PART 1

1 Globalizing Business

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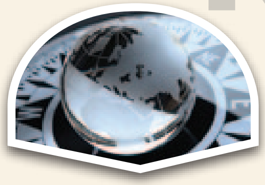
LEARNING OBJECTIVES

After studying this chapter, you should be able to . . .

- **1-1** Explain the concepts of international business and global business.
- **1-2** Give three reasons why it is important to study global business.
- **1-3** Articulate the fundamental question that the study of global business seeks to answer and two perspectives from which to answer it.
- **1-4** Identify three ways of understanding what globalization is.
- **1-5** Appreciate *the size of the global economy and* the strengths of multinationals.

After you finish this chapter, go to **PAGE 17** for **STUDY TOOLS**



ETHICAL DILEMMA/EMERGING MARKETS

Coca-Cola in Africa

Founded in 1892, Coca-Cola first entered Africa in 1929. While Africa had always been viewed as "backwater," it has recently emerged as a major growth market commanding strategic attention. Of the $27 billion that Coca-Cola would invest in emerging economies between 2010 and 2020, $12 billion would be used to beef up plants and distribution facilities in Africa. Why does Coca-Cola show such strong commitments to Africa? Both the push and pull effects are at work.

The push comes from the necessity to find new sources of growth for this mature firm, which has promised investors 7%–9% earnings growth. In 1998, its stock reached a high-water mark at $88. But it dropped to $37 in 2003. Since 2004, the share price rallied again, rising from $43 to a new peak of $90 in November 2014 (adjusted for a 2:1 share split in 2012). Can Coca-Cola's stock reach higher?

Its home markets are unlikely to help. Between 2006 and 2011, US sales declined for five consecutive years. Further, health advocates accused Coca-Cola of contributing to an epidemic of obesity in the United States and proposed to tax soft drinks to pay for health care. While Coca-Cola defeated the tax initiative, it is fair to say the room for growth at home is limited. In Europe and Japan, sales are similarly flat. Elsewhere, in China, strong local rivals have made it tough for Coca-Cola to break out. Its acquisition of a leading local fruit juice firm was blocked by the government, which did not seem to bless Coca-Cola's further growth. In India, Pepsi is so popular that "Pepsi" has become the Hindi shorthand for all bottled soft drinks (including Coke!). In Latin America, sales are encouraging but growth is limited. Mexicans on average are already guzzling 665 servings of Coca-Cola products every year, the highest in the world. There is only so much sugary water one can drink every day.

In contrast, Coca-Cola is pulled by Africa, where it has a commanding 29% market share versus Pepsi's 15%. With 65,000 employees and 160 plants, Coca-Cola is Africa's largest private sector employer. Yet, annual per capita consumption of Coca-Cola products is only 39 servings in Kenya. For the continent as a whole, disposable income is growing. In 2014, 100 million Africans earned at least $5,000 per person. While Africa indeed has some of the poorest countries in the world, 12 African countries (with a combined population of 100 million) have a ~~GDP~~ per capita that is greater than China's. Coca-Cola is hoping to capitalize on Africa's improved political stability and physical infrastructure. Countries not fighting civil wars make Coke's operations less disruptive, and new roads penetrating the jungle can obviously elevate sales.

Coca-Cola is already in all African countries. The challenge now, according to chairman and CEO Muhtar Kent, will be to deep dive into "every town, every village, every township." This will not be easy. War, poverty, and poor infrastructure make it extremely difficult to distribute and market products in hard-to-access regions. Undaunted, Coca-Cola is in a street-by-street campaign to increase awareness and consumption of its products. The crowds and the poor roads dictate that some of the deliveries have to be done manually on pushcarts or trolleys. Throughout the continent, Coca-Cola has set up 3,000 manual distribution centers. Taking a page from its playbook in Latin America, especially Mexico, Coca-Cola has aggressively courted small corner stores. Coca-Cola and its bottlers offer small corner store owners delivery, credit, and direct coaching—ranging from the tip not to ice down the Cokes until the midday rush to save electricity to helping on how to buy a house after vendors make enough money.

In Africa, US-style accusations of Coca-Cola's alleged contribution to the obesity problem are unlikely. After all, the primary concern in many communities is too few available calories of any kind. However, this does not mean that Coca-Cola faces no criticisms in Africa. It has to defend itself from critics who accuse it of depleting fresh water, encouraging expensive and environmentally harmful refrigeration, and hurting local competitors who hawk beverages. In response, Coca-Cola often points out the benefits it has brought. In addition to the 65,000 jobs it has directly created, one million local jobs are indirectly created by its vast system of distribution, which moves beverages from bottling plants deep into the slums and the bush a few crates at a time.

"Ultimately," the *Economist* opined, "doing business in Africa is a gamble on the future." Overall, CEO Kent is very optimistic about Africa. In his own words at a media interview:

> *Africa is the untold story, and could be the big story, of the next decade, like India and China were this past decade. The presence and the significance of our business in Africa is far greater than India and China even today. The relevance is much bigger. . . . In Africa, you've got an incredibly young population, a dynamic population. Huge disposable incomes. I mean, $1.6 trillion of GDP, which is bigger than Russia, bigger than India. It's a big economy, and so rich underground. And whether the next decade becomes the decade of Africa or not, in my opinion, will depend upon one single thing—and everything is right there to have it happen—that is better governance. And it is improving, there is no question.*

Sources: M. Blanding, The Coke Machine (New York: Avery, 2010); "Coke's last round," Bloomberg Businessweek, 1 November 2010: 54–61; "For India's consumers, Pepsi is the real thing," Bloomberg Businessweek, 20 September 2010: 26–27; "Can Coke surpass its record high of $88 a share?" Bloomberg Businessweek, 6 June 2011: 49–50; "Business in Africa," Economist, 9 September 2006: 60–62; "Index of happiness," Economist, 5 July 2008: 58; "A continent goes shopping," Economist, 18 August 2012: 57–58; D. Zoogah, M. W. Peng, and H. Woldu, "Institutions, resources, and organizational effectiveness in Africa," Academy of Management Perspectives (2015, in press).

How do firms such as Coca-Cola compete around the globe? How can competitors such as PepsiCo, Nestlé, and local hawkers fight back? What determines the success and failure of these firms—and numerous others—around the world? This book will address these and other important questions on global business.

1-1 WHAT IS GLOBAL BUSINESS?

Traditionally, **international business (IB)** is defined as a business (or firm) that engages in international (cross-border) economic activities. It can also refer to the action of doing business abroad. A previous generation of IB textbooks almost always takes the foreign entrant's perspective. Consequently, such books deal with issues such as how to enter foreign markets and how to select alliance partners. The most frequently discussed foreign entrant is the **multinational enterprise (MNE)**, defined as a firm that engages in **foreign direct investment (FDI)** by directly investing in, controlling, and managing value-added activities in other countries.[1] Of course, MNEs and their cross-border activities are important. But they cover only one side of IB—the foreign side. Students educated by these books often come away with the impression that the other side of IB—namely, domestic firms—does not exist. But domestic firms obviously do not just sit around in the face of foreign entrants such as MNEs. They actively compete and/or collaborate with foreign entrants.[2] In other words, focusing on the foreign entrant side captures only one side of the coin at best.

