GLOBALIZING Business

CHAPTER 1

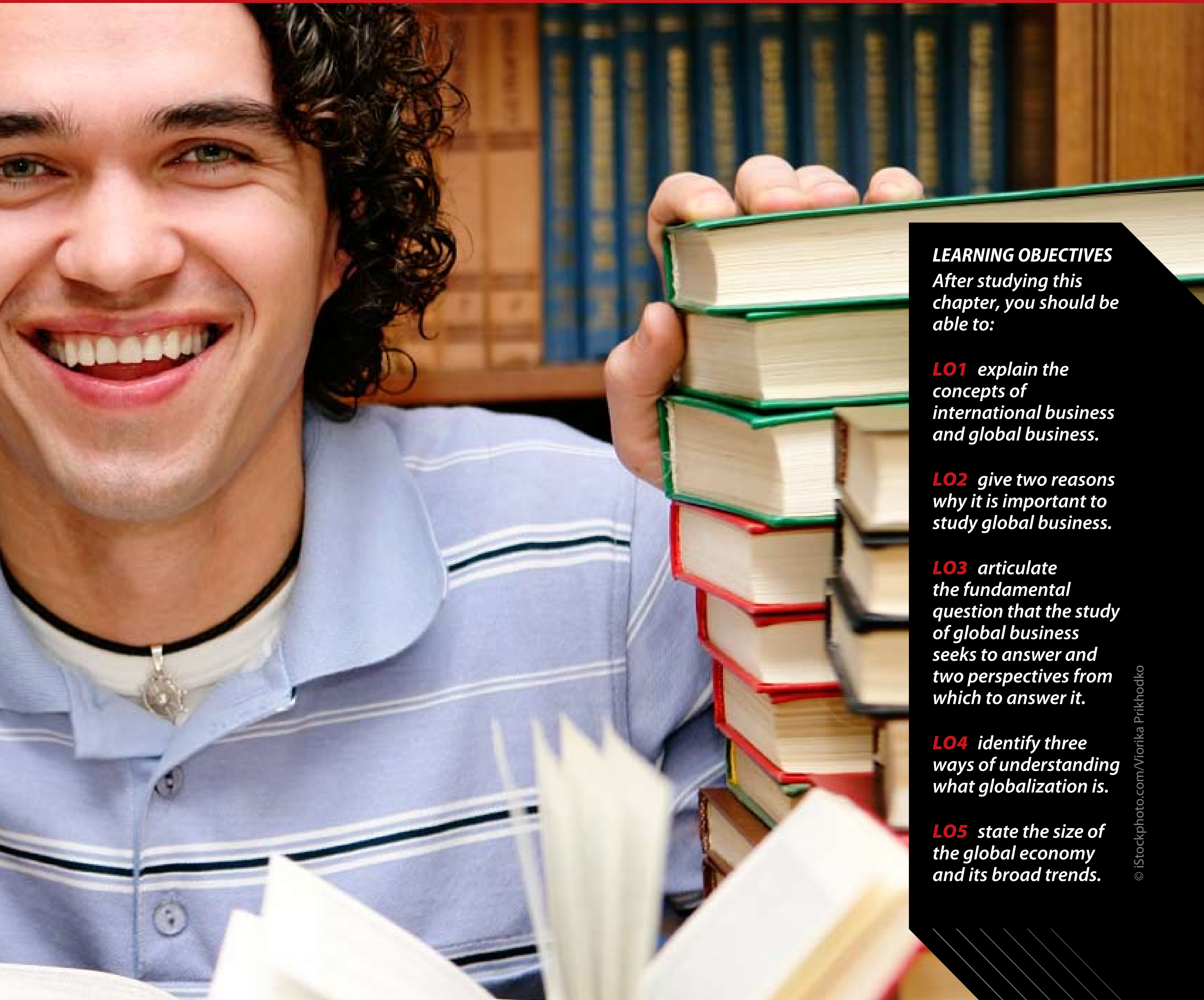
OPENING CASE

In Which Country Was Your Book Made?

In which country was your book made? Yes, the very copy you are reading now. If you answer "The United States, of course!," you will be given only partial credit. Some of you will look at the copyright page (the page after the title page) and point out that the publisher, South-Western Cengage Learning, has a Mason, Ohio, address. You'll take this as evidence that the book is a US product. Are you sure?

The nationality of our publisher is difficult to track down. It has also been *changing*. Founded in 1902, South-Western had been an independent US publisher until it was acquired in 1986 by the Thomson Corporation, an $8 billion Canadian firm whose shares are listed in Toronto (TSX: TOC) and New York (NYSE: TOC). South-Western thus became a wholly owned subsidiary of Thomson. The book contract that I signed in 2006 was with Thomson—more specifically with "Thomson Learning South-Western," a unit of Thomson Learning that had been one of the four major divisions within the Thomson Corporation. The unit had approximately $2.47 billion in sales in 2006. Since most of us would call a Toyota car a Japanese car regardless of where it is actually produced, we could call the book a Canadian book.

