conference on Trade and Development, World Investment Report 2018. (Data for 2019–2020 are forecast.)



1.5 FIGURE

National share of largest multinational corporations.

Source: Forbes *Global 2000 in 2003 and 2017.*

multinational enterprise (MNE)

A firm that owns business operations in more than one country.

the largest recipient has been China, which received about $250 billion in inflows last year. As we shall see later in this text, the sustained flow of foreign investment into developing nations is an important stimulus for economic growth in those countries, which bodes well for the future of countries such as China, Mexico, and Brazil—all leading beneficiaries of this trend.

THE CHANGING NATURE OF THE MULTINATIONAL ENTERPRISE

A **multinational enterprise (MNE)** is any business that has productive activities in two or more countries. In the last half a century, two notable trends in the demographics of the multinational enterprise have been (1) the rise of non-U.S. multinationals and (2) the growth of mini-multinationals.

Non-U.S. Multinationals

In the 1960s, global business activity was dominated by large U.S. multinational corporations. With U.S. firms accounting for about two-thirds of foreign direct investment during the 1960s, one would expect most multinationals to be U.S. enterprises. According to the data summarized in Figure 1.5, in 2003 when *Forbes* started compiling its ranking of the top 2000 multinational corporations, 38.8 percent of the world's 2000 largest multinationals were U.S. firms (776 of the 2000 on the list). The second-largest source country was Japan with 16.6 percent of the largest multinationals. The United Kingdom accounted for 6.6 percent of the world's largest multinationals at the time. The large number of U.S. multinationals has long reflected U.S. economic dominance in the half a century after World War II, while the large number of British multinationals reflected that country's industrial dominance in the early decades of the twentieth century, which has carried on to some degree until today.

By now, things have shifted. Some 27 percent, or 540 firms, of the top 2000 global firms are now U.S. multinationals, a drop of 236 firms among the top 2000 global firms in only about a decade and a half. Japan and the United Kingdom also saw drops in their firms' inclusion among the top 2000 firms in the world.

These shifts in powerful multinational corporations and their home bases can be expected to continue. Specifically, we expect that even firms from developing nations will emerge as important competitors in global markets, further shifting the axis of the world economy away from North America and Western Europe and challenging the long dominance of companies from the so-called developed world. One such rising competitor, the Dalian Wanda Group, is profiled in the accompanying Management Focus.

The Rise of Mini-Multinationals

Another trend in international business has been the growth of small- and medium-size multinationals (mini-multinationals).[23] When people think of international businesses, they tend to think of firms such as ExxonMobil, General Motors, Ford, Panasonic, Procter & Gamble, Sony, and Unilever—large, complex multinational corporations with operations that span the globe. Although most international trade and investment is still conducted by large firms, many medium-size and small businesses are becoming increasingly involved in international trade and investment. The rise of the Internet is lowering the barriers that small firms face in building international sales.

Consider Lubricating Systems Inc. of Kent, Washington. Lubricating Systems, which manufactures lubricating fluids for machine tools, employs 25 people, and generates sales of $6.5 million. It's hardly a large, complex multinational, yet more than $2 million of the company's sales are generated by exports to a score of countries, including Japan, Israel, and the United Arab Emirates. Lubricating Systems has also set up a joint venture with a German company to serve the European market.[24]

Consider also Lixi Inc., a small U.S. manufacturer of industrial X-ray equipment; more than half of Lixi's $24.4 million in revenues comes from exports to Japan.[25] Or take G. W. Barth, a manufacturer of cocoa-bean roasting machinery based in Ludwigsburg, Germany. Employing

management FOCUS

Wanda Group

The Dalian Wanda Group is perhaps the world's largest real estate company, although as yet it is little known outside of China. Established in 1988, Dalian Wanda Group is the largest owner of five-star hotels in the world. The company's real estate portfolio includes 133 Wanda shopping malls and 84 hotels. It also has extensive activities in the film business, sports holdings, tourism, and children's entertainment. The stated ambition of Dalian Wanda is to become a world-class multinational by 2020 with assets of $200 billion, revenue of $100 billion, and net profits of $10 billion.

In 2012, Dalian Wanda made a significant step in this direction when it acquired the U.S. cinema chain AMC Entertainment Holdings for $2.6 billion. At the time, the acquisition was the largest ever of a U.S. company by a Chinese enterprise, surpassing the $1.8 billion takeover of IBM's PC business by Lenovo in 2005. AMC is the second-largest cinema operator in North America, where moviegoers spend more than $10 billion a year on tickets. After the acquisition was completed, the headquarters of AMC remained in Kansas City. Dalian, however, indicated that it would inject capital into AMC to upgrade its theaters to show more IMAX and 3D movies.

In 2015, Wanda followed its AMC acquisition with the purchase of Hoyts Group, an Australian cinema operator with more than 150 cinemas. By combining AMC movie theaters with Hoyts and its already extensive movie properties in China, Dalian Wanda has become the largest cinema operator in the world with more than 500 cinemas. This puts Wanda in a strong position when negotiating distribution terms with movie studios.

Wanda is also expanding its international real estate operations. In 2014, it announced that it won a bid for a prime plot of land in Beverly Hills, Los Angeles. Wanda plans to invest $1.2 billion to construct a mixed-use development. The company also has a sizable project in Chicago, where it is investing $900 million to build the third-tallest building in the city. In addition, Wanda has real estate projects in Spain, Australia, and London.

