part one

Introduction and Overview

The Globalization of Health Care

Health care has long been considered one of the industries least vulnerable to dislocation from globalization. After all, like many service businesses, health care is normally delivered where it is purchased. However, for some activities and procedures, this assumption is now changing. The trend began with certain diagnostic procedures, such as MRI scans. The United States has a shortage of radiologists, the doctors who specialize in reading and interpreting diagnostic medical images, including X-rays, CT scans, MRI scans, and ultrasounds. Demand for radiologists has been growing twice as fast as the rate at which medical schools are graduating radiologists with the skills and qualifications required to read medical images. This imbalance between supply and demand means that radiologists are expensive; an American radiologist can earn as much as $400,000 a year. In the early 2000s, an Indian radiologist working at Massachusetts General Hospital, Dr. Sanjay Saini, found a way to deal with the shortage and expense—send images over the Internet to India where radiologists could interpret them. This would reduce the workload on America's radiologists and also cut costs. A radiologist in India might earn one-tenth of the salary of his or her U.S. counterpart. Plus, because India is on the opposite side of the globe, the images could be interpreted while it was nighttime in the United States and be ready for the attending physician when he or she arrived for work the following morning.

The globalization trend has now spilled over into surgery. In the fall of 2008, for example, Adrienne de Forrest of Colorado had hip surgery in Chennai, India, while Texan David Jones had triple bypass surgery in New Delhi. Both patients were uninsured. De Forrest's surgery cost $8,000, and Jones's cost $16,000, including travel expenses.

Globalization

1

LEARNING OBJECTIVES

After you have read this chapter, you should:

- **LO1** Understand what is meant by the term *globalization*.
- **LO2** Be familiar with the main drivers of globalization.
- **LO3** Appreciate the changing nature of the global economy.
- **LO4** Understand the main arguments in the debate over the impact of globalization.
- **LO5** Appreciate how the process of globalization is creating opportunities and challenges for business managers.

Had those operations been done in the United States, they would have cost $45,000 and $250,000 respectively. Forrest and Jones are not alone; in 2007, some 750,000 Americans traveled abroad for medical treatment. The consulting company Deloitte forecasts that those numbers will reach 15 million by 2015.

Some might be worried about the quality of medical care in other countries, but medical tourists typically go to new hospitals, most of which are private, where highly skilled physicians treat them, many of whom trained in places like the United States or Britain. Costs in these countries generally run from 20 to 35 percent of costs for the same procedure in the United States.

A number of factors are driving the globalization trend. First is the high cost of medical care in the United States, which is the source of the largest number of patients. Then is the fact that over 45 million Americans are uninsured and many more are underinsured and face high co-payments for expensive procedures. Many of these people find it far cheaper to fly abroad to get treatment. Third, is the emergence of high-quality private hospital chains in places like India and Singapore. Fourth, the rising costs of insuring their workforces are starting to persuade some large American companies to look abroad. And finally, some insurance companies are starting to experiment with payment for foreign treatment at internationally accredited hospitals. In 2008, for example, Aetna, a large insurer, launched a pilot scheme in partnership with Singaporean hospitals. Aetna started to give Americans the option to have procedures costing $20,000 or more in the United States performed in Singapore, where the company believes that the quality of care is better than at the average American hospital.[1]

Introduction

Over the past few decades, a fundamental shift has been occurring in the world economy. We are moving away from a world in which national economies were relatively self-contained entities, isolated from each other by barriers to cross-border trade and investment; by distance, time zones, and language; and by national differences in government regulation, culture, and business systems. And we are moving toward a world in which barriers to cross-border trade and investment are declining; perceived distance is shrinking due to advances in transportation and telecommunications technology; material culture is starting to look similar the world over; and national economies are merging into an interdependent, integrated global economic system. The process by which this is occurring is commonly referred to as *globalization*.

In today's interdependent global economy, an American might drive to work in a car designed in Germany that was assembled in Mexico by the American automaker Ford from components made in the United States and Japan that were fabricated from Korean steel and Malaysian rubber. She may have filled the car with gasoline at a BP service station owned by a British multinational company. The gasoline could have been made from oil pumped from a well off the coast of Africa by a French oil company that transported it to the United States in a ship owned by a Greek shipping line. She might pull into a drive-through coffee shop run by a Korean immigrant and order a "single, tall, nonfat latte" and a chocolate-covered biscotti. The coffee beans came from Brazil and the chocolate from Peru, while the biscotti was made locally using an old Italian recipe.

Elsewhere in the world, a Singaporean might talk to his stockbroker on a Nokia cell phone that was designed in Finland and assembled in Texas using chip sets produced in Taiwan that were designed by Indian engineers working for Texas Instruments. He could tell the stockbroker to purchase shares in Deutsche Telekom, a German telecommunications firm that was transformed from a former state-owned monopoly into a global company by an energetic Israeli CEO.

An Indian may turn on her radio, which was made in Malaysia by a Japanese firm, to hear a popular hip-hop song by a group of Danes in English who signed a recording contract with a French music company to promote their music in Asia. After the song ends, a news announcer might inform the listener that antiglobalization protests at a meeting of the World Economic Forum in Davos, Switzerland, have turned violent. One protester has been killed. The announcer then turns to the next item, a story about how fear of interest rate hikes in the United States has sent Japan's Nikkei stock market index down sharply.

This is the world in which we live. It is a world where the volume of goods, services, and investment crossing national borders has expanded faster than world output consistently for more than half a century. It is a world where some $4 *trillion* in foreign exchange transactions are made every day, where $18 trillion of goods and $4 trillion of services are sold across national borders.[2] It is a world in which international institutions such as the World Trade Organization and gatherings of leaders from the world's most powerful economies have called for even lower barriers to cross-border trade and investment. It is a world where the symbols of material and popular culture are increasingly global: from Coca-Cola and Starbucks to Sony PlayStations, Nokia cell phones, MTV shows, Disney films, IKEA stores, and Apple iPods. It is a world in which products are made from inputs that come from all over the world. It is a world in which an economic crisis in Asia can cause a recession in the United States, and the threat of higher interest rates in the United States really did help drive Japan's Nikkei index down in the spring of 2006. In 2008, the financial crisis in the United States triggered off a global economic slowdown through 2008 and 2009. It is also a world in which globalization has been both embraced and questioned. While some hail globalization as a driver of global economic development, others vigorously protest against globalization. Globalization lies at the heart of contentious issues such as unemployment in developed nations, environmental degradation, and the Americanization of popular culture. And yes, these protests have on occasion turned violent.

For businesses, this process has produced many opportunities. Firms can expand their revenues by selling around the world and/or reduce their costs by producing in nations where key inputs, including labor, are cheap. The global expansion of enterprises has been facilitated by favorable political and economic trends. Since the collapse of communism at the end of the 1980s, the pendulum of public policy in nation after nation has swung toward the free market end of the economic spectrum. Regulatory and administrative barriers to doing business in foreign nations have come down, while those nations have often transformed their economies, privatizing state-owned enterprises, deregulating markets, increasing competition, and welcoming investment by foreign businesses. This has allowed businesses both large and small, from both advanced nations and developing nations, to expand internationally.

At the same time, globalization has created new threats for businesses accustomed to dominating their domestic markets. Foreign companies have entered many formerly protected industries in developing nations, increasing competition and driving down prices. For three decades, U.S. automobile companies have been battling foreign enterprises, as Japanese, European, and now Korean companies have taken business from them. Similarly, smaller businesses in Asia and other parts of the world struggle to survive against the influx of powerful and highly cost-competitive multinationals, particularly those from the United States.

As globalization unfolds, it is transforming industries and creating anxiety among those who believed their jobs were protected from foreign competition. Historically, while many workers in manufacturing industries worried about the impact foreign competition might have on their jobs, workers in service industries felt more secure. Now this too is changing. Advances in technology, lower transportation costs, and the rise of skilled workers in developing countries imply that many services no longer need to be performed where they are delivered. For example, accounting work is being outsourced from America to India. Indian accountants, trained in U.S. tax rules, perform work for U.S. accounting firms.[3] They access individual tax returns stored on computers in the United States, perform routine calculations, and save their work so that it can be inspected by a U.S. accountant, who then bills clients. As the best-selling author Thomas Friedman has recently argued, the world is becoming flat.[4]

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

What is Globalization?

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

THE GLOBALIZATION OF MARKETS

The **globalization of markets** refers to the merging of historically distinct and separate national markets into one huge global marketplace. Falling barriers to cross-border trade have made it easier to sell internationally. It has been argued for some time that the tastes and preferences of consumers in different nations are beginning to converge on some global norm, thereby helping to create a global market.[5] Consumer products such as

Citigroup credit cards, Coca-Cola soft drinks, Sony PlayStation video games, McDonald's hamburgers, Starbucks coffee, and IKEA furniture are frequently identified as prototypical examples of this trend. Firms such as these are more than just beneficiaries of this trend; they are also facilitators of it. By offering the same basic product worldwide, they help to create a global market.

A company does not have to be the size of these multinational giants to facilitate and benefit from the globalization of markets. In the United States, for example, nearly 90 percent of firms that export are small and medium enterprises account for nearly 34 percent of total U.S. exports in 2010.[6] Typical of these is Hytech, a New York-based manufacturer of solar panels that generates 40 percent of its $3 million in annual sales from exports to five countries, or B&S Aircraft Alloys, another New York company whose exports account for 40 percent of its $8 million annual revenues.[7] The situation is similar in several other nations. In Germany, for example, which is the world's largest exporter, a staggering 98 percent of small and mid-sized companies have exposure to international markets, either via exports or international production.[8]

Despite the global prevalence of Citigroup credit cards, McDonald's hamburgers, Starbucks coffee, and IKEA stores, it is important not to push too far the view that national markets are giving way to the global market. As we shall see in later chapters, significant differences still exist at national and regional levels along many relevant dimensions, including consumer tastes and preferences, distribution channels, culturally embedded value systems, business systems, and legal regulations. These differences frequently require companies to customize marketing strategies, product features, and operating practices to best match conditions in a particular country.

Beijing, China: Chinese shoppers walk through Beijing's main downtown shopping promenade past a Kentucky Fried Chicken (KFC) franchise. KFC is one of the most successful international businesses in China due to its adaptation and appeal to the Chinese market.

The most global markets currently are not markets for consumer products—where national differences in tastes and preferences are still often important enough to act as a brake on globalization—but markets for industrial goods and materials that serve a universal need the world over. These include the markets for commodities such as aluminum, oil, and wheat; for industrial products such as microprocessors, DRAMs (computer memory chips), and commercial jet aircraft; for computer software; and for financial assets from U.S. Treasury bills to eurobonds and futures on the Nikkei index or the Mexican peso.