Or at least we would have when the book was conceived. The winds of global change that are a main theme of this book have also directly impacted the book itself. In 2007, the Thomson Corporation sold Thomson Learning for $7.75 billion to two private equity groups: the London-based Apax Partners and Toronto-based OMERS Partners. Apax Partners is one of the oldest and largest private equity firms in the world with more than $30 billion under its management. OMERS is one of the largest and most sophisticated asset management entities in Canada with over $45 billion in assets. In July 2007, Thomson Learning, now under new British and Canadian ownership, changed its name to Cengage Learning. The



© iStockphoto.com/Viorika Prikhodko

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

LO1 *explain the concepts of international business and global business.*

LO2 *give two reasons why it is important to study global business.*

LO3 *articulate the fundamental question that the study of global business seeks to answer and two perspectives from which to answer it.*

LO4 *identify three ways of understanding what globalization is.*

LO5 *state the size of the global economy and its broad trends.*

OPENING CASE

new name was based on being at the "center of engagement" for its customers worldwide. Cengage Learning is a multinational publisher with operations in 39 countries. In the academic marketplace, it serves students, teachers, professors, and learning institutions at the elementary, secondary, and college levels. Cengage Learning will continue to emphasize its brands, including Heinle, Gale, Wadsworth, Delmar Learning, and our very own, South-Western. In our own segment for business and economics college textbooks with the South-Western brand, Cengage Learning (formerly Thomson Learning) is number one in the world in terms of market share, followed by McGraw-Hill (with the Irwin brand) and Pearson (with the Prentice Hall brand). While Cengage is now UK and Canadian owned, Pearson is also UK owned, and McGraw-Hill is US owned. However, because Cengage Learning's corporate headquarters is in Stamford, Connecticut, it can also be labeled a US-based publisher. But, to be technically accurate, it is a UK- and Canadian-owned multinational corporation headquartered in the United States.

So "Which country made your book?" is a very tricky question because Cengage Learning is a global company. Now, let us try a more straightforward one: Which country *produced* your book? In the jargon of publishing, "production" involves the typesetting of a manuscript into printable plates by a production house, which is neither a publisher nor a printer. (Actual printing is called "manufacturing.") The answer is uncertain because the decision about where this book will be produced was not made at the time when it was written (July 2008). Based on my experience with two previous books with the same publisher, *Global Strategy* (2006) and *Global Business* (2009), my guess is that the production for *GLOBAL* will be done either in India or the United States. *Global Strategy* was produced in India. *Global Business* was produced in the United States, although our publisher also accepted bids on the project from production houses based in India. All of you who are opening this book probably already know that India has emerged as a leading global player in information technology (IT) and related services known as business process outsourcing (BPO). But how many of you would have thought that the very book you are holding now may have been produced in India? The manufacturing of the book is no less complicated than the production. *Global Strategy* was printed in the United States by a Canadian-owned printer, and *Global Business* was printed in Canada. *GLOBAL* may be printed in the United States, Canada, or another country.

A few years ago, a majority of the Thomson textbooks were handled by US production houses. Since 2000, offshore outsourcing of services, primarily to Indian production houses, has been growing at 8% a year at Thomson (now Cengage Learning). In response, US production houses often fight back by becoming "Indian"—by establishing subsidiary operations in India. In this very global business, Indian production houses not only need to fend for themselves against US rivals but also need to watch out for rivals from other emerging economies. For now, non-English-speaking competitors from Brazil, China, and Poland have a hard time winning contracts from Cengage. In the short run, the Philippines, with its large supply of low-cost, English-speaking professionals, seems determined to eat some of India's lunch. In the long run, Bulgaria, China, and Pakistan may emerge as global contenders in IT/BPO. For managers at current and would-be competitors in these companies, there is no doubt that their number one job is to figure out how to take advantage of the globalization of their business.

Sources: Author's interviews with Cengage Learning (formerly Thomson Learning) executives, 2005–2008; M. W. Peng, "Competing in and out of India," *Global Strategy* (Cincinnati: South-Western Thomson Learning, 2006) 3–4; Thomson Investor Day presentations, 6 October 2005 and 6 October 2006; Cengage Learning, available online at http://www.cengage.com.

How do firms compete around the globe? How can the British, Canadian, Indian, and US firms involved in the production of your textbook strengthen their competitive advantage? How can the Brazilian, Chinese, Pakistani, Philippine, and Polish firms that want to have a piece of the action overcome their disadvantage? What determines the success or failure of these firms around the world? This book will address these and other important questions on global business.

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.

***LO1* Explain the concepts of international business and global business.**

***LO2* Give two reasons why it is important to study global business.**

WHAT IS GLOBAL BUSINESS AND WHY STUDY IT?

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,

© iStockphoto.com/Christopher Hudson

and managing value-added activities in other countries.[1] MNEs and their cross-border activities are important, but they cover only one side of IB, namely, 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 do not just sit around in the face of foreign entrants such as MNEs. They actively compete and/or collaborate with foreign entrants. In other words, focusing on the foreign entrant side captures only one side of the coin at best.[2]

There are two key words in IB: international (I) and business (B).

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 before 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 (as opposed to a functional view) grounded in a global environment. Consequently, it makes sense that your textbook should give you both the I and B parts, not just the I part.

Global business is defined in this book as business around the globe—thus the title of this book, *GLOBAL*. 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. Not long ago, competition among college textbook publishers was primarily on a nation-by-nation basis. Before South-Western was acquired by Canada's Thomson and more recently by Britain's Apax partners and Canada's OMERS Partners, and before Prentice Hall was acquired by Britain's Pearson, South-Western, Prentice Hall, and McGraw-Hill fought each other largely in the United States. A different set of publishers competed in other countries. Now Cengage (formerly Thomson), Pearson, and McGraw-Hill have significantly globalized their competition, thanks to rising demand for high-quality business textbooks in English. They are competing against each other in many markets around the globe. 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.