Today, the Wanda Group is already among the top 400 companies in the world with some 130,000 employees, $90 billion in assets, and about $45 billion in revenue.

Sources: Keith Weir, "China's Dalian Wanda to Acquire Australia's Hoyts for $365.7 Million," *Reuters*, June 24, 2015; Zachary Mider, "China's Wanda to Buy AMC Cinema Chain for $2.6 Billion," *Bloomberg Businessweek*, May 21, 2012; and Wanda Group Corporate, www.wanda-group.com.

just 65 people, this small company has captured 70 percent of the global market for cocoa-bean roasting machines.[26] International business is conducted not just by large firms but also by medium-size and small enterprises.

THE CHANGING WORLD ORDER Historically, between 1989 and 1991, a series of democratic revolutions swept the communist world. For reasons that are explored in more detail in Chapter 3, in country after country throughout eastern Europe and eventually in the Soviet Union itself, Communist Party governments collapsed. The Soviet Union receded into history, replaced by 15 independent republics. Czechoslovakia divided itself into two states, while Yugoslavia dissolved into a bloody civil war among its five successor states.

Since then, many of the former communist nations of Europe and Asia have seemed to share a commitment to democratic politics and free market economics. For half a century, these countries were essentially closed to Western international businesses. Now, they present a host of export and investment opportunities. Three decades later, the economies of many of the former communist states are still relatively undeveloped, however, and their continued commitment to democracy and market-based economic systems cannot be taken for granted. Disturbing signs of growing unrest and totalitarian tendencies are seen in several eastern European and central Asian states, including Russia, which has shown signs of shifting back toward greater state involvement in economic activity and authoritarian government.[27] Thus, the risks involved in doing business in such countries are high, but so may be the returns.

In addition to these changes, quieter revolutions have been occurring in China, other states in Southeast Asia, and Latin America. Their implications for international businesses may be just as profound as the collapse of communism in eastern Europe and Russia some time ago. China

Which Is More Important—Similarities or Differences?

International strategy has seen significant changes in recent years. Multinational enterprises now have to evaluate their core uniqueness and how they can drive their uniqueness to be leveraged in the global marketplace better. For some, such thinking may represent a major shift—to focus on similarities across nations and customers instead of differences. This could be an important shift because companies and their people are trained to look for differences and form strategies based on satisfying the needs of customers with slight or significant differences across the globe. In the future, we may be looking for similarities first and then focusing on the similarities that outweigh the differences in tastes, wants, and needs. Do you agree that focusing on similarities across countries is a better way to developing strategy than focusing on differences?

Source: globalEDGE.msu.edu/content/gbr/gbr7-2.pdf.

suppressed its pro-democracy movement in the bloody Tiananmen Square massacre of 1989. On the other hand, China continues to move progressively toward greater free market reforms. If what is occurring in China continues for two more decades, China may move from third-world to industrial superpower status even more rapidly than Japan did. If China's GDP per capita grows by an average of 6 to 7 percent, which is slower than the 8 to 10 percent growth rate achieved during the past decade, then by 2030 this nation of 1.4 billion people could boast an average GDP per capita of about $23,000, roughly the same as that of Chile or Poland today.

The potential consequences for international business are enormous. On the one hand, China represents a huge and largely untapped market. Reflecting this, between 1983 and today, annual foreign direct investment in China increased from less than $2 billion to $250 billion annually. On the other hand, China's new firms are proving to be very capable competitors, and they could take global market share away from Western and Japanese enterprises (see the Management Focus on the Wanda Group). Thus, the changes in China are creating both opportunities and threats for established international businesses.

As for Latin America, both democracy and free market reforms have been evident there too. For decades, most Latin American countries were ruled by dictators, many of whom seemed to view Western international businesses as instruments of imperialist domination. Accordingly, they restricted direct investment by foreign firms. In addition, the poorly managed economies of Latin America were characterized by low growth, high debt, and hyperinflation—all of which discouraged investment by international businesses. In the past two decades, much of this has changed. Throughout most of Latin America, debt and inflation are down, governments have sold state-owned enterprises to private investors, foreign investment is welcomed, and the region's economies have expanded. Brazil, Mexico, and Chile have led the way. These changes have increased the attractiveness of Latin America, both as a market for exports and as a site for foreign direct investment. At the same time, given the long history of economic mismanagement in Latin America, there is no guarantee that these favorable trends will continue. Indeed, Bolivia, Ecuador, and most notably Venezuela have seen shifts back toward greater state involvement in industry in the past few years, and foreign investment is now less welcome than it was during the 1990s. In these nations, the government has seized control of oil and gas fields from foreign investors and has limited the rights of foreign energy companies to extract oil and gas from their nations. Thus, as in the case of eastern Europe, substantial opportunities are accompanied by substantial risks.

GLOBAL ECONOMY OF THE TWENTY-FIRST CENTURY The past quarter century has seen rapid changes in the global economy. Barriers to the free flow of goods, services, and capital have been coming down. As their economies advance, more nations are joining the ranks of the developed world. A generation ago, South Korea and Taiwan were viewed as second-tier developing nations. Now they boast large economies, and firms based there are major players in many global industries, from shipbuilding and steel to electronics and chemicals. The move toward a global economy has been further strengthened by the widespread adoption of liberal economic policies by countries that had firmly opposed them for two generations or more. In short, current trends indicate the world is moving toward an economic system that is more favorable for international business.

