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International Business

THIRD EDITION

McGraw Hill

INTERNATIONAL BUSINESS

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J. Michael Geringer
OHIO UNIVERSITY

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Mc Graw Hill

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BRIEF CONTENTS

DEDICATION

Mike dedicates this book to his parents, Raymond and JoAnn, and his partner, Kristie, who have provided continued support and encouragement for his writing and other life activities.

Jeanne dedicates this book to her best friends, Nick Athanassiou and Raven McCrory, her finance professor, Dr. N. D. Qui, and her ION research buddies.

ABOUT THE AUTHORS

J. Michael Geringer

J. Michael Geringer is the O'Bleness Professor of International Strategy at Ohio University. He earned a BS in business at Indiana University and MBA and PhD degrees at the University of Washington. He has authored or edited over 45 books and monographs, more than 180 published papers, and more than 40 case studies; he serves on the editorial boards of several leading international academic journals, including editor-in-chief or associate editor for four journals; he served as the Saastamoinen Foundation chair at the Helsinki School of Economics in Finland; he was the founding chair of the Strategic Alliances Committee of the Licensing Executives Society; he served as the chair of both the International Business and the Strategy and Policy divisions of the Administrative Sciences Association of Canada; and he is past chair of the Academy of Management's International Management division. His research has appeared in *Strategic Management Journal, Academy of Management Journal, Journal of International Management, Columbia Journal of World Business, Management International Review, Journal of Management Studies, Human Resource Management Journal, Long Range Planning, Organisation Studies, Thunderbird International Business Review,* and *Journal of Applied Psychology,* among others. He has received 11 "best paper" awards for his research, including the Decade Award for most influential article from the *Journal of International Business Studies.* He was awarded the Presidential Research Scholar award from Ohio University and the Distinguished Scholar Award from California Polytechnic State University. In addition to spending many years living abroad, he has traveled and worked in dozens of nations worldwide. His teaching performance has earned numerous awards in the United States, Canada, Asia, Africa, Australia, and Europe, including the University Distinguished Teacher Award. In addition to many service activities with various social and nongovernmental organizations, Geringer is active in consulting and executive development for multinational corporations and executives from six continents.

Jeanne M. McNett

Jeanne M. McNett served as a researcher at Northeastern University in the D'Amore-McKim College of Business and Professor of Management, Emerita, at Assumption College. Dr. McNett also has taught at Morris College and the University of Maryland in their Asian and European divisions. She earned her PhD at the University of Massachusetts, Amherst, and her MBA at the Cass School of Business, City University, London, United Kingdom. She has had expatriate assignments in Germany, the United Kingdom, Saudi Arabia, Japan, and Korea. Her interests include the role of culture in international business and the pedagogy of international management. Her publications include the *Blackwell Encyclopedia of Management, International Management,* second and third editions (Blackwell, 2006; Wiley, 2015); *The Blackwell Handbook of Global Management* (Blackwell, 2004); and *A Primer on Sustainability* (Business Expert Press, 2014). Her teaching, research, and presentations have received awards, including the Roethlisberger Best Paper of the Year Award from the *Journal of Management Education* and the Alpha Phi Alpha Teacher of the Year Award. She is involved in community sailing on Cape Cod and in Open University Wellfleet, a community education effort.

Donald A. Ball

Donald A. Ball, a consultant to multinational corporations, was a professor of marketing and international business for several years after leaving the industry. He has a degree in mechanical engineering from Ohio State and a doctorate in business administration from the University of Florida. Ball has published articles in the *Journal of International Business Studies* and other publications. Before obtaining his doctorate, he spent 15 years in various marketing and production management positions in Mexico, South America, and Europe.

MODULE WALKTHROUGH

International Business is organized into three sections to maximize its utility to instructors and students alike. The opening section, Module 1, defines the nature of international business and the three environments in which it is conducted, as well as the nature and continuing importance of international institutions and how they affect business. The second section, comprised of Modules 2 through 8, focuses on the uncontrollable forces at work in all business environments and discusses their inevitable impact on business practice. We devote the third and final section, Modules 9 through 15, to a discussion of how managers deal with all the forces affecting international business.

Module 1: The Challenging Context of International Business: Discusses the importance of international business and how it differs from domestic business. Describes the history of globalization and the internationalization of business and markets, including the driving forces encouraging firms to internationalize their operations. Compares key arguments in favor of and opposing the globalization of business.

Module 2: International Trade and Investment: Describes trends and traits of international trade and foreign direct investment. Introduces and distinguishes among the theories that explain why certain goods are traded internationally. Describes the growth of and explanations for foreign direct investment.

Module 3: Sociocultural Forces: Explores what culture is and its influence on business. The module looks at how cultures show themselves, provides frameworks for analyzing cultures, describes the global mind-set and a model for building strength from diverse cultures, and closes with advice for operating in other cultures.

Module 4: Sustainability and Natural Resources: Describes environmental sustainability in a business context, provides frameworks for sustainability, examines the characteristics of environmentally sustainable businesses, and then moves to a discussion of natural resources that includes geography and energy options.

Module 5: Political Forces That Affect Global Trade: Looks at government involvement in business, the importance of government stability to business, the role of country risk assessment, and the ways governments impede trade through tariffs and other trade barriers.

Module 6: Intellectual Property Rights and Other Legal Forces: Reviews legal systems and the rule of law, discusses legal concerns in international business, the ways intellectual property can be protected, and the international standardization of some laws. Examines specific national-level legal approaches in competition, trade, tort, ethics, and accounting.

Module 7: Economic and Socioeconomic Forces: Explains the purpose of economic analysis and discusses different categories of countries based on levels of national economic development. Explores human-needs development and global population trends involving urbanization, treatment of gender, ethnicity, and other sociocultural factors.

Module 8: The International Monetary System and Financial Forces: Describes the development of the international monetary system from the gold standard through today's floating currency exchange rate system and describes the process of exchange rate movement. Discusses the financial forces governments can exert and the significance of the balance of payments to international business decisions.

Module 9: International Competitive Strategy: Examines international competitive strategy and how companies use strategic planning to address international business opportunities and challenges. Discussion includes how companies develop competencies to give them competitive advantage in national, regional, and global markets.

Module 10: Organizational Design and Control: Explains why the design of organizations is important to international companies and the various dimensions managers must consider when designing their organizations. Explains why and how decision making is allocated across subsidiaries of an international company, both wholly owned and jointly owned.

Module 11: Global Leadership Issues and Practices: Covers issues associated with global leadership, including the importance of creating a global mind-set, what is different between global leadership and domestic leadership, and the competencies necessary for effective global leadership. Identifies approaches for selecting and developing effective global leaders, as well as the challenges of leading global teams and global change.

Module 12: International Markets: Assessment and Entry Modes: Provides approaches to market screening and environmental analysis. Describes some of the issues market researchers may encounter in foreign markets. Explains international market entry modes.

Module 13: Marketing Internationally: Looks at considerations associated with marketing products internationally and ways in which these considerations differ from domestic marketing activity. Addresses issues including discussion of differences between the total product, the physical product, and the brand name; considerations in deciding which parts of the marketing mix to standardize, localize, or "glocalize"; and international pricing and distribution strategies.

Module 14: Managing Human Resources in an International Context: Examines worldwide labor conditions and the international human resource management approach, including recruitment, selection, training and development, expatriation, and compensation. Identifies some of the challenges and opportunities of an expatriate position, for the expat and for his or her family members. Describes compensation packages for expatriate executives.

Module 15: International Accounting and Financial Management: Outlines the major accounting issues related to operating in international currencies, explores the benefits of triple-bottom-line accounting, reviews capital structure choices, describes why ICs move funds. Reviews foreign exchange risks and their hedging. Looks at taxation as an international financial force.

In addition to the 15 core modules discussed above, *International Business* provides 3 additional bonus modules to provide coverage of selected material that may be of particular value to students and instructors.

Bonus Module A: International Institutions from a Business Perspective: Describes why international institutions are important to business, including an introduction to institutional theory. Describes several significant international and regional institutions, including the UN, the IMF, the World Bank, and the OECD. Examines the major trading blocs as successful institutions and their levels of economic integration.

Bonus Module B: **Export and Import Practices:** Examines practices and procedures for engaging in exporting and importing, including sources of export counseling and support, key terms used in exporting and importing, sources of export financing, and export documentation.

Bonus Module C: **Global Operations and Supply Chain Management:** An overview of important operations issues in conducting international business, including the management of international supply chains, the relationship between design and supply chain management, alternatives for global sourcing arrangements, and key issues in decisions regarding global standardization of production processes and procedures.

NEW AND IMPROVED COVERAGE

The world of international business is always changing and challenging, so this third edition has been substantially updated in order to help convey this sense of excitement, challenge, and change to the reader. Engaging elements such as CultureFacts and margin quotes have been updated throughout the new edition to help the reader think differently about a range of international business–related topics and issues. A brief summary of key changes we have made in this new edition, module by module, is included in the following paragraphs.

Module 1: The Challenging Context of International Business

New examples have been included within the text across the various sections of the chapter. The section on international environmental forces has been reorganized and terminology updated to improve flow and comprehensibility. Data on the scope and scale of multinational enterprises, foreign direct investment, and international trade have been updated. We have a new IB in Practice box that explores what it means to "buy American." The discussion of globalization, including arguments for and against these forces, has been updated and reorganized. We have included a new From Backpack to Briefcase vignette of a recent student who has pursued her interests in international business. We have prepared a new end of module Minicase that examines some of the key impacts of the COVID-19 pandemic on international business.

Module 2: International Trade and Investment

This module incorporates extensive updates of data on both international goods and services trade as well as foreign direct investment. We also discuss the impact of the COVID-19 pandemic on the levels and nature of international business activity. Major exporting and importing countries are identified, and we provide a discussion of the continued regionalization of international trade activity. The popular Global Debate box on offshoring to India has been updated, as has the IB in Practice box that examines whether trade deficits are good or bad for a country. As a contrast to the Global Debate box on outsourcing to India, the end-of-module Minicase examines the emergence of Brazil as a potential location for outsourcing information technology activities, particularly for international companies in the Americas.

Module 3: Sociocultural Forces

To help highlight the important role of sociocultural forces in international business, we now begin the module with an introductory discussion that challenges students to examine whether and to what extent they should adjust their behavior and practices to conform with local customs or whether such adaptation might not be morally justifiable. We have provided updated examples and references to new research across the module. For example, we discuss the need for international businesspeople to be mindful of whether and how their products and imagery may conflict with religious or other cultural values and beliefs, using examples of Nike and TikTok, among others. We have also prepared a new Global Debate box that examines the role of sociocultural forces in the decision regarding what employees to select for international positions.

Module 4: Sustainability and Natural Resources

As issues of climate change and sustainability gain increased attention in international business activities, this module responds to such trends by providing an up-to-date discussion of these important issues. The introductory vignette examines how sustainability has taken on a more prominent role among international businesses and their leaders, including how these practices are increasingly linked to international trade, investment, and even a company's attractiveness for potential new recruits. In addition to updating research and data on sustainability, this module has a variety of new and updated examples of how these practices are being incorporated by various companies around the world. There is expanded discussion of organizations and practices associated with measuring and reporting sustainability practices of international organizations. There is expanded discussion of trends toward increased use of renewable energy sources, including wind and solar, across nations and regions of the globe. The Global Debate box on the Paris Climate Accord has been updated and expanded to incorporate impacts of the COVID-19 pandemic as well as the transition to new political leadership in the United States.

Module 5: Political Forces That Affect Global Trade

This module updates research and examples on the impact of political forces on international business, including in areas such as trends on government ownership of businesses, Britain's exit from the European Union, and protectionism and its impact on trade. We supplement this discussion with a new IB in Practice box that examines the United States' threat to ban the Chinese social media company TikTok from access to the U.S. market. There is an updated and expanded discussion of cybercrime, an area of increasing concern in international business and political arenas. We have included a new From Backpack to Briefcase vignette of a recent student who has pursued her interests in international business. There is also an updated end-of-module Minicase examining the use of child labor for producing chocolate, along with efforts by governments, businesses, and nongovernmental organizations to end this practice.

Module 6: Intellectual Property Rights and Other Legal Forces

This module begins with an updated vignette on the threat posed by counterfeit pharmaceutical drugs, including for COVID-19 vaccines. The module incorporates updated research, statistical data, and company examples regarding a broad array of legal issues, including intellectual property rights. These issues include cybersquatting efforts that attempted to exploit the onset of the COVID-19 pandemic, as well as implementation of the European Union's Directive on Copyright in the Digital Single Market. We have included a new From Backpack to Briefcase vignette of a recent student who has used international business travel and training to help her pursue a career in international business law.

Module 7: Economic and Socioeconomic Forces

This module begins with a new introductory vignette that highlights how socioeconomic forces influenced the response to the COVID-19 pandemic in two contrasting nations: Thailand and Germany. The module includes current research, data, and examples for a broad array of economic and socioeconomic forces, including levels and rates of economic development, nature of underground economies, income distribution and consumption, and the size and cost of national labor forces. Socioeconomic factors such as population density and aging have also been updated. The popular and engaging IB in Practice box on the use of the Big Mac Index for assessing purchasing power parity has been updated and expanded. There is a new From Backpack to Briefcase vignette of a student who has pursued his passion for international business experience. We have also included a new Minicase at the end of the module, addressing how an aging population may affect a country's manufacturing ability and competitiveness.