In many global markets, the same firms frequently confront each other as competitors in nation after nation. Coca-Cola's rivalry with PepsiCo is a global one, as are the rivalries between General Motors and Toyota, Boeing and Airbus, Caterpillar and Komatsu in earthmoving equipment, and Sony, Nintendo, and Microsoft in video games. If a firm moves into a nation not currently served by its rivals, many of those rivals are sure to follow to prevent their competitor from gaining an advantage.[9] As firms follow each other around the world, they bring with them many of the assets that served them well in other national markets—including their products, operating strategies, marketing strategies, and brand names—creating some homogeneity across markets. Thus, greater uniformity replaces diversity. In an increasing number of industries, it is no longer meaningful to talk about "the German market," "the Korean market," "the Brazilian market," or "the Japanese market"; for many firms, there is only the global market.

THE GLOBALIZATION OF PRODUCTION

The **globalization of production** refers to the sourcing of goods and services from locations around the globe to take advantage of national differences in the cost and quality of **factors of production** (such as labor, energy, land, and capital). By doing this, companies hope to

Boeing's 787 rolls out.

lower their overall cost structure or improve the quality or functionality of their product offering, thereby allowing them to compete more effectively. Consider the Boeing 777, a commercial jet airliner. Eight Japanese suppliers make parts for the fuselage, doors, and wings; a supplier in Singapore makes the doors for the nose landing gear; three suppliers in Italy manufacture wing flaps; and so on.[10] In total, some 30 percent of the 777, by value, is built by foreign companies. For the 787, Boeing has pushed this trend even further, with some 65 percent of the total value of the aircraft scheduled to be outsourced to foreign companies, 35 percent of which will go to three major Japanese companies.[11]

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

For another example of a global web of activities, consider the case of Vizio discussed in the accompanying Management Focus feature. Vizio, an American company with just 75 employees, has become one of the largest sellers of flat panel TVs in the United States in just four years by coordinating a global web of activities: bringing together components manufactured in South Korea, China, and the United States, arranging for their assembly in Mexico, and then selling them in the United States.

Early outsourcing efforts were primarily confined to manufacturing activities, such as those undertaken by Boeing and Vizio; increasingly, however, companies are taking advantage of modern communications technology, particularly the Internet, to outsource service activities to low-cost producers in other nations. The Internet has allowed hospitals to outsource some radiology work to India; while U.S. physicians sleep, images from MRI scans and the like are read at night and the results are ready in the morning. Many software companies, including IBM, now use Indian engineers to perform maintenance functions on software designed in the United States. The time difference allows Indian engineers to run debugging tests on software written in the United States when U.S. engineers sleep, and the corrected code is transmitted back to the United States over secure Internet connections so it is ready for U.S. engineers to work on the following day. Dispersing value-creation activities in this way can compress the time and lower the costs required to develop new software programs.

MANAGEMENT FOCUS

Vizio and the Market for Flat Panel TVs

They begin as glass panels that are manufactured in high-tech fabrication centers in South Korean, Taiwan, and Japan. Operating sophisticated tooling in environments that must be kept absolutely clean, these factories produce sheets of glass twice as large as king size beds to exacting specifications. From there, the glass panels travel to Mexican plants located alongside the U.S. border. There they are cut to size, combined with electronic components shipped in from Asia and the United States, assembled into finished TVs, and loaded onto trucks bound for retail stores in the United States. It's a huge business. U.S. consumers spend over $35 billion a year on flat panel TVs.

The underlying technology for flat panel displays was invented in the United States in the late 1960s by RCA. But after RCA and rivals Westinghouse and Xerox opted not to pursue the technology, the Japanese company Sharp made aggressive investments in flat panel displays. By the early 1990s, Sharp was selling the first flat panel screens, but as the Japanese economy plunged into a decade-long recession, investment leadership shifted to South Korean companies such as Samsung. Then the 1997 Asian crisis hit Korea hard, and Taiwanese companies seized leadership. Today, Chinese companies are starting to elbow their way into the flat panel display manufacturing business.

As production for flat panel displays migrates its way around the globe to low cost locations, there are clear winners and losers. U.S. consumers, who have benefited from the falling prices of flat panel TVs and are snapping them up. Efficient manufacturers have taken advantage of globally dispersed supply chains to make and sell low-cost, high-quality flat panel TVs. Foremost among these has been the California-based company, Vizio. Founded by a Taiwanese immigrant, in just six years sales of Vizio flat panel TVs ballooned from nothing to over $2 billion in 2008, and in early 2009, the company was the largest provider to the United States market with a 21.7 percent share. Vizio, however, has less than 100 employees. They focus on final product design, sales, and customer service. Vizio outsources most of its engineering work, all of its manufacturing and much of its logistics. For each of its models, Vizio assembles a team of supplier partners strung across the globe. Its 42-inch flat panel TV, for example, contains a panel from South Korea, electronic components from China, and processors from the United States, and it is assembled in Mexico. Vizio's managers scour the globe continually for the cheapest manufacturers of flat panel displays and electronic components. They sell most of their TVs to large discount retailers such as Costco and Sam's Club. Good order visibility from retailers, coupled with tight management of global logistics, allows Vizio to turn over its inventory every three weeks, twice as fast as many of its competitors, which is a major source of cost saving in a business where prices are falling continually.

On the other hand, the shift to flat panel TVs has caused pain in certain sectors of the economy, such as those firms that make traditional cathode ray TVs in high-cost locations. In 2006, for example, Japanese electronics manufacturers Sanyo laid off 300 employees at its U.S. factory, and Hitachi closed its TV manufacturing plant in South Carolina, laying off 200 employees. Both Sony and Hitachi of course both make still make TVs, but they are flat panel TVs assembled in Mexico from components manufactured in Asia.[12]

Other companies, from computer makers to banks, are outsourcing customer service functions, such as customer call centers, to developing nations where labor is cheaper.

Robert Reich, who served as secretary of labor in the Clinton administration, has argued that as a consequence of the trend exemplified by companies such as Boeing, IBM, and Vizio, in many cases it is becoming irrelevant to talk about American products, Japanese products, German products, or Korean products. Increasingly, according to Reich, outsourcing productive activities to different suppliers results in the creation of products that are global in nature, that is, "global products."[13] But as with the globalization of markets, companies must be careful not to push the globalization of production too far. As we will see in later chapters, substantial impediments still make it difficult for firms to achieve the optimal dispersion of their productive activities to locations around the globe. These

impediments include formal and informal barriers to trade between countries, barriers to foreign direct investment, transportation costs, and issues associated with economic and political risk. For example, government regulations ultimately limit the ability of hospitals to outsource the process of interpreting MRI scans to developing nations where radiologists are cheaper.

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

The Emergence of Global Institutions

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

The **World Trade Organization** (like the GATT before it) is primarily responsible for policing the world trading system and making sure nation-states adhere to the rules laid down in trade treaties signed by WTO member states. As of 2013, the 159 member nations of the WTO collectively accounted for 98 percent of world trade, thereby giving the organization enormous scope and influence. The WTO is also responsible for facilitating the establishment of additional multinational agreements between WTO member states. Over its entire history, and that of the GATT before it, the WTO has promoted lowering barriers to cross-border trade and investment. In doing so, the WTO has been the instrument of its member states, which have sought to create a more open global business system unencumbered by barriers to trade and investment between countries. Without an institution such as the WTO, the globalization of markets and production is unlikely to have proceeded as far as it has. However, as we shall see in this chapter and in Chapter 6 when we look closely at the WTO, critics charge that the organization is usurping the national sovereignty of individual nation-states.

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

The IMF is often seen as the lender of last resort to nation-states whose economies are in turmoil and currencies are losing value against those of other nations. Repeatedly during the past decade, for example, the IMF has lent money to the governments of troubled states, including Argentina, Indonesia, Mexico, Russia, South Korea, Thailand, and Turkey. More recently, the IMF has taken a very proactive role in helping countries cope with some of the effects of the global financial crisis in 2008 and 2009. IMF loans come with strings attached, however; in return for loans, the IMF requires nation-states to adopt specific economic policies aimed at returning their troubled economies to stability and growth. These requirements have sparked controversy. Some critics charge that the IMF's policy recommendations are often inappropriate; others maintain that by telling national governments what economic policies they must adopt, the IMF, like the WTO, is usurping the sovereignty of nation-states. We shall look at the debate over the role of the IMF in Chapter 10.

The United Nations has the important goal of improving the well-being of people around the world.

The **United Nations** was established on October 24, 1945, by 51 countries committed to preserving peace through international cooperation and collective security. Today nearly every nation in the world belongs to the United Nations; membership now totals 192 countries. When states become members of the United Nations, they agree to accept the obligations of the UN Charter, an international treaty that establishes basic principles of international relations. According to the charter, the UN has four purposes: to maintain international peace and security, to develop friendly relations among nations, to cooperate in solving international problems and in promoting respect for human rights, and to be a center for harmonizing the actions of nations. Although the UN is perhaps best known for its peacekeeping role, one of the organization's central mandates is the promotion of higher standards of living, full employment, and conditions of economic and social progress and development—all issues that are central to the creation of a vibrant global economy. As much as 70 percent of the work of the UN system is devoted to accomplishing this mandate. To do so, the UN works closely with other international institutions such as the World Bank. Guiding the work is the belief that eradicating poverty and improving the well-being of people everywhere are necessary steps in creating conditions for lasting world peace.[14]

Another institution that has been in the news of late is the Group of Twenty or **G20**. Established in 1999, the G20 comprises the finance ministers and central bank governors of the 19 largest economies in the world, as well as representatives from the European Union and the European Central Bank. Originally established to formulate a coordinated policy response to financial crises in developing nations, in 2008 and 2009 the G20 became the forum through which major nations attempted to launch a coordinated policy response to the global financial crisis.

Drivers of Globalization

Two macro factors underlie the trend toward greater globalization.[15] The first is the decline in barriers to the free flow of goods, services, and capital that has occurred since the end of World War II. The second factor is technological change, particularly the dramatic developments in recent years in communication, information processing, and transportation technologies.

DECLINING TRADE AND INVESTMENT BARRIERS

During the 1920s and 30s, many of the world's nation-states erected formidable barriers to international trade and foreign direct investment. **International trade** occurs when a firm exports goods or services to consumers in another country. **Foreign direct investment (FDI)** occurs when a firm invests resources in business activities outside its home country. Many of the barriers to international trade took the form of high tariffs on imports of manufactured goods. The typical aim of such tariffs was to protect domestic industries from foreign competition. One consequence, however, was "beggar-thy-neighbor" retaliatory trade policies, with countries progressively raising trade barriers against each other. Ultimately, this depressed world demand and contributed to the Great Depression of the 1930s.

Having learned from this experience, the advanced industrial nations of the West committed themselves after World War II to removing barriers to the free flow of goods, services, and capital between nations.[16] This goal was enshrined in the General Agreement on Tariffs and Trade. Under the umbrella of GATT, eight rounds of negotiations among member states have worked to lower barriers to the free flow of goods and services. The most recent round of negotiations to be completed, known as the Uruguay Round, was finalized in December 1993. The Uruguay Round further reduced trade barriers; extended GATT to cover services as well as manufactured goods; provided enhanced protection for patents, trademarks, and copyrights; and established the World Trade Organization to police the international trading system.[17] Table 1.1 summarizes the impact of GATT agreements on average tariff rates for manufactured goods. As can be seen, average tariff rates have fallen significantly since 1950.