But it is always hazardous to use established trends to predict the future. The world may be moving toward a more global economic system, but globalization is not inevitable. Countries may pull back from the recent commitment to liberal economic ideology if their experiences do not match their expectations. There are clear signs, for example, of a retreat from liberal economic ideology in Russia. If Russia's hesitation were to become more permanent and widespread, the liberal vision of a more prosperous global economy based on free market principles might not occur as quickly as many hope. Clearly, this would be a tougher world for international businesses.

Also, greater globalization brings with it risks of its own. This was starkly demonstrated in 1997 and 1998, when a financial crisis in Thailand spread first to other East Asian nations and then to Russia and Brazil. Ultimately, the crisis threatened to plunge the economies of the developed world, including the United States, into a recession. We explore the causes and consequences of this and other similar global financial crises in Chapter 11. Even from a purely economic perspective, globalization is not all good. The opportunities for doing business in a global economy may be significantly enhanced, but as we saw in 1997–1998, the risks associated with global financial contagion are also greater. Indeed, during 2008–2009, a crisis that started in the financial sector of America, where banks had been too liberal in their lending policies to homeowners, swept around the world and plunged the global economy into its deepest recession since the early 1980s, illustrating once more that in an interconnected world a severe crisis in one region can affect the entire globe. Still, as explained later in this text, firms can exploit the opportunities associated with globalization while reducing the risks through appropriate hedging strategies. These hedging strategies may also become more and more important as the world balances globalization efforts with a potential increase in nationalistic tendencies by some countries (e.g., recently in the United States and United Kingdom).

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The Globalization Debate

LO 1-4

Explain the main arguments in the debate over the impact of globalization.

Is the shift toward a more integrated and interdependent global economy a good thing? Many influential economists, politicians, and business leaders seem to think so.[28] They argue that falling barriers to international trade and investment are the twin engines driving the global economy toward greater prosperity. They say increased international trade and cross-border investment will result in lower prices for goods and services. They believe that globalization stimulates economic growth, raises the incomes of consumers, and helps create jobs in all countries that participate in the global trading system. The arguments of those who support globalization are covered in detail in Chapters 6, 7, and 8. As we shall see, there are good theoretical reasons for believing that declining barriers to international trade and investment do stimulate economic growth, create jobs, and raise income levels. Moreover, as described in Chapters 6, 7, and 8, empirical evidence lends support to the predictions of this theory. However, despite the existence of a compelling body of theory and evidence, globalization has its critics.[29] Some of these critics are vocal and active, taking to the streets to demonstrate their opposition to globalization. Here, we look at the nature of protests against globalization and briefly review the main themes of the debate concerning the merits of globalization. In later chapters, we elaborate on many of these points.

ANTIGLOBALIZATION PROTESTS Popular demonstrations against globalization date back to December 1999, when more than 40,000 protesters blocked the streets of Seattle in an attempt to shut down a World Trade Organization meeting being held in the city. The demonstrators were protesting against a wide range of issues, including job losses in industries under attack from foreign competitors, downward pressure on the wage rates of unskilled workers, environmental degradation, and the cultural imperialism of global media and multinational enterprises, which was seen as being dominated by what some protesters called the "culturally impoverished" interests and values of the United States. All of these ills, the demonstrators claimed, could be laid at the feet of globalization. The World Trade Organization was meeting to try to launch a new round of talks to cut barriers to cross-border trade and investment. As such, it was seen as a promoter of globalization and a target for the protesters. The protests turned violent, transforming the normally placid streets of Seattle into a running battle between "anarchists" and Seattle's bemused and poorly prepared police department. Pictures of brick-throwing protesters and armored police wielding their batons were duly recorded by the global media, which then circulated the images around the world. Meanwhile, the WTO meeting failed to reach an agreement, and although the protests outside the meeting halls had little to do with that failure, the impression took hold that the demonstrators had succeeded in derailing the meetings.

Emboldened by the experience in Seattle, antiglobalization protesters have made a habit of turning up at major meetings of global institutions. Smaller-scale protests have periodically occurred in several countries, such as France, where antiglobalization activists destroyed a McDonald's restaurant in 1999 to protest the impoverishment of French culture by American imperialism (see the accompanying Country Focus for details). While violent protests may give the antiglobalization effort a bad name, it is clear from the scale of the demonstrations that support for the cause goes beyond a core of anarchists. Large segments of the population in many countries believe that globalization has detrimental effects on living standards, wage rates, and the environment. Indeed, the strong support for President Donald Trump in the 2016 U.S. election was primarily based on his repeated assertions that trade deals had exported U.S. jobs overseas and created unemployment and low wages in America.

country FOCUS

Protesting Globalization in France

It all started one night in August 1999, but it might as well have been today. Back in 1999, 10 men under the leadership of local sheep farmer and rural activist José Bové crept into the town of Millau in central France and vandalized a McDonald's restaurant under construction, causing an estimated $150,000 in damage. These were no ordinary vandals, however, at least according to their supporters, for the "symbolic dismantling" of the McDonald's outlet had noble aims, or so it was claimed. The attack was initially presented as a protest against unfair American trade policies. The European Union (EU) had banned imports of hormone-treated beef from the United States, primarily because of fears that it might lead to health problems (although EU scientists had concluded there was no evidence of this). After a careful review, the World Trade Organization stated the EU ban was not allowed under trading rules that the EU and United States were party to and that the EU would have to lift it or face retaliation. The EU refused to comply, so the U.S. government imposed a 100 percent tariff on imports of certain EU products, including French staples such as foie gras, mustard, and Roquefort cheese. On farms near Millau, Bové and others raised sheep whose milk was used to make Roquefort. They felt incensed by the American tariff and decided to vent their frustrations on McDonald's.