Module 8: The International Monetary System and Financial Forces

This module has a new introductory vignette that discusses how the COVID-19 pandemic not merely disrupted lives and businesses worldwide, but also helped to accelerate adoption of fintech and contribute toward change in the global financial services industry. New examples are included across the module to illustrate key concepts, along with updated research and data on international financial forces. In addition to a new From Backpack to Briefcase vignette, this module also contains an updated Minicase on the Asian Development Bank.

Module 9: International Competitive Strategy

The introductory vignette, examining Netflix's global strategy, has been updated. New examples have been provided for key elements such as the mission and vision statements of international companies, including Amazon and Tesla. The challenging Global Debate box examining Google and its efforts to navigate censorship pressures in China has been updated. New and expanded examples have been provided throughout the discussion of competitive strategies to help the reader better understand the home replication, multidomestic, global, and transnational strategy concepts. The impact of the COVID-19 pandemic has been incorporated in multiple areas, including planning and scenario building. There is a new From Backpack to Briefcase vignette and the popular Minicase on Walmart has been updated to incorporate recent developments in its Chinese and Indian ventures.

Module 10: Organizational Design and Control

This module begins with a new introductory vignette that discusses 3M's efforts to improve performance by restructuring its international operations. The new edition also has new and updated examples of international companies, such as Boeing, Liebherr International, Pandora, and IBM, that illustrate different types of organizational structures. Supplementing the updated IB in Practice box on working in a global virtual organization, we have incorporated a new discussion of how the COVID-19 pandemic has affected the use of work from home and other flexible working practices, as well as promoting the use of alternatives to physical travel for employees of international companies. In addition to the incorporation of new research and data, this module has a new From Backpack to Briefcase vignette, and the Minicase has been updated.

Module 11: Global Leadership Issues and Practices

This module's introductory vignette has been revised and updated to enhance its focus on the development of international leaders. The discussion of global mind-set has been expanded to incorporate recent research on this concept, and the popular Global Debate box on participation of women in global leadership positions has been updated. The discussion of leading virtual and geographically dispersed teams has been expanded to incorporate the impact of the COVID-19 pandemic on international companies' operations. We have also included a new From Backpack to Briefcase vignette that illustrates how a recent student has leveraged international opportunities to enhance her cross-cultural leadership training and experience.

Module 12: International Markets: Assessment and Entry Modes

This module begins with a new vignette that addresses global trends and differences associated with companies' efforts to reach the millennial consumers, including social media and technology dimensions. The module has updated the data, programs, and websites associated with market assessment. The Global Debate box now addresses trends and traits of sub-Saharan Africa that suggest this region could become a key market for international companies to focus on in coming years. There is a new section examining the use of social media influencers in sociocultural screening and market assessment efforts. The IB in Practice box highlights how Uniqlo has increasingly thrived in its Asian market expansion efforts but continues to struggle to gain significant traction in the U.S. market for fashion clothing. There is an expanded discussion of trends in the market research techniques being used within our changing global environment, along with a new From Backpack to Briefcase vignette.

Module 13: Marketing Internationally

This module begins with an updated vignette about how social media and technology are helping to transform marketing practices for luxury goods in China. There is a substantial updating of the fascinating IB in Practice box, capturing continued developments and challenges in IKEA's efforts to penetrate the furniture market in India. The module incorporates new research, updated data, and practical company examples about marketing practices in international business. The Global Debate box has been updated to include continuing developments in efforts to enable businesses and travelers from the United States to enter the Cuban market. We have included a new From Backpack to Briefcase vignette of a recent student who is pursuing international experiences and education, and the Minicase on Dollar Shave Club's efforts to expand its business model to international markets has been updated and expanded.

Module 14: Managing Human Resources in an International Context

This module has updated its discussion of global workforces, including issues of urbanization, immigration, brain drain, and unionization. In addition to incorporating new research findings, this module presents new data and examples, including information relevant to trends involving millennial workers.

Module 15: International Accounting and Financial Management

The introductory vignette on sovereign wealth funds incorporates new information to reflect current conditions, and data and examples throughout the module have been updated. We discuss recent efforts and accomplishments in the harmonization of international accounting standards and the U.S. FASB principles. The IB in Practice box examines the rapid development of mobile banking technology and applications in Africa and its impact on a continent generally lacking in extensive brick-and-mortar financial infrastructure.

Bonus Module A: International Institutions from a Business Perspective

This module's new opening vignette examines the World Bank's role in supporting developing countries' efforts to combat the COVID-19 pandemic. Data and examples have been updated or added throughout the module. New material highlights recent developments in economic cooperation and trade, including the United States–Mexico–Canada Agreement, the 54-member African Continental Free Trade Area, and the Regional Comprehensive Economic Partnership championed by the Association of Southeast Asian Nations. We have incorporated a new From Backpack to Briefcase vignette of a recent student and her international experiences in school and after graduation.

Bonus Module B: Export and Import Practices

This module provides a detailed overview of the specific practices and requirements associated with exporting and importing and the module has been updated to include the most current websites, standards, and examples of business applications. The new International Chamber of Commerce Incoterms are incorporated in the tables and discussion. Our overview of the different official procedures required for exporting and importing, comparing the United States with various regions of the world, has been updated to reflect recent developments. The Global Debate box addressing ethical issues in the export of live animals has been expanded to incorporate new material. We have a new From Backpack to Briefcase vignette.

Bonus Module C: Global Operations and Supply Chain Management

The introductory vignette examining how 3D printing may disrupt global supply chains and production decisions has been updated to incorporate new data on this rapidly evolving issue. The discussion of global sourcing has a new discussion of logistical issues associated with shipping, including a discussion of the globally disruptive Suez Canal blockage in March 2021. We have also expanded the discussion of challenges of ensuring that supply chains do not incorporate elements such as child labor, forced labor, or environmentally damaging activities, using examples of Apple and H&M. The discussion of logistics and supply chains has been expanded to include new concepts and examples related to disruptions experienced from the COVID-19 pandemic. Both the IB in Practice and Global Debate boxes have been updated with new data and developments. We have included new research findings, and we also include a new From Backpack to Briefcase vignette.

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Any effort to create a valuable new package of learning materials such as *International Business* involves the efforts not only of the authors and their invaluable editorial team, but also the insights, support, and encouragement of numerous other individuals and institutions. To the long list of individuals to whom we are indebted, we want to add Nicholas Athanassiou, Northeastern University; Joseph R. Biggs, California Polytechnic State University—San Luis Obispo; Marcelo Cano-Kollmann, Ohio University; Grigorios Livanis, Ohio University; Paul Frantz, Long Beach State University; Wendell McCulloch, Long Beach State University; Bill Pendergast, California Polytechnic State University—San Luis Obispo; Jere Ramsey, California Polytechnic State University—San Luis Obispo; Hugh Sherman, Ohio University; Mary Tucker, Ohio University; Ike Uzuegbunam, Howard University; Kristie Nies, Ballad Health; and Ed Yost, Ohio University. We also wish to acknowledge Melinda Zuniga, Yana Saltaeva, Ella Michelich, Cameron Mauzy, Sarah Wartinger, Leah Allan, Mackenzie Perry, Lily Denoma, and Danielle Demaria, who helped with research.

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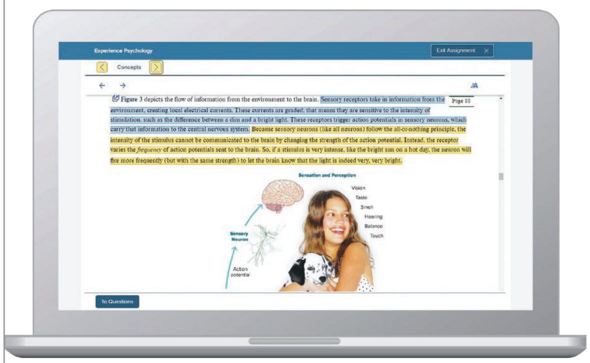

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INTERNATIONAL BUSINESS

module

1 The Challenging Context of International Business

> **“To tackle the challenges of globalization will require a serious commitment to making international knowledge and skills a policy priority. . . . Knowledge of the world is no longer a luxury, it is a necessity.”**
>
> *—Nicholas Platt, President Emeritus of the Asia Society*[1]

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LEARNING OBJECTIVES

After reading this module, you should be able to:

LO 1-1 **Show** how international business differs from domestic business.

LO 1-2 **Describe** the history and future of international business.

LO 1-3 **Discuss** the dramatic internationalization of business.

LO 1-4 **Identify** the kinds of drivers that are leading firms to internationalize their operations.

LO 1-5 **Compare** the key arguments for and against the globalization of business.

Improve Job Opportunities by Getting International Experience

Will international experience help you to get a job? The answer is a definite "yes," according to Dan Black, director of campus recruiting for the Americas for Ernst & Young, who says, "We definitely see overseas experience as an advantage. . . . Our clients are demanding more of us these days. They want diversity of thought and diversity of values."

International experience is valuable not only for new hires, but also for mid-career individuals who aspire to higher positions and greater responsibility. For example, as a young assistant controller at Medtronic, a Fortune 500 medical device company, Gary Ellis was considered to be on the fast track for a top management position, but company executives felt he first needed broader experience. They sent Ellis to lead their European headquarters in Belgium, where he was responsible for many top-level duties. Two years later, when the corporate controller position in Medtronic's home office became vacant, Ellis earned the job due to the chief executive officer's (CEO) belief that successful future executives will be those who have lived and worked for several years in another country. Ellis's international experience ultimately helped him become Medtronic's chief financial officer and senior vice president.

Although many companies want their top executives to have years of foreign experience, do CEOs recognize the value of international business education for all managers? Surveying CEOs of the 162 largest firms on *Fortune*'s list of the 500 largest U.S. corporations, our research found that the CEOs strongly believed: (1) an international orientation should be an important part of college business education; (2) international business skills and knowledge were important not merely for promotion to senior executive positions, but also for entry-level positions and across a broad array of functional as well as cross-functional areas; and (3) the importance indicated in the preceding points was magnified for companies that anticipated increasing importance of international activities in the next five years. For developing international skills, CEOs believed that a number of courses in the international business curriculum are relevant to their companies. In addition to an Introduction to International Business course, the internationally oriented courses viewed as the most important for early career positions included topics related to: (1) international strategy and competitiveness, (2) international legal and political issues, (3) international negotiation, and (4) foreign language.

Did you note the reason for this emphasis on foreign experience for managers? It is increased involvement of the firm in international business. What about companies with no foreign operations of any kind? Do their managers need this global perspective? They do indeed, because it will help them not only to be alert for both sales and sourcing opportunities in foreign markets but also to be watchful for new foreign competitors preparing to invade their domestic market. International experience can increase your respect for other cultures, teach you to deal with very different styles of leadership, and enhance your ability to manage diversity within teams. In addition, according to recruiters, foreign experience reflects independence, resourcefulness, and entrepreneurship. People who work and support themselves overseas tend to be inquisitive, adaptive, and flexible—valuable qualities in today's work environment. International experience is an important variable in explaining better decision making and strategic choices.

So what can you do to improve your chances to obtain an overseas post? You can take classes in the area of international business, perhaps leading to a degree in an international business–related field. In addition, even while you are in school or shortly after graduation, consider traveling abroad to study, to work (whether as a business intern, as a teacher, or even in such positions as bartender or child care provider), or to volunteer in community development activities. The Institute of International Education found that, "Longer periods of study abroad have a high impact on subsequent job offers and the development of most skills. Short-term programs are most effective at developing teamwork skills."

If you already have a job, you can enhance your opportunities for international experience by making your boss and the human resource management department aware of your interest and the fact that you have studied international business. Look for opportunities to remind them that you continue to be interested in a foreign assignment (your performance review is an ideal time to inform them). Try to meet people who work with the company's foreign affiliates as well as visitors from overseas. As evidence of your strong interest in foreign employment, take additional international business courses and study foreign languages. Make sure that people in your company know what you are doing.

Throughout this book you will find examples of ways to develop, apply, and promote your international skills and

> **"An international experience offers the chance to build confidence, develop a level of resilience and use creative approaches in navigating a different culture. These are important attributes that most employers seek in a worker.[2]"**
>
> *—David J Smith, President, Forage Center for Peacebuilding and Humanitarian Education*

experience through features such as "Get That Job! From Backpack to Briefcase" vignettes that describe international experiences of current students and recent graduates. Hopefully, through effective application of these suggestions, you will build a successful foundation for your own international experiences!

Sources: "Gaining an Employment Edge—The Impact of Study Abroad," Institute of International Education, October 2017; "The Value of International Education to U.S. Business," Institute of International Education, July 4, 2018; Susan Adams, "How a Job Abroad Can Give Your Career a Big Boost," *Forbes,* November 4, 2010, www.forbes.com; Peder Greve, Torsten Biemann, and Winfried Ruigrok, "Foreign Executive Appointments: A Multilevel Examination," *Journal of World Business,* vol. 50, no. 4, October 2015, 674–686; Lisa Dragoni, In-Sue Oh, Paul E. Tesluk, Ozias Moore, Paul VanKatwyk, and Joy Hazucha, "Developing Leaders' Strategic Thinking through Global Work Experience: The Moderating Role of Cultural Distance," *Journal of Applied Psychology,* vol. 99, March 2, 2014, 867–882; J. Michael Geringer and W.R. Pendergast, "Firmly Rooting IB Research in the Soil of Relevance: Integration and Recommendations," *Thunderbird International Business Review,* vol. 54, no. 2, March/April 2012, 263–269; J. Michael Geringer and William R. Pendergast, "CEO Views on the Value of International Business Skills and Education," *The International Journal of Management and Business,* vol. 1, no. 1, January 2010, 1–29; Christine Farrugia and Jodi Sanger, "Gaining an Employment Edge: The Impact of Study Abroad on 21st Century Skills & Career Prospects in the United States," Institute of International Education, October 2017; and J. Michael Geringer, William R. Pendergast, and Ike Uzuegbunam, "Firm Internationalization and CEO Perceptions of International Business Education and Skills," *Journal of Human Resources and Adult Learning,* vol. 15, no. 1, June 2019, 20–31.