There are *two* key words in IB: international (I) and business (B). However, previous textbooks all focus on the international aspect (the foreign entrant) to the extent that the business part (which also includes domestic business) almost disappears. This is unfortunate because IB is fundamentally about B in addition to being I. To put it differently, the IB course in the undergraduate and MBA curricula at numerous business schools is probably the *only* course with the word "business" in the course title. All other courses you take are labeled management, marketing, finance, and so on, representing one functional area but not the overall picture of business. Does it matter? Of course! It means that your IB course is an *integrative* course that has the potential to provide you with an overall business perspective grounded in a global environment (as opposed to a relatively narrow functional view). Consequently, it makes sense that your textbook should give you both the I and B parts, not just the I part.

To cover both the I and B parts, **global business** is defined in this book as business around the globe—thus the title of this book: *GLOBAL*. For the B part, the activities include *both* international (cross-border) activities covered by traditional IB books and domestic (non-IB) business activities. Such deliberate blurring of the traditional boundaries separating international and domestic business is increasingly important today, because many previously national (domestic) markets are now globalized. For example, not long ago, competition among college business textbook publishers was primarily on a nation-by-nation basis. The Big Three—Cengage Learning (our publisher), Prentice Hall, and McGraw-Hill—primarily competed in the United States. A different set of publishers competed in other countries. As a result, textbooks studied by British students would be

International business (IB) (1) A business (or firm) that engages in international (cross-border) economic activities or (2) the action of doing business abroad.

Multinational enterprise (MNE) A firm that engages in foreign direct investment and operates in multiple countries.

Foreign direct investment (FDI) Investment in, controlling, and managing value-added activities in other countries.

Global business Business around the globe.

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authored by British professors and published by British publishers, textbooks studied by Brazilian students would be authored by Brazilian professors and published by Brazilian publishers, and so on. Now Cengage Learning (under British and Canadian ownership), Pearson Prentice Hall (under British ownership), and McGraw-Hill (under US ownership) have significantly globalized their competition, thanks to rising demand for high-quality business textbooks in English. Around the globe, they compete against each other in many markets, publishing in multiple languages. For instance, *GLOBAL* and its sister books—*Global Business, Global Strategy*, and *International Business* (a European adaptation)—are published by different subsidiaries in Chinese, Spanish, and Portuguese in addition to English, reaching customers in over 30 countries. Despite such worldwide spread of competition, in each market—down to each school—textbook publishers have to compete locally. In other words, no professor teaches globally, and all students study locally. This means that *GLOBAL* has to win adoption for every class every semester. Overall, it becomes difficult to tell in this competition what is international and what is domestic. Thus, "global" is a better word to capture the essence of this competition.

GLOBAL also differs from other IB books because most focus on competition in developed economies. Here, by contrast, we devote extensive space to competitive battles waged throughout **emerging economies**, a term that has gradually replaced the term "developing countries" since the 1990s. Another commonly used term is **emerging markets**. How important are emerging economies? Collectively, they command 48% of world trade, attract 60% of FDI inflows, and generate 40% FDI outflows. Overall, emerging economies contribute approximately 50% of the global **gross domestic product (GDP)**.[3] In 1990, they accounted for less than a third of a much smaller world GDP. Note that this percentage is adjusted for **purchasing power parity (PPP)**, which is an adjustment to reflect the differences in cost of living.

Of many emerging economies, Brazil, Russia, India, and China—commonly referred to as **BRIC**—command more attention. With South Africa, BRIC becomes **BRICS**. As a group, BRICS countries have 40% of the world's population, covers a quarter of the world's land area, and contribute more than 25% of global GDP (on a PPP basis). In addition to BRICS, other interesting terms include BRICM (BRIC + Mexico), BRICET (BRIC + Eastern Europe and Turkey), and Next Eleven (N-11—consisting of Bangladesh, Egypt, Indonesia, Iran, Korea, Mexico, Nigeria, Pakistan, Philippines, Turkey, and Vietnam).

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Overall, the Great Transformation of the global economy is embodied by the tremendous shift in economic weight and engines of growth toward emerging economies in general and BRIC(S) in particular. Led by BRIC(S), emerging economies accomplished "the biggest economic transformation in modern economy," according to the *Economist*.[4] In China, per capita income doubled in about ten years, an achievement that took Britain 150 years and the United States 50 years as they industrialized. Throughout emerging economies, China is not alone. While groupings such as BRIC(S) and N-11 are always arbitrary, they serve a useful purpose—namely, highlighting their economic and demographic scale and trajectory that enable them to challenge developed economies in terms of weight and influence in the global economy.

Of course, the Great Transformation is not a linear story of endless and uniform high-speed growth. Most emerging economies have experienced some significant slow down recently.[5] It is possible that they may not be able to repeat their extraordinary growth sprint during the decade between 1998 (the Asian economic crisis) and 2008 (the global financial crisis). For example, in 2007, Brazil accomplished an annual economic growth of 6%, Russia 8%, India 10%, and China 14%. In 2017, they would be very lucky if they could achieve half of these enviable growth rates. However, it seems that emerging economies *as a group* are destined to grow both their absolute GDP and their percentage of world GDP relative to developed economies. The debate centers on how much and how fast (or how slow) such growth will be in the future.

The global economy can be viewed as a pyramid shown in Exhibit 1.1. The top consists of about one billion people with per capita annual income of $20,000 or higher. These are mostly people who live in the developed economies of the **Triad**, which consists of North America, Western

Emerging economy (emerging market) A developing country.

Gross domestic product (GDP) The sum of value added by resident firms, households, and governments operating in an economy.

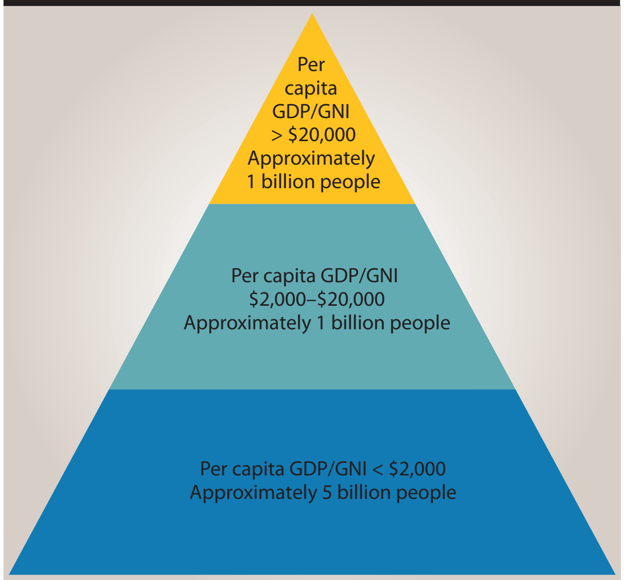
Purchasing power parity (PPP) A conversion that determines the equivalent amount of goods and services different currencies can purchase. This conversion is usually used to capture the differences in cost of living in different countries.