In late 2001, the WTO launched a new round of talks aimed at further liberalizing the global trade and investment framework. For this meeting, it chose the remote location of Doha in the Persian Gulf state of Qatar. At Doha, the member states of the WTO staked out an agenda. The talks were scheduled to last three years, although as of 2013 they are effectively stalled due to opposition from several key nations. The Doha agenda includes cutting tariffs on industrial goods, services, and agricultural products; phasing out subsidies to agricultural producers; reducing barriers to cross-border investment; and limiting the use of antidumping laws. If these talks are successfully completed, the biggest gain may come from discussion on agricultural products; average agricultural tariff rates are still about 40 percent, and rich nations spend some $300 billion a year in subsidies to support their farm sectors. The world's poorer nations have the most to gain from any reduction in agricultural tariffs and subsidies; such reforms would give them access to the markets of the developed world.[18]

In addition to reducing trade barriers, many countries have also been progressively removing restrictions to foreign direct investment. According to the United Nations, some 90 percent of the 2,700-odd changes made worldwide between 1992 and 2009 in the laws governing foreign direct investment created a more favorable environment for FDI.[19]

Such trends have been driving both the globalization of markets and the globalization of production. Lowering barriers to international trade enables firms to view the world,

TABLE 1.1

Average Tariff Rates on Manufactured Products as Percent of Value

	1913	1950	1990	2010
France	21%	18%	5.9%	3.9%
Germany	20	26	5.9	3.9
Italy	18	25	5.9	3.9
Japan	30	—	5.3	2.3
Holland	5	11	5.9	3.9
Sweden	20	9	4.4	3.9
Great Britain	—	23	5.9	3.9
United States	44	14	4.8	3.2

Sources: The 1913–1990 data are from "Who Wants to Be a Giant?" *The Economist:* A Survey of the Multinationals, June 24, 1995, pp. 3–4. Copyright © The Economist Books, Ltd. The 2010 data are from World Trade Organization, *The World Trade Report 2011* (Geneva: WTO, 2011).

rather than a single country, as their market. Lowering trade and investment barriers also allows firms to base production at the optimal location for that activity. Thus, a firm might design a product in one country, produce component parts in two other countries, assemble the product in yet another country, and then export the finished product around the world.

According to WTO data, the volume of world merchandise trade has grown faster than the world economy since 1950.[20] In addition, since the mid-1980s the value of international trade in services has also grown robustly. Trade in services now accounts for almost 20 percent of the value of all international trade. Increasingly, international trade in services has been driven by advances in communications, which allow corporations to outsource service activities to different locations around the globe (see the opening case). Thus, as noted earlier, many corporations in the developed world outsource customer service functions, from software maintenance activities to customer call centers, to developing nations where labor costs are lower.

The evidence also suggests that foreign direct investment is playing an increasing role in the global economy as firms increase their cross-border investments. The average yearly outflow of FDI increased from $25 billion in 1975 to a record $1.3 trillion in 2012. Though it remains lower than the 2007 record figure of $2 trillion, the long-term outlook still remains positive.[21] As a result of the strong FDI flow, by 2011 the global stock of FDI exceeded $20 trillion, up from $10 trillion in 2005. At least 82,000 parent companies had 810,000 affiliates in foreign markets that collectively employed more than 77 million people abroad and generated value accounting for around 11 percent of global GDP. The foreign affiliates of multinationals had an estimated $32 trillion in global sales, much higher than the value of global exports, which stood at close to $20 trillion.[22]

The globalization of markets and production and the resulting growth of world trade, foreign direct investment, and imports all imply that firms are finding their home markets under attack from foreign competitors. Japanese carmakers have gained a sizeable market share in the United States. At the same time, back in Japan, U.S. companies such as Kodak, Procter & Gamble, and Merrill Lynch are expanding their presence, while Apple, General Motors and Starbucks have now entered China. The Dutch company Philips has lost its dominant position in Europe to Asian brands such as Japan's JVC, Matsushita, and Sony, and Korea's Samsung and LG. The growing integration of the world economy into a single, huge marketplace is increasing the intensity of competition in a range of manufacturing and service industries.

However, declining barriers to cross-border trade and investment cannot be taken for granted. As we shall see in subsequent chapters, demands for "protection" from foreign competitors are still often heard in countries around the world, including the United States. Although a return to the restrictive trade policies of the 1920s and 30s is unlikely, it is not clear whether the political majority in the industrialized world favors further reductions in trade barriers. Particularly, the global financial crisis of 2008–2009, and the drop in global output that followed thereafter, led to more calls for oversight, and trade barriers to protect domestic jobs.

THE ROLE OF TECHNOLOGICAL CHANGE

The lowering of trade barriers made globalization of markets and production a theoretical possibility. Technological change has made it a tangible reality. Since the end of World War II, the world has seen major advances in communication, information processing, and transportation technology, including the explosive emergence of the Internet.

MICROPROCESSORS AND TELECOMMUNICATIONS

Perhaps the single most important innovation has been the development of the microprocessor, which enabled the explosive growth of high-power, low-cost computing, vastly increasing the amount of information that individuals and firms can process. The microprocessor also underlies many recent advances in telecommunications technology. Over the past 30 years, developments in satellite, optical fiber, and wireless technologies, and the Internet have revolutionized global communications. These technologies rely on the microprocessor to encode, transmit, and decode the vast amount of information that flows along these electronic highways. The cost of microprocessors continues to fall, while

their power increases (a phenomenon known as **Moore's Law**, which predicts that the power of microprocessor technology doubles and its cost of production falls by half every 18 months).[23] As this happens the cost of global communications plummets, which lowers the costs of coordinating and controlling a global organization.

The Internet

In 1990, fewer than 1 million users were connected to the Internet. By 1995, the figure had risen to 50 million. By 2012, the Internet had 2.4 billion users.[24] The Internet has developed into the information backbone of the global economy. Global e-commerce sales was valued at over US $1 trillion in 2012.[25] Viewed globally, the Web is emerging as an equalizer. It rolls back some of the constraints of location, scale, and time zones.[26] It makes it much easier for buyers and sellers to find each other, wherever they may be located and whatever their size, and allows businesses, both small and large, to expand their global presence at a lower cost than ever before.

Transportation Technology

In addition to developments in communication technology, several major innovations in transportation technology have occurred since World War II. In economic terms, the most important are probably the development of commercial jet aircraft and super-freighters and the introduction of containerization, which simplifies transshipment from one mode of transport to another. The advent of commercial jet travel, by reducing the time needed to get from one location to another, has effectively shrunk the globe.

Containerization has revolutionized the transportation business, significantly lowering the costs of shipping goods over long distances. Before the advent of containerization, moving goods from one mode of transport to another was very labor intensive, lengthy, and costly. It could take days and several hundred longshoremen to unload a ship and reload goods onto trucks and trains. With the advent of widespread containerization in the 1970s and 80s, the whole process can now be executed by a handful of longshoremen in a couple of days. Since 1980, the world's containership fleet has more than quadrupled, reflecting in part the growing volume of international trade and in part the switch to this mode of transportation. As a result of the efficiency gains associated with containerization, transportation costs have plummeted, making it much more economical to ship goods around the globe, thereby helping to drive the globalization of markets and production. Between 1920 and 1990, the average ocean freight and port charges per ton of U.S. export and import cargo fell from $95 to $29 (in 1990 dollars).[27] An increased share of cargo now goes by air. Between 1955 and 1999, average air transportation revenue per ton-kilometer fell by more than 80 percent.[28]

Implications for the Globalization of Production

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

Globalization at General Electric

General Electric, the company that Thomas Edison founded, and now the largest industrial conglomerate in America, produces a wide array of goods and services, from medical equipment, power generators, jet engines, and home appliances, to financial services and even television broadcasting (GE owns NBC, one of America's big three network broadcasters). This giant company with revenues of close to $180 billion is no stranger to international business. GE has been operating and selling overseas for decades. During the tenure of legendary CEO Jack Welch, GE's main goal was to be number 1 or 2 *globally* in every business in which it participated. To further this goal, Welch sanctioned an aggressive and often opportunistic foreign direct investment strategy. GE took advantage of economic weakness in Europe from 1989 to1995 to invest $17.5 billion in the region, half of which was used to acquire some 50 companies. When the Mexican peso collapsed in value in 1995, GE took advantage of the economic uncertainty to purchase companies throughout in Latin America. And when Asian slipped into a major economic crisis in 1997–1998 due to turmoil in the Asian currency markets, Welch urged his managers to view it as a buying opportunity. In Japan alone, the company spent $15 billion on acquisition in just six months. As a result, by the end of Welch's tenure in 2001, GE earned over 40 percent of its revenues from international sales, up from 20 percent in 1985.

Welch's GE, however, was still very much an American company doing business abroad. Under the leadership of his successor, Jeffery Immelt, GE seems to be intent on becoming a true *global* company. For one thing, international revenues continue to grow faster than domestic revenues, passing 50 percent of the total in 2007. This expansion is increasingly being powered by the dynamic economies of Asia, particularly India and China. GE now sells more wide-bodied jet engines to India than in the Untied States, and GE is a major beneficiary of the huge infrastructure investments now taking place in China as that country invests rapidly in airports, railways, and power stations. By 2012, analysts estimate that GE will be generating 55 to 60 percent of its business internationally.

To reflect the shifting center of gravity, Immelt has made some major changes in the way GE is organized and operates. Until recently, all of GE's major businesses had head offices in the United States and were tightly controlled from the center. Then in 2004, GE moved the head office of its health care business from the United States to London, the home of Amersham, a company GE had just bought. Next, GE relocated the headquarters for the unit that sells equipment to oil and gas companies to Florence, Italy. And in 2008, the company moved the headquarters for GE Money to London. Moreover, it gave country managers more power. Why is GE doing this? The company believes that to succeed internationally, it must be close to its customers. Moving GE Money to London, for example, was prompted by a desire to be closer to customers in Europe and Asia. Executives at GE Health Care like London because it allows easier flights to anywhere in the world.

GE has also shifted research overseas. Since 2004, it has opened R&D centers in Munich, Germany; Shanghai, China; and Bangalore, India. The belief is that by locating in those economies where it is growing rapidly, GE can better design equipment that is best suited to local needs. For example, GE Health Care makes MRI scanners that cost $1.5 million each, but its Chinese research center is designing MRI scanners that can be priced for $500,000 and are more likely to gain sales in the developing world.