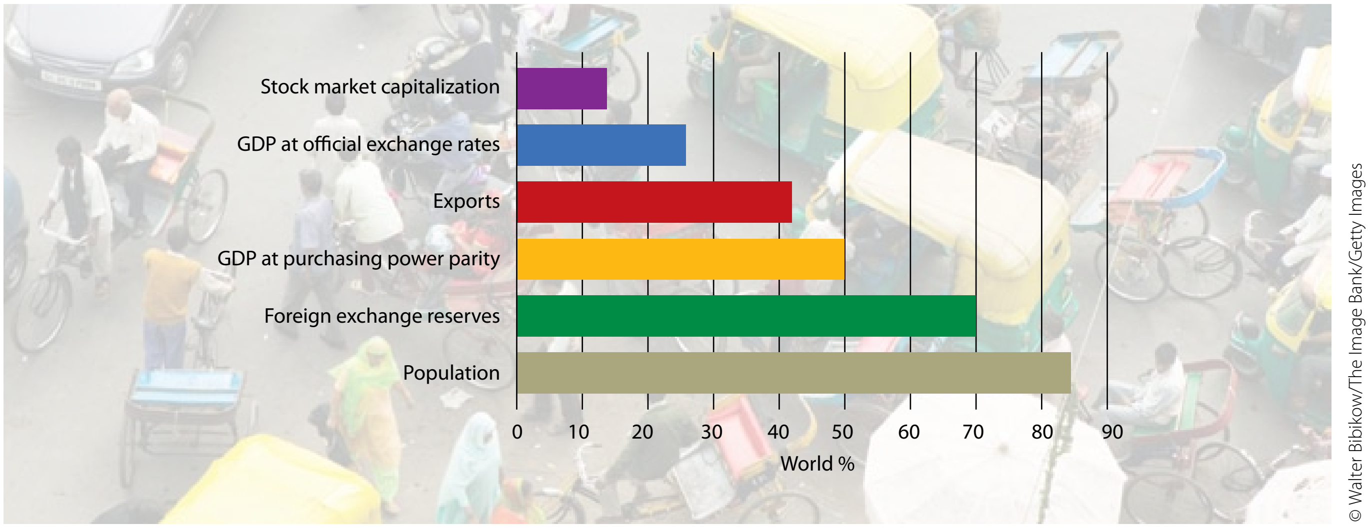
This book also differs from other books on IB because most focus on competition in developed economies. Here, by contrast, you'll find extensive space devoted to competitive battles waged throughout **emerging economies**, a term that has gradually replaced the term "developing countries" since the 1990s.[3] Another commonly used term is **emerging markets** (see the Closing Case). How important are emerging economies? Collectively, they now contribute approximately 50% of the global **gross domestic product (GDP)**, as shown

Global business
Business around the globe.

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.

EXHIBIT 1.1 The Contributions of Emerging Economies



Source: "Climbing back," *Economist*, 21 January 2006: 69. Original data are from the International Monetary Fund's *World Economic Outlook* database.

in Exhibit 1.1. Note that this percentage is adjusted for **purchasing power parity (PPP)**, a conversion that determines the equivalent amount of goods and services that different currencies can purchase and that is used to capture the differences in cost of living in different countries. Using official (nominal) exchange rates without adjusting for PPP, emerging economies contribute about 26% of the global GDP. Why is there such a huge difference between the two measures? Because the cost of living (such as housing and haircuts) in emerging economies tends to be lower than that in developed economies. For example, one dollar spent in Mexico can buy a lot more than one dollar spent in the United States. Some emerging economies are growing rapidly and commanding significant managerial attention.[4]

The global economy can be viewed as a pyramid, as shown in Exhibit 1.2. 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 Europe, and Japan. Another billion people making $2,000 to $20,000 a year make up the second tier. The vast majority of humanity—about four billion people—make less than $2,000 a year and comprise the **base of the pyramid**. Most MNEs (and most traditional IB books) focus on the top and second tiers and end up ignoring the base of the pyramid.[5] An increasing number of such low-income countries have shown increasingly more economic opportunities as income levels have risen. Today's students—and tomorrow's business leaders—will ignore these opportunities at the base of the pyramid at their own peril. This book will help ensure that you will not ignore these opportunities (see the Closing Case).

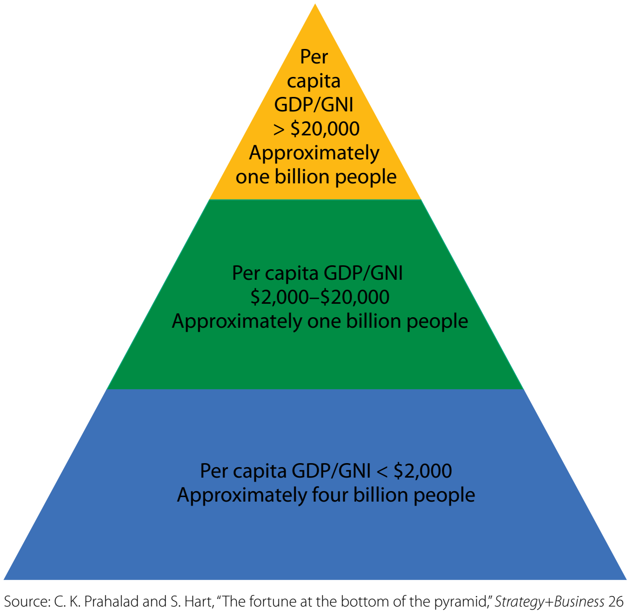
Global business (or IB) is one of the most exciting, challenging, and relevant subjects offered by business

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.