BRIC An acronym for the emerging economies of Brazil, Russia, India, and China.

BRICS An acronym for the emerging economies of Brazil, Russia, India, China, and South Africa.

Triad Three regions of developed economies (North America, Western Europe, and Japan).

EXHIBIT 1.1 THE GLOBAL ECONOMIC PYRAMID



Source: C. K. Prahalad and S. Hart, "The fortune at the bottom of the pyramid," Strategy+Business 26 (2002): 54–67 and S. Hart, Capitalism at the Crossroads (Philadelphia: Wharton School Publishing, 2005) 111.

Europe, and Japan. Another billion people making $2,000 to $20,000 a year form the second tier. The vast majority of humanity—about five billion people—make less than $2,000 a year and comprise the **base of the pyramid (BoP)**. Most MNEs (and most traditional IB books) focus on the top and second tiers and end up ignoring the BoP. An increasing number of such low-income countries have shown increasingly more economic opportunities as income levels have risen.[6] Today's students—and tomorrow's business leaders—will ignore these opportunities in BoP markets at their own peril. This book will help ensure that you will not ignore these opportunities.

1-2 WHY STUDY GLOBAL BUSINESS?

Global business (or IB) is one of the most exciting, challenging, and relevant subjects offered by business schools. There are at least three compelling reasons why you should study it—and study hard (Exhibit 1.2). First, you don't want to be a loser. Mastering global business knowledge helps advance your employability and career in an increasingly competitive global economy. An ignorant individual is unlikely to emerge as a winner in global competition.

Second, expertise in global business is often a prerequisite to join the top ranks of large firms, something many ambitious students aspire to. It is now increasingly difficult, if not impossible, to find top managers at large firms who do not possess significant global competence. Eventually you will need hands-on global experience, not merely knowledge acquired from this course. However, in order to set yourself apart as an ideal candidate to be selected for an executive position, you will need to demonstrate that you are interested in global business and have mastered such knowledge during your education. This is especially true if you are interested in gaining experience as an **expatriate manager** (or "expat" for short)—a manager who works abroad (see Chapter 13 for details).

Thanks to globalization, low-level jobs not only command lower salaries, but are also more vulnerable. On the other hand, top-level jobs, especially those held by expats, are both financially rewarding and relatively secure. Expats often command a significant **international premium** in compensation—a significant pay raise when working overseas. In US firms, their total compensation package is approximately $250,000 to $300,000 (including benefits; not all is take-home pay). For example, if a 2,000-employee ball bearing factory in Canton, Ohio, is shut down and the MNE sets up a similar factory in Canton (Gunagzhou), China, only about 10 to 20 jobs would be saved. Yes, you guessed it: Those jobs would consist of a few top-level positions such as the CEO, CFO, factory director, and chief engineer who will be sent by the MNE as expats to China to start up operations there. The MNE often gives them many more perks in China than it did in Ohio. How about company-subsidized luxury housing plus maid services, free tuition for children in American or international schools, and all-expenses-paid vacations for the whole family to see their loved ones in Ohio? Moreover, these expats do not live in China forever. When they return to

Base of the pyramid (BoP) The vast majority of humanity, about five billion people, who make less than $2,000 a year.

Expatriate manager (expat) A manager who works outside his or her native country.

International premium A significant pay raise commanded by expatriates when working overseas.

EXHIBIT 1.2 WHY STUDY GLOBAL BUSINESS?

- Advancing your employability and your career in the global economy
- Better preparation for possible expatriate assignments abroad
- Stronger competence in interacting with foreign suppliers, partners, and competitors and in working for foreign-owned employers in your own country

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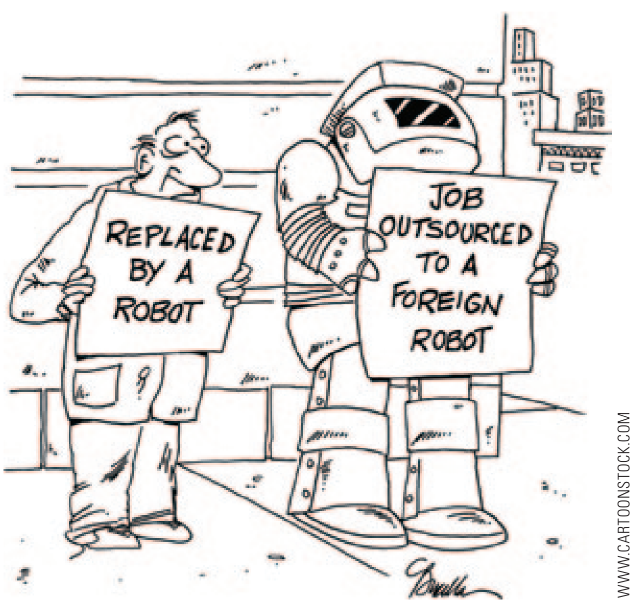
the United States after a tour of duty (usually two to three years), if their current employer does not provide attractive career opportunities, they are often hired away by competitor firms. This is because competitor firms are also interested in globalizing their business by tapping into the expertise and experience of these former expats. And, yes, competitor firms will have to pay them even more to hire away these internationally experienced managers. This indeed ~~is~~ a virtuous cycle.

This hypothetical example is designed to motivate you to study hard so that someday, you may become one of these sought-after, globe-trotting managers. But, even if you don't want to be an expat, we assume that you don't want to join the ranks of the unemployed due to factory closings and business failures (see Exhibit 1.3).

Lastly, even if you do not aspire to compete for the top job at a large firm or work overseas, and even if you work at a small firm or are self-employed, you may find yourself dealing with foreign-owned suppliers and buyers, competing with foreign-invested firms in your home market, and perhaps even selling and investing overseas. Alternatively, you may find yourself working for a foreign-owned firm, your domestic employer may be acquired by a foreign player, or your unit may be ordered to shut down for global consolidation. Any of these is a very likely scenario, because approximately 80 million people worldwide, including 18 million Chinese, six million Americans, and one million British, are employed by foreign-owned firms. In the private sector, Taiwan-based Foxconn is the largest employer in China, India-based Tata Group is the largest employer in the UK, IBM is the second largest employer in India, and Coca-Cola is the largest employer in Africa (see the Opening Case). Understanding how global business decisions are made may facilitate your own career in such firms. If there is a strategic rationale to downsize your unit, you would want to be prepared and start polishing your resume right away. In other words, it is your career that is at stake. Don't be the last to know! To avoid the fate humorously portrayed in Exhibit 1.3, a good place to start is to study hard and do well in your IB course. Of course, don't forget to put *this* course on your resume as a highlight of your education. (In Focus has additional advice on what language and what fields to study).