GE is also rapidly internationalizing its senior management. Once viewed as a company that preferred to hire managers from the Midwest because of their strong work ethic, foreign accents are now frequently heard among the higher ranks. Country managers, who in the past were often American expatriates, increasingly come from the regions in where they work. GE has found that local nationals are invaluable when trying to sell to local companies and governments, where a deep understanding of local language and culture is often critical. In China, for example, the government is a large customer, and working closely with government bureaucrats requires a cultural sensitivity that is difficult for outsiders to gain. In addition to the internationalization of their management ranks, GE's American managers are increasingly traveling overseas for management training and company events. In 2008, in a highly symbolic gesture, GE Transportation, which is based in Erie, Pennsylvania, moved its annual sales meeting to Sorrento, Italy from Florida. "It was time that the Americans learnt to deal with jet lag," according to the head of the unit.[29]

The development of commercial jet aircraft has also helped knit together the worldwide operations of many international businesses. Using jet travel, a Singaporean manager only needs to spend a day at most traveling to his or her firm's European or American operations. This enables the manager to oversee a globally dispersed production system.

Implications for the Globalization of Markets

In addition to the globalization of production, technological innovations have facilitated the globalization of markets. Low-cost global communications networks such as the World Wide Web are helping to create electronic global marketplaces. As noted above, low-cost transportation has made shipping products around the world more economical, thereby helping to create global markets. For example, due to the tumbling costs of shipping goods by air, roses grown in Ecuador can be sold in New York two days later while they are still fresh. This has given rise to an industry in Ecuador that did not exist 20 years ago and that now supplies a global market for roses. In addition, low-cost jet travel has resulted in the mass movement of people between countries. This has reduced the cultural distance between countries and is bringing about some convergence of consumer tastes and preferences. At the same time, global communication networks and global media are creating a worldwide culture. Many countries now receive U.S. television networks such as CNN, MTV, and HBO, and Hollywood films are shown the world over. In any society, the media are primary conveyors of culture; as global media develop, we must expect the evolution of something akin to a global culture. A logical result of this evolution is the emergence of global markets for consumer products.

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

The Changing Demographics of the Global Economy

Hand in hand with the trend toward globalization has been a fairly dramatic change in the demographics of the global economy over the past 30 years. As late as the 1960s, four trends described the demographics of the global economy. The first was U.S. dominance in the world economy and world trade picture. The second was U.S. dominance in world foreign direct investment. Related to this, the third trend was the dominance of large, multinational U.S. firms on the international business scene. The fourth was that roughly half the globe—the centrally planned economies of the Communist world—were off-limits to international businesses. As the following section explains, all four of these qualities either have changed or are now changing rapidly.

THE CHANGING WORLD OUTPUT AND WORLD TRADE PICTURE

In the early 1960s, the United States was still by far the world's dominant industrial power. In 1963, the United States accounted for 38.3 percent of world economic activity, measured by gross domestic product (GDP). By 2012, the United States accounted for 23.1 percent of world GDP, still the world's largest industrial power but down significantly in relative size since the 1960s (see Table 1.2 on page 16). Nor was the United States the only developed nation to see its relative standing slip. The same occurred to Germany, France, and the United Kingdom, all nations that were among the first to industrialize. This change was the result of a faster economic growth of several other economies, particularly in Asia. For example, as can be seen from Table 1.2, from 1963 to 2010, China's share of world GDP increased

TABLE 1.2

The Changing Demographics of World Output and Trade

Sources: Output data from World Bank database, April 2013. Export data from WTO press release, "Trade to remain subdued in 2013," April 10, 2013.

Country	Share of World Output, 1960 (%)	Share of World Output, 2011 (%)	Share of World Exports, 2012 (%)
United States	38.3	21.4	8.7
Germany	8.7	5.1	7.9
France	4.6	4.0	3.3
Italy	3.0	3.1	2.8
United Kingdom	5.3	3.5	2.6
Canada	3.0	2.5	2.5
Japan	3.3	8.4	4.5
China	NA	10.5	11.4

from a trivial amount to 9.4 percent. Other countries that markedly increased their share of world output included Japan, Thailand, Malaysia, Taiwan, and South Korea.

Over the past 30 years, U.S. dominance in export markets has waned as Japan, Germany, and a number of newly industrialized countries such as South Korea and China have taken a larger share of world exports. During the 1960s, the United States routinely accounted for 20 percent of world exports of manufactured goods. But as Table 1.2 shows, the U.S. share of world exports of goods and services had slipped to 8.7 percent by 2012, behind that of China.

As emerging economies such as China, India, and Brazil continue to grow, a further relative decline in the share of world output and world exports accounted for by the United States and other long-established developed nations seems likely.

Most forecasts now predict a rapid rise in the share of world output accounted for by developing nations such as China, India, Indonesia, Thailand, South Korea, Mexico, and Brazil and a commensurate decline in the share enjoyed by rich industrialized countries such as Great Britain, Germany, Japan, and the United States. If current trends continue, the Chinese economy could be larger than that of the United States on a purchasing power parity basis, while the economy of India will approach that of Germany. The World Bank has estimated that today's developing nations may account for more than 60 percent of world economic activity by 2020, while today's rich nations, which currently account for more than 55 percent of world economic activity, may account for only about 38 percent. These suggest that a shift in the economic geography of the world is now underway, although the magnitude of that shift is not totally evident. For international businesses, the implications of this changing economic geography are clear: Many of tomorrow's economic opportunities may be found in the developing nations of the world, and many of tomorrow's most capable competitors will probably also emerge from these regions. A case in point has been the dramatic expansion of India's software sector, which is profiled in the accompanying Country Focus feature.

THE CHANGING FOREIGN DIRECT INVESTMENT PICTURE

Reflecting the dominance of the United States in the global economy, U.S. firms accounted for 66.3 percent of worldwide foreign direct investment flows in the 1960s. British firms were second, accounting for 10.5 percent, while Japanese firms were a distant eighth, with only 2 percent. The dominance of U.S. firms was so great that books were written about the economic threat U.S. corporations posed to Europe.[30] Several European governments, most notably France, talked of limiting investment by U.S. firms.

However, as the barriers to the free flow of goods, services, and capital fell, and as other countries increased their shares of world output, non-U.S. firms increasingly began to invest

India's Software Sector

Some 30 years ago, a number of small software enterprises were established in Bangalore, India. Typical of these enterprises was Infosys Technologies, which was started by seven Indian entrepreneurs with about $1,000 between them. Infosys now has annual revenues of $22 billion and some 60,000 employees, but it is just one of over a hundred software companies clustered around Bangalore, which has become the epicenter of India's fast growing information technology sector. From a standing start in the mid 1980s, by 2008–2009 this sector was generating revenues of $60 billion. Combined software services, hardware sales, and business process outsourcing exports were expected to hit $47 billion, a 16 percent growth rate despite a sharp global economic slowdown during 2008–2009. India had also emerged as home to some of the fastest growing software service companies on the planet, including Infosys, Wipro, Tata Consultancy Services, and HCL Technologies.

The growth of the Indian software sector is based on four factors. First, the country has an abundant supply of engineering talent. Every year Indian universities graduate some 400,000 engineers. Second, labor costs in India are low. The cost to hire an Indian graduate is roughly 12 percent of the cost of hiring an American graduate. Third, many Indians are fluent in English, which makes coordination between Western firms and India easier. Fourth, due to time differences, Indians can work while Americans sleep. This means, for example, that software code written in America during the day can be tested in India and at night shipped back via the Internet to America in time for the start of work the following day. In other words, by utilizing Indian labor and the Internet, software enterprises can create global software development factories that are working 24 hours a day.

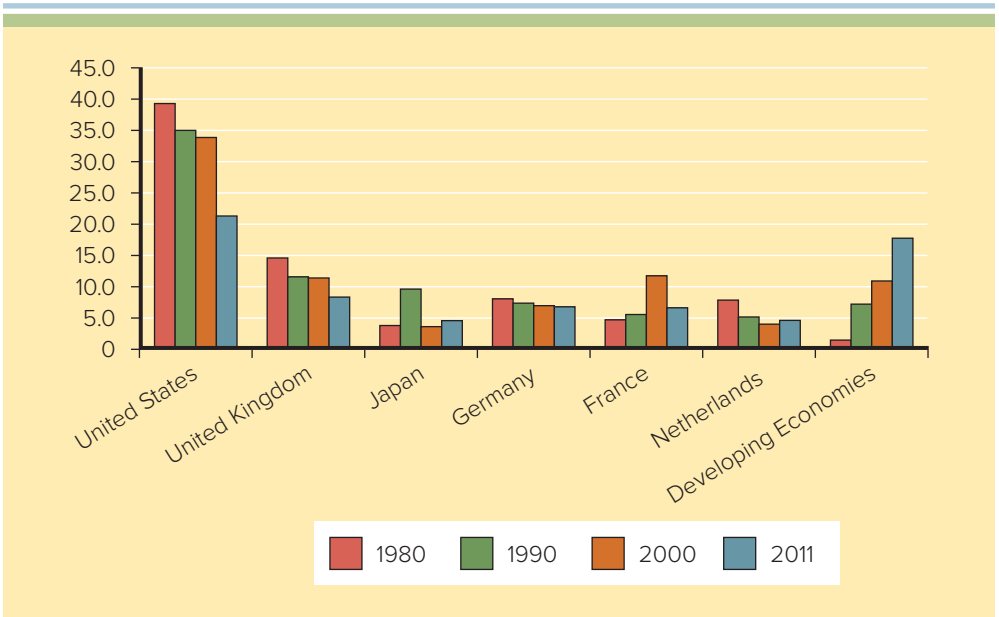
Initially, Indian software enterprises focused on the low end of the software industry, supplying basic software development and testing services to Western firms. But as the industry has grown in size and sophistication, Indian firms have moved up-market. Today, the leading Indian companies compete directly with the likes of IBM and EDS for large software development projects, business process outsourcing contracts, and information technology consulting services. These markets are booming. Estimates suggest that global spending on information technology outsourcing will rise from $193 billion in 2004 to over $250 billion by 2010, with Indian enterprises capturing a larger slice of the pie. One response of Western firms to this emerging competitive threat has been to invest in India to garner the same kind of economic advantages that Indian firms enjoy. IBM, for example, has invested $2 billion in its Indian operations, and now has 53,000 employees located there, more than in any other country except America. In 2007, it announced plans to invest another $6 billion over the next few years in India. Microsoft too has made major investments in India, including an R&D center in Hyderabad which employs 900 people. The center was located there specifically to tap into talented Indian engineers who did not want to move to the United States.[31]

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

One consequence of these developments is illustrated in Figure 1.1, which shows how the stock of foreign direct investment by the world's six most important national sources—the