Bové and his compatriots were arrested and charged. About the same time in the Languedoc region of France, California winemaker Robert Mondavi had reached agreement with the mayor and council of the village of Aniane and regional authorities to turn 125 acres of wooded hillside belonging to the village into a vineyard. Mondavi planned to invest $7 million in the project and hoped to produce top-quality wine that would sell in Europe and the United States for $60 a bottle. However, local environmentalists objected to the plan, which they claimed would destroy the area's unique ecological heritage. José Bové, basking in sudden fame, offered his support to the opponents, and the protests started. In May 2001, the socialist mayor who had approved the project was defeated in local elections in which the Mondavi project had become the major issue. He was replaced by a communist, Manuel Diaz, who denounced the project as a capitalist plot designed to enrich wealthy U.S. shareholders at the cost of his villagers and the environment. Following Diaz's victory, Mondavi announced he would pull out of the project. A spokesperson noted, "It's a huge waste, but there are clearly personal and political interests at play here that go way beyond us."

So, are the French opposed to foreign investment? The experience of McDonald's and Mondavi seems to suggest so, as does the associated news coverage, but look closer and a different reality seems to emerge. Today, McDonald's has more than 1,200 restaurants in France. McDonald's employs 69,000 workers in the country. France is the most profitable market for McDonald's after the United States. In short, 20 years after the protests, France is a major success story for McDonald's. Moreover, France has long been one of the most favored locations for inward foreign direct investment, receiving more than $700 billion of foreign investment between 2000 and 2017, which makes it one of the top destinations for foreign investment in Europe. American companies have always accounted for a significant percentage of this investment. French enterprises have also been significant foreign investors; some 1,100 French multinationals have about $1.1 trillion of assets in other nations. For all of the populist opposition to globalization, French corporations and consumers appear to be embracing it.

Sources: "Behind the Bluster," *The Economist*, May 26, 2001; "The French Farmers' Anti-Global Hero," *The Economist*, July 8, 2000; C. Trueheart, "France's Golden Arch Enemy?" *Toronto Star*, July 1, 2000; J. Henley, "Grapes of Wrath Scare Off U.S. Firm," *The Economist*, May 18, 2001, p. 11; United Nations, *World Investment Report*, 2014 (New York & Geneva: United Nations, 2011); and Rob Wile, "The True Story of How McDonald's Conquered France," *Business Insider*, August 22, 2014.

Both theory and evidence suggest that many of these fears are exaggerated; both politicians and businesspeople need to do more to counter these fears. Many protests against globalization are tapping into a general sense of loss at the passing of a world in which barriers of time and distance, and significant differences in economic institutions, political institutions, and the level of development of different nations produced a world rich in the diversity of human cultures. However, while the rich citizens of the developed world may have the luxury of mourning the fact that they can now see McDonald's restaurants and Starbucks coffeehouses on their vacations to exotic locations such as Thailand, fewer complaints are heard from the citizens of those countries, who welcome the higher living standards that progress brings.

GLOBALIZATION, JOBS, AND INCOME One concern frequently voiced by globalization opponents is that falling barriers to international trade destroy manufacturing jobs in wealthy advanced economies such as the United States and Western Europe. Critics argue that falling trade barriers allow firms to move manufacturing activities to countries where wage rates are much lower.[30] Indeed, due to the entry of China, India, and states from eastern Europe into the global trading system, along with global population growth, the pool of global labor has increased more than fivefold between 1990 and today. Other things being equal, we might conclude that this enormous expansion in the global labor force, when coupled with expanding international trade, would have depressed wages in developed nations.

This fear is often supported by anecdotes. For example, D. L. Bartlett and J. B. Steele, two journalists for the *Philadelphia Inquirer* who gained notoriety for their attacks on free trade, cite the case of Harwood Industries, a U.S. clothing manufacturer that closed its U.S. operations, where it paid workers $9 per hour, and shifted manufacturing to Honduras, where textile workers received 48 cents per hour.[31] Because of moves such as this, argue Bartlett and Steele, the wage rates of poorer Americans have fallen significantly over the past quarter of a century.

In the past few years, the same fears have been applied to services, which have increasingly been outsourced to nations with lower labor costs. The popular feeling is that when corporations such as Dell, IBM, or Citigroup outsource service activities to lower-cost foreign suppliers—as all three have done—they are "exporting jobs" to low-wage nations and contributing to higher unemployment and lower living standards in their home nations (in this case, the United States). Some U.S. lawmakers have responded by calling for legal barriers to job outsourcing.