EXHIBIT 1.3 JOBS OUTSOURCED



Source: *Harvard Business Review*, April 2012: 34.

1-3 A UNIFIED FRAMEWORK

Global business is a vast subject area. It is one of the few courses that will make you appreciate why your university requires you to take a number of diverse courses in general education. We will draw on major social sciences such as economics, geography, history, psychology, political science, and sociology. We will also draw on a number of business disciplines such as finance, marketing, and strategy. The study of global business is thus very interdisciplinary.[7] It is easy to lose sight of the forest while scrutinizing various trees or even branches. The subject is not difficult, and most students find it to be fun. The number one student complaint is about the overwhelming amount of information. Truth be told: this is also *my* number one complaint as your author. You may have to read and learn this material, but I have to bring it all together in a way that makes sense and in a compact book that does not go on and on and on for 900 pages. To make your learning more focused, more manageable, and hopefully more fun, in this book we will develop a unified framework consisting of one fundamental question and two core perspectives (shown in Exhibit 1.4).

1-3a One Fundamental Question[8]

What is it that we do in global business? Why is it so important that practically all students in business schools around the world are either required or recommended

InFocus: Emerging Markets

What Language and What Fields Should I Study?

On September 3, 2007, Markéta Straková of Tabor, the Czech Republic, wrote to *BusinessWeek* columnists Jack Welch and Suzy Welch:

> *I am thinking of studying Portuguese, but in your opinion, what language should I learn to succeed in the world of business? And what fields of study hold the most potential?*

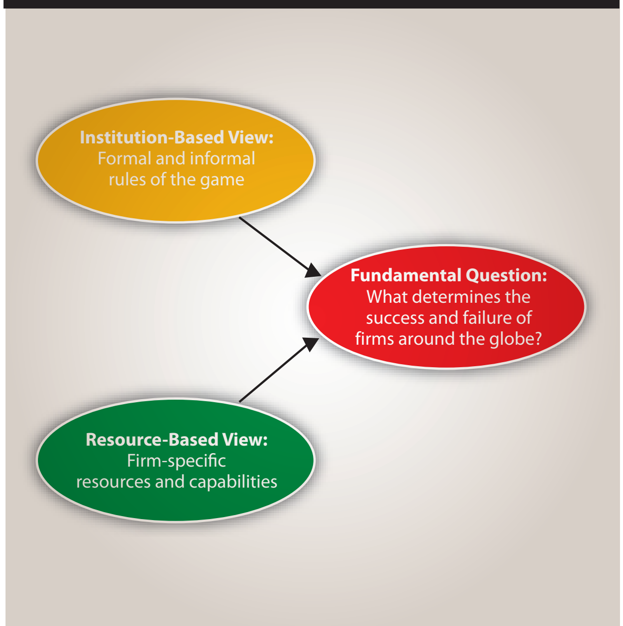
Jack Welch was the former chairman and CEO of General Electric (GE), and Suzy Welch was the former editor of *Harvard Business Review*. They wrote back in the same issue of *BusinessWeek*:

> *You're on to something with Portuguese, since it will give you a leg up in several markets with good potential, such as Brazil and some emerging African nations. Spanish is also a good choice, as it will allow you to operate with more ease throughout Latin America, and, increasingly, the United States. But for our money—and if you can manage the much higher order of commitment—Chinese is the language to learn. China is already an economic powerhouse. It will only gain strength. Anyone who can do business there with the speed and intimacy that fluency affords will earn a real competitive edge.*
>
> *As for what to study—and if you want to be where the action is now and for the next couple of decades—consider the industries focused on alternative sources of energy. Or learn everything you can about the confluence of three fields: biotechnology, information technology, and nanotechnology. For the foreseeable future, the therapies, machines, devices, and other products and services that these fields bring to market will revolutionize society—and business.*
>
> *That said, when it comes to picking an education field and ultimately a career, absolutely nothing beats pursuing the path that truly fascinates your brain, engages your energy, and touches your soul. Whatever you do, do what turns your crank. Otherwise your job will always be just work, and how dreary is that?*

HJSCHNEIDER/SHUTTERSTOCK.COM

Source: J. Welch and S. Welch, "Ideas: The Welch way," *BusinessWeek*, 3 September 2007, 104.

EXHIBIT 1.4 A UNIFIED FRAMEWORK FOR GLOBAL BUSINESS



to take this course? While there are certainly a lot of questions to raise, a relentless interest in what determines the success and failure of firms around the globe serves to focus the energy of our field. Global business is fundamentally about not limiting yourself to your home country. It is about treating the global economy as your potential playground (or battlefield). Some firms may be successful domestically but fail miserably overseas. Other firms successfully translate their strengths from their home markets to other countries. If you were expected to lead your firm's efforts to enter a particular foreign market, wouldn't you want to find out what drives the success and failure of other firms in that market?

Overall, the focus on firm performance around the globe defines the field of global business (or IB) more than anything else. Numerous other questions all relate in one way or another to this most fundamental question. Therefore, all chapters in this book will be centered on this fundamental question: What determines the success and failure of firms around the globe?

1-3b First Core Perspective: An Institution-Based View[9]

An **institution-based view** suggests that the success and failure of firms are enabled and constrained by institutions. By **institutions**, we mean the rules of the game. Doing business around the globe requires intimate knowledge about both formal rules (such as laws) and informal rules (such as values) that govern competition in various countries as an **institutional framework**. Firms that do not do their homework and thus remain ignorant of the rules of the game in a certain country are not likely to emerge as winners.

Formal institutions include laws, regulations, and rules. For example, Hong Kong's laws are well known for treating all comers, whether from neighboring mainland China (whose firms are still technically regarded as "nondomestic") or far-away Chile, the same as they treat indigenous Hong Kong firms. Such equal treatment enhances the potential odds for foreign firms' success. It is thus not surprising that Hong Kong attracts a lot of outside firms. Other rules of the game discriminate against foreign firms and undermine their chances for success. India's recent attraction as a site for FDI was only possible after its regulations changed from confrontational to accommodating. Prior to 1991, India's rules severely discriminated against foreign firms. For example, in the 1970s, the Indian government demanded that Coca-Cola either hand over the recipe for its secret syrup, which it does not even share with the US government, or get out of India. Painfully, Coca-Cola chose to leave India. Its return to India since the 1990s speaks volumes about how much the rules of the game have changed in India.