FIGURE 1.1

Percentage Share of Total FDI Stock, 1980–2011

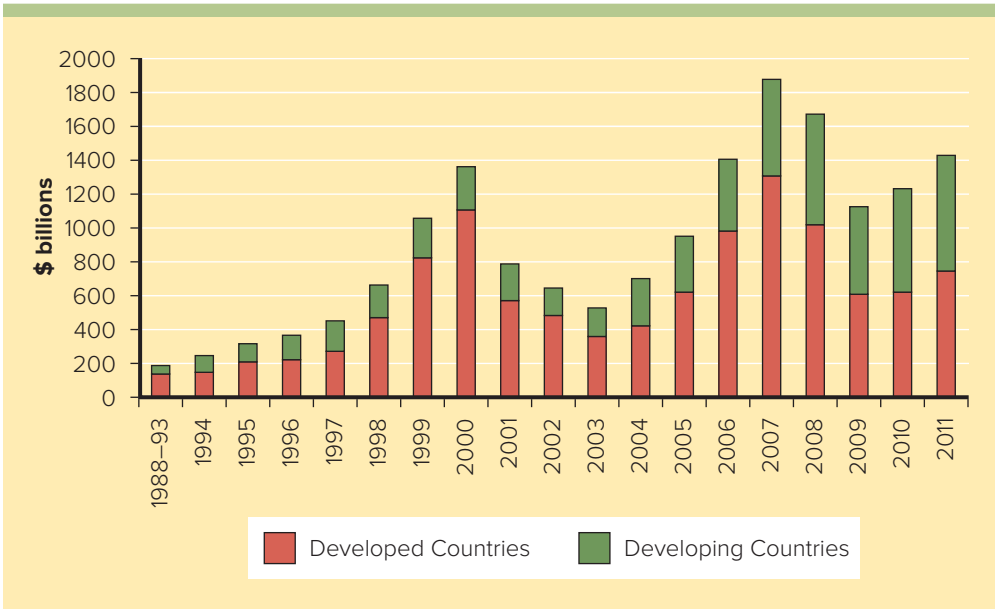


United States, the United Kingdom, Germany, the Netherlands, France, and Japan—changed between 1980 and 2011. (The **stock of foreign direct investment** refers to the total cumulative value of foreign investments.) Figure 1.1 also shows the stock accounted for by firms from developing economies. The share of the total stock accounted for by U.S. firms declined from about 38 percent in 1980 to 21 percent in 2011. Meanwhile, the shares accounted for by France and the world's developing nations increased markedly. The rise in the share of FDI stock accounted for by developing nations reflects a growing trend for firms from these countries to invest outside their borders. In 2011, firms based in developing nations accounted for 17.5 percent of the stock of foreign direct investment, up from only 1.1 percent in 1980. Firms based in Hong Kong, South Korea, Singapore, Taiwan, India, and mainland China accounted for much of this investment.

Figure 1.2 illustrates two other important trends—the sustained growth in cross-border flows of foreign direct investment that occurred during the 1990s and the importance of

FIGURE 1.2

FDI Inflows, 1988–2011



developing nations as the destination of foreign direct investment. Throughout the 1990s, the amount of investment directed at both developed and developing nations increased dramatically, a trend that reflects the increasing internationalization of business corporations. A surge in foreign direct investment from 1998 to 2000 was followed by a slump from 2001 to 2003 associated with a slowdown in global economic activity after the collapse of the financial bubble of the late 1990s and 2000. However, the growth of foreign direct investment resumed in 2004 and continued through 2007 to hit record level. Foreign direct investment, however, slowed down after the global financial crisis of 2008–2009. Among developing nations, the largest recipient of foreign direct investment has been China, which from 2004–2011 received $60 billion to $100 billion a year in inflows. As we shall see later in this book, the sustained flow of foreign investment into developing nations is an important stimulus for economic growth in those countries, which bodes well for the future of countries such as China, Mexico, and Brazil, all leading beneficiaries of this trend.

THE CHANGING NATURE OF THE MULTINATIONAL ENTERPRISE

A **multinational enterprise** (MNE) is any business that has productive activities in two or more countries. Since the 1960s, two notable trends in the demographics of the multinational enterprise have been (1) the rise of non-U.S. multinationals and (2) the growth of mini-multinationals.

Non-U.S. Multinationals

In the 1960s, large U.S. multinational corporations dominated global business activity. With U.S. firms accounting for about two-thirds of foreign direct investment during the 1960s, one would expect most multinationals to be U.S. enterprises. According to the data summarized in Figure 1.3, in 1973, 48.5 percent of the world's 260 largest multinationals were U.S. firms. The second-largest source country was the United Kingdom, with 18.8 percent of the largest multinationals. Japan accounted for 3.5 percent of the world's largest multinationals at the time. The large number of U.S. multinationals reflected U.S. economic dominance in the three decades after World War II, while the large number of British multinationals reflected that country's industrial dominance in the early decades of the 20th century.

By 2010, things had shifted significantly. Of the world's 100 largest nonfinancial multinationals, 21 were U.S. enterprises; 15 were French; 11, German; 15, British; and 8, Japanese.[32] Although the 1973 data are not strictly comparable with the later data, they illustrate the trend (the 1973 figures are based on the largest 260 firms, whereas the later figures are based

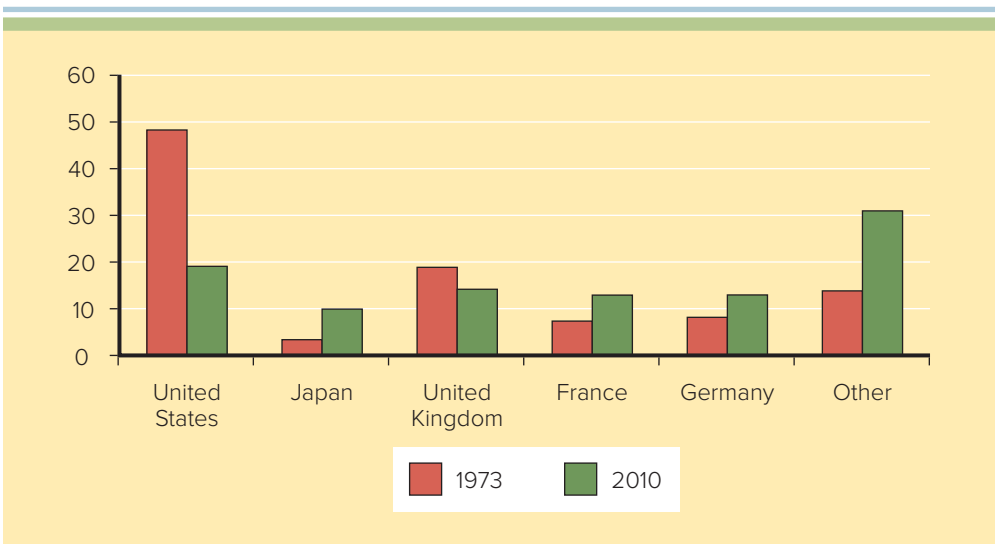


FIGURE 1.3

National Origin of Largest Multinational Enterprises, 1973 and 2010

MANAGEMENT FOCUS

China's Hisense—An Emerging Multinational

Hisense is rapidly emerging as one of China's leading multinationals. Like many other Chinese corporations, Hisense traces its origins back to a state-owned manufacturer, in this case Qingdao No. 2 Radio Factory, which was established in 1969 with just 10 employees. In the 1970s, the state-owned factory diversified into the manufacture of TV sets, and by the 1980s it was one of China's leading manufacturers of color TVs, making sets designed by Matsushita under license. In 1992, a 35-year-old engineer named Zhou Houjian was appointed head of the enterprise. In 1994, the shackles of state ownership were relaxed when the Hisense Company Ltd was established, with Zhou as CEO (he is now Chairman of the Board).

Under Zhou's leadership, Hisense entered a period of rapid growth, product diversification, and global expansion. By 2007, the company had sales of $6.2 billion and had emerged as one of China's premier makers of TV sets (with an 11 percent share of the domestic market), air conditioners, refrigerators, personal computers, and telecommunications equipment. In 2007, Hisense sold around 10 million TVs, 3 million air conditioners, 4 million CDMA wireless phones, 6 million refrigerators, and 1 million personal computers. International sales accounted for $490 million, or more than 15 percent of total revenue. The company had established overseas manufacturing subsidiaries in Algeria, Hungary, Iran, Pakistan, and South Africa, and it was growing rapidly in developing markets where it was taking share away from long-established consumer electronics and appliance makers.

Hisense's ambitions are grand. It seeks to become a global enterprise with a world class consumer brand. It aims to increase revenue to over $12 billion in 2010, a goal that may be attainable following the 2006 acquisition of its troubled Chinese rival, Kelon. What is different about Hisense is that although it is without question a low-cost manufacturer, it believes its core strength is not in low-cost manufacturing, but in rapid product innovation. The company believes that the only way to gain leadership in the highly competitive markets in which it competes is to continuously launch advanced, high-quality and competitively priced products. To this end, Hisense established its first R&D center in China in the mid-1990s. This was followed by a South African R&D center in 1997 and a European R&D center in 2007. The company established its U.S. R&D center in Atlanta in August 2010. In 2006, these R&D centers filed for some 534 patents.

Hisense's technological prowess is evident in its digital TV business. It introduced set-top boxes in 1999, making it possible to browse the Internet from a TV. In 2002, Hisense introduced its first interactive digital TV, and in 2005 it developed China's first core digital processing chip for digital TVs, breaking the country's reliance on foreign chip makers for this core technology. In 2006, Hisense launched an innovative line of multimedia TVs that integrated digital high definition technology, network technology, and flat-panel displays.[33]

on the largest 100 multinationals). The globalization of the world economy has resulted in a relative decline in the dominance of U.S. firms in the global marketplace.

According to UN data, the ranks of the world's largest 100 multinationals are still dominated by firms from developed economies.[34] However, the growth in the number of multinationals from developing economies is evident when we look at smaller firms. Firms from developing nations can be expected to emerge as important competitors in global markets, further shifting the axis of the world economy away from North America and Western Europe and threatening the long dominance of Western companies. One such rising competitor, Hisense, one of China's premier manufacturers of consumer appliances and telecommunications equipment, is profiled in the accompanying Management Focus feature.

The Rise of Mini-Multinationals

Another trend in international business has been the growth of medium-size and small multinationals (mini-multinationals).[35] When people think of international businesses, they

tend to think of firms such as Exxon, General Motors, Ford, Fuji, Kodak, Matsushita, Procter & Gamble, Sony, and Unilever—large, complex multinational corporations with operations that span the globe. Although large firms still conduct most international trade and investment, many medium-size and small businesses are becoming increasingly involved in international trade and investment.

For another example, consider Lubricating Systems, Inc., of Kent, Washington. Lubricating Systems, which manufactures lubricating fluids for machine tools, employs 25 people and generates sales of $6.5 million. It is hardly a large, complex multinational, yet its exports to a score of countries, including Japan, Israel, and the United Arab Emirates, generate more than $2 million of the company's sales. Lubricating Systems also has set up a joint venture with a German company to serve the European market.[36] Consider also Lixi, Inc., a small U.S. manufacturer of industrial X-ray equipment; 70 percent of Lixi's $4.5 million in revenues comes from exports to Japan.[37] Or take G. W. Barth, a manufacturer of cocoa-bean roasting machinery based in Ludwigsburg, Germany. Employing just 65 people, this small company has captured 70 percent of the global market for cocoa-bean roasting machines.[38] International business is conducted not just by large firms but also by medium-size and small enterprises.