Supporters of globalization reply that critics of these trends miss the essential point about free trade agreements—the benefits outweigh the costs.[32] They argue that free trade will result in countries specializing in the production of those goods and services that they can produce most efficiently, while importing goods and services that they cannot produce as efficiently. When a country embraces free trade, there is always some dislocation—lost textile jobs at Harwood Industries or lost call-center jobs at Dell—but the whole economy is better off as a result. According to this view, it makes little sense for the United States to produce textiles at home when they can be produced at a lower cost in Honduras or China. Importing textiles from China leads to lower prices for clothes in the United States, which enables consumers to spend more of their money on other items. At the same time, the increased income generated in China from textile exports increases income levels in that country, which helps the Chinese purchase more products produced in the United States, such as pharmaceuticals from Amgen, Boeing jets, microprocessors made by Intel, Microsoft software, and Cisco routers.

The same argument can be made to support the outsourcing of services to low-wage countries. By outsourcing its customer service call centers to India, Dell can reduce its cost structure and thereby its prices for computers. U.S. consumers benefit from this development. As prices for computers fall, Americans can spend more of their money on other goods and services. Moreover, the increase in income levels in India allows Indians to purchase more U.S. goods and services, which helps create jobs in the United States. In this manner, supporters of globalization argue that free trade benefits *all* countries that adhere to a free trade regime.

If the critics of globalization are correct, three things must be shown. First, the share of national income received by labor, as opposed to the share received by the owners of capital (e.g., stockholders and bondholders), should have declined in advanced nations as a result of downward pressure on wage rates. Second, even though labor's share of the economic pie may have declined, this does not mean lower living standards if the size of the total pie has increased sufficiently to offset the decline in labor's share—in other words, if economic growth and rising living standards in advanced economies have offset declines in labor's share (this is the position argued by supporters of globalization). Third, the decline in labor's share of national income must be due to moving production to low-wage countries, as opposed to improvement in production technology and productivity.

Several studies shed light on these issues.[33] First, the data suggest that over the past two decades, the share of labor in national income has declined. However, detailed analysis suggests the share of national income enjoyed by *skilled labor* has actually *increased*, suggesting that the fall in labor's share has been due to a fall in the share taken by *unskilled labor*. A study by the IMF suggested the earnings gap between workers in skilled and unskilled sectors has widened by 25 percent over the past two decades.[34] Another study that focused on U.S. data found that exposure to competition from imports led to a decline in real wages for workers who performed *unskilled* tasks, while having no discernible impact on wages in skilled occupations. The same study found that skilled and unskilled workers in sectors where exports grew saw an increase in their real wages.[35] These figures suggest that *unskilled labor* in sectors that have been exposed to more efficient foreign competition probably has seen its share of national income decline over the past three decades.

However, this does not mean that the *living standards* of unskilled workers in developed nations have declined. It is possible that economic growth in developed nations has offset the fall in the share of national income enjoyed by unskilled workers, raising their living standards.

Evidence suggests that real labor compensation has expanded in most developed nations since the 1980s, including the United States. Several studies by the Organisation for Economic Co-operation and Development (OECD), whose members include the 34 richest economies in the world, conclude that while the gap between the poorest and richest segments of society in OECD countries has widened, in *most* countries real income levels have increased for all, including the poorest segment. In one study, the OECD found that real household income (adjusted for inflation) increased by 1.7 percent annually among its member states. The real income level of the poorest 10 percent of the population increased at 1.4 percent on average, while that of the richest 10 percent increased by 2 percent annually (i.e., while everyone got richer, the gap between the most affluent and the poorest sectors of society widened). The differential in growth rates was more extreme in the United States than most other countries. The study found that the real income of the poorest 10 percent of the population grew by just 0.5 percent a year in the United States, while that of the richest 10 percent grew by 1.9 percent annually.[36]

As noted earlier, globalization critics argue that the decline in unskilled wage rates is due to the migration of low-wage manufacturing jobs offshore and a corresponding reduction in demand for unskilled workers. However, supporters of globalization see a more complex picture. They maintain that the weak growth rate in real wage rates for unskilled workers owes far more to a technology-induced shift within advanced economies away from jobs where the only qualification was a willingness to turn up for work every day and toward jobs that require significant education and skills. They point out that many advanced economies report a shortage of highly skilled workers and an excess supply of unskilled workers. Thus, growing income inequality is a result of the wages for skilled workers being bid up by the labor market and the wages for unskilled workers being discounted. In fact, evidence suggests that technological change has had a bigger impact than globalization on the declining share of national income enjoyed by labor.[37] This suggests that a solution to the problem of slow real income growth among the unskilled is to be found not in limiting free trade and globalization but in increasing society's investment in education to reduce the supply of unskilled workers.[38]

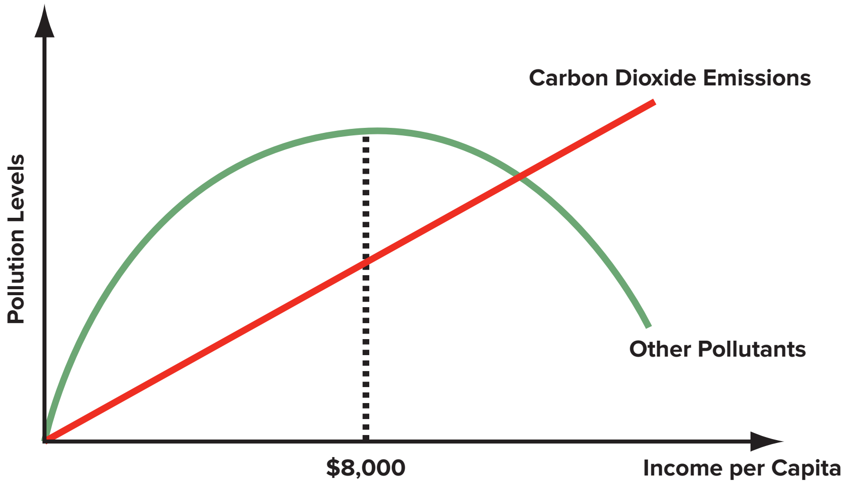
Finally, it is worth noting that the wage gap between developing and developed nations is closing as developing nations experience rapid economic growth. For example, one estimate suggests that wages in China will approach Western levels in two decades.[39] To the extent that this is the case, any migration of unskilled jobs to low-wage countries is a temporary phenomenon representing a structural adjustment on the way to a more tightly integrated global economy.