Informal institutions include cultures, ethics, and norms. They also play an important part in shaping the success and failure of firms around the globe (see the Closing Case). For example, individualistic societies, particularly the English-speaking countries such as Australia, Britain, and the United States, tend to have a relatively higher level of entrepreneurship as reflected in the high number of business start-ups. Why? Because the act of founding a new firm is a widely accepted practice in individualistic societies. Conversely, collectivistic societies such as Japan often have a hard time fostering entrepreneurship. Most people there refuse to stick their neck out to found new businesses~~,~~ because it is contrary to the norm.

Overall, an institution-based view suggests that institutions shed a great deal of light on what drives firm performance around the globe. Next, we turn to our second core perspective.

1-3c Second Core Perspective: A Resource-Based View[10]

The institution-based view suggests that the success and failure of firms around the globe are largely determined by their environment. However, insightful as this perspective is, there is a major drawback. If we push this view to its logical extreme, then firm performance around

Institution-based view A leading perspective in global business that suggests that firm performance is, at least in part, determined by the institutional frameworks governing firm behavior around the world.

Institution Formal and informal rules of the game.

Institutional framework Formal and informal institutions that govern individual and firm behavior.

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the globe would be *entirely* determined by environments. The validity of this extreme version is certainly questionable.

The **resource-based view** helps overcome this drawback. While the institution-based view primarily deals with the *external* environment, the resource-based view focuses on a firm's *internal* resources and capabilities. It starts with a simple observation: In a harsh, unattractive environment, most firms either suffer or exit. However, against all odds, a few superstars thrive in such an environment. For instance, despite the former Soviet Union's obvious hostility toward the United States during the Cold War, PepsiCo began successfully operating in the former Soviet Union in the 1970s (!). In another example, airlines often lose money. But a small number of players, such as Southwest in the United States, Ryanair in Ireland, Hainan in China, and IndiGo in India, have been raking in profits year after year. In the fiercely competitive fashion industry, Zara has been defying gravity. How can these firms succeed in such a challenging environment? What is special about them? A short answer is that PepsiCo, Southwest, Ryanair, Hainan, IndiGo, and Zara must have certain valuable and unique *firm-specific* resources and capabilities that are not shared by competitors in the same environment.

Doing business outside one's home country is challenging. Foreign firms have to overcome a **liability of foreignness**, which is the *inherent* disadvantage that foreign firms experience in host countries because of their nonnative status.[11] Just think about all the differences in regulations, languages, cultures, and norms. Think about the odds against Toyota and Honda when they tried to eat some of General Motors' and Ford's lunch in the American heartland. Against such significant odds, the primary weapons that foreign firms such as Toyota and Honda employ are *overwhelming* resources and capabilities that can offset their liability of foreignness. Today, many of us take it for granted that the best-selling car in the United States rotates between the Toyota Camry and the Honda Civic, that Coca-Cola is the best-selling soft drink in Mexico, and that Microsoft Word is the world's number one word-processing software. We really shouldn't. Why? Because it is *not* natural for these foreign firms to dominate nonnative markets. These firms must possess some very rare and powerful firm-specific resources and capabilities that drive these remarkable success stories. This is a key theme of the resource-based view, which focuses on how winning firms develop unique and enviable resources and capabilities and how competitor firms imitate and then innovate in an effort to outcompete the winning firms.

Resource-based view A leading perspective in global business that suggests that firm performance is, at least in part, determined by its internal resources and capabilities.

Liability of foreignness The inherent disadvantage that foreign firms experience in host countries because of their nonnative status.

Globalization The close integration of countries and peoples of the world.

1-3d A Consistent Theme

Given our focus on the fundamental question of what determines the success and failure of firms around the globe, we will develop a unified framework by organizing the material in *every* chapter according to the two core perspectives, namely, the institution-based and resource-based views (see the Closing Case).[12] With our unified framework—an innovation in IB textbooks—we will not only explore the global business "trees," but also see the global business "forest."

1-4 WHAT IS GLOBALIZATION?

Globalization, generally speaking, is the close integration of countries and peoples of the world. This abstract five-syllable word is now frequently heard and debated. Those who approve of globalization count its contributions to include greater economic growth, higher standards of living, increased technology sharing, and more extensive cultural integration. Critics argue that globalization undermines wages in rich countries, exploits workers in poor countries, gives MNEs too much power, destroys the environment, and promotes inequality. So what exactly is globalization? This section outlines three views on globalization, recommends the pendulum view, and introduces the idea of semiglobalization.

1-4a Three Views on Globalization

Depending on what sources you read, globalization could be one of the following:

- A new force sweeping through the world in recent times.
- A long-run historical evolution since the dawn of human history.
- A pendulum that swings from one extreme to another from time to time

An understanding of these views helps put the debate about globalization in perspective. First, opponents


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of globalization suggest that it is a new phenomenon beginning in the late 20th century, driven by recent technological innovations and a Western ideology focused on exploiting and dominating the world through MNEs. The arguments against globalization focus on an ideal world free of environmental stress, social injustice, and sweatshop labor, but present few clear alternatives to the present economic order. Advocates and anti-globalization protesters often argue that globalization needs to be slowed down, if not stopped.

A second view contends that globalization has always been part and parcel of human history. Historians debate whether globalization started 2,000 or 8,000 years ago. MNEs existed for more than two millennia, with their earliest traces discovered in Phoenician, Assyrian, and Roman times. International competition from low-cost countries is nothing new. In the first century A.D., the Roman emperor Tiberius was so concerned about the massive quantity of low-cost Chinese silk imports that he imposed the world's first known import quota of textiles. Today's most successful MNEs do not come close to wielding the historical clout of some earlier MNEs, such as the East India Company during colonial times (see the Closing Case). In a nutshell, globalization is nothing new and will always exist.

A third view suggests that globalization is the "closer integration of the countries and peoples of the world which has been brought about by the enormous reduction of the costs of transportation and communication and the breaking down of artificial barriers to the flows of goods, services, capital, knowledge, and (to a lesser extent) people across borders."[13] Globalization is neither recent nor one-directional. It is, more accurately, a process similar to the swing of a pendulum.

1-4b The Pendulum View on Globalization

The third, pendulum view probably makes the most sense, because it can help us understand the ups and downs of globalization. The current era of globalization originated in the aftermath of World War II, when major Western nations committed to global trade and investment. However, between the 1950s and the 1970s, this view was not widely shared. Communist countries, such as the former Soviet Union and China, sought to develop self-sufficiency. Many noncommunist developing countries such as Argentina, Brazil, India, and Mexico focused on fostering and protecting domestic industries. But refusing to participate in global trade and investment ended up breeding uncompetitive industries. In contrast,


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four developing economies in Asia—namely, Hong Kong, Singapore, South Korea, and Taiwan—earned their stripes as the "Four Tigers" by participating in the global economy. They became the *only* economies once recognized as less developed (low-income) by the World Bank to have subsequently achieved developed (high-income) status.