A Starbucks coffee store in Beijing, China. Company executives say China is the coffee chain's No. 1 growth market.
VCG/Getty Images

What about you? Are you involved in the global economy yet? Think back to how you began your own day. After you awoke to your Samsung smartphone's alarm and switched on your bedside light from IKEA, you may have watched some funny videos on TikTok while drinking a can of Red Bull. Then maybe you played some Mario Kart on your Nintendo Switch, before turning on your Toshiba television for the news and weather while you showered with Dove shower gel and brushed your teeth with Close-Up toothpaste. After drying your hair with a Conair dryer, maybe you slipped into some Lululemon athletic tights and Adidas running shoes, then drove off to class in your Honda with its Firestone tires and a tank full of Shell gasoline. Meanwhile, on the other side of the world, a group of Nike-clad South Korean students may be turning off their Apple iPads after checking Facebook and debating whether they should stop for hamburgers and Cokes at McDonald's or coffee at Starbucks and then tweet their friends about where to meet to play FIFA 21 on Xbox. They toss their books and other materials into their JanSport backpacks and put on their North Face jackets and Oakley sunglasses as they head out the door.

What do you and the Korean students have in common? You are all consuming products made by foreign-owned companies. This is the result of international business.

All you have read so far points to one salient fact: all managers need to have a basic knowledge of international business to meet the challenge of global competition. Acquiring this knowledge consists, in part, of learning the special terminology of international business, an important part of every introductory course. To assist you in learning international business language, we've included a glossary at the end of the book and listed the most important terms at the end of each module. They also appear in bold print where they are first discussed in the text and with their definitions in the margin.

LO 1-1
Show how international business differs from domestic business.

What Is International Business and What Is Different about It?

Because international business is a relatively new discipline and is extremely dynamic, you will find that the definitions of a number of terms vary among users. To avoid confusion due to the range of different definitions of terms in international business, we will employ the following definitions, which are generally accepted by managers. **International business**

international business
Business that is carried out across national borders

is business that is carried out across national borders. This definition includes not only international trade and foreign manufacturing but also the growing service industry in areas such as transportation, tourism, advertising, consulting, construction, retailing, wholesaling, and mass communications. **Foreign business** denotes the operations of a company outside its home or domestic market; many refer to this as business conducted within a foreign country. This term sometimes is used interchangeably with "international business" by some writers, although that will not be our practice. An **international company (IC)** is a company with operations in multiple nations. International companies may not have any investment in nations other than their home nation, which might be the case for a company that is only involved in exporting and selling its goods or services in other nations.

International business differs from domestic business in that a firm operating across borders must deal with the forces of three kinds of environments: domestic, foreign, and international. In contrast, a firm whose business activities are carried out within the borders of one country needs to be concerned essentially with only the domestic environment. However, no domestic firm is entirely free from foreign or international environmental forces because the possibility of having to face competition from foreign imports or from foreign competitors that set up operations in its own market is always present. Let us first examine these forces and then see how they operate in the three environments.

> "TRAVEL IS FATAL TO PREJUDICE, BIGOTRY, AND NARROW-MINDEDNESS, AND MANY OF OUR PEOPLE NEED IT SORELY ON THESE ACCOUNTS. BROAD, WHOLESOME, CHARITABLE VIEWS OF MEN AND THINGS CANNOT BE ACQUIRED BY VEGETATING IN ONE LITTLE CORNER OF THE EARTH ALL ONE'S LIFETIME."
>
> —*Mark Twain,* The Innocents Abroad, *1869*

THE INFLUENCE OF EXTERNAL AND INTERNAL ENVIRONMENTAL FORCES

The term **environment** as used here means all the forces influencing the life and development of the firm. The forces themselves can be classified as external or internal. The external forces are commonly called **uncontrollable forces**, which are external forces management has no direct control over, although it can exert influence—such as lobbying for a change in a law or heavily promoting a new product that requires a change in a cultural attitude. External forces consist of the following:

1. *Competitive:* kinds and numbers of competitors, their locations, and their activities.
2. *Distributive:* national and international agencies that distribute goods and services.
3. *Economic:* variables (such as gross national income [GNI], unit labor cost, and personal consumption expenditure) that influence a firm's ability to do business.
4. *Financial:* variables such as interest rates, inflation rates, and taxation.
5. *Socioeconomic:* characteristics and distribution of the human population.
6. *Labor:* composition, skills, and attitudes of workers.
7. *Sociocultural:* elements of culture (such as attitudes, beliefs, and opinions) important to international managers.
8. *Political:* elements of nations' political climates such as nationalism, forms of government, and international organizations.
9. *Legal:* the many foreign and domestic laws governing how international firms must operate.
10. *Technological:* the technical skills and equipment that affect how resources are converted to products.
11. *Physical:* elements of nature such as topography, climate, and natural resources.

Management must adapt to changes in the uncontrollable environmental variables in order to enhance the prospects for their company's survival and success. The internal forces over which management does have some control and can manage in response to

foreign business
The operations of a company outside its home or domestic market

international company (IC)
A company with operations in multiple nations

environment
All the forces influencing the life and development of the firm

uncontrollable forces
The external forces that management has no direct control over

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In South Korea, avoid writing in red ink, as this is used when writing the names of deceased family members. Writing a name in red ink is considered rude because it can mean the person is deceased or you wish death or harm upon them. #Koreaculture #culturalrudeness

Paul Ellis/Getty Images

changes in uncontrollable forces, such as human resources, finance, production, organizational structures and processes, and marketing, are called the **controllable forces**.

controllable forces
Internal forces that management administers to adapt to changes in the uncontrollable forces

Consider how change in political forces—the expansion of the European Union (EU) by 10 nations in 2004, two more in 2007, and another in 2013, and the 2016 UK vote to leave the EU—affected all the controllable forces of firms worldwide that do business in or with the 28 EU member-nations. Suddenly these firms had to examine their business practices and change those affected by these membership changes. For example, some European concerns and **foreign affiliates** in the EU relocated parts of their existing operations or established new facilities within other nations in the Union, such as Poland, in order to exploit differences such as access to more abundant or lower-wage labor.[3] Other companies, such as HSBC and JPMorgan, relocated hundreds of jobs, billions of euros in assets, or even their European headquarters from the United Kingdom to avoid potential complications from the United Kingdom's departure from the EU.[4] This has included companies such as TRW and 3M, which have acquired or expanded their operations in Poland due to the low cost and high quality of the workforce available there, as well as Poland's proximity to major European markets such as Germany. Some U.S. and Asian companies set up or acquire facilities in one or more of the member-countries to supply this giant free trade area. By doing this, companies such as Google and Apple have helped avoid or reduce import duties on products coming from their home countries.[5]

foreign affiliate
A company controlled by another company that is located in a foreign land, and this control may be exercised by a variety of means, both those involving stock ownership and those involving nonownership mechanisms

THE DOMESTIC ENVIRONMENT

domestic environment
All the uncontrollable forces originating in the home country that surround and influence the life and development of the firm

The **domestic environment** is all the uncontrollable forces originating in the home country that surround and influence the life and development of the firm. Obviously, these are the forces with which managers are most familiar. Being domestic forces, however, does not preclude their affecting foreign operations. For example, if the home country is suffering from a shortage of foreign currency, which might result from an event such as a sharp decline in the value of that country's currency, the government may place restrictions on overseas investment to reduce its outflow. As a result, managers of multinationals find that they cannot expand overseas facilities as they would like to do. Similarly, a labor union may decide to call a strike at the domestic manufacturing operations of a company, causing disruption in the supply of parts to the company's assembly activities in another nation.

THE FOREIGN ENVIRONMENT

foreign environment
All the uncontrollable forces originating outside the home country that surround and influence the firm

The **foreign environment** refers to all the uncontrollable forces originating outside the home country that surround and influence the firm. The forces in the foreign environment are the same as those in the domestic environment except they occur outside the firm's home country. However, they operate differently for several reasons, including those provided here.

Forces Have Different Values Even though the kinds of forces in the two environments are identical, their values often differ widely, and at times they are completely opposed to each other. A classic example of diametrically opposed political-force values and the bewilderment they create for multinational managers is the sanctions placed on Russia and selected Russian companies by the European Union, the United States, Canada, and other nations in response to Russia's actions in Ukraine in 2014, including the annexation of Crimea. The Russian government imposed retaliatory sanctions, including bans on the importation of food products from Europe. A number of salmon-farming companies in Norway suddenly lost access to the Russian market, their biggest export market, after Norway decided to participate in the anti-Russia sanctions. At the same time, fish farmers in the Faroe Islands, an autonomous part of Denmark, experienced a windfall from increased demand by Russia for their products.[6] Despite Denmark's participation in the Russian sanctions, the Faroe Islands exercised their autonomy and chose not to join their fellow citizens in imposing these sanctions, enabling them to capture record levels of export business.

Forces Can Be Difficult to Assess Another problem with foreign forces is they are frequently difficult to assess. This is especially true of legal and political forces. A highly nationalistic law may be passed to appease a section of the local population. To all outward appearances, the government may appear to be against foreign investment; yet pragmatic leaders may actually encourage it. A good example is Mexico, which in 1938 nationalized its oil industry and subsequently prohibited any foreign firms from participation in oil exploration and production in the country. However, despite Mexico's having one of the world's largest reserves of oil, production suffered continuing declines due to the government oil monopoly's lack of sufficient money or expertise to exploit promising new deposits from deepwater wells and shale rock formations. Governmental leaders in Mexico repeatedly and unsuccessfully attempted to reform legislation to allow access to foreign investment and technology, creating uncertainty for companies wanting to enter this promising market. The situation persisted until 2013, when Mexico finally passed an energy reform law that allowed foreign companies to invest in the country's energy sector.[7] However, by 2020, Mexican president Lopez Obrador suggested these reforms might be repealed and that the government monopoly might be restored.[8]

Another good example is social media. Sites such as Twitter, WhatsApp, and Google are blocked in China, with similar services instead offered by Chinese providers such as Weibo, WeChat, and Baidu. In addition, the EU implemented the General Data Protection Regulation (GDPR), which establishes strict rules for how firms such as those in social media can store and use customers' data, with violators subject to harsh penalties.

The Forces Are Interrelated As you study this text, it will be evident that the forces are often interrelated. This in itself is not a novelty, because the same situation confronts a domestic manager. On the foreign scene, however, the kinds of interaction that occur and the outcomes may differ. For instance, the combination of high-cost capital and an abundance of unskilled labor in many developing countries may lead to the use of a lower level of technology than would be employed in the more industrialized nations. In other words, given a choice between installing costly, specialized machinery needing fewer workers and installing less expensive, general-purpose machinery requiring a larger labor force, management will frequently choose the latter when faced with high interest rates and a large pool of available workers. Another example is the interaction between physical and sociocultural forces. Barriers to the free movement of a nation's people, such as mountain ranges and deserts, help maintain pockets of distinct cultures within a country, and this has an effect on decision making by international businesses.

THE INTERNATIONAL ENVIRONMENT

The **international environment** consists of the interactions between the domestic environmental forces and the foreign environmental forces, as well as interactions between the foreign environmental forces of two countries, such as when an affiliate in one country does business with customers in another. This agrees with our earlier definition of international business: business that involves the crossing of national borders.

international environment
Interaction between domestic and foreign environmental forces, as well as interactions between the foreign environmental forces of two countries

For example, employees at the headquarters of a multidomestic or global company work in the international environment if they work in any way with another nation, whereas those in a foreign affiliate do not unless they too are engaged in international business through exporting or the management of other affiliates. In other words, sales managers at the Chinese electronics firm Xiaomi do not work in the international environment if they sell cellular phones only in China. If Xiaomi's China operations export smartphones to another country such as India, then sales managers are affected by forces of both China's domestic environment and India's foreign environment and thus are working in the international environment. International organizations whose actions affect the international environment are also properly part of it. These organizations include (1) worldwide bodies (e.g., World Bank), (2) regional economic groupings of nations (United States–Mexico–Canada Agreement, European Union, Mercosur), and (3) organizations bound by industry agreements (Organization of Petroleum Exporting Countries, or OPEC).

"GLOBETROTTING DESTROYS ETHNOCENTRICITY. IT HELPS YOU UNDERSTAND AND APPRECIATE DIFFERENT CULTURES. TRAVEL CHANGES PEOPLE. IT BROADENS PERSPECTIVES AND TEACHES NEW WAYS TO MEASURE QUALITY OF LIFE."

—*Rick Steves, travel guru*[9]

Decision Making Is More Complex Those who work in the international environment find that decision making is more complex than it is in a purely domestic environment. Consider managers in a home office who must make decisions affecting affiliates in just 10 different countries (many ICs are in 20 or more countries). They not only must take into account the domestic forces but also must evaluate the influence of 10 foreign national environments. Instead of having to consider the effects of a single set of 10 forces, as do their domestic counterparts, they have to contend with 10 sets of 10 forces, both individually and collectively, because there may be some interaction.