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

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

EXHIBIT 1.2 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.

© iStockphoto.com/Shelly Perry

schools. Your business school probably requires this course. But, beyond that, there are at least two compelling reasons why you should study it. First, 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 for an executive position, you'll need to demonstrate that you are interested in global business and have mastered knowledge of it during your education. This is especially true if you expect to gain experience as an **expatriate manager**—a manager who works abroad, or "expat" for short (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 Lima, Ohio, is shut down and the MNE sets up a similar factory in Lima, Peru, only about 10 to 20 jobs would be saved. Those jobs would consist of a few top-level positions such as the CEO, CFO, CIO, factory director, and chief engineer who will be sent by the MNE as expats to Peru to start up operations there. Because it is regarded as a "hardship" assignment, the MNE has to give them many more perks in Peru than it did in Ohio. How about company-subsidized luxury housing plus maid services, free tuition for children in American or international schools in Peru, and all-expenses-paid vacations for the whole family to see their loved ones in Ohio? Moreover, these expats do not live in Peru forever. When they return to the United States after a tour of duty (usually 2 to 3 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 hypothetical example is designed to motivate you to study hard so that you might 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 layoffs like those in Lima, Ohio. For an example of what happens in such cases, check out the 1998 movie *The Full Monty*. It portrays how laid-off steel workers in the UK, in order to make a living, pick up an alternative line of work that my editors do not allow me to mention here—psst . . . it's male strip dancing.

Second, 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, 6 million Americans, and 1 million British, are employed by foreign-owned firms. 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 able to figure this out and be the first one to post your resume on Monster.com. In other words, it is your career that is at stake. Don't be the last to know! In short, in this age of global competition, how do you keep from being Bangalored or Shanghaied (that is, having your job outsourced to India or China)?[6] A good place to start is to study hard and do well in your IB course.

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.

***LO3** Articulate the fundamental question that the study of global business seeks to answer and two perspectives from which to answer it.*

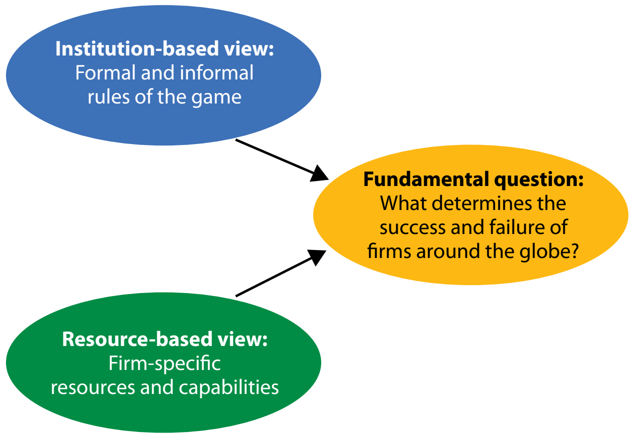
A UNIFIED FRAMEWORK

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 seemingly unrelated 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 and marketing. The study of global business is thus very interdisciplinary. It is very 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 (based on previous student feedback) is that there is an overwhelming amount of information. 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 way that is understandable. To make your learning more manageable (and hopefully more fun), we will develop a unified framework (shown in Exhibit 1.3) that is explained in this section.

One Fundamental Question

What is it that we do in global business? Why is it so important that practically every student in business schools around the world is either required or recommended 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 but treating the entire global economy as your potential playground (or battlefield). Some firms may be successful domestically but fail miserably when they venture abroad. Other firms successfully translate their strengths from their home market to other countries. If you were 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?

EXHIBIT 1.3 A Unified Framework for Global Business



Overall, the focus on firm performance around the globe defines the field of global business (or IB) more than anything else. Numerous other questions and topics all relate in one way or the other to this most fundamental question. Therefore, all of the chapters in this book will be centered on this consistent theme: *What determines the success and failure of firms around the globe?*[7] *GLOBAL* is the first global business (or IB) textbook to develop its chapters with a consistent theme in mind. Why is this unified framework important? It will enable you to see the global business forest as well as its trees. Each chapter will introduce you to new material (trees), but you will always be able to relate it back to the fundamental question. By the time we reach the end of the text, you will be able to provide an answer to this fundamental question. As we procede through the book, we will look at this question from two different core perspectives: an institution-based view and a resource-based view.

What determines the success and failure of firms around the globe?

First Core Perspective: An Institution-Based View

An **institution-based view** suggests that the success and failure of firms are enabled and constrained by institutions.[8] By **institutions**, we mean structures that define 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. If you establish a firm in a given country, you will work within the **institutional framework**, or the formal and informal institutions that govern individual and firm behavior in that country. 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, or formal rules of the game, include laws and regulations. For example, Hong Kong's laws and regulations treat all comers, whether from neighboring mainland China (whose firms are still technically regarded as "non-domestic") or far-away Chile, the same as they treat indigenous Hong Kong firms. This equal treatment enhances the potential odds for the success of foreign firms. It is thus not surprising that Hong Kong attracts a lot of outside firms. Other rules of the game, which may discriminate against foreign firms, would undermine the chances for foreign entrants. India's recent attraction as a site for foreign investment in IT/BPO (see Opening Case) was only possible after it changed its FDI regulations from confrontational to accommodating. Prior to 1991, India's rules severely discriminated against foreign firms. As a result, few foreign firms bothered to show up there, and the few that did had a hard time. 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 the changing rules of the game in India.