THE CHANGING WORLD ORDER

Between 1989 and 1991, a series of remarkable democratic revolutions swept the Communist world. For reasons that are explored in more detail in Chapter 2, in country after country throughout Eastern Europe and eventually in the Soviet Union itself, Communist Party governments collapsed. The Soviet Union has receded into history, having been replaced by 15 independent republics. Czechoslovakia has divided itself into two states, while Yugoslavia dissolved into a bloody civil war, now thankfully over, among its five successor states.

Many of the former Communist nations of Europe and Asia seem to share a commitment to democratic politics and free market economics. If this continues, the opportunities for international businesses may be enormous. For half a century, these countries were essentially closed to Western international businesses. Now they present a host of export and investment opportunities. Just how this will play out over the next 10 to 20 years is difficult to say. The economies of many of the former Communist states are still relatively undeveloped, and their continued commitment to democracy and free market economics cannot be taken for granted. Disturbing signs of growing unrest and totalitarian tendencies continue to be seen in several Eastern European and Central Asian states, including Russia, which has shown signs of shifting back toward greater state involvement in economic activity.[39] Thus, the risks involved in doing business in such countries are high, but so may be the returns.

In addition to these changes, more quiet revolutions have been occurring in China, other states in Southeast Asia, and Latin America.

The potential consequences for international business are enormous, as this leads to growth in market opportunities, as well as increased opportunities to derive benefits from the globalization of production.

THE GLOBAL ECONOMY OF THE TWENTY-FIRST CENTURY

As discussed, the past quarter century has seen rapid changes in the global economy. Barriers to the free flow of goods, services, and capital have been coming down. The volume of cross-border trade and investment has been growing more rapidly than global output, indicating that national economies are becoming more closely integrated into a single, interdependent, global economic system. As their economies advance, more nations are joining the ranks of the developed world. A generation ago, South Korea and Taiwan were viewed as second-tier developing nations. Now they boast large economies, and their firms are major players in

many global industries, from shipbuilding and steel to electronics and chemicals. The move toward a global economy has been further strengthened by the widespread adoption of liberal economic policies by countries that had firmly opposed them for two generations or more. Thus, in keeping with the normative prescriptions of liberal economic ideology, in country after country we have seen state-owned businesses privatized, widespread deregulation adopted, markets opened to more competition, and commitment increased to removing barriers to cross-border trade and investment. This suggests that over the next few decades, countries such as the Czech Republic, Mexico, Poland, Brazil, China, India, and South Africa may build powerful market-oriented economies. In short, current trends indicate that the world is moving rapidly toward an economic system that is more favorable for international business.

But it is always hazardous to use established trends to predict the future. The world may be moving toward a more global economic system, but globalization is not inevitable. Countries may pull back from the recent commitment to liberal economic ideology if their experiences do not match their expectations. Periodic signs, for example, indicate a retreat from liberal economic ideology in Russia. Russia has experienced considerable economic pain as it tries to shift from a centrally planned economy to a market economy. If Russia's hesitation were to become more permanent and widespread, the liberal vision of a more prosperous global economy based on free market principles might not occur as quickly as many hope.

Also, greater globalization brings with it risks of its own. This was starkly demonstrated in 1997 and 1998 when a financial crisis in Thailand spread first to other East Asian nations and then in 1998 to Russia and Brazil. Ultimately, the crisis threatened to plunge the economies of the developed world, including the United States, into a recession. We explore the causes and consequences of this and other similar global financial crises in Chapter 10. Even from a purely economic perspective, globalization is not all good. The opportunities for doing business in a global economy may be significantly enhanced, but as we saw in 1997–1998, the risks associated with global financial contagion are also greater. Still, as explained later in this book, firms can exploit the opportunities associated with globalization, while at the same time reducing the risks through appropriate hedging strategies.

The Globalization Debate

Is the shift toward a more integrated and interdependent global economy a good thing? Many influential economists, politicians, and business leaders seem to think so.[40] They argue that falling barriers to international trade and investment are the twin engines driving the global economy toward greater prosperity. They say increased international trade and cross-border investment will result in lower prices for goods and services. They believe that globalization stimulates economic growth, raises the incomes of consumers, and helps create jobs in all countries that participate in the global trading system. The arguments of those who support globalization are covered in detail in Chapters 5, 6, and 7. As we shall see, there are good theoretical reasons for believing that declining barriers to international trade and investment do stimulate economic growth, create jobs, and raise income levels. As described in Chapters 6 and 7, empirical evidence lends support to the predictions of this theory. However, despite the existence of a compelling body of theory and evidence, globalization has its critics.[41] Some of these critics have become increasingly vocal and active, taking to the streets to demonstrate their opposition to globalization. Here we look at the nature of protests against globalization and briefly review the main themes of the debate concerning the merits of globalization. In later chapters, we elaborate on many of the points mentioned below.

ANTIGLOBALIZATION PROTESTS

Street demonstrations against globalization date to December 1999, when more than 40,000 protesters blocked the streets of Seattle in an attempt to shut down a World Trade Organization meeting being held in the city. The demonstrators were protesting against

Protesting Globalization in France

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

Bove and his compatriots were arrested and charged. They quickly became a focus of the antiglobalization movement in France that was protesting everything from a loss of national sovereignty and "unfair" trade policies that were trying to force hormone-treated beef on French consumers, to the invasion of French culture by alien American values, so aptly symbolized by McDonald's. Lionel Jospin, France's prime minister, called the cause of Jose Bove "just." Allowed to remain free pending his trial, Bove traveled to Seattle in December to protest against the World Trade Organization, where he was feted as a hero of the antiglobalization movement. In France, Bove's July 2000 trial drew some 40,000 supporters to the small town of Millau, where they camped outside the courthouse and waited for the verdict. Bove was found guilty and sentenced to three months in jail, far less than the maximum possible sentence of five years. His supporters wore T-shirts claiming, "The world is not merchandise, and neither am I."

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

So are the French opposed to foreign investment? The experiences of McDonald's and Mondavi seem to suggest so, as does the associated news coverage, but look closer and a different reality seems to emerge. McDonald's has more than 800 restaurants in France and continues to do very well there. In fact, France is one of the most profitable markets for McDonald's. France has long been one of the most favored locations for inward foreign direct investment, receiving over $450 billion of foreign investment between 2006 and 2008, more than any other European nation with the exception of Britain. American companies have always accounted for a significant percentage of this investment. Moreover, French enterprises have also been significant foreign investors; some 1,100 French multinationals account for around 8 percent of the global stock of foreign direct investment.[42]

Demonstrators at the WTO meeting in Seattle in December 1999.

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

Smaller scale protests against globalization have occurred in several countries, such as France, where antiglobalization activists destroyed a McDonald's restaurant in August 1999 to protest the impoverishment of French culture by American imperialism (see Country Focus feature, "Protesting Globalization in France," on page 23 for details). While violent protests may give the antiglobalization effort a bad name, it is clear from the scale of the demonstrations that support for the cause goes beyond a core of anarchists. Large segments of the population in many countries believe that globalization has detrimental effects on living standards and the environment.

GLOBALIZATION, JOBS, AND INCOME

One concern that globalization opponents frequently voice is that falling barriers to international trade destroy manufacturing jobs in wealthy advanced economies such as the United States and Western Europe. The critics argue that falling trade barriers allow firms to move manufacturing activities to countries where wage rates are much lower.[43] Indeed, due to the entry of China, India, and Eastern European states into the global trading system, along with global population growth, estimates suggest that the pool of global labor may have quadrupled between 1985 and 2005, with most of the increase taking place after 1990.[44] Other things

being equal, one might conclude that this enormous expansion in the global labor force, when coupled with expanding international trade, would have depressed wages in developed nations.

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

Supporters of globalization reply that critics of these trends miss the essential point about free trade—the benefits outweigh the costs.[45] They argue that free trade will result in countries specializing in the production of those goods and services that they can produce most efficiently, while importing goods and services that they cannot produce as efficiently. When a country embraces free trade, there is always some dislocation, but the whole economy is better off as a result. According to this view, it makes little sense for the United States to produce textiles at home when they can be produced at a lower cost in Honduras or China (which, unlike Honduras, is a major source of U.S. textile imports). Importing textiles from China leads to lower prices for clothes in the United States, which enables consumers to spend more of their money on other items. At the same time, the increased income generated in China from textile exports increases income levels in that country, which helps the Chinese purchase more products produced in the United States, such as pharmaceuticals from Amgen, Boeing jets, Intel-based computers, Microsoft software, and Cisco routers.

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

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

So what do the data say? Several recent studies shed light on these questions.[46] First, the data suggest that over the last two decades the share of labor in national income has declined. The decline in share is much more pronounced in Europe and Japan (about 10 percentage points) than in the United States and the United Kingdom (where it is 3–4 percentage points). However, detailed analysis suggests that *skilled labor's* share of national income has actually *increased,* suggesting that the fall in labor's share has been due to a fall in the share going to *unskilled labor*. For illustration, a study of long-term trends in income distribution in the United States concluded that

> Nationwide, from the late 1970s to the late 1990s, the average income of the lowest-income families fell by over 6 percent after adjustment for inflation, and the average real income of the middle fifth of families grew by about 5 percent. By contrast, the average real income of the highest-income fifth of families increased by over 30 percent.[47]

Another study suggested that the earnings gap between workers in skilled and unskilled sectors has widened by 25 percent over the last two decades.[48] In sum, it is unskilled labor in developed nations that has seen its share of national income decline over the last two decades.

However, this does not mean that the *living standards* of unskilled workers in developed nations have declined. It is possible that economic growth in developed nations has offset the fall in unskilled workers' share of national income, raising their living standards. In fact, evidence suggests that real labor compensation has expanded robustly in most developed nations since the 1980s, including the United States. A study by the Organization for Economic Cooperation and Development, whose members include the 20 richest economies in the world, noted that while the gap between the poorest and richest segments of society in some OECD countries had widened, this trend was by no means universal.[49]

The situation, however, is often different in developing nations. As noted earlier, globalization critics argue that the decline in unskilled wage rates is due to the migration of low-wage manufacturing jobs offshore and a corresponding reduction in demand for unskilled workers. However, supporters of globalization see a more complex picture. They maintain that the apparent decline in real wage rates of unskilled workers owes far more to a technology-induced shift within advanced economies away from jobs where the only qualification was a willingness to turn up for work every day and toward jobs that require significant education and skills. They point out that many advanced economies report a shortage of highly skilled workers and an excess supply of unskilled workers. Thus, growing income inequality is a result of the labor market bidding up wages for skilled workers and discounting the wages for unskilled workers. In fact, recent evidence suggests that technological change has had a bigger impact than globalization on labor's declining share of national income.[50] This indicates that the solution to the problem of stagnant incomes among the unskilled is to be found not in limiting free trade and globalization but in increasing society's investment in education to reduce the supply of unskilled workers.[51] The question remains, however, whether these concepts are entirely unrelated. Globalization particularly is not a topic of economic relevance alone: it also carries with it deep social implications.