For example, if management agrees to labor's demands at one foreign affiliate, chances are it will have to offer a similar settlement at another affiliate because of the tendency of unions to exchange information across borders. Furthermore, as we shall observe throughout this text, not only are there many sets of forces, but there are also extreme differences among them.

Self-Reference Criterion Another common cause of the added complexity of foreign environments is managers' unfamiliarity with other cultures. To make matters worse, some managers will ascribe to others their own preferences and reactions. Thus, a foreign production manager, facing a backlog of orders, may offer their workers extra pay for overtime. When they fail to show up, the manager is perplexed: "Back home they always want to earn more money." This manager has failed to understand that the foreign workers may prefer time off to more money. This unconscious reference to the manager's own cultural values, called the **self-reference criterion**, is probably the biggest cause of international business blunders. Successful managers are careful to examine a problem in terms of the local cultural traits as well as their own.

self-reference criterion
Unconscious reference to your own cultural values when judging behaviors of others in a new and different environment

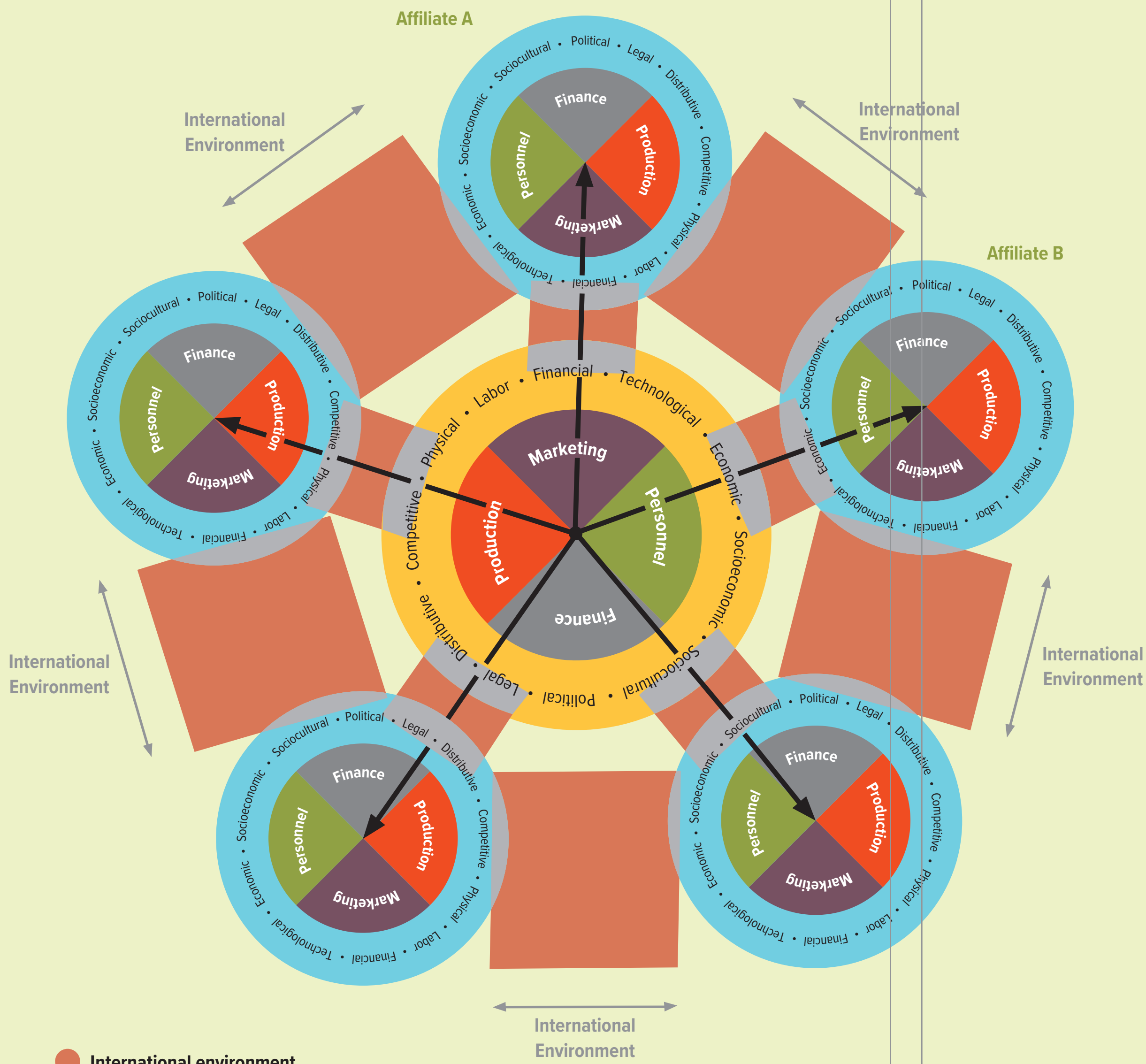
A solid understanding of the business concepts and techniques employed in the United States and other advanced industrial nations is a requisite for success in international business. However, because transactions take place across national borders, three environments—domestic, foreign, and international—may be involved, instead of just one. Thus, in international business, the international manager has three choices in deciding what to do with a concept or a technique employed in domestic operations: (1) transfer it intact, (2) adapt it to local conditions, or (3) not use it overseas. International managers who have discovered there are differences in the environmental forces are better prepared to decide which option to follow. To be sure, no one can be an expert on all these forces for all nations, but just knowing that differences may exist will cause people to "work with their antennas extended." In other words, when they enter international business, they will know they must look out for important variations in many of the forces they take for granted in the domestic environment.

CULTURE FACTS @internationalbiz

People living in cultures in which unequal wealth and power are more acceptable, such as China, Russia, and India, are less likely to help people in need or donate to charitable causes than are people from nations with low scores on inequality acceptance, such as Canada, Australia, the United States, and Ireland. #unequalwealth #unequalpower #acceptable #nodonations

The relationships among the forces in the three environments we have been discussing form the basis of our international business environments model as shown in Figure 1.1. The external or uncontrollable forces in both the domestic and the foreign environments surround the internal forces controlled by management. The domestic environment of the international firm's home country is surrounded by as many sets of foreign

FIGURE 1.1 International Business Environments



International environment

Domestic environment
(Includes socioeconomic, sociocultural, political, legal, distributive, competitive, physical, labor, financial, technological, and economic environments)

Foreign environment
(Includes socioeconomic, sociocultural, political, legal, distributive, competitive, physical, labor, financial, technological, and economic environments)

environments as there are countries in which the company does business. Solid lines connecting the internal forces at the home office to the internal forces in the foreign affiliates indicate the lines of control. The rust areas indicate the international environment in which employees in the headquarters of the international firm work. If, for example, the affiliate in foreign environment A exports to or manages the affiliate in foreign environment B, then its people are also working in the international environment, as shown by the rust section.

LO 1-2
Describe the history and future of international business.

Is Internationalization of Business a New Trend, and Will It Continue?

While international business as a discipline is relatively new, as a business practice it is not, so let's briefly explore the history of international business.

During the Hellenistic Age, before the Roman Empire was established, Phoenician and Greek merchants were sending representatives abroad to sell their goods. Subsequently, a vast expansion of agricultural and industrial production in China stimulated the emergence of an internationally integrated trading system stretching from Asia to the Mediterranean and Africa. The old saying that "all roads lead to Rome" might have instead been stated as "all roads lead to China" within the international trade system, as China was the world's leading manufacturing country for about 1,800 years, until it was replaced by Britain in about 1840.

The impact of the emerging international trading system was extensive. Politics, the arts, agriculture, industry, and other sectors of human life were profoundly influenced by the goods and ideas that came with trade. Public health was also affected. An interesting precursor to contemporary concerns about global health epidemics, such as the Zika virus and COVID-19, was international trade's association with the spread of the plague, one of the worst natural disasters in history. Believed to have originated in Asia, the plague moved west with traders and soldiers, carried by fleas that lived on rodents on ships and caravans. Called the Black Death in Europe and repeated in waves from the mid-1300s through the 1600s, the plague ravaged cities, caused widespread hysteria, and killed one-quarter of China's people and one-third of the population of Europe.[10]

The rise of the Ottoman Empire before 1300, ultimately spanning Europe, North Africa, and the Middle East, profoundly influenced the emerging trade routes for people, goods, money, animals, and microorganisms that spanned from England to China, across the Mediterranean and northern Africa, and through Central Asia and the Indian Ocean region. The powerful central location of the Ottomans within this trading web had the effect of raising the cost of Asian trade for Europeans and thus drove a search for sea routes to Asia, including the expeditions that discovered the Americas.

In 1600, Great Britain's British East India Company, a newly formed trading firm, began to establish foreign branches throughout Asia, an action soon followed by many of the other European nations intent on exploiting trade opportunities for national advantage, including Portugal, the Netherlands, and France. In 1602, the Dutch East India Company was formed to carry out colonial activities in Asia and to open ocean trade routes to the East. The first company to issue stock, it is also frequently identified as the world's first **multinational corporation**.[11] By the end of the 1600s, ships commissioned by European trading companies regularly traveled to Asia via an interconnected Atlantic, Indian, and Pacific Ocean system of government-protected trade routes. Their goal was to acquire goods for sale or resale within various Asian markets and ultimately to return to Europe with valuable cargoes of cloth, spices, and other goods that would yield significant profits for investors. The 17th and 18th centuries have frequently been termed the "Age of Mercantilism" because the power of nations depended directly on the sponsorship and control of merchant capital, which expanded under the direct subsidization and protection of national governments.

multinational corporation
A corporation that owns or controls the production of goods or services in at least one nation outside its home nation

A number of multinational corporations existed in the late 1800s. One of the first U.S. companies to own foreign production facilities, have worldwide distribution networks, and market its products under global brands was Singer Manufacturing Company. In 1868, Singer built a factory in Scotland and, by 1880, it had become a global organization with an outstanding international sales organization and several overseas manufacturing plants. Other firms, such as J&P Coats (United Kingdom) and Ford Motor Company, soon followed, and by 1914, at least 37 U.S. companies had production facilities in two or more overseas locations.[12] In contrast to today's situation, in the 1920s all cars sold in Japan were made in the United States by Ford and General Motors and sent to Japan in

FIGURE 1.2 Evolution of the World's Economic Center of Gravity from AD 1 to 2025

Source: "Urban World: Cities and the Rise of the Consuming Class," McKinsey Global Institute, June 2012.

knocked-down kits to be assembled locally. European companies were also moving overseas. For example, pharmaceutical maker Friedrich Bayer purchased an interest in a New York plant in 1865, two years after setting up his plant in Germany. Then, because of high import duties in his overseas markets, he proceeded to establish plants in Russia (1876), France (1882), and Belgium (1908).[13]

As you have just read, multinational corporations existed well before World War I, and the level of intracompany trade of multinationals in 1930, as a percentage of overall world trade, may have exceeded the proportion at the beginning of the 21st century.[14] Yet only in recent years have multinationals become the object of much discussion and investigation, especially concerning the increasing globalization of their operations. While most multinationals are based in the developed nations of the world, recently there has been a surge in the number arising in emerging economies.[15] Indeed, rapid urbanization of populations combined with industrialization in the emerging markets is quickly shifting the world's economic center of gravity from Europe and the Americas back to Asia, where it had been until the start of the industrial revolution in the 1800s. The rate at which this shift is occurring is unprecedented, as shown in Figure 1.2.

The Growth of International Firms and International Business

LO 1-3
Discuss the dramatic internationalization of business.

The number and size of U.S. and foreign international firms have been increasing rapidly in recent years, as have the levels of foreign direct investment (FDI) and exporting.

EXPANDING NUMBER OF INTERNATIONAL COMPANIES

A **multinational enterprise (MNE)** is a company made up of entities in more than one nation, operating under a decision-making system that allows a common strategy and coherent policies. It is estimated there are more than 103,000 MNEs with nearly 900,000 foreign affiliates.[16] These MNEs collectively account for more than half of world trade.[17] In 2018,

multinational enterprise (MNE)
A company made up of entities in more than one nation, operating under a decision-making system that allows a common strategy and coherent policies

the 100 largest nonfinancial multinationals alone accounted for $15.5 trillion in assets and $9.4 trillion in annual sales and had 17.5 million employees.[18]

While the vast majority of MNEs are privately owned, government ownership also represents an important element among the world's international companies. There is a minimum of 650 state-owned MNEs, from both developing and developed countries, with more than 8,500 foreign affiliates.[19] The assets of the 400 largest state-owned firms, some of which are not yet MNEs, exceeded $45 trillion in 2018, equivalent to 50 percent of the world's global domestic product.

As a result of this expansion, the affiliates of foreign companies have become increasingly important in the industrial and economic life of many nations, both developed and developing. This situation is in sharp contrast to the one that existed when dominant economic interests were in the hands of local citizens. The expanding importance of foreign-owned firms in local economies came to be viewed by a number of governments as a threat to their autonomy. However, there has been a marked liberalization of government policies and attitudes toward foreign investment in both developed and developing nations in recent years.[20] Many government leaders know that local firms must obtain modern commercial technology in the form of direct investment, purchase of capital goods, and the right to use the international company's expertise if they are to be competitive in world markets.