Inspired by the Four Tigers, more countries and regions—such as China in the late 1970s, Latin America in the mid 1980s, Central and Eastern Europe in the late 1980s, and India in the 1990s—realized that joining the world economy was a must. As these countries started to emerge as new players in the world economy, they became collectively known as "emerging economies." As a result, globalization rapidly accelerated.

However, globalization, like a pendulum, is unable to keep going in one direction. Rapid globalization in the 1990s and the 2000s saw some significant backlash. First, the rapid growth of globalization led to the historically inaccurate view that globalization is new. Second, it created fear among many people in developed economies that they would lose jobs. Finally, some factions in emerging economies complained against the onslaught of MNEs, alleging that they destroy not only local companies, but also local cultures and values.

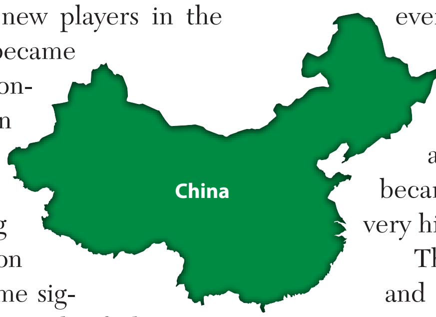
The December 1999 protests in Seattle and the September 2001 terrorist attacks in New York and Washington are undoubtedly some of the most visible and most extreme acts of antiglobalization forces at work. As a result, international travel was curtailed, and global trade and investment flows slowed in the early 2000s. Then in the mid 2000s, worldwide GDP, cross-border trade, and per capita GDP all soared to historically high levels. It was during that period "BRIC" became a buzzword.

Risk management Identification and assessment of risks and the preparation to minimize the impact of high-risk, unfortunate events.

Scenario planning A technique to prepare and plan for multiple scenarios (either high or low risk).

Unfortunately, the party suddenly ended in 2008. The 2008–2009 global economic crisis was unlike anything the world had seen since the Great Depression (1929–1933). The crisis showed, for better or worse, how interconnected the global economy has become. Deteriorating housing markets in the United States, fueled by unsustainable subprime lending practices, led to massive government bailouts of failed firms. The crisis quickly spread around the world, forcing numerous governments to bail out their own troubled banks. Global output, trade, and investment plummeted, while unemployment skyrocketed. The 2008–2009 crisis became known as the Great Recession. Many people blamed globalization for the Great Recession.

After unprecedented government intervention in developed economies, confidence was growing that the global economy had turned the corner.[14] However, starting in 2010, the Greek debt crisis and then the broader PIGS debt crisis ("PIGS" refers to Portugal, Ireland or Italy, Greece, and Spain) erupted. The already slow recovery in Europe thus became slower, and unemployment hovered at very high levels.



The Great Recession reminds all firms and managers of the importance of **risk management**—the identification and assessment of risks and the preparation to minimize the impact of high-risk, unfortunate events. As a technique to prepare and plan for multiple scenarios (either high risk or low risk), **scenario planning** is now extensively used around the world. The recovery has seen more protectionist measures, since the stimulus packages and job creation schemes of various governments often emphasize "buy national" (such as "buy American") and "hire locals." In short, the pendulum is swinging back.

Like the proverbial elephant, globalization is seen by everyone yet rarely comprehended. The sudden ferocity of the 2008–2009 crisis surprised everybody—ranging from central bankers to academic experts. Remember all of us felt sorry when we read the story of a bunch of blind men trying to figure out the shape and form of the elephant. We really shouldn't. Although we are not blind, our task is more challenging than the blind men who study a standing animal. Our beast—globalization—does not stand still and often rapidly moves, back and forth (!). Yet, we try to live with it, avoid being crushed by it, and even attempt to profit from it. Overall, relative to the other two views, the view of globalization as a pendulum is more balanced and more realistic. In other words, globalization has both rosy and dark sides, and it changes over time.

1-4c Semiglobalization

Despite the hype, globalization is not complete. Do we really live in a globalized world? Are selling and investing abroad just as easy as at home? Obviously not. Most measures of market integration, such as trade and FDI, have recently scaled new heights, but still fall far short of pointing to a single, globally integrated market. In other words, what we have may be labeled **semiglobalization**, which is more complex than extremes of total isolation and total globalization. Semiglobalization suggests that barriers to market integration at borders are high, but not high enough to insulate countries from each other completely.[15]

Semiglobalization calls for more than one way of strategizing around the globe. Total isolation on a nation-state basis would suggest localization—a strategy of treating each country as a unique market. An MNE marketing products to 100 countries will need to come up with 100 versions. This strategy is clearly too costly. Total globalization, on the other hand, would lead to standardization—a strategy of treating the entire world as one market. The MNE can just market one version of "world car" or "world drink." But the world obviously is not that simple. Between total isolation and total globalization, semiglobalization has no single right way of doing business around the globe, resulting in a wide variety of experimentations. Overall, (semi)globalization is neither to be opposed as a menace nor to be celebrated as a panacea; it is to be *engaged*.

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1-5 A GLANCE AT THE GLOBAL ECONOMY

Twenty-first century business leaders face enormous challenges (see Debate). This book helps overcome some of these challenges. As a backdrop for the remainder of this book, this section offers a basic understanding of the global economy. The global economy in 2013 was an approximately $75 trillion economy (total global GDP calculated at official, nominal exchange rates—alternatively, $100 trillion on a PPP basis).[16] While there is no need to memorize a lot of statistics, it is useful to remember this $75 trillion (or $100 trillion) figure to put things in perspective.

One frequent observation in the globalization debate is the enormous size of multinationals. Take a look at the largest MNE within one sizeable country: Volkswagen's worldwide sales would represent 10% of German GDP, Samsung's sales 17% of South Korean GDP, and BP's sales 26% of British GDP.[17] Exhibit 1.5 shows the most recent top ten firms. The top three largest MNEs—measured by sales—happened to be headquartered in North America, Europe, and Asia. If the largest MNE, Walmart, were an independent country, it would be the 27th largest economy—its sales were smaller than Belgium's GDP but larger than Venezuela's. The sales of

Semiglobalization A perspective that suggests that barriers to market integration at borders are high but not high enough to completely insulate countries from each other.

EXHIBIT 1.5 TOP TEN LARGEST FIRMS IN THE WORLD (MEASURED BY SALES)

	Corporate name	Country	Revenues
1	Walmart Stores	United States	$476 billion
2	Royal Dutch Shell	Netherlands	$460 billion
3	Sinopec Group	China	$457 billion
4	China National Petroleum Corporation	China	$432 billion
5	Exxon Mobil	United States	$408 billion
6	BP	United Kingdom	$396 billion
7	State Grid	China	$333 billion
8	Volkswagen	Germany	$261 billion
9	Toyota Motor	Japan	$256 billion
10	Glencore	Switzerland	$233 billion

Source: Adapted from Fortune, "Global 500," 21 July 2014: F-1. Data refer to 2013.