Finally, it is worth noting that the wage gap between developing and developed nations is closing as developing nations experience rapid economic growth. For example, one estimate suggests that wages in China will approach Western levels in about 30 years.[52] Proponents of globalization will argue that to the extent that this is the case, any migration of unskilled jobs to low-wage countries is a temporary phenomenon representing a structural adjustment on the way to a more tightly integrated global economy. In many developing economies thought, the increase in economic growth only serves to widen income gaps between rich and poor, thus exacerbating the problem than solving it.

GLOBALIZATION, LABOR POLICIES, AND THE ENVIRONMENT

A second source of concern is that free trade encourages firms from advanced nations to move manufacturing facilities to less developed countries that lack adequate regulations to protect labor and the environment from abuse by the unscrupulous.[53] Globalization critics often argue that adhering to labor and environmental regulations significantly increases the costs of manufacturing enterprises and puts them at a competitive disadvantage in the global marketplace vis-à-vis firms based in developing nations that do not have to comply with such regulations. Firms deal with this cost disadvantage, the theory goes, by moving their production facilities to nations that do not have such burdensome regulations or that fail to enforce the regulations they have.

If this were the case, one might expect free trade to lead to an increase in pollution and result in firms from advanced nations exploiting the labor of less developed nations.[54] This argument was used repeatedly by those who opposed the 1994 formation of the North American Free Trade Agreement (NAFTA) between Canada, Mexico, and the United States. They painted a picture of U.S. manufacturing firms moving to Mexico in droves so that they would be free to pollute the environment, employ child labor, and ignore workplace safety and health issues, all in the name of higher profits.[55]

Supporters of free trade and greater globalization express doubts about this scenario. They argue that tougher environmental regulations and stricter labor standards go hand in hand with economic progress.[56] In general, as countries get richer, they enact tougher

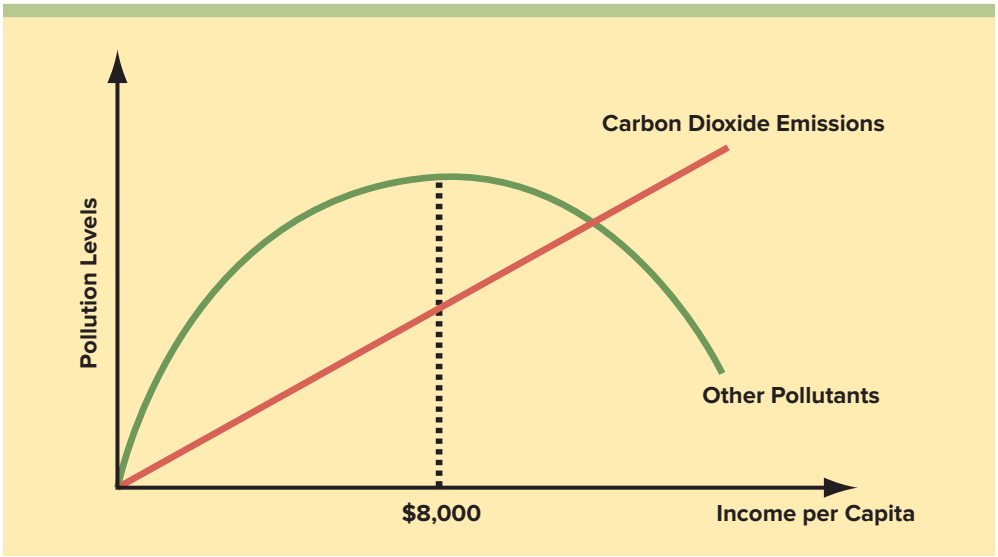


FIGURE 1.4

Income Levels and Environmental Pollution

environmental and labor regulations.[57] Because free trade enables developing countries to increase their economic growth rates and become richer, this should lead to tougher environmental and labor laws. By creating wealth and incentives for enterprises to produce technological innovations, the free market system and free trade could make it easier for the world to cope with pollution and population growth.

Factually, pollution levels are rising in the world's poorer countries, even as they have been falling in developed nations. While this affirms the argument that economic development can foster better environmental conditions, it does not address the whole global picture, particularly the situation in emerging economies. This finding must also be interpreted keeping in mind the trends towards offshoring and outsourcing, which suggest that multinationals from developed nations may also contribute towards the rising pollution in less developed countries.

A number of econometric studies have found consistent evidence of a hump-shaped relationship between income levels and pollution levels (see Figure 1.4).[58] As an economy grows and income levels rise, initially pollution levels also rise. However, past some point, rising income levels lead to demands for greater environmental protection, and pollution levels then fall. A seminal study by Grossman and Krueger found that the turning point generally occurred before per capita income levels reached $8,000.[59]

While the hump-shaped relationship depicted in Figure 1.4 seems to hold across a wide range of pollutants—from sulfur dioxide to lead concentrations and water quality—carbon dioxide emissions are an important exception, rising steadily with higher income levels. Given that increased atmospheric carbon dioxide concentrations are a cause of global warming, this should be of serious concern. The solution to the problem, however, is probably not to roll back the trade liberalization efforts that have fostered economic growth and globalization, but to get the nations of the world to agree to tougher standards on limiting carbon emissions. Although UN-sponsored talks have had this as a central aim since the 1992 Earth Summit in Rio de Janeiro, there has been little success in moving toward the ambitious goals for reducing carbon emissions laid down in the Earth Summit and subsequent talks in Kyoto in 2007 and Copenhagen in 2009. This is in part because the two largest emitters of carbon dioxide, the United States and China, have refused to sign global agreements for tighter pollution control.

GLOBALIZATION AND NATIONAL SOVEREIGNTY

Another concern voiced by critics of globalization is that today's increasingly interdependent global economy shifts economic power away from national governments and toward supranational organizations such as the World Trade Organization, the European Union, and the

United Nations. As perceived by critics, unelected bureaucrats now impose policies on the democratically elected governments of nation-states, thereby undermining the sovereignty of those states and limiting the nation's ability to control its own destiny.[60]

As noted earlier, the WTO was founded in 1994 to police the world trading system established by the General Agreement on Tariffs and Trade. The WTO arbitrates trade disputes between the 159 states that are signatories to the GATT. The arbitration panel can issue a ruling instructing a member state to change trade policies that violate GATT regulations. If the violator refuses to comply with the ruling, the WTO allows other states to impose appropriate trade sanctions on the transgressor.

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

GLOBALIZATION AND THE WORLD'S POOR

Critics of globalization argue that despite the supposed benefits associated with free trade and investment, over the past hundred years or so the gap between the rich and poor nations of the world has gotten wider. In 1870, the average income per capita in the world's 17 richest nations was 2.4 times that of all other countries. In 1990, the same group was 4.5 times as rich as the rest.[61] While recent history has shown that some of the world's poorer nations are capable of rapid periods of economic growth—witness the transformation that has occurred in some Southeast Asian nations such as South Korea, Thailand, and Malaysia—there appear to be strong forces for stagnation among the world's poorest nations. A quarter of the countries with a GDP per capita of less than $1,000 in 1960 had growth rates of less than zero from 1960 to 1995, and a third had growth rates of less than 0.05 percent.[62] However, the question still remains: if globalization is such a positive development, this divergence between the rich and poor should not have occurred.

U2's Bono has actively lobbied to have the unpayable debt of poor countries written off.

Although the reasons for economic stagnation vary, several factors stand out, none of which have anything to do with free trade or globalization.[63] Many of the world's poorest countries have suffered from totalitarian governments, economic policies that destroyed wealth rather than facilitated its creation, endemic corruption, scant protection for property rights, and war. Such factors help explain why countries such as Afghanistan, Cambodia, Cuba, Haiti, Iraq, Libya, Nigeria, Sudan, Vietnam, and Zaire have failed to improve the economic lot of their citizens during recent decades. A complicating factor is the rapidly expanding populations in many of these countries. Without a major change in government, population growth may exacerbate their problems. Promoters of free trade argue that the best way for these countries to improve their lot is to lower their barriers to free trade and investment and to implement economic policies based on free market economics.[64]

Many of the world's poorer nations are being held back by large debt burdens. Of particular concern are the 40 or so "highly indebted poorer countries" (HIPCs), which are home to some 700 million people. Among these countries, the average government debt burden is equivalent to 85 percent of the value of the economy, as measured by gross domestic product, and the annual cost of serving government debt consumes 15 percent of the country's export earnings.[65] Servicing such a heavy debt load leaves the governments of these countries with little left to invest in

important public infrastructure projects, such as education, health care, roads, and power. The result is that the HIPCs are trapped in a cycle of poverty and debt that inhibits economic development. Free trade alone, some argue, is a necessary but not sufficient prerequisite to help these countries bootstrap themselves out of poverty. Instead, large-scale debt relief is needed for the world's poorest nations to give them the opportunity to restructure their economies and start the long climb toward prosperity. Supporters of debt relief also argue that new democratic governments in poor nations should not be forced to honor debts that their corrupt and dictatorial predecessors incurred and mismanaged long ago.

In the late 1990s, a debt relief movement began to gain ground among the political establishment in the world's richer nations.[66] Fueled by high-profile endorsements from Irish rock star Bono (who has been a tireless and increasingly effective advocate for debt relief), Pope John Paul II, the Dalai Lama, and influential Harvard economist Jeffrey Sachs, the debt relief movement was instrumental in persuading the United States to enact legislation in 2000 that provided $435 million in debt relief for HIPCs. More important perhaps, the United States also backed an IMF plan to sell some of its gold reserves and use the proceeds to help with debt relief. The IMF and World Bank have now picked up the banner and have embarked on a systematic debt relief program.

For such a program to have a lasting effect, however, debt relief must be matched by wise investment in public projects that boost economic growth (such as education) and by the adoption of economic policies that facilitate investment and trade. The rich nations of the world also can help by reducing barriers to the importation of products from the world's poorer nations, particularly tariffs on imports of agricultural products and textiles. High tariff barriers and other impediments to trade make it difficult for poor countries to export more of their agricultural production. The World Trade Organization has estimated that if the developed nations of the world eradicated subsidies to their agricultural producers and removed tariff barriers to trade in agriculture this would raise global economic welfare by $128 billion, with $30 billion of that going to developing nations, many of which are highly indebted. The faster growth associated with expanded trade in agriculture could reduce the number of people living in poverty by as much as 13 percent by 2015, according to the WTO.[67]

Managing in the Global Marketplace

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

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

Differences between countries require that an international business vary its practices country by country. Marketing a product in Brazil may require a different approach from marketing the product in Germany; managing U.S. workers might require different skills than managing Japanese workers; maintaining close relations with a particular level of government may be very important in Mexico and irrelevant in Great Britain; pursuing a business strategy might be successful in Canada but might not work in South Korea; and so on.