Despite this change in attitude, there are still critics of large global firms who cite such statistics as the following to "prove" that host governments are powerless before them: Only 23 nations had gross national incomes (GNIs) greater than the 2020 total annual sales of Walmart, the company with the greatest level of sales in the world.[21] However, a nation's GNI and a company's sales are not directly comparable because GNI is a measure of value added, not sales. If a nation's total sales were computed, the result would be far greater than its GNI because there would be triple and quadruple counting.

For example, suppose a steel manufacturer sells steel wire to a tire company, which uses it to build tires. Then the tire company sells the tires to automakers, which mount them on their automobiles, which they in turn sell to the public. Sales of the wire would be counted three times. However, in calculating GNI, governments merely sum the values added in each transaction, which is the difference between the sales of the company and the costs of materials bought outside the company. If company sales were measured by value added, Walmart's 2020 revenues of $524 billion would have been $20.1 billion on a value-added basis.[22] While Walmart's sales are about the same as Belgium's GNI, when both the economy and the company are measured by the value added, Belgium's economy is about 26 times the size of Walmart.

A firm's size may at times give it bargaining power, as in the case of a government that wants a firm to set up an affiliate because of the employment it will offer and the purchases it will make from other firms in that country, in exchange for allowing the company to have access to the host nation and its market. Yet, regardless of the parent firm's size, each affiliate is a local company that must comply with the laws in the country in which it is located. If it does not, it can be subject to legal action or even government seizure.

FOREIGN DIRECT INVESTMENT AND EXPORTING ARE GROWING RAPIDLY

One variable commonly used to measure where and how fast internationalization is taking place is total foreign direct investment. **Foreign direct investment (FDI)** refers to direct investments in equipment, structures, and organizations in a foreign country at a level sufficient to obtain significant management control. It does not include mere foreign investment in stock markets. The total stock of outward FDI worldwide was $34.6 trillion at the beginning of 2020, nearly five times larger than what it was in 2000.[23]

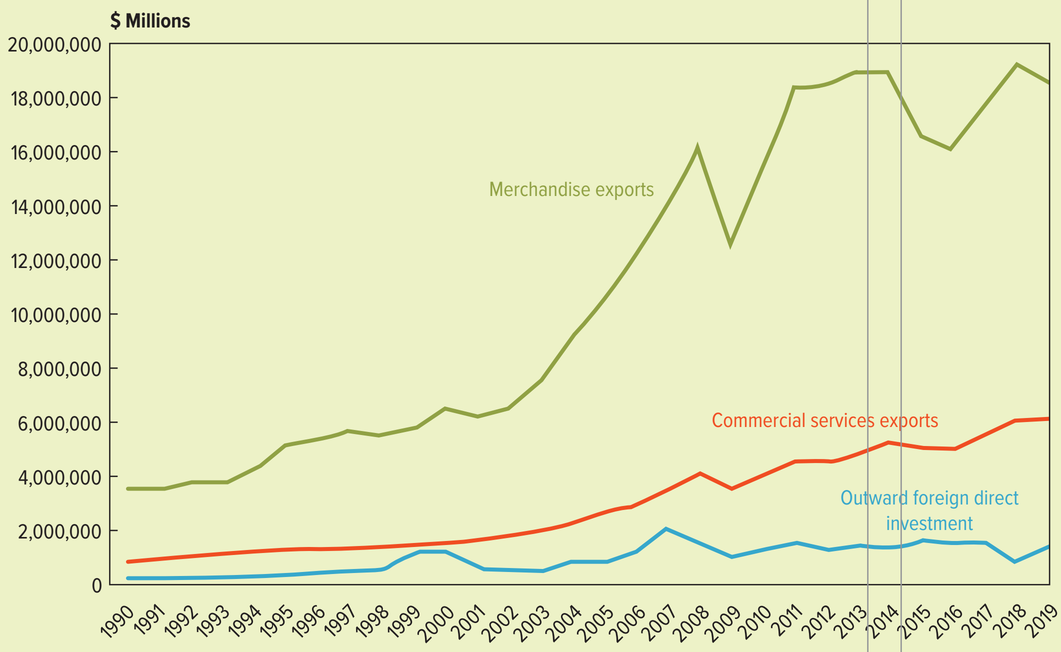
Of course, a substantial amount of international business is exporting rather than FDI. **Exporting** is the transportation of any domestic good or service to a destination outside a country or region. It is the opposite of **importing**, which is the transportation of any good

foreign direct investment (FDI)
Direct investments in equipment, structures, and organizations in a foreign country at a level sufficient to obtain significant management control; does not include mere foreign investment in stock markets

exporting
The transportation of any domestic good or service to a destination outside a country or region

importing
The transportation of any good or service into a country or region, from a foreign origination point

FIGURE 1.3 World Merchandise Exports, Commercial Services Exports, and Outward Foreign Direct Investment, 1990–2019 (US$ millions)



Sources: "Annex Table 2: FDI Outflows, by Region and Economy, 1990–2017," UNCTAD, Jun 6, 2018.; "Merchandise: Total Trade and Share, Annual, 1948–2017," UNCTADSTAT, July 4, 2018; "Services (BPM5): Exports and Imports of Total Services, Value, Shares and Growth, Annual, 1980–2013," UNCTADSTAT, July 4, 2018; "Services (BPM6): Exports and Imports of Total Services, Value, Shares, and Growth, Annual, 2005–2017," UNCTADSTAT, July 4, 2018; UNCTADSTAT, "Total Trade in Services," October 20, 2020; NCTADSTAT, "Total Trade in Goods," October 13, 2020; and "Annex Table 2: FDI Stock, by Region and Economy, 2000, 2010, and 2019," UNCTAD, October 20, 2020.

or service into a country or region, from a foreign origination point. Merchandise exports have grown faster than world output in nearly each of the past 60 years. World merchandise exports grew from $2.0 trillion in 1980 to $3.5 trillion in 1990, $6.5 trillion in 2000, $15.3 trillion in 2010, and $19.5 trillion in 2018. This means that exports in 2018 were nearly 10 times larger than they were in 1980 and 3 times larger than they were in 2000.[24] The level of services exports worldwide grew even more during this time, from $396 billion in 1980 to $831 billion in 1990, $1.5 trillion in 2000, $4.0 trillion in 2010, and $6.1 trillion in 2019. This means that services exports in 2019 were 15.5 times larger than they were in 1980.[25] Figure 1.3 shows the growth in outward FDI and in services and merchandise exports from 1990 to 2019.[26]

What Is Driving the Internationalization of Business?

LO 1-4
Identify the kinds of drivers that are leading firms to internationalize their operations.

Five major kinds of drivers, all based on change, are leading firms to internationalize their operations: (1) technological, (2) market, (3) cost, (4) political, and (5) competitive.

TECHNOLOGICAL DRIVERS

Advances in computers and communications technology are permitting an increased flow of ideas and information across borders, enabling customers to learn about foreign goods. Cable and satellite TV systems in Europe and Asia, for example, allow an advertiser to reach numerous countries simultaneously, thus creating regional and sometimes global demand. Global communications networks enable manufacturing workers to coordinate production and design functions worldwide so that plants in many parts of the world may be working on the same product.

The Internet and network computing enable small companies to compete globally because they make possible the rapid flow of information regardless of the physical location of the buyer and seller. Internet videoconferencing allows sellers to demonstrate their products to prospective buyers all over the world without the need to travel. It also permits international companies to hold corporate meetings among managers from headquarters and overseas affiliates without expensive, time-consuming travel. Communicating via e-mail is faster and more reliable than using postal mail. In addition, the Internet has given home office managers greater confidence in their ability to direct overseas operations from afar.

Advances in computer-based communications are allowing virtual integration, which permits firms to become more physically fragmented as they search the world for lower-cost inputs. For example, practical, relatively inexpensive international communication enables large insurance, banking, software, and other firms to "body shop"—that is, transmit computer-oriented tasks worldwide to a cheap but skilled labor force. The clients of numerous Indian software companies are based in the United States. A decade ago, software teams were required to fly back and forth between the two countries. Now, at the end of the day, customers in the United States e-mail their problems to India. The Indians then work on developing solutions and deliver these back to the United States early the next day. For their work, Indian software engineers often receive only 15 to 20 percent as much pay as do their U.S. counterparts. International reliance on computer-based communication tools, such as Zoom and Skype, skyrocketed further during the worldwide COVID-19 pandemic due to quarantines and other constraints on travel and traditional face-to-face work contexts.

MARKET DRIVERS

As companies internationalize, they also become global customers. Frequently, a firm will go abroad to protect its home market. Service companies (for example, in accounting, advertising, marketing research, banking, law) will establish foreign operations in markets where their principal accounts are located to prevent competitors from gaining access to those accounts. They know that once a competitor has been able to demonstrate to top management what it can do by serving a foreign affiliate, it may be able to take over the entire account. Similarly, suppliers to original equipment manufacturers (for example, battery manufacturers supplying automobile producers) often follow their large customers. These suppliers have an added advantage because they are moving into new markets with a guaranteed customer base.

Managers are always under pressure to increase the sales and profits of their firms, and when they face a mature, saturated market at home, they begin to search for new markets outside the home country. They find that (1) markets with a rising gross domestic product (GDP) per capita and population growth appear to be viable candidates for their operations, and (2) the economies of some nations where they are not doing business are growing at a considerably faster rate than is the economy of their own market. For example, the United States has only about 5 percent of the world's population, so the vast proportion of most U.S. companies' potential customers are located elsewhere.

COST DRIVERS

Going abroad, whether by exporting or by producing overseas, can frequently lower the cost of goods sold. Increasing total sales by exporting not only will reduce research and development (R&D) costs per unit but also will make other economies of scale possible. One means of achieving them is to globalize product lines around a small number of models that have broad appeal across nations, which can help to reduce development, production, and inventory costs. Management can also move production or other parts of the company's value chain to countries where costs are lower. For example, low electricity prices in Iceland due to extensive geothermal power has helped attract energy-intensive aluminum smelting facilities, which consume about 75 percent of the electricity produced in that country.[27]

Another factor that can positively affect the cost of goods sold is the inducements—such as reduced taxes or subsidies for R&D—that some governments offer to attract new investment. Many nations, especially developing countries, offer export processing zones in which firms, mostly foreign manufacturers, enjoy almost complete absence of taxation and regulation of materials brought into the zones for processing and subsequent re-export. Dramatic reductions in the cost of generating and transmitting information due to innovations in computing and telecommunications, as well as the decline in transportation costs, have facilitated this trend toward relocating activities worldwide.

POLITICAL DRIVERS

There is a trend toward increased unification and socialization of the global community. Preferential trading arrangements that group several nations into a single market, such as the United States–Mexico–Canada Agreement (USMCA) and the EU, have presented firms with significant marketing opportunities. Many firms have moved swiftly to gain access to the combined markets of these trading partners, by either exporting to or producing in the area.

Two other aspects of this trend are contributing to the globalization of business operations: (1) the progressive reduction of barriers to trade and foreign investment by most governments, which is hastening the opening of new markets by international firms that are both exporting to them and building production facilities in them, and (2) the privatization of much of the industry in formerly communist nations and the opening of their economies to global competition.

Even with governmental actions to open their economies to international business, concerns about shielding markets from potential protectionism by host country markets may still remain a motive for a company to increase the level of its international business activity. For example, when a government sees that local industry is threatened by imports, it may erect import barriers to stop or reduce these imports. Even threats to do this can be sufficient to induce the exporter to invest in production facilities in the importing country.

CULTURE FACTS @internationalbiz

In Scandinavian countries, lower rankings on the masculinity scale versus the ranking of the United States reflect greater emphasis on values of caring for others and quality of life. In these countries, the proportion of children who live in poverty in single-mother families is 11 percent; the comparable figure for the United States is 55 percent. #scandinaviancountries #caring #qualityoflife

COMPETITIVE DRIVERS

Competition continues to increase in intensity. New firms, many from newly industrialized and developing countries, have entered world markets in automobiles, computers, and electronics, for example. Another competitive driving force for globalization is the fact that companies are defending their home markets from competitors by entering the competitors' home markets to distract them. A firm might choose not to enter a single country and establish a production plant because the nation lacks sufficient market size to justify the investment. However, the firm might choose to enter that same country if it was part of a larger trading group (for example, the EU, Association of Southeast Asian Nations [ASEAN], Mercosur). It is one thing to be shut out of Belgium, but it is another to be excluded from all of the EU nations, with their combined population of 500 million people and GDP of approximately $19 trillion.

Companies may also be driven to internationalize their operations in order to guarantee the supply of key raw materials. Few developed nations possess sufficient domestic supplies of raw materials. Japan and Europe are almost

Citgo Petroleun Corporation, although based in the United States, is majority-owned by Venezuela's state-owned PDVSA.
John Margolies Roadside America photograph archive (1972-2008), Library of Congress, Prints and Photographs Division [LC-DIG-mrg-05333]

Are You Really Buying American?

Various individuals and groups from business, politics, labor, and other sectors have promoted “Buy American” policies in order to create jobs and promote economic growth and national security on a domestic basis. Although debate continues on the pros and cons of such an approach, it can be interesting to consider what that might mean in terms of your own life.

Consider the following scenario of a “typical” American family: The Osbornes, Jesse and Ann, live in the suburbs of Chicago. Jesse is a manager at the Trader Joe’s specialty grocery store chain. Ann is an advertising executive for Leo Burnett Worldwide.