Informal institutions, or informal rules of the game, include cultures, ethics, and norms. These are not established by laws and regulations, yet they play an important part in shaping the success and failure of firms around the globe. 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 number of business start-ups. Why? Because the act of founding a new firm tends to deviate from the social norm of working for someone else, a norm that is not as strong in collectivistic societies. Conversely, collectivistic societies such as Japan often have a hard time fostering entrepreneurship. Most people there refuse to stick their neck out to find new businesses because it is contrary to the norm.

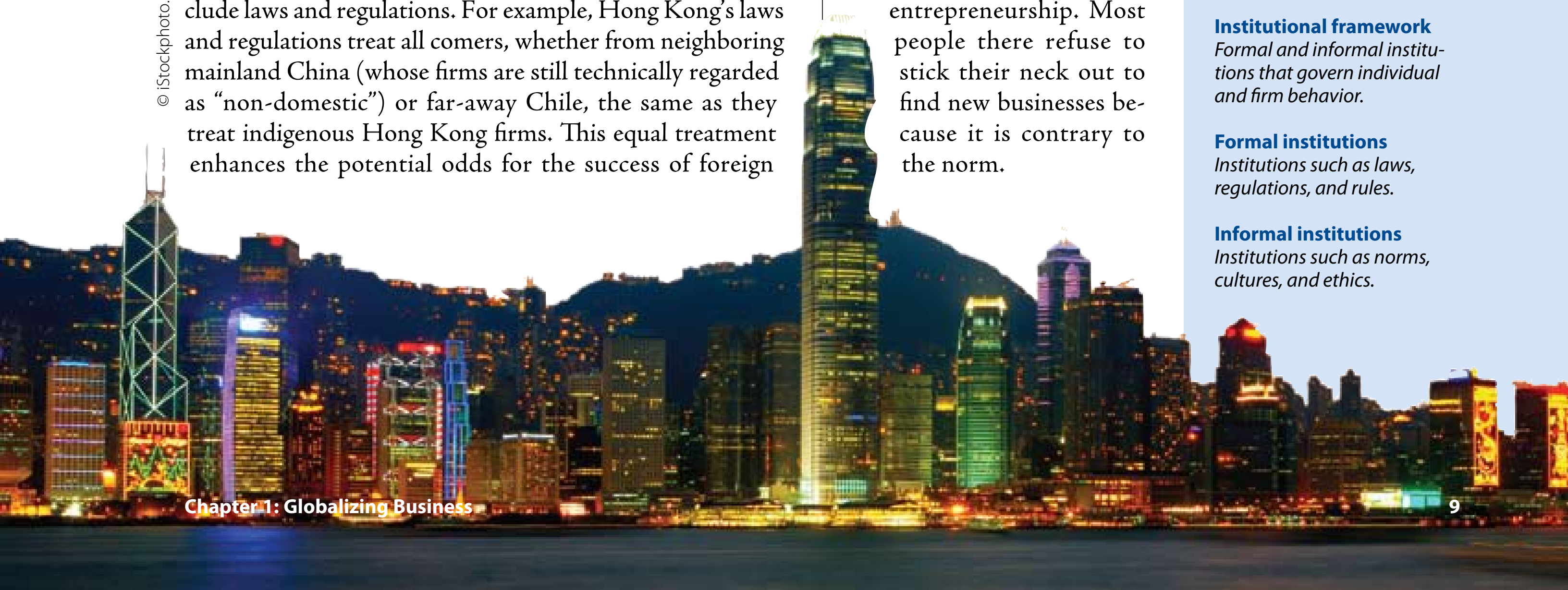
Institution-based view
A leading perspective in global business that suggests that firm performance is, at least in part, determined by the institutional frameworks governing firm behavior around the world.

Institutions
Formal and informal rules of the game.

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

Formal institutions
Institutions such as laws, regulations, and rules.

Informal institutions
Institutions such as norms, cultures, and ethics.


© iStockphoto.com/Andy Hwang

Overall, an institution-based view suggests that institutions, or the formal and informal rules of the game, shed a great deal of light on what drives firm performance around the globe.

Second Core Perspective: A Resource-Based View

The institution-based view suggests that the success and failure of firms around the globe are largely determined by their environments. This is certainly correct. Indeed, India failed to attract much FDI prior to 1991, and Japan does not nurture a lot of internationally competitive start-ups. However, insightful as this perspective is, there is a major drawback. If we push this view to its logical extreme, then firm performance around the globe would be *entirely* determined by environment. The validity of this extreme version is certainly questionable.

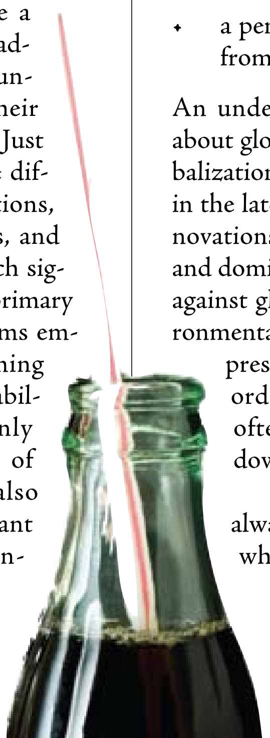
The **resource-based view** has emerged to overcome this drawback.[9] While the institution-based view primarily deals with the *external* environment, the resource-based view focuses on a firm's *internal* resources and capabilities. It starts with a simple observation: In harsh, unattractive environments, most firms either suffer or exit. However, a few superstars do thrive in these environments against all odds. For example, 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(!) Most retailers struggle in the current recession, and some have dropped out of business. But a small number of players, such as Wal-Mart, have been raking in profits year after year—Wal-Mart's profits grew 4% in 2008, and its sales in the first quarter of 2009 increased 3.8%. How can these firms succeed in highly unattractive and often hostile environments? A short answer is that PepsiCo and Wal-Mart must have certain valuable and unique *firm-specific* resources and capabilities that are not shared by competitors in the same environments.