GLOBALIZATION, LABOR POLICIES, AND THE ENVIRONMENT

A second source of concern is that free trade encourages firms from advanced nations to move manufacturing facilities to less developed countries that lack adequate regulations to protect labor and the environment from abuse by the unscrupulous.[40] Globalization critics often argue that adhering to labor and environmental regulations significantly increases the costs of manufacturing enterprises and puts them at a competitive disadvantage in the global marketplace vis-à-vis firms based in developing nations that do not have to comply with such regulations. Firms deal with this cost disadvantage, the theory goes, by moving their production facilities to nations that do not have such burdensome regulations or that fail to enforce the regulations they have.

If this were the case, we might expect free trade to lead to an increase in pollution and result in firms from advanced nations exploiting the labor of less developed nations.[41] This argument was used repeatedly by those who opposed the 1994 formation of the North American Free Trade Agreement (NAFTA) among Canada, Mexico, and the United States. They painted a picture of U.S. manufacturing firms moving to Mexico in droves so that they would be free to pollute the environment, employ child labor, and ignore workplace safety and health issues, all in the name of higher profits.[42] Interestingly, some of the same arguments are now materializing again with the Donald Trump presidency in the United States. Many of his followers and supporters have been presenting similar arguments against NAFTA. Consequently, the United States, Canada, and Mexico appear set to renegotiate a number of the agreements included in the overall NAFTA agreement.

Supporters of free trade and greater globalization express doubts about this scenario. They argue that tougher environmental regulations and stricter labor standards go hand in hand with economic progress.[43] In general, as countries get richer, they enact tougher environmental and



1.6 FIGURE

Income levels and environmental pollution.

Source: C. W. L. Hill and G. T. M. Hult, Global Business Today *(New York: McGraw-Hill Education, 2018).*

labor regulations.[44] Because free trade enables developing countries to increase their economic growth rates and become richer, this should lead to tougher environmental and labor laws. In this view, the critics of free trade have got it backward: Free trade does not lead to more pollution and labor exploitation; it leads to less. By creating wealth and incentives for enterprises to produce technological innovations, the free market system and free trade could make it easier for the world to cope with pollution and population growth. Indeed, while pollution levels are rising in the world's poorer countries, they have been falling in developed nations. In the United States, for example, the concentration of carbon monoxide and sulfur dioxide pollutants in the atmosphere has decreased by 60 percent since 1978, while lead concentrations have decreased by 98 percent—and these reductions have occurred against a background of sustained economic expansion.[45]

A number of econometric studies have found consistent evidence of a hump-shaped relationship between income levels and pollution levels (see Figure 1.6.).[46] As an economy grows and income levels rise, initially pollution levels also rise. However, past some point, rising income levels lead to demands for greater environmental protection, and pollution levels then fall. A seminal study by Grossman and Krueger found that the turning point generally occurred before per capita income levels reached $8,000.[47]

While the hump-shaped relationship depicted in Figure 1.6 seems to hold across a wide range of pollutants—from sulfur dioxide to lead concentrations and water quality—carbon dioxide emissions are an important exception, rising steadily with higher-income levels. Given that carbon dioxide is a heat-trapping gas and given that there is good evidence that increased atmospheric carbon dioxide concentrations are a cause of global warming, this should be of serious concern. The solution to the problem, however, is probably not to roll back the trade liberalization efforts that have fostered economic growth and globalization but to get the nations of the world to agree to policies designed to limit carbon emissions. In the view of most economists, the most effective way to do this would be to put a price on carbon-intensive energy generation through a carbon tax. To ensure that this tax does not harm economic growth, economists argue that it should be revenue neutral, with increases in carbon taxes offset by reductions in income or consumption taxes.[48]

Although UN-sponsored talks have had reduction in carbon dioxide emissions as a central aim since the 1992 Earth Summit in Rio de Janeiro, until recently there has been little success in moving toward the ambitious goals for reducing carbon emissions laid down in the Earth Summit and subsequent talks in Kyoto, Japan, in 1997, Copenhagen in 2009, and Paris in 2015, for example. In part, this is because the largest emitters of carbon dioxide, the United States and China, failed to reach agreements about how to proceed. China, a country whose carbon emissions are increasing at a rapid rate, has until recently shown little appetite for tighter pollution controls. As for the United States, political divisions in Congress and a culture of denial have made it difficult for the country to even acknowledge, never mind move forward with, legislation designed to tackle climate change. However, in late 2014, the United States and China struck a historic deal under which both countries agreed to potentially significant reductions in carbon emissions. This was followed by a broadly based multilateral agreement reached in Paris in 2015 that has committed the nations of the world to carbon reduction targets. If these agreements hold, progress may be made on this important issue.