Ann listens to the new Adam Lambert CD on her Alpine car stereo in her Jeep Cherokee while driving home from work, stopping for gas at the Shell station. At the grocery store, she fills her cart with a variety of items, including Ragu spaghetti sauce, Hellmann’s mayonnaise, Carnation Instant Breakfast drink, CoffeeMate nondairy coffee creamer, Arrowhead water, Chicken-of-the-Sea canned tuna, Lipton tea, Dannon yogurt, several packages of Stouffer’s Lean Cuisine frozen dinners, and some Hot Pockets. For a treat, she picks up some Ben & Jerry’s ice cream, Toll House cookies, a jar of Nutella, and some Tic Tacs. She also grabs some cans of Alpo for their dog, Sassy, and a box of Friskies and a bag of Tidy Cat cat litter for their cat, Lily. She goes down the toiletries aisle for some Dove soap, Aquafresh toothpaste, Q-tips cotton swabs, Tums, and Jergen’s moisturizing lotion. She also picks up a copy of the new Danielle Steele book and a copy of *Elle* magazine, then uses her Bic pen to sign the credit card slip for her purchases.

After leaving his office, Jesse stops at the liquor store for a case of Budweiser beer and a bottle of Wild Turkey bourbon, then goes to the sporting goods store to pick up some Wilson racquetballs.

Ann’s favorite TV show, *Jeopardy*, is just starting as Jesse comes in the door, so she pours herself a glass of Beringer wine from Napa Valley and heads to her IKEA recliner while Jesse prepares dinner and downloads the latest *Batman* installment onto his Lenovo computer.

While this may sound like a very typical evening for many Americans, foreign-owned firms produced nearly every item the Osbornes purchased or consumed:

- Trader Joe’s is owned by a family trust set up by German businessman Theo Albrecht.
- Leo Burnett Worldwide is owned by Publicis of France.
- Sony Music of Japan produces and distributes Adam Lambert’s CDs.

Holly Curry/McGraw Hill

- Japan’s Alps Electric produces Alpine car stereos.
- Jeep is a brand of vehicles made by Chrysler, which is owned by Netherlands-based Stellantis.
- The British-Dutch company Royal Dutch Shell owns Shell.
- Nestlé of Switzerland produces Alpo, Arrowhead, Carnation Instant Breakfast, CoffeeMate, Friskies, Hot Pockets, Stouffer’s Lean Cuisine, Toll House, and Tidy Cat.
- Unilever, a British-Dutch multinational, makes Dove soap, Hellmann’s, Q-tips, Lipton, and Ben & Jerry’s.
- Mizkan Group, a Japanese company, produces Ragu.
- Groupe Danone of France produces Dannon yogurt.
- Chicken-of-the-Sea tuna is made by Chicken of the Sea International, which is owned by Thai Union International of Thailand.
- Tums and Aquafresh are produced by GlaxoSmithKline of the United Kingdom.
- Ferrero SpA of Italy produces Tic Tacs and Nutella.
- Japan’s Kao owns Jergen’s.
- Lagardere Group of France owns the *Elle* fashion magazine.
- Danielle Steele books are published by Penguin Random House, which is owned by Bertelsmann AG of Germany.
- Société Bic of France produces Bic pens.
- Columbia Pictures, owned by Sony of Japan, released the *Batman* movies; Sony Pictures Television distributes *Jeopardy*.
- AB InBev of Belgium produces Budweiser.
- Gruppo Campari of Italy owns the Wild Turkey brand.
- Amer Sports of Finland owns Wilson Sporting Goods.

- Beringer Winery of Napa, California, is owned by Australia's Treasury Wine Estates.
- IKEA of Sweden sells IKEA recliners.
- Lenovo computers are produced by Lenovo of China.

This simple example reflects the impact of extensive foreign investments in the United States, especially in recent years. Even some of the best-known "American" products and brands are now produced by foreign firms.

Investments have also flowed outward from the United States. U.S. companies such as Coca-Cola, Apple, Starbucks, McDonald's, Nike, Microsoft, and Levi's are found in Japan, South Korea, China, Australia, Singapore, and nearly every European nation. U.S. companies have also purchased a range of foreign companies and brands.

Critical Thinking Questions

1. Should it matter to consumers whether the companies that make their products are based in the consumers' home country or not? Explain your rationale.
2. Why has there been almost no negative backlash among Americans to the flood of foreign investment into their country?

Sources: From company websites (October 20, 2020).

totally dependent on foreign sources for many important materials, and even the United States depends on imports for more than half of its consumption of aluminum, chromium, manganese, nickel, tin, and zinc. To ensure a continuous supply and maintain their competitiveness, manufacturers in the industrialized countries are being forced to invest, primarily in the developing nations where most new deposits are being discovered.

A company might also invest in downstream markets as a way of protecting its existing international business. For example, a number of OPEC nations have invested in refining and marketing outlets, such as filling stations and heating-oil distributors, to guarantee a market for their crude oil at more favorable prices. A major foreign investor in the United States is the oil company Petrôleos de Venezuela, which first invested in Citgo in 1986 and assumed full ownership in 1990. The energy company BP of the United Kingdom invested over $115 billion in the United States between 2005 and 2018 and has over 14,000 U.S. employees.[28]

The result of this rush to globalization has been explosive growth in international business. Many of the issues associated with globalization are highly complex, and there is no single measure of globalization or of integration within the world economy. Each element of global integration can have different effects. Following are some of the arguments for and against the globalization process and its outcomes.

What Are the Arguments for and against the Globalization of Business?

LO 1-5
Compare the key arguments for and against the globalization of business.

Although globalization is discussed everywhere—television shows, Internet chat rooms, political demonstrations, parliaments, management boardrooms, and labor union meetings—so far it has no widely accepted definition. In fact, its definition continues to broaden. Now, for example, social scientists discuss the political, social, environmental, historical, geographic, and even cultural implications of globalization.[29] Some also speak of technological globalization, political globalization, and the like.

The most common definition and the one used in international business is that of **economic globalization**—the tendency toward an international integration and interdependency of goods, technology, information, labor, and capital, or the process of making this integration happen. The term "globalization" was first coined by Theodore Levitt in a *Harvard Business Review* article in which he maintained that new technologies had "proletarianized" communication, transport, and travel, creating worldwide markets for standardized consumer products at lower prices. He maintained that the future belonged to global corporations that did not cater to local differences in taste but, instead, adopted strategies that operated "as if the entire world (or major regions of it) were a single entity; [such an organization] sells the same things in the same way everywhere."[30]

economic globalization
The tendency toward an international integration and interdependency of goods, technology, information, labor and capital, or the process of making this integration happen

Demonstrators at a World Trade Organization meeting.
Agung Kuncahya B. Xinhua News Agency/Newscom

The merits of globalization have been the subject of many heated debates in recent years. There have been extensive public protests about globalization and the liberalization of international trade at World Trade Organization (WTO) meetings and at other gatherings of international organizations and leaders. The debate is, in many respects, waged by diametrically opposed groups with extremely different views regarding the consequences of globalization. Sifting through the propaganda and hyperbole spouted by both sides is a challenge. A 20-nation survey conducted in 2019 revealed that a majority of respondents viewed globalization as being good for their country.[31] Nevertheless, it is important to recognize the various perspectives on globalization because these arguments can generate appeal (or rejection) both intellectually and emotionally. The contributions of free trade and globalization to dramatic reductions in worldwide poverty are contrasted with anecdotal stories of people losing their livelihoods under the growing power of multinationals. Likewise, increases in service-sector employment are contrasted against losses in high-paying manufacturing jobs. Let's examine some of the most prominent arguments that are typically raised regarding globalization.

CONCERNS WITH GLOBALIZATION

Those expressing concern with globalization have come from a range of sectors of society, and they express a correspondingly diverse set of concerns.[32] Some fundamentally oppose the very process and outcomes of globalization on ideological grounds,[33] while others may merely be concerned about finding ways to better manage globalization processes and the resulting outcomes. Some of the opponents' concerns may be viewed as naïve or clearly inconsistent with the preponderance of evidence. Other challenges to globalization may have theoretical merit or other supporting evidence and certainly may be worthy of discussion and the fostering of substantive change.

Although perspectives on the globalization debate may, in many respects, depend on one's values and ideology, thus further compounding efforts to reach a mutually agreed-upon resolution, let us first ask this question: what are some of the primary concerns of the opponents of globalization? While many of the anti-globalizers concede that globalization "increases the size of the pie," they also claim that it has been accompanied by a broad array of injurious social implications. Among their concerns, let us briefly examine four primary ones here: (1) that globalization has produced uneven results across nations and people, (2) that globalization has had deleterious effects on labor and labor standards, (3) that globalization has contributed to a decline in environmental and health conditions, and (4) that globalization threatens to reduce national sovereignty.

Uneven Results across Nations and People In stark contrast to the positive picture presented by supporters of globalization, opponents describe the painful impact of foreign investment and trade liberalization on the people of the world. Far from causing everyone to be a winner, they say the promise of export-led growth has failed to materialize in several places. For example, most of Latin America has failed to replicate Asia's success despite efforts to liberalize, privatize, and deregulate its economies, with results ranging from disappointment in Mexico to catastrophe in Argentina. Similarly, efforts in sub-Saharan Africa have produced only limited benefits, and the number of people there who are living in extreme poverty rose nearly 50 percent between 1990 and 2018, from 290 million to 433 million people.[34] According to the World Bank, China experienced a more than 35 percent increase between 1990 and 2010 in the Gini coefficient, indicating a significantly higher level of economic inequality during this period of rapid internationalization of the Chinese economy.[35] Open world markets, it seems, may offer the possibility of economic development—but the recipe is neither easy in its implementation nor universal in its outcomes.

Many opponents of globalization have claimed that there is a huge gap between the world's rich and poor and that globalization has caused that gap to increase. The gap between rich and poor is unquestionable, but the evidence is perhaps unclear regarding the charge that globalization has been the cause of this inequality. Although Martin Wolf's analysis shows that income inequality has not risen in most developing countries that have integrated with the world economy, it does show that inequality has increased in some places, most notably in China. Inequality has risen in some high-income countries as well, but he attributes that more to the nature of technological change than to globalization. When income data are adjusted to reflect relative purchasing power, the inequality in income between poor and rich nations diminishes. Wolf also notes that while globalization of trade and investment is an enabler to improved income and living standards, the results may vary if obstacles exist such as poor governance or excessive borrowing.[36]

Deleterious Effects on Labor and Labor Standards The impact of globalization on labor standards has become an oft-mentioned concern of workers in the United States, Europe, and elsewhere. With trade liberalization through the WTO and increased mobility of capital, measures to keep a country's industries within its borders have been reduced, and companies have an easier time divesting their interests in one country and moving to another. Workers fear they lack the skills and resources to compete in an increasingly competitive global marketplace and will experience lower wages and benefits, fewer job opportunities, and higher risk of unemployment as a result. Workers in developed countries frequently voice concerns that their jobs will migrate to developing nations where there are lower standards, and thus lower costs, leading to the infamous "race to the bottom," in which developed nations with more rigorous labor standards become disadvantaged.

The concern can run both ways, however. Although labor standards in developing countries are usually lower than in industrialized countries, they are rising—and evidence shows that multinationals investing in host nations pay higher wages, create new jobs at a faster rate, and spend more on R&D than do local firms.[37] Developing countries may also view the imposition of more demanding labor standards within their borders as a barrier to free trade. They may feel that lower-cost labor constitutes their competitive advantage and that if they are forced to implement more stringent labor standards, then companies may no longer have an incentive to set up operations in their countries, damaging their prospects for improved economic development.

As Gary Burtless, Robert Z. Lawrence, Robert E. Litan, and Robert J. Shapiro, the authors of *Globaphobia*, ask, "Is it humane for the United States to refuse to trade with these countries because their labor standards are not as high as we would prefer? The consequence of taking this position is that many Third World workers will have no jobs at all, or must take jobs that pay even lower wages and have even worse working conditions than those currently available in the export-oriented sector."[38] For example, Mexico's agricultural sector, which represented a major portion of that country's employment, was estimated to have lost 2 million jobs after NAFTA was implemented, which contributed to many of them crossing the border into the United States in search of employment and better pay.[39]

A Decline in Environmental and Health Conditions Regarding concerns of antiglobalization forces that globalization contributes to declining environmental standards, former president Ernesto Zedillo of Mexico stated, "Economic integration tends to favor, not worsen, the environment. Since trade favors economic growth, it brings about at least part of the necessary means to preserve the environment. The better off people are, the more they demand a clean environment. Furthermore, it is not uncommon that employment opportunities in export activities encourage people to give up highly polluting marginal occupations."[40]

GLOBAL DEBATE

Is the "Bottom of the Pyramid" a Market Worth Serving?

The term "Bottom of the Pyramid," popularized by the late Professor C. K. Prahalad, refers to approximately 3 billion of the world's poorest inhabitants who survive on less than $2 per day. For people at this level of poverty, basic survival needs are just barely met.

Traditionally, it was common practice by businesses, donors, and governments to view these poor as victims. However, Prahalad suggested that they should instead be viewed as a tremendous potential market for the products of multinational enterprises. He suggested that the world's poorest inhabitants represented substantial untapped purchasing power. If served in ways appropriate to their needs, not only would the poor represent a huge market, but they could also receive tremendous benefit, and poverty could be reduced significantly. In addition, the ability of members of this population to achieve their full potential could be greatly enhanced.