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 non-native status.[10] Just think about all the differences in regulations, languages, cultures, and norms. Against such significant odds, the primary weapon foreign firms employ is overwhelming resources and capabilities that not only offset the liability of foreignness but also offer them significant competitive advantage. Today, many of us take it for granted that the Toyota Camry is the best-selling car in the United States, Coca-Cola is the best-selling soft drink in Mexico, and Microsoft Word is the market-leading word processing software around the world. We really shouldn't. Why? Because it is *not* natural for these foreign firms to dominate non-native markets. These firms must possess some very rare and powerful firm-specific resources and capabilities that drive these remarkable success stories and are the envy of their rivals around the globe.

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 non-native status.

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



© iStockphoto.com/Trevor Hunt

LO4 Identify three ways of understanding what globalization is.

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 and 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, and gives MNEs too much power. Globalization is significantly more complex than our basic definition suggests. This section outlines three views on globalization, recommends the pendulum view, and introduces the idea of semiglobalization.

Three Views on Globalization

Depending on what sources you read, globalization could be

- a new force sweeping through the world in recent times,
- a long-run historical evolution since the dawn of human history, or
- 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 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 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.[11] 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.[12] In a nutshell, globalization is nothing new and will probably 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.

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, from the 1950s into the 1970s, this view was not widely shared. Communist countries, such as China and the former Soviet Union, sought to develop self-sufficiency. Many non-communist 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, 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 and 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. For example, between 1990 and 2000, while world output grew by 23%, global trade expanded by 80% and the total flow of FDI increased fivefold.[14]

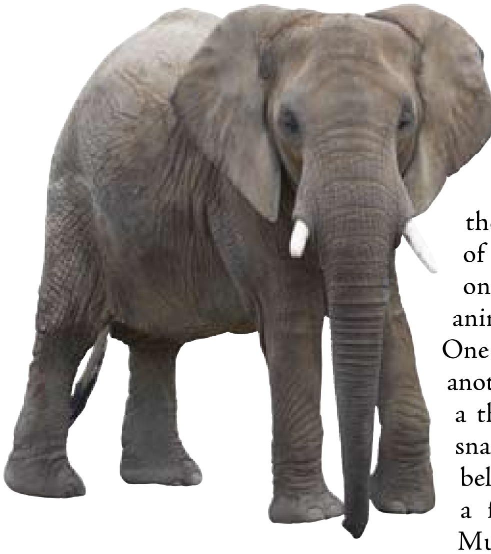
The pendulum model suggests, however, that globalization is unable to keep going in one direction. Rapid globalization in the 1990s saw some significant backlash. First, the rapid growth of globalization led to the historically inaccurate view that globalization is new. Second, it created fear among many people in developed economies that they would lose jobs. Emerging economies not only seem to attract many low-end manufacturing jobs away from developed economies, but they also increasingly appear to threaten some high-end 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, values, and the environment.

While small-scale acts of vandalizing McDonald's restaurants are reported in a variety of countries, the December 1999 anti-globalization protests in Seattle and the September 2001 terrorist attacks in New York and Washington are undoubtedly the most visible and most extreme acts of anti-globalization forces at work. As a result, international travel was curtailed, and global trade and investment flows slowed in the early 2000s. In the mid 2000s, worldwide GDP, cross-border trade, and per capita GDP all soared to historically high levels. More than half of the world GDP growth now comes from emerging economies, whose per capita GDP grew 4.6% annually in the decade ending 2007. In particular, **BRIC**, a newly coined acronym for

BRIC
A newly coined acronym for the emerging economies of Brazil, Russia, India, and China.

The Romans were the first to impose import quotas.

the emerging economies of Brazil, Russia, India, and China, has become a new buzzword. Developed economies averaged 2% per capita GDP growth in the same period. More recently (since 2008), devastated by the skyrocketing oil prices and the subprime mess, the United States and many other countries have entered into a recession. This recession has been characterized by a painful financial meltdown and numerous government bailout efforts. Rightly or wrongly, many people have blamed globalization for the most recent crisis (see the In Focus feature).



The effort to understand globalization brings to mind the story of the six blind men trying to figure out the shape and form of an elephant based on what part of the animal they touched. One thinks it is a wall, another calls it a spear, a third argues it is a snake, and the others believe it to be a tree, a fan, and a rope. Much like the elephant, globalization is seen by everyone but rarely comprehended in full. Our task is even more challenging, because we try to live with, avoid being crushed by, and even attempt to profit from a rapidly moving beast called globalization. Relative to the other two views, the view of globalization as a pendulum is a more balanced and realistic perspective. In other words, globalization has both rosy and dark sides, and it changes over time.