Notwithstanding this, supporters of free trade point out that it is possible to tie free trade agreements to the implementation of tougher environmental and labor laws in less developed countries. NAFTA, for example, was passed only after side agreements had been negotiated that committed Mexico to tougher enforcement of environmental protection regulations. Thus, supporters of free trade argue that factories based in Mexico are now cleaner than they would have been without the passage of NAFTA.[49]

They also argue that business firms are not the amoral organizations that critics suggest. While there may be some rotten apples, most business enterprises are staffed by managers who are committed to behaving in an ethical manner and would be unlikely to move production offshore just so they could pump more pollution into the atmosphere or exploit labor. Furthermore, the relationship between pollution, labor exploitation and production costs may not be that suggested by critics. In general, a well-treated labor force is productive, and it is productivity rather than base wage rates that often has the greatest influence on costs. The vision of greedy managers who shift production to low-wage countries to exploit their labor force may be misplaced.

GLOBALIZATION AND NATIONAL SOVEREIGNTY Another concern voiced by critics of globalization is that today's increasingly interdependent global economy shifts economic power away from national governments and toward supranational organizations such as the World Trade Organization, the European Union, and the United Nations. As perceived by critics, unelected bureaucrats now impose policies on the democratically elected governments of nation-states, thereby undermining the sovereignty of those states and limiting the nation's ability to control its own destiny.[50]

The World Trade Organization is a favorite target of those who attack the headlong rush toward a global economy. As noted earlier, the WTO was founded in 1995 to police the world trading system established by the General Agreement on Tariffs and Trade. The WTO arbitrates trade disputes among its 162 member states. The arbitration panel can issue a ruling instructing a member state to change trade policies that violate GATT regulations. If the violator refuses to comply with the ruling, the WTO allows other states to impose appropriate trade sanctions on the transgressor. As a result, according to one prominent critic, U.S. environmentalist, consumer rights advocate, and sometime presidential candidate Ralph Nader:

> Under the new system, many decisions that affect billions of people are no longer made by local or national governments but instead, if challenged by any WTO member nation, would be deferred to a group of unelected bureaucrats sitting behind closed doors in Geneva (which is where the headquarters of the WTO are located). The bureaucrats can decide whether or not people in California can prevent the destruction of the last virgin forests or determine if carcinogenic pesticides can be banned from their foods; or whether European countries have the right to ban dangerous biotech hormones in meat . . . . At risk is the very basis of democracy and accountable decision making.[51]

In contrast to Nader, many economists and politicians maintain that the power of supranational organizations such as the WTO is limited to what nation-states collectively agree to grant. They argue that bodies such as the United Nations and the WTO exist to serve the collective interests of member states, not to subvert those interests. Supporters of supranational organizations point out that the power of these bodies rests largely on their ability to persuade member states to follow a certain action. If these bodies fail to serve the collective interests of member states, those states will withdraw their support and the supranational organization will quickly collapse. In this view, real power still resides with individual nation-states, not supranational organizations.

GLOBALIZATION AND THE WORLD'S POOR Critics of globalization argue that despite the supposed benefits associated with free trade and investment, over the past 100 years or so the gap between the rich and poor nations of the world has gotten wider. In 1870, the average income per capita in the world's 17 richest nations was 2.4 times that of all other countries. In 1990, the same group was 4.5 times as rich as the rest. In 2019, the 34 member states of the Organisation for Economic Co-operation and Development (OECD), which includes most of the world's rich economies, had an average gross national income (GNI) per person of more than $40,000, whereas the world's 40 least developed countries had a GNI of under $1,000 per capita—implying that income per capita in the world's 34 richest nations was 40 times that in the world's 40 poorest.[52]

While recent history has shown that some of the world's poorer nations are capable of rapid periods of economic growth—witness the transformation that has occurred in some Southeast Asian nations such as South Korea, Thailand, and Malaysia—there appear to be strong forces for stagnation among the world's poorest nations. A quarter of the countries with a GDP per capita of less than $1,000 in 1960 had growth rates of less than zero, and a third had growth rates of less than 0.05 percent.[53] Critics argue that if globalization is such a positive development, this divergence between the rich and poor should not have occurred.

Although the reasons for economic stagnation vary, several factors stand out, none of which has anything to do with free trade or globalization.[54] Many of the world's poorest countries have suffered from totalitarian governments, economic policies that destroyed wealth rather than facilitated its creation, endemic corruption, scant protection for property rights, and prolonged civil war. A combination of such factors helps explain why countries such as Afghanistan, Cuba, Haiti, Iraq, Libya, Nigeria, Sudan, Syria, North Korea, and Zimbabwe have failed to improve the economic lot of their citizens during recent decades. A complicating factor is the rapidly expanding populations in many of these countries. Without a major change in government, population growth may exacerbate their problems. Promoters of free trade argue that the best way for these countries to improve their lot is to lower their barriers to free trade and investment and to implement economic policies based on free market economics.[55]

Many of the world's poorer nations are being held back by large debt burdens. Of particular concern are the 40 or so "highly indebted poorer countries" (HIPCs), which are home to some 700 million people. Among these countries, the average government debt burden has been as high as 85 percent of the value of the economy, as measured by gross domestic product, and the annual costs of serving government debt have consumed 15 percent of the country's export earnings.[56] Servicing such a heavy debt load leaves the governments of these countries with little left to invest in important public infrastructure projects, such as education, health care, roads, and power. The result is the HIPCs are trapped in a cycle of poverty and debt that inhibits economic development. Free trade alone, some argue, is a necessary but not sufficient prerequisite to help these countries bootstrap themselves out of poverty. Instead, large-scale debt relief is needed for the world's poorest nations to give them the opportunity to restructure their economies and start the long climb toward prosperity. Supporters of debt relief also argue that new democratic governments in poor nations should not be forced to honor debts that were incurred and mismanaged long ago by their corrupt and dictatorial predecessors.