Examples of companies that have been promoted as highlighting the potential of serving the bottom of the pyramid include microcredit companies (those who lend small amounts of money—as little as $5 or $10—to people with few or no assets); consumer products companies such as India's Hindustan Unilever (which offers single-use packets of shampoo that works effectively in unheated water); and retailers such as Brazil's Casas Bahia, which offer credit to people who otherwise would not qualify in order for them to purchase basic appliances and similar goods.

Others have questioned whether a focus on the bottom of the pyramid truly represented an attractive business opportunity. Prahalad's colleague at the University of Michigan, Professor Aneel Karnani, argued that profit opportunities associated with such a focus were modest at best, especially for large companies that required economies of scale. While the aggregate level of consumption might be substantial in dollar terms, 3 billion people times an average of perhaps $1.50 per day yields a total annual market of over $1.6 trillion, which is just a bit over 10 percent of the size of the U.S. economy alone. The costs of serving such a culturally disparate and geographically dispersed population of poor, a large portion who live in rural areas with limited infrastructure, will be quite substantial. Individual transactions will be of very small size and the customers highly price-sensitive. After accounting for costs of food, shelter, clothing, and fuel, they have limited room for nonessential items.

Beyond market attractiveness, some have questioned the proposal that multinationals serve the base of the pyramid market. For example, concerns have been raised about the ethical appropriateness of a profit-oriented focus on serving the most impoverished of the world's inhabitants, particularly with products such as tobacco, alcohol, or makeup.

Peeter Viisimaa/Getty Images

Critical Thinking Questions

1. Do you think the bottom of the pyramid represents an attractive and appropriate market for multinational corporations? Why or why not? For which products or services might this market be most appropriate?
2. If customers at the base of the pyramid could be convinced to allocate some of their meager income to products such as cigarettes, alcoholic beverages, or cosmetics, would it be socially responsible for multinationals to pursue such opportunities? Why or why not?

Sources: Jason Haber, "Why the Bottom of the Consumer Pyramid Should Be Your New Target Market," *Entrepreneur,* May 26, 2016; Subinay Bedi, "A Foundational Criticism of the Base of the Pyramid Model," Paper, October 15, 2012; C. K. Prahalad, *The Fortune at the Bottom of the Pyramid: Eradicating Poverty Through Profits,* Upper Saddle River, NJ: Wharton School Publishing, August 25, 2004; Aneel G. Karnani, "The Mirage of Marketing to the Bottom of the Pyramid: How the Private Sector Can Help Alleviate Poverty," *California Management Review,* vol. 49, no. 4, July 1, 2007, 90–111; and Kirk Davidson, "Ethical Concerns at the Bottom of the Pyramid: Where CSR Meets BOP," *Journal of International Business Ethics,* vol. 2, no. 1, 2009, 22–32.

Yet a difficulty caused by NAFTA and the maquiladora program that began before NAFTA is the substantial increases in ground, water, and air pollution along the Mexico–U.S. border. Damage to the environment has been caused by the many new production facilities and the movement of thousands of Mexicans to that area to work in them. In addition, some health and environmental issues extend beyond the scope of trade agreements. Some of NAFTA's rules on trade in services may cause governments to weaken environmental standards for sometimes hazardous industries like logging, trucking, water supply, and real estate development. For example, to comply with NAFTA's rules on trade in services, U.S. clean air standards were waived in order to allow trucks based in Mexico to haul freight on U.S. highways. Globalization opponents argue that this could increase air pollution and associated health concerns in border states because the aging Mexican truck fleet pollutes more than similar U.S. trucks, and these vehicles do not use the cleaner fuels required in the United States.

Protesters have also claimed that, under liberalized rules regarding the globalization of trade and investment, businesses have an incentive to move their highly polluting activities to nations that have the least rigorous environmental regulations or a lower risk of liability associated with operations that can create environmental or health-related problems. On the other hand, the economic growth fostered by globalization can help generate and distribute additional resources for protecting the environment, and improved trade and investment can enhance the exchange of more environmentally friendly technologies and best practices, particularly within developing nations.

The global COVID-19 pandemic has fostered additional antagonism toward globalization. Critics of globalization have pointed to increasing interconnectedness of nations and the international movement of people and products as key vectors for helping to spread the virus. They blame globalization for the pace and scope of infection as well as the associated damage to community and economic health within and across nations. Globally dispersed and segmented supply chains have hindered nations' access to key inputs, such as personal protection equipment, ingredients for testing, and drugs for treatment. Yet, medical historians and others have noted that the global flu pandemic of 1918 occurred without a globalized economy.[41] Indeed, anti-globalization actions such as border closures and restrictions on medical exports may have hindered the pace and effectiveness of addressing the pandemic.[42] Further, globalization may have enhanced the scope and speed of vaccine development and subsequent rollout of vaccines globally, critical elements for protecting human health and securing economic recovery.

Reduced National Sovereignty A frequent complaint against globalization concerns nations' desires not to be reliant on any other nation, particularly for critical resources, technologies, or manufacturing capacity.[43] Globalization has also been linked to waves of international migration and unwanted immigration.[44] The COVID-19 pandemic served as a reminder of the risks of depending on other nations, even key allies, for key goods such as medical equipment or pharmaceuticals. As a result, critics have proposed "de-globalization" in order to reduce a nation's vulnerability to negative implications of international organizations (e.g., the International Monetary Fund or the World Trade Organization) and global trade and investment, limit challenges resulting from complex global supply chains, enhance privacy and data protection, and enhance national sovereignty. For example, Peter Navarro, a trade advisor to President Trump, argued that the U.S. needed to "bring home its manufacturing capabilities and supply chains for essential medicines."[45] Despite these arguments against globalization, no country has the ability to be fully self-reliant for all of the goods and services required by its economy. Further, our ability to effectively address many of the critical challenges that face us in our contemporary world, such as climate change, global pandemics and other health issues, or control of tax dodging behaviors, will continue to require cooperation on a regional or global level. For example, the COVAX initiative involved collaboration of over 170 nations to help develop and disperse vaccines at an unprecedented speed and scale to address the COVID-19 pandemic and to facilitate equitable access to treatment for populations in less prosperous nations of the world.[46]

ARGUMENTS SUPPORTING GLOBALIZATION

Some argue that globalization and related developments have produced positive contributions for the world and its inhabitants.[47] This section of our discussion addresses some of the more prominent arguments in this regard.

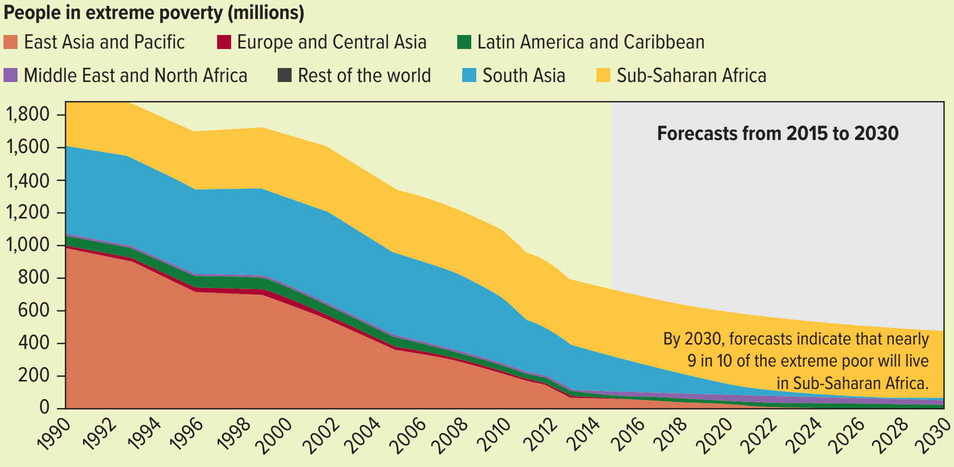
> **"A GROWING BODY OF EVIDENCE SHOWS THAT COUNTRIES THAT ARE MORE OPEN TO TRADE GROW FASTER OVER THE LONG RUN THAN THOSE THAT REMAIN CLOSED. AND GROWTH DIRECTLY BENEFITS THE WORLD'S POOR."**
>
> *—Horst Kohler, managing director of the International Monetary Fund, and James Wolfensohn, president of the World Bank*[52]

Free Trade Enhances Socioeconomic Development The proposition that free trade is the best strategy for advancing the world's economic development is one of the few on which the majority of economists agree, not only because it is theoretically compelling, but also because it has been demonstrated in practice.

Data have shown a clear and definitive link between liberalization of trade and economic growth.[48] On a wide range of measures—poverty, education, health, and life expectancy—more people have become better off at a faster pace in the past 60 years than at any other time in history. Evidence is strong regarding the dramatic decline in both the proportion and the absolute number of destitute people, as shown in Figure 1.4. Data from the World Bank show that the number of people in extreme poverty declined from 35 percent of the world's population in 1990 to less than 10 percent in 2018, meaning almost 2 billion fewer people worldwide living in extreme poverty, and that number is projected to continue to decline.[49] Even in economically advanced countries, studies suggest that the majority of benefits from international trade go to the lower income segments of the population.[50] Overall, the benefits of international trade to improved living standards in the United States since World War II have been estimated at more than $2 trillion annually, meaning that more than one-tenth of what the country produces and consumes is the result of international trade.[51]

Life expectancy in the developing world has nearly doubled since World War II, and infant mortality has decreased in all developing regions of the world. The proportion of children in the labor force has fallen by approximately two-thirds since 1960.[53] Global literacy grew from 52 percent in 1950 to 86.5 percent in 2020, and

FIGURE 1.4 Number of People Living in Extreme Poverty



Source: Divyanshi Wadhwa, "The Number of Extremely Poor People Continues to Rise in Sub-Saharan Africa," https://blogs.worldbank.org/opendata/number-extremely-poor-people-continues-rise-sub-saharan-africa, October 15, 2020.

on average, the more globally integrated countries spend more on public education, especially in developing countries.[54] In addition, citizens from more globally integrated countries have greater levels of civil liberties and political rights. Within a generation's time, there has been an enormous improvement in the human condition, and every one of the development success stories is based on export-led growth facilitated by the liberalization of trade.

Globalization, accompanied by efficient global supply chains and improvements in air and sea transportation, allows us to source products from around the world. Because of globalization, we can obtain a vast cornucopia of affordable items: fresh foods regardless of season, the newest electronic goods, a diverse array of music and clothing, and other modern conveniences and options. The opportunity to enjoy this increased variety and choice in our lives is often taken for granted as a normal state of affairs, rather than being a result of globalization.

Of course, countries can reject globalization. Indeed, some have, and they are among the most impoverished countries in the world. As an article in the *Financial Times* puts it, "They are victims of their refusal to globalize."[55]

Free Trade Promotes More and Better Jobs Expanded trade is also linked with the creation of more and better jobs. Between 1991 and 2020—a period of immense technological change and growth in trade—over 42 million more nonfarm jobs were created than were destroyed in the United States, an increase of 40 percent.[56] It is true that when a country opens to trade, just as when new technologies are developed, some of its sectors may not be competitive. Companies may go out of business and some jobs will be lost. The general consensus is that more jobs are lost due to technological developments, such as computerization and automation, than to the impact of globalization. A recent study estimates that jobs lost in the United States due to imports averaged about 312,000 per year from 2001 to 2016, a relatively modest amount in an economy that in recent years has added about 200,000 jobs per month.[57] Many of these lost jobs involved standardized, low-value-added, repetitive activities. But trade also creates new jobs, and these tend to be better than the ones that were lost, many of them in higher-value-added, service-based activities such as design, engineering, finance, and health care. Indeed, between 2001 and 2019, exports alone created over 156,000 jobs per year or about half of the jobs lost to imports.[58] Overall, the benefits from increased international trade have exceeded the costs from lost wages and unemployment by a 50-to-1 ratio since World War II and by a 5-to-1 ratio since 2003.[59] Additional jobs have been created by foreign investment linked to globalization of markets and trade, with many of these new jobs being well-compensated. Indeed, wage rates in U.S.-based subsidiaries of foreign multinationals are about 30 percent above the national average.[60] The key is not to block change but, instead, to manage the costs of trade adjustment and to support the transition of workers to more competitive and higher value-creating employment.

Discussing globalization, economist Jeffrey Sachs commented, "We are interconnected, and we will remain interconnected, there is definitely a very powerful, positive side to this interconnection. It makes possible very wonderful things, most importantly the sharing of knowledge and know-how, the benefits of diversity, the benefits of specialization. The very things that Adam Smith wrote about in 1776 when he talked about the wealth of nations, and his point was wealth of nations comes from an interconnected world, a world in which each part of the world can help to meet the needs and wants of other parts of the world."[61]

What about you? Do you think that economic globalization tends to be a process that creates more benefits than harm and should be encouraged? Or do you think that efforts should be undertaken to limit or even reverse the economic globalization process? Why? Admittedly, this is a complicated issue. Our hope is that by learning about international business, including through books such as this one, you can better understand the complex and interrelated phenomenon of globalization.

Lily DeNoma in Arequipa, Peru: Go Abroad to Gain New Perspectives

Lily DeNoma

The summer after my freshman year, I spent seven weeks on an AIESEC volunteership in Arequipa, Peru, working for a local nonprofit focused on educating children in lower-income areas. Going into this adventure, I was a naïve and young 19-year-old with no knowledge of Spanish, no idea what it was like to live abroad, and only some experience working with individuals from other countries. I was, however, studying International Business at my university and was ready to go into this opportunity with a very open mind about what I could learn and experience.