Semiglobalization

Despite the debate over it, globalization is not complete. 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 completely insulate countries from each other.[15] Semiglobalization calls for more than one way of doing business around the globe. Total isolation on a nation-state basis would suggest localization, or a strategy of treating each country as a unique market. Total globalization, on the other hand, would lead to standardization, or a strategy of treating the entire world as one market. But semiglobalization has no single right strategy, 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*.

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.

***LO5** State the size of the global economy and its broad trends.*

GLOBAL BUSINESS AND GLOBALIZATION AT A CROSSROADS

The challenge confronting a new generation of business leaders in the 21st century is enormous. At the dawn of the 21st century, globalization's seemingly inevitable forward direction took a turn, revealing globalization to be more of a pendulum than a one-way march. This directly affects you as a future business leader, as a consumer, and as a citizen. At least two sets of sudden, high-profile events occurred that have had significant ramifications for business around the world: anti-globalization protests and terrorist attacks. First, large-scale anti-globalization protests began in December 1999, when over 50,000 protesters blocked downtown Seattle in an attempt to derail a ministerial meeting of the World Trade Organization (WTO). The demonstrators were protesting against a wide range of issues, including job losses resulting from foreign competition, downward pressure on wages for unskilled workers, and environmental destruction. Since Seattle, anti-globalization protesters have turned up at just about every major globalization meeting, and some protests have

© iStockphoto.com/Wolfgang Amri/ © Tim Matsui/Liaison Agency/Newsmakers/Getty Images

IN FOCUS

Global Financial Crisis, 2008

The year 2008 showed—rightly or wrongly—how interconnected the world economy has become. Deteriorating housing markets in the United States, fueled by unsustainable subprime lending practices, led to massive government bailouts of leading financial services firms starting in September. While the rest of the world initially held its breath, most people probably shared the sentiment expressed by Brazil's president, Luiz Inacio Lula da Silva, that the crisis would be "Bush's crisis" (referring to George W. Bush) that had nothing to do with "us."

Unfortunately, the crisis quickly spread to Europe, forcing British, French, German, and other EU governments to nationalize a large chunk of their banks that were overstretched. Moreover, banks and capital markets throughout emerging economies were also pulled down, although not as badly as in developed economies. The glow of bright spots such as Brazil, Russia, India, and China (known as BRIC) dimmed as their growth slowed down, credit tightened, and foreign hot money was withdrawn. Weaker economies such as Hungary, Pakistan, and Ukraine had to be rescued by loans from the International Monetary Fund (IMF) to stay afloat.

Clearly, such an unprecedented global financial crisis requires a global response. On November 14–15, 2008, the G-20 Leaders Summit took place in Washington, DC. On April 2, 2009, they met again in London. G-20 refers to the Group of Twenty, consisting of 19 of the world's largest national economies and the European Union, which collectively comprise 90% of global GDP and 80% of world trade. As a significant expansion of the old, rich-country-only G-7, G-20 was the first time this group of leaders from developed and emerging economies met. While the G-20 Summit offered promises that the G-20 countries would work together, few concrete details on how to fight the global financial crisis were announced. Nevertheless, the very fact that the G-20 leaders met and that they agreed to enhance the voice of emerging economies (and to essentially phase out the G-7) was widely regarded as a significant progress. From a moral and ethical standpoint, the G-20 countries clearly have a special responsibility in combating the global economic crisis and restoring economic growth. The question is: How?

Sources: "After the fall," *Economist*, 15 November 2008, 29–31; "Goodbye G7, hello G20," *Economist*, 22 November 2008, 89; Fact sheet: Summit on Financial Markets and the World Economy (press release), *The White House*, 15 November 2008, available online at http://www.whitehouse.gov.

become violent. One protester died in the April 2009 protests in London against the G-20 Summit. It is obvious that numerous individuals in many countries believe that globalization has detrimental effects on living standards and the environment. As shown throughout this book, neither the pro-globalization nor the anti-globalization forces have won the debate on globalization.[16]

The terrorist attacks in New York and Washington, DC, on September 11, 2001, and more recent terrorist attacks elsewhere in the world are the second events. After the attacks in the United States, terrorists struck Afghanistan, Britain, India, Indonesia, Iraq, Pakistan, and Spain. Terrorism, which used to be "a random political risk of relatively insignificant proportions,"[17] is now a leading concern for business leaders around the globe. Heightened risk of terrorism has reduced freedom of international movement as various countries curtailed visas and immigration; enhanced security checks at airports, seaports, and land border crossing points; and cancelled or scaled down trade and FDI deals, especially in high-risk regions such as the Middle East.

The challenge that faces you, then, involves a complex set of issues surrounding the benefits and costs of globalization as well as threats and hindrances to global business caused by terrorism. This book will provide you with a roadmap to help you navigate that challenge. At this critical juncture in global business, two things will be important as you move forward. First, you must have a basic understanding of the world economy. Second, you must critically examine your own personal views and biases on globalization. This section helps you do both.

A Glance at the World Economy

The world economy at the beginning of the 21st century is an approximately $55 trillion economy (total global GDP calculated at official, nominal exchange rates). While there is no need to memorize a lot of statistics, it is useful to remember this $55 trillion figure to put things in perspective.