In the late 1990s, a debt relief movement began to gain ground among the political establishment in the world's richer nations.[57] Fueled by high-profile endorsements from Irish rock star Bono (who has been a tireless and increasingly effective advocate for debt relief), the Dalai Lama, and influential Harvard economist Jeffrey Sachs, the debt relief movement was instrumental in persuading the United States to enact legislation in 2000 that provided $435 million in debt relief for HIPCs. More important perhaps, the United States also backed an IMF plan to sell some of its gold reserves and use the proceeds to help with debt relief. The IMF and World Bank have now picked up the banner and have embarked on a systematic debt relief program.

For such a program to have a lasting effect, however, debt relief must be matched by wise investment in public projects that boost economic growth (such as education) and by the adoption of economic policies that facilitate investment and trade. Consistent with this, in June 2005, the finance ministers from several of the world's richest economies (including the United States) agreed to provide enough funds to the World Bank and IMF to allow them to cancel a further $55 billion in debt owed by the HIPCs. The goal was to enable the HIPCs to redirect resources from debt payments to health and education programs, and for alleviating poverty.

The richest nations of the world also can help by reducing barriers to the importation of products from the world's poorest nations, particularly tariffs on imports of agricultural products and textiles. High-tariff barriers and other impediments to trade make it difficult for poor countries to export more of their agricultural production. The World Trade Organization has estimated that if the developed nations of the world eradicated subsidies to their agricultural producers and removed tariff barriers to trade in agriculture, this would raise global economic welfare by $128 billion, with $30 billion of that going to poor nations, many of which are highly indebted. The faster growth associated with expanded trade in agriculture could significantly reduce the number of people living in poverty according to the WTO.[58]

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Despite the large gap between the rich and poor nations, there is some evidence that progress is being made. In 2015, the United Nations adopted what were known as the Sustainable Development Goals. These were 17 economic and human development goals for the world. We address these goals in Chapter 5. Overall, it is hard to escape the conclusion that globalization and lower barriers to cross-border trade and investment are major factors in this remarkable prospect.

Managing in the Global Marketplace

LO 1-5

Understand how the process of globalization is creating opportunities and challenges for management practice.

international business

Any firm that engages in international trade or investment.

Much of this text is concerned with the challenges of managing in an international business. An **international business** is any firm that engages in international trade or investment. A firm does not have to become a multinational enterprise, investing directly in operations in other countries, to engage in international business, although multinational enterprises are international businesses. All a firm has to do is export or import products from other countries. As the world shifts toward a truly integrated global economy, more firms—both large and small—are becoming international businesses. What does this shift toward a global economy mean for managers within an international business?

As their organizations increasingly engage in cross-border trade and investment, managers need to recognize that the task of managing an international business differs from that of managing a purely domestic business in many ways. At the most fundamental level, the differences arise from the simple fact that countries are different. Countries differ in their cultures, political systems, economic systems, legal systems, and levels of economic development. Despite all the talk about the emerging global village and despite the trend toward globalization of markets and production, as we shall see in this text, many of these differences are very profound and enduring.

Differences among countries require that an international business vary its practices country by country. Marketing a product in Brazil may require a different approach from marketing the product in Germany; managing U.S. workers might require different skills from managing Japanese workers; maintaining close relations with a particular level of government may be very important in Mexico and irrelevant in Great Britain; the business strategy pursued in Canada might not work in South Korea; and so on. Managers in an international business must not only be sensitive to these differences but also adopt the appropriate policies and strategies for coping with them. Much of this text is devoted to explaining the sources of these differences and the methods for successfully coping with them.

A further way in which international business differs from domestic business is the greater complexity of managing an international business. In addition to the problems that arise from the differences between countries, a manager in an international business is confronted with a range of other issues that the manager in a domestic business never confronts. The managers of an international business must decide where in the world to site production activities to minimize costs and maximize value added. They must decide whether it is ethical to adhere to the lower labor and environmental standards found in many less developed nations. Then they must decide how best to coordinate and control globally dispersed production activities (which, as we shall see later in the text, is not a trivial problem). The managers in an international business also must decide which foreign markets to enter and which to avoid. They must choose the appropriate mode for entering a particular foreign country. Is it best to export its product to the foreign country? Should the firm allow a local company to produce its product under license in that country? Should the firm enter into a joint venture with a local firm to produce its product in that country? Or should the firm set up a wholly owned subsidiary to serve the market in that country? As we shall see, the choice of entry mode is critical because it has major implications for the long-term health of the firm.

Conducting business transactions across national borders requires understanding the rules governing the international trading and investment system. Managers in an international business must also deal with government restrictions on international trade and investment. They must find ways to work within the limits imposed by specific governmental interventions. As this text