After taking my first solo flight and arriving in Arequipa, reality hit very quickly when I realized I was in a foreign country I had never been to before, where I didn't know anyone, and where I didn't know how to speak the language. Despite what seemed like discouraging realizations, I was determined to tackle any challenges that came up as I lived in Peru.

In terms of my life in Peru and day-to-day experiences, I lived with a host family in an apartment near the city center, with a girl my age and her mom. Every day I would take a bus to the city center, meet with the nine other volunteers that worked with me at the nonprofit, then we would take an hour-long bus ride to the nonprofit. After arriving at work at around 9 am, we would each go to our assigned classroom to help the teacher with their lesson, assist with any activity they were doing, or teach a lesson ourselves. Afterward, we would eat lunch prepared by the school, dance with the kids at recess, have one more hour of class time, then head back home.

Although this seems like a simple outline of a workday, there were many more challenges within it. First, the bus system was sporadic, didn't have a formal schedule, and required some local knowledge to know which bus to even get on. At the nonprofit, every teacher and administrator we worked with spoke only Spanish, while we delivered lessons in both Spanish and English to more than 30 children at a time. Finally, the team of volunteers was diverse, as we were a group of 10 university students from seven different countries, all with very different ideas on the best ways to teach, how to communicate with our supervisors, and overall how to work together efficiently.

Despite this, it was all of these little challenges and obstacles that increased my teamwork skills, communication skills, and overall confidence immensely. If I was able to decipher a Peruvian bus system in a non-native language, then figuring out the subway in New York wouldn't be a problem. If I was able to understand my supervisor's expectations without speaking their language, then understanding my manager at a job in the United States would be easy. Finally, if I could find a way to productively work together with an extremely diverse group from around the world, then tackling a group project in a class at my university would seem effortless.

This two-month experience in Peru allowed me to gain new perspectives on how to confront any obstacles I face, as well as changed my mindset to tackle challenges with optimism and excitement. Although I don't currently work in any job related to teaching or speaking Spanish, the skills I learned throughout my time in Peru have allowed me to succeed in the rest of my time at my university. Now, as a senior, I've been able to have multiple internships in sales, marketing, research, and consulting, while also gaining multiple leadership positions in different organizations on campus. All of these opportunities wouldn't have been possible without the experience I gained in Peru, and although these experiences also had their challenges, I was able to face them with enthusiasm and confidence.

This volunteership taught me that any kind of international experience—even if it isn't directly related to your field of work—can help you tremendously in gaining soft skills and can change your perspective when facing any new challenge.

Source: Lily DeNoma.

SUMMARY

LO 1-1
Show how international business differs from domestic business.

International business is business whose activities are carried out across national borders. International business differs from its domestic counterpart in that it involves three environments—domestic, foreign, and international—instead of one. Although the kinds of forces are the same in the domestic and foreign environments, their values often differ, and changes in the values of foreign forces are at times more difficult to assess. The international environment is defined as the interactions (1) between the domestic environmental forces and the foreign environmental forces and (2) between the foreign environmental forces of two countries when an affiliate in one country does business with customers in another.

LO 1-2
Describe the history and future of international business.

International business has a long and important history, extending thousands of years into the past. Politics, the arts, agriculture, industry, public health, and other sectors of human life have been profoundly influenced by the goods and ideas that have come with international trade. Rapid urbanization of populations combined with industrialization in the emerging markets is quickly shifting the world's economic center of gravity from Europe and the Americas back to Asia.

LO 1-3
Discuss the dramatic internationalization of business.

Global competition is mounting as the number of international companies expands rapidly. The huge increase in import penetration, plus the massive amounts of overseas investment, means that firms of all sizes face competitors from everywhere in the world. This increasing internationalization of business is requiring managers to have a global business perspective gained through experience, education, or both.

LO 1-4
Identify the kinds of drivers that are leading firms to internationalize their operations.

The five major kinds of drivers, all based on change, that are leading international firms to globalize their operations are as follows, with an example for each kind: (1) technological—advances in communications technology, (2) market—global firms become global customers, (3) cost—globalization of product lines and production helps reduce costs by achieving economies of scale, (4) political—preferential trading agreements, and (5) competitive—firms are defending their home markets from foreign competitors by entering the foreign competitors' markets.

LO 1-5
Compare the key arguments for and against the globalization of business.

Economic globalization refers to the tendency toward an international integration and interdependency of goods, technology, information, labor, and capital, or the process of making this integration happen. The merits of globalization have been the subject of many heated debates in recent years. Key concerns with the globalization of business include (1) globalization has produced uneven results across nations and people; (2) globalization has had deleterious effects on labor and labor standards; (3) globalization has contributed to a decline in environmental and health conditions; and (4) globalization threatens to reduce national sovereignty. Key arguments in support of the globalization of business include (1) free trade enhances socioeconomic development and (2) free trade promotes more and better jobs.

KEY TERMS

CRITICAL THINKING QUESTIONS

1. Business is business, and every firm has to find ways to produce and market its goods. Why, then, might managers be unable to successfully apply the techniques and concepts they have learned in their own country to other areas of the world?
2. Give examples to show how an international business manager might manipulate one of the controllable forces in answer to a change in the uncontrollable forces.
3. Although forces in the foreign environment are the same as those in the domestic environment, they operate differently. Why is this so?
4. Why, in your opinion, do the authors regard the use of the self-reference criterion as "probably the biggest cause of international business blunders"? Can you think of an example?
5. Discuss some possible conflicts between host governments and foreign-owned companies.
6. "A nation whose GNI is smaller than the sales volume of a global firm is in no position to enforce its wishes on the local affiliate of that firm." Is this statement true or false? Please explain your rationale.
7. What examples of globalization can you identify within your community? How would you classify each of these examples (as international investment, international trade, other)?
8. Why is there opposition to globalization of trade and integration of the world's economy? Is there a way the debate can move beyond a simplistic argument for or against globalization and toward how best to strengthen the working of the global economy in order to enhance the welfare of the world and its inhabitants? What might this require?
9. You have decided to take a job in your hometown after graduation. Why should you study international business?
10. How can international issues, such as COVID-19, demonstrate arguments both for and against globalization?
11. How could certain skills, like critical thinking, teamwork, and problem solving, be learned differently through an international internship or other work experience versus through a domestic internship or other work experience?

globalEDGE RESEARCH TASK http://globalEDGE.msu.edu/

Use the globalEDGE website (http://globaledge.msu.edu/) to complete the following exercises:

1. You are assigned the task of identifying a set of indicators that can be used to measure the level of globalization of nations. Choose a country of your choice under the "Global Insights" section of globalEDGE and check the "KOF Index of Globalization" in the "Indices" subsection. What three main aspects of globalization are measured? Now, click the external source link, and using the drop-down menus under the graph on this new page, note the different dimensions used to measure these aspects. Open the "KOF Working Paper" and find what types of indicators are used to calculate these dimensions. What do you think about the calculation method of those dimensions? How relevant are the indicators used? What other dimensions and indicators can be used to measure globalization?
2. You are interested in finding out whether the development level of a country and its most developed industries are related to its socioeconomic characteristics. You selected the United States, Mexico, and Uganda as your sample. Locate each country under the "Global Insights" section of globalEDGE. First, check the age distribution of their total population in the "Statistics" subsection, then, find their per capita GDP in the "Economy" subsection and take notes. Finally, check the total export amounts and top-10 exported products in the "Trade Statistics" sub-sections. What are some of the trends you noticed? How is age distribution related to the per capita GDP, international trade volume, and the types of products exported by the country? Can you use socioeconomic features of a country as a predictor for the level of development and guess the most developed industries in the country? How?

MINICASE

THE COVID-19 PANDEMIC: TEMPORARY HICCUP OR PERMANENT CHANGE FOR INTERNATIONAL BUSINESS?

International business relies on the interconnectedness of relationships across various consumer, business, and national entities. Decades of efforts to reduce barriers to trade have helped to facilitate the flow of money, products, and people across international markets and corresponding benefits to a broad range of entities.

However, the continued growth of international business is not assured. In late 2019, a novel coronavirus strain, SARS-CoV-2 (COVID-19), spread from its origin in Wuhan, China, and developed into an international health pandemic. Though past viral epidemics such as the Middle East Respiratory Syndrome (MERS), Severe Acute Respiratory Syndrome (SARS), and Ebola greatly affected the efficiency of business operations in certain regions, no recent health epidemic developed on a global scale in the way COVID-19 did. For the sake of protecting the health and safety of their citizens against the virus, many nations introduced trade and travel restrictions that forced international companies to alter the way they function.

Major COVID-19 safety measures included restricted cross-border movement among previously interconnected nations. For example, although the European Union had previously implemented policies to facilitate free flow of goods and persons between most member-nations, COVID-19 forced many of these nations to consider closing their borders or significantly limit travel across them. The World Tourism Organization noted that by April 2020, all of its destinations had imposed some sort of COVID-19 restrictions on travel, and nearly half had completely closed borders to noncitizens. Supply chains for products ranging from automobiles and electronics to clothing and pharmaceuticals experienced delays, forcing many manufacturers to halt production due to shortages of imported parts.

The effects of restricted trade and travel greatly affected economic growth for most nations. The United Nations predicted foreign direct investment decreases of 30 to 40 percent from 2020–2021 due to uncertainty associated with COVID-19. Investment levels could also be affected over the longer term, both locally and internationally, due to sustained economic uncertainty. The World Trade Organization projected that export volumes worldwide would decrease in the double-digits as a result of the pandemic, although exports were expected to subsequently recover. That latter outcome, however, was contingent on successful implementation of policies to alleviate the negative impact of COVID-19 and nations returning to pre-pandemic states—an outcome disputed among researchers.

What appears certain, at least to some, is that there will be changes in the world economy and in the relationships formed by international business entities. COVID-19-induced behavioral changes have fostered what many economists call a retreat from globalization and a return to nationalism. Closing of borders and tightening of trade policies forced many companies to reconsider their reliance on a complex web of international relationships. Supply chain management may be one of the most affected areas in international business because restricted movement and concerns about safe shipping either postponed or ended relationships with some supply partners. A majority of Fortune 500 companies source their materials from China but stopped accepting shipments from Chinese suppliers due to concerns about virus outbreaks. With health and safety concerns threatening relationships with suppliers located in distant locations, companies may redirect their attention toward domestic suppliers, or at least suppliers located closer to home.

Growth in nationalistic sentiment has been accompanied by increased government involvement in the economy. Unable to manage the fallout from the pandemic on their own, citizens and business leaders looked to their governments for aid. While the Japanese and South Korean governments quickly closed their borders and regulated international trade, other governments like the British were criticized for their slow reaction to intercede and assist the national economy. Increased state intervention and involvement, including through the distribution of stimulus packages, has been projected to heighten national dependency and a movement away from globalization. Although the process of globalization is unlikely to wholly reverse, COVID-19 raises uncertainty about nations' dependence on international partners and may lead to some abandonment of their lesser channels and relationships.

Many firms struggle with the question of what adaptation, recovery, and change might look like post–COVID-19. Underdeveloped nations and emerging markets are predicted to face the most difficult recovery processes. In these countries, COVID-19 decreased external product and service demand, caused substantial capital outflows, and forced many governments to take on additional debt to mitigate national damage. The pandemic's economic effects may delay or restrict development in these nations, thus affecting expansion of international business into new markets via trade and foreign direct investment.

In contrast, firms from more developed and economically secure nations may find themselves positioned for more rapid adaptation and recovery. Although there are numerous examples of companies that have experienced severe pain or even failure, many firms have focused on maintaining existing performance while also ensuring the health and safety of their employees. Adaptation to a new business climate is necessary to enable continued operational effectiveness. Though many nations placed restrictions on travel and trade, advancements in digital technology allow employees to stay connected virtually and companies to continue engaging with their consumers. In fact, successful deployment of advances in digitalization and the use of technology to circumvent barriers may position these developments to become even more valuable and essential in future international business dealings.

Some sectors of the economy may be positioned to experience a full post-pandemic rebound. Research from the U.S. Chamber of Commerce suggests the COVID-19 pandemic will bring in sustained new business for companies that fundamentally operate within social distancing and strict health guidelines, such as box subscription services and cleaning services. Furthermore, virtual services, consulting, and technology-based companies are poised to succeed in a new business climate that values socially distanced work. According to research from the Boston Consulting Group, approximately 80 percent of companies across all industries stated that they were actively exploring ways to shift go-to-market strategies from in-person to digital channels.

While the role of technology and digitalization may be the new norm for international companies as consumers exhibit continued concerns about health and safety post-pandemic, some sectors may lag. For example, air travel, tourism, and hospitality industries may experience a sustained downturn while they strive to regain the trust of customers. Indeed, some clients may evidence a permanent redirection of a significant portion of their business away from historical sectors and suppliers.

For international businesses that rely on movement across borders, COVID-19 has slowed, but not stopped, development. The impact of the pandemic is likely to cause firms to readdress their relationships and competencies, while also adapting to the new state of operating. Though it may take time to adjust, some companies have found themselves able to adapt faster than they thought. The future of international business will depend on resiliency to change, though the definite way in which it will operate cannot be certain until the pandemic has ended.

Discussion Questions

1. In your opinion, could COVID-19 lead to a reversal of globalization? If so, what might the implications of this reversal be for international businesses?
2. In what ways might international business companies make use of technology and digitalization to adapt to the new work environment impacted by COVID-19 and create new business opportunities?
3. Which sectors of business activity are likely to be the slowest to rebound from effects of COVID-19, and why?

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