Managers in an international business must not only be sensitive to these differences, but they must also adopt the appropriate policies and strategies for coping with them. Much of this book is devoted to explaining the sources of these differences and the methods for successfully coping with them.

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

Conducting business transactions across national borders requires understanding the rules governing the international trading and investment system. Managers in an international business must also deal with government restrictions on international trade and investment. They must find ways to work within the limits imposed by specific governmental interventions. As this book explains, even though many governments are nominally committed to free trade, they often intervene to regulate cross-border trade and investment. Managers within international businesses must develop strategies and policies for dealing with such interventions.

Cross-border transactions also require that money be converted from the firm's home currency into a foreign currency, and vice versa. Because currency exchange rates vary in response to changing economic conditions, managers in an international business must develop policies for dealing with exchange rate movements. A firm that adopts a wrong policy can lose large amounts of money, whereas one that adopts the right policy can increase the profitability of its international transactions.

In sum, managing an international business is different from managing a purely domestic business for at least four reasons: (1) countries are different, (2) the range of problems a manager in an international business confronts is wider and the problems themselves more complex than the problems a manager in a domestic business confronts, (3) an international business must find ways to work within the limits imposed by government intervention in the international trade and investment system, and (4) international transactions involve converting money into different currencies.

In this book we examine all these issues in depth, paying close attention to the different strategies and policies that managers pursue to deal with the various challenges created when a firm becomes an international business. Chapters 2 and 3 explore how countries differ from each other with regard to their political, economic, legal, and cultural institutions. Chapter 4 takes a detailed look at the ethical issues that arise in international business. Chapters 5 to 8 look at the international trade and investment environment within which international businesses must operate. Chapters 9 to 11 review the international monetary system. These chapters focus on the nature of the foreign exchange market and the emerging global monetary system. Chapters 12 to 14 explore the strategy of international businesses. Chapters 15 to 20 look at the management of various functional operations within an international business, including production, marketing, and human relations. By the time you complete this book, you should have a good grasp of the issues that managers working within international business have to grapple with on a daily basis, and you should be familiar with the range of strategies and operating policies available to compete more effectively in today's rapidly emerging global economy.

CHAPTER SUMMARY

This chapter sets the scene for the rest of the book. It shows how the world economy is becoming more global and reviews the main drivers of globalization, arguing that they seem to be thrusting nation-states toward a more tightly integrated global economy. We looked at how the nature of international business is changing in response to the changing global economy; we discussed some concerns raised by rapid globalization; and we reviewed implications of rapid globalization for individual managers. The chapter made the following points:

1. Over the past two decades, we have witnessed the globalization of markets and production.
2. The globalization of markets implies that national markets are merging into one huge marketplace. However, it is important not to push this view too far.
3. The globalization of production implies that firms are basing individual productive activities at the optimal world locations for the particular activities. As a consequence, it is increasingly irrelevant to talk about American products, Japanese products, or German products, since these are being replaced by "global" products.
4. Two factors seem to underlie the trend toward globalization: declining trade barriers and changes in communication, information, and transportation technologies.
5. Since the end of World War II, barriers to the free flow of goods, services, and capital have been lowered significantly. More than anything else, this has facilitated the trend toward the globalization of production and has enabled firms to view the world as a single market.
6. As a consequence of the globalization of production and markets, in the last decade world trade has grown faster than world output, foreign direct investment has surged, imports have penetrated more deeply into the world's industrial nations, and competitive pressures have increased in industry after industry.
7. The development of the microprocessor and related developments in communication and information processing technology have helped firms link their worldwide operations into sophisticated information networks. Jet air travel, by shrinking travel time, has also helped to link the worldwide operations of international businesses. These changes have enabled firms to achieve tight coordination of their worldwide operations and to view the world as a single market.
8. By the mid-1990s, the dominance of the U.S economy has reduced. U.S. share of world output had been cut in half and Western European and Southeast Asian economies accounted for major shares. The U.S. share of worldwide foreign direct investment had also fallen, by about two-thirds. U.S. multinationals were now facing competition from a large number of Japanese and European multinationals. In addition, mini-multinationals emerged.
9. One of the most dramatic developments of the past 20 years has been the collapse of communism in Eastern Europe, which has created enormous long-run opportunities for international businesses. In addition, the move toward free market economies in China and Latin America is creating opportunities (and threats) for Western international businesses.
10. The benefits and costs of the emerging global economy are being hotly debated among businesspeople, economists, and politicians. The debate focuses on the impact of globalization on jobs, wages, the environment, working conditions, and national sovereignty.
11. Managing an international business is different from managing a domestic business for at least four reasons: (*a*) countries are different, (*b*) the range of problems confronted by a manager in an international business is wider and the problems themselves more complex than those confronted by a manager in a domestic business, (*c*) managers in an international business must find ways to work within the limits imposed by government intervention in the international trade and investment system, and (*d*) international transactions involve converting money into different currencies.

Critical Thinking and Discussion Questions

1. Describe the shifts in the world economy over the past 30 years. What are the implications of these shifts for international businesses based in Great Britain? North America? Hong Kong?
2. "The study of international business is fine if you are going to work in a large multinational enterprise, but it has no relevance for individuals who are going to work in small firms." Evaluate this statement.
3. How have changes in technology contributed to the globalization of markets and production? Would the globalization of production and markets have been possible without these technological changes?
4. "Ultimately, the study of international business is no different from the study of domestic business. Thus, there is no point in having a separate course on international business." Evaluate this statement.
5. How might the Internet and the associated World Wide Web affect international business activity and the globalization of the world economy?
6. If current trends continue, China may be the world's largest economy by 2020. Discuss the possible implications of such a development for (*a*) the world trading system, (*b*) the world monetary system, (*c*) the business strategy of today's European and U.S. global corporations, and (*d*) global commodity prices.
7. Reread the Management Focus feature on Globalization at General Electric and then answer the following questions:
   a. Why do you think GE has invested so aggressively in foreign expansion? What opportunities is it trying to exploit?
   b. What is GE trying to achieve by moving some of the headquarters of its global business to foreign locations? How might such moves benefit its country of incorporation?
   c. What is the goal behind trying to "internationalize" the senior management ranks at GE? What do you think it means to "internationalize" these ranks?
   d. What does the GE example tell you about the nature of true global business?

Research Task globalEDGE globaledge.msu.edu

Globalization

Use the globalEDGE™ site to complete the following exercises:

Exercise 1

Your company has developed a new product that has universal appeal across countries and cultures. In fact, it is expected to achieve high penetration rates in all the countries where it is introduced, regardless of the average income of the local populace. Considering the costs of the product launch, the management team has decided to initially introduce the product only in countries that have a sizeable population base. You are required to prepare a preliminary report with the top 10 countries in terms of population size. A member of management has indicated that a resource called the "World Population Data Sheet" may be useful for the report. Since growth opportunities are another major concern, the average population growth rates should be listed also for management's consideration.

Exercise 2

You are working for a company that is considering investing in a foreign country. Investing in countries with different traditions is an important element of your company's long-term strategic goals. As such, management has requested a report regarding the attractiveness of alternative countries based on the potential return of FDI. Accordingly, the ranking of the top 25 countries in terms of FDI attractiveness is a crucial ingredient for your report. A colleague mentioned a potentially useful tool called the "FDI Confidence Index" which is updated periodically. Find this index, and provide additional information regarding how the index is constructed.

CLOSING CASE

IKEA—The Global Retailer

IKEA may be the world's most successful global retailer. Established by Ingvar Kamprad in Sweden in 1943 when he was just 17 years old, today the home-furnishing superstore has grown into a global cult brand with 230 stores in 33 countries that host 410 million shoppers a year and generate sales of €14.8 billion ($17.7 billion). Kamprad, who still owns the private company, was identified by *Forbes* Magazine as the world's 11th wealthiest person in 2010.

IKEA's target market is the global middle class who are looking for low-priced but attractively designed furniture and household items. The company applies the same basic formula worldwide: Open large warehouse stores festooned in the blue and yellow colors of the Swedish flag that offer 8,000 to 10,000 items, from kitchen cabinets to candlesticks. Use wacky promotions to drive traffic into the stores. Configure the interior of the stores so that customers have to pass through each department to get to the checkout. Add restaurants and child care facilities so that shoppers stay as long as possible. Price the items as low as possible. Make sure that product design reflects the simple, clean Swedish lines that have become IKEA's trademark. And then watch the results—customers who enter the store planning to buy a $40 coffee table and end up spending $500 on everything from storage units to kitchenware.

IKEA aims to reduce the price of its offerings by 2 to 3 percent per year, which requires relentless attention to cost cutting. With a network of 1,300 suppliers in 53 countries, IKEA devotes considerable attention to finding the right manufacturer for each item. Consider the company's best-selling Klippan love seat. Designed in 1980, the Klippan, with its clean lines, bright colors, simple legs, and compact size, has sold some 1.5 million units since its introduction. IKEA originally manufactured the product in Sweden but soon transferred production to lower-cost suppliers in Poland. As demand for the Klippan grew, IKEA then decided that it made more sense to work with suppliers in each of the company's big markets to avoid the costs associated with shipping the product all over the world. Today there are five suppliers of the frames in Europe, plus three in the United States and two in China. To reduce the cost of the cotton slipcovers, IKEA has concentrated production in four core suppliers in China and Europe. The resulting efficiencies from these global sourcing decisions enabled IKEA to reduce the price of the Klippan by some 40 percent between 1999 and 2005.

Despite its standard formula, to achieve global success IKEA had to adapt its offerings to the tastes and preferences of consumers in different nations. IKEA first discovered this in the early 1990s when it entered the United States. The company soon found that its European-style offerings didn't always resonate with American consumers. Beds were measured in centimeters, not the king, queen, and twin sizes with which Americans are familiar. Sofas weren't big enough, wardrobe drawers were not deep enough, glasses were too small, curtains too short, and U.S. size appliances didn't fit in the kitchens. Since then, IKEA has redesigned its U.S. offerings to appeal to American consumers, which has resulted in stronger sales. The same process is now unfolding in China, where the company has already established eight stores by 2010. The store layout in China reflects the layout of many Chinese apartments, and since many Chinese apartments have balconies, IKEA's Chinese stores include a balcony section. IKEA also has had to adapt its locations in China, where car ownership is still not widespread. In the West, IKEA stores are generally located in suburban areas and have lots of parking space. In China, stores are located near public transportation, and IKEA offers delivery services so that Chinese customers can get their purchases home.[68]

Case Discussion Questions

1. How has the globalization of markets benefited IKEA?
2. How has the globalization of production benefited IKEA?
3. What does the IKEA story teach you about the limits of treating the entire world as a single integrated global marketplace?

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