Debate: Ethical Dilemma

The Globalization Debate and You

EXHIBIT 1.6 VIEWS ON GLOBALIZATION

Overall, do you think globalization is *good* for…	General public	Business students
…US consumers like you?	68%	96%
…US companies?	63%	77%
…the US economy?	64%	88%
…strengthening poor countries' economies?	75%	82%

Sources: A. Bernstein, "Backlash against globalization," BusinessWeek, 24 April 2000: 43; M. W. Peng and H. Shin, "How do future business leaders view globalization?," Thunderbird International Business Review 50, no. 3 (2008): 179. All dierences are statistically signi cant.

As a future business leader, you are not a detached reader. The globalization debate directly affects *your* future. Therefore, it is imperative that you participate in the globalization debate instead of letting other people make decisions on globalization that will significantly affect your career, your consumption, and your country. It is important to know your own biases when joining the debate.

By the very act of taking an IB course and reading this book, you probably already have some pro-globalization biases compared to non-business majors elsewhere on campus and the general public in your country. You are not alone. In the last several decades, most executives, policy makers, and scholars in both developed and emerging economies, who are generally held to be the elite in these societies, are biased toward acknowledging the benefits of globalization. Although it is long known that globalization carries both benefits and costs, many of the elite have failed to take into sufficient account the social, political, and environmental costs associated with globalization. However, just because the elite share certain perspectives on globalization does *not* mean that most other members of the society share the same views. To the extent that powerful economic and political institutions are largely controlled by the elite in almost every country, it is not surprising that some anti-globalization groups, feeling powerless, end up resorting to unconventional tactics such as mass protests to make their point.

Many of the opponents of globalization are **nongovernmental organizations (NGOs)** such as environmentalists, human rights activists, and consumer groups. Ignoring them will be a grave failure when doing business around the globe. Instead of viewing NGOs as opponents, many firms view them as partners. NGOs do raise a valid point when they insist that firms, especially MNEs, should have a broader concern for the various stakeholders affected by the MNEs' actions around the world (see Chapter 15 for details).

Nongovernmental organization (NGO) An organization that is not affiliated with governments.

It is certainly interesting and perhaps alarming to note that as would-be business leaders who will shape the global economy in the future, current business school students already exhibit values and beliefs in favor of globalization similar to those held by executives, policy makers, and scholars, and different from those held by the general public. Shown in Exhibit 1.6, US business students have significantly more positive (almost one-sided) views toward globalization than the general public. While these data are based on US business students, my teaching and lectures around the globe suggest that most business students in the world—regardless of their nationality—seem to share such positive views on globalization. This is not surprising. Both self-selection to study business and socialization within the curriculum, in which free trade is widely regarded as positive, may lead to certain attitudes in favor of globalization. Consequently, business students tend to focus more on the economic gains of globalization and be less concerned with its darker sides.

Current and would-be business leaders need to be aware of their own biases embodied in such one-sided views toward globalization. Since business schools aspire to train future business leaders by indoctrinating students with the dominant values managers hold, these results suggest that business schools may have largely succeeded in this mission. However, to the extent that current managers (and professors) have strategic blind spots, these findings are potentially alarming. They reveal that business students already share these blind spots. Despite possible self-selection in choosing to major in business, there is no denying that student values are shaped, at least in part, by the educational experience business schools provide. Knowing such limitations, business school professors and students need to work especially hard to break out of this mental straitjacket.

In order to combat the widespread tendency to have one-sided, rosy views, a significant portion of this book is devoted to the numerous debates that surround globalization. Debates are systematically introduced in *every* chapter to provoke more critical thinking and discussion. It is debates that drive practice and research forward. Therefore, it is imperative that you be exposed to

SUSAN LEGGETT/SHUTTERSTOCK.COM

cutting-edge debates and encouraged to form your own views. In addition, ethics is emphasized throughout the book. At least one Ethical Dilemma feature can be found in each chapter (in this chapter, see the Opening Case and the Closing Case in addition to this Debate box). Two whole chapters are devoted to ethics, norms, and cultures (Chapter 3) and corporate social responsibility (Chapter 15).

Sources: T. Friedman, *The World Is Flat* (New York: Farrar, Straus, and Giroux, 2005); M. W. Peng and E. Pleggenkuhle-Miles, "Current debates in global strategy," *International Journal of Management Reviews* 11 (2009): 51–68; M. W. Peng, S. Sun, and D. Blevins, "The social responsibility of international business scholars," *Multinational Business Review* 19 (2011): 106–119; R. Rajan, *Fautlines* (Princeton, NJ: Princeton University Press, 2010); D. Rodrik, *The Globalization Paradox* (New York: Norton, 2011).

the largest EU-based MNE, Royal Dutch Shell, were larger than the GDP of each of the following EU member countries: Austria, Denmark, Finland, Ireland, and Portugal. The sales of the largest Asia-based MNE, Sinopec, were larger than the GDP of each of the following Asian economies: Hong Kong, Malaysia, Phillippines, Singapore, and Thailand. Today, over 82,000 MNEs manage at least 810,000 subsidiaries overseas.[18] Total annual sales for the largest 500 MNEs exceed $31 trillion (about one third of global output).[19]

Exhibit 1.7 documents the change in the makeup of the 500 largest MNEs. While MNEs from the Triad (North America, Europe, and Japan) dominate the list, their share has been shrinking—thanks to the Great Transformation (discussed earlier). Among MNEs from emerging economies, those from BRIC contribute 118 firms to the Fortune Global 500 list. In particular, MNEs from China have come on strong.[20] With 52 *Fortune* Global 500 company headquarters, Beijing now has the heaviest concentration of such headquarters. In comparison, Tokyo has 41 *Fortune* Global 500 headquarters (the world's second heaviest concentration) and New York 20 (third heaviest concentration). Clearly, global rivals cannot afford to ignore emerging multinationals such as those based in Beijing, and students studying this book need to pay attention to these emerging multinationals.

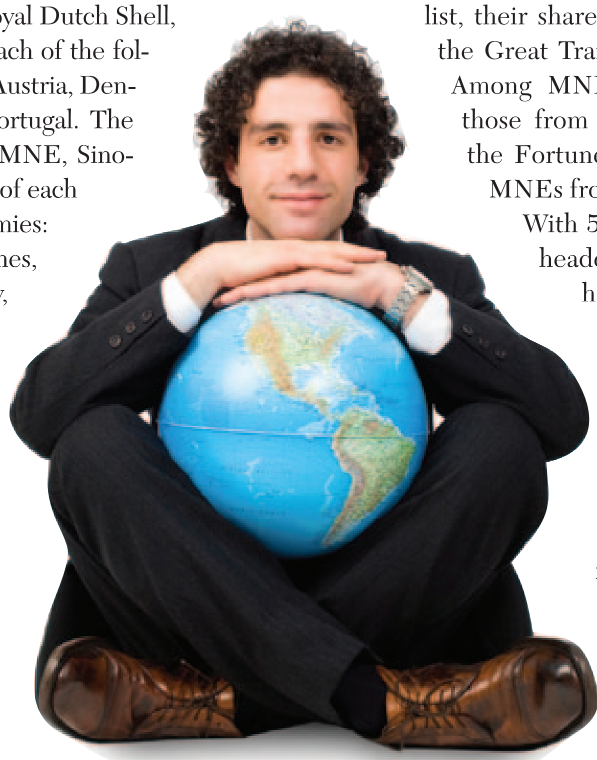

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EXHIBIT 1.7 RECENT CHANGES IN THE *FORTUNE* GLOBAL 500

	2005	2010	2014
Developed economies			
United States	170	133	128
European Union	165	149	128
Japan	70	68	57
Switzerland	12	15	13
Canada	14	11	10
Australia	8	8	8
Emerging economies			
China	20	61	95
India	6	8	8
Brazil	4	7	7
Russia	5	7	8
BRIC	35	83	118

Sources: Compiled from various Fortune issues. The most recent Fortune Global 500 list (for 2014) was published in Fortune, 21 July 2014.

1-6 ORGANIZATION OF THE BOOK

This book has three parts. Part 1 is *foundations*. Following this chapter, Chapters 2, 3, and 4 deal with the two leading perspectives: institution-based and resource-based views. Part 2 covers *tools*, focusing on trade (Chapter 5), foreign investment (Chapter 6), foreign exchange (Chapter 7), and global and regional integration (Chapter 8). Part 3 focuses on *managing* around the world. We start with the internationalization of small, entrepreneurial firms (Chapter 9), followed by ways to enter foreign markets (Chapter 10), to make alliances and acquisitions work (Chapter 11), and to strategize, structure, and learn (Chapter 12), to manage human resources (Chapter 13), to deal with marketing and supply chain management (Chapter 14), and finally to manage corporate social responsibility (Chapter 15).

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ETHICAL DILEMMA/EMERGING MARKETS

The Rebirth of the East India Company

Before picking up this book, the majority of readers are likely to have already heard of the East India Company. Yes, we are talking about *the* East India Company, the colonial trading company that created British India, founded Hong Kong and Singapore, and introduced tea, coffee, and chocolate to Britain and large parts of the world. Wait a minute—as you scratch your head over your rusty memory from history books—wasn't the company dead? Yes, it was dead—or, technically, dissolved or nationalized in 1874 by the British government. But, no, it was not dead.

After a hiatus of over 130 years, the East India Company was reborn and relaunched in 2005 by a visionary and entrepreneurial Indian businessman Sanjiv Mehta. With permissions granted by the UK Treasury for an undisclosed sum of money, Mumbai-born Mehta became the sole owner, chairman, and CEO of the *new* East India Company with the rights to use the name and original trademarks. His goals were to unlock and strengthen the potential value of the world's first multinational and the world's first global brand. In 2010, with much fanfare the East India Company launched its first luxury fine foods store in the prestigious Mayfair district of London. In 2014, the East India Company set up a new boutique inside London's most prestigious department store Harrods—a format called "store in store." The initial products included premium coffees and teas, artisan sweet and savory biscuits, an exquisite range of chocolates, and gourmet salts and sugars. While the old company obviously never had a website, the new one proudly announced on its website:

> *We see our role as bringing together the best the world has to offer; to create unique goods that help people to explore and experience what's out there. Products that help people see their world in a different and better light. Products that have the power to amaze and astonish. . . . The East India Company made a wide range of elusive, exclusive, and exotic ingredients familiar, affordable, and available to the world; ingredients which today form part of our daily and national cuisines. Today we continue to develop and market unique and innovative products that breathe life into the history of the Company. We trade foods crafted by artisans and specialists from around the world, with carefully sourced ingredients, unique recipes, and distinguished provenances.*

Just like the old East India Company, the new company is a "born global" enterprise, which immediately declared its intention to expand globally upon its launch. By 2014 it had expanded throughout Europe (Austria, Finland, France, Germany, the Netherlands, Norway, and Spain), Asia Pacific (Australia, China, Hong Kong, Japan, Malaysia, and South Korea), and the Middle East (Kuwait and Qatar). Its online store can deliver anywhere worldwide. Overall, in the first five years since 2005, the East India Company spent $15 million to develop its new business. In 2011, the Mahindra Group, one of India's most respected business houses, acquired a minority stake in the East India Company. After receiving capital injection from Mahindra, the East India Company announced that it would invest $100 million in the next five years to grow the iconic brand.

LEON NEAL/GETTY IMAGES

What made the (old) East India Company such a household name? Obviously the products it traded had to deliver value to be appreciated by customers around the world. At its peak, it employed a third of the British labor force, controlled half of the world's trade, issued its own coins, managed an army of 200,000, and ruled 90 million Indians. Its organizational capabilities must have been awesome. Equally important was its political abilities to leverage and control the rules of the game around the world, ranging from managing politicians back home in the UK to manipulating political intrigues in India. Granted a royal charter by Queen Elizabeth I in 1600, the old East India Company certainly benefitted from formal backing of the state. Informally, the brand still resonates with the two and a half billion people in the British Commonwealth, especially Indians. Mehta was tremendously moved by the over 14,000 ~~(!)~~ e-mails from Indians all over the world wishing him well when he announced the acquisition. In his own words: "I have not created the brand, history has created it. I am just the curator of it."

Blending continuity and change, the saga of the East India Company continues. Mehta said he believed the East India Company was the Google of its time. But one reporter suggested that "Google is in fact the East India Company of its modern era. Let's see if Google is still around and having the same impact in 400 years' time."

Case Discussion Questions

1. From an institution-based view and a resource-based view, explain what was behind the success and (ultimate) failure of the old East India Company?
2. Visit a (new) East India Company store in (or near) your city or visit its online store. Do you like it? Why?
3. From a resource-based view, explain what is special about the new East India Company?
4. From an institution-based view, predict the likely success or failure of the new East India Company.
5. ***ON ETHICS***: Critics argue that the old East India Company was a vanguard of colonialism and was associated with all the dark shades associated with colonialism. As a spokesperson for the new East India Company, how do you react to such criticisms to defend and promote the new venture?

Sources: "The empire strikes back," Arabian Business, 4 October 2014: www.arabianbusiness.com; East India Company, "EIC today," "History," "Press," 2015: www.theeastindiacompany.com; East India Company, "History of fine foods," 2014: www.eicfinefoods.com; "The company that ruled the waves," Economist, 17 December 2011: www.economist.com; "Hidden germs," Economist, 12 April 2014: www.economist.com.

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