A frequent observation in the globalization debate is the enormous size of MNEs: 47 of the world's top 100 economic entities (countries measured by GDP and companies measured by sales) are companies. If the two largest MNEs, US-based Wal-Mart and Exxon Mobil, were independent countries, they would be the 22nd and 23rd largest economies, respectively. (Their sales are smaller than Indonesia's GDP but larger than Poland's.) The sales of the largest EU-based MNE, Royal Dutch Shell, were larger than the GDP of each of the following EU members: Norway, Denmark, Greece, and Ireland. The sales of the largest Asia Pacific–based MNE, Toyota, were greater than the GDP of each of the following Asia Pacific countries: Malaysia, Singapore, and New Zealand.

In 2006, over 77,000 MNEs controlled at least 770,000 subsidiaries overseas.[18] Total annual sales for the largest 500 MNEs exceed $20 trillion (about 40% of global output). Exhibit 1.4 documents the change in the makeup of the 500 largest MNEs. In general, over 80% of the 500 largest MNEs come from the Triad. Since 1990, the United States has contributed about one third of these firms, the European Union has maintained a reasonably steady increase, and Japan has experienced the most dramatic variation (roughly corresponding to its economic boom and bust with several years of delay).

Among MNEs from emerging economies, those from South Korea and Brazil have largely maintained their presence in the *Fortune* Global 500. MNEs from China have come on strong—Beijing is now headquarters to 18 *Fortune* Global 500 firms, four fewer than New York City. In some industries, these MNEs, often regarded as "Third World multinationals" or "dragon multinationals," have joined the top ranks.[19] Clearly, Western rivals cannot afford to ignore them, and students reading this book need to pay attention to these emerging multinationals.

The Globalization Debate and You

As a future business leader, you are not a detached reader. The globalization debate directly affects *your* future.[20] 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. Unfortunately, many of the elite fail to understand the limits of their beliefs and mistakenly assume that the rest of the world thinks like them. To the extent that powerful economic and political institutions are largely controlled by the elite in almost every country, it is not sur-

EXHIBIT 1.4 Changes in the *Fortune* Global 500

Country/bloc	1990	1995	2000	2001	2002	2003	2004	2005	2006	2007
United States	164	153	185	178	192	189	176	170	162	153
European Union	129	148	136	139	150	147	161	165	165	170
Japan	111	141	95	88	88	100	81	70	67	64
Canada	12	6	13	5	14	12	13	14	16	14
South Korea	11	12	8	12	13	9	11	12	14	15
Switzerland	11	16	10	9	11	12	11	12	13	14
China	0	2	10	10	11	14	16	20	24	29
Australia	9	4	7	6	6	7	9	8	8	8
Brazil	3	4	3	4	4	3	3	4	5	5
Others	50	14	33	49	11	7	19	25	26	28
Total	500	500	500	500	500	500	500	500	500	500

Source: Based on data from various issues of *Fortune* Global 500. Finland and Sweden are included in Others prior to 1996 and in the European Union after 1996.

prising 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. At present, this view is increasingly moving from the peripheral to the mainstream (see Chapter 14).

It is certainly interesting and perhaps alarming to note that as would-be business leaders who will shape the global

EXHIBIT 1.5 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%

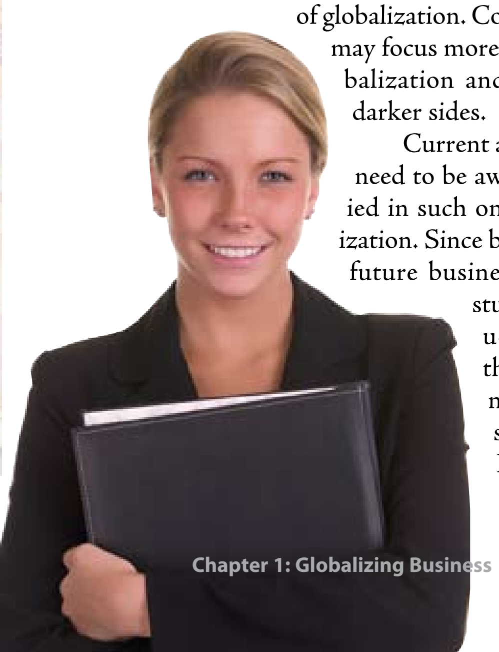
Sources: A. Bernstein, "Backlash against globalization," *Business Week*, 24 April 2000: 43 and M. W. Peng and H. Shin, "How do future business leaders view globalization?," *Thunderbird International Business Review* 50, no. 3 (2008): 179. All differences are statistically significant.

Current and would-be business leaders need to be aware of their own bias embodied in such one-sided views toward globalization

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 1.5, 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 world suggest that most business students around 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 may 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 bias 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 should 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. Beyond this chapter, which illustrates a big debate in itself, debates are systematically introduced in *every* chapter to provoke more critical thinking and discussion. Virtually all textbooks uncritically present knowledge "as is" and ignore the fact that the field is alive with numerous debates. No doubt, debates drive practice and research forward. Therefore, it is imperative that you be exposed to cutting-edge debates and encouraged to form your own views when engaging in these debates. In addition, ethics is emphasized throughout the book. A featured Ethical Dilemma can be found in every chapter. In addition, two whole chapters are devoted to ethics, norms, and cultures (Chapter 3) and corporate social responsibility (Chapter 14).



Nongovernmental organizations (NGOs) *Organizations that are not affiliated with governments. Such organizations include environmentalist groups, human rights activists, and consumer groups.*

ORGANIZATION OF THE BOOK

This book has three parts. Part I is *foundations*. Following this chapter, Chapters 2, 3, and 4 deal with the two leading perspectives: institution- and resource-based views. Part II covers *tools*, focusing on trade (Chapter 5), foreign investment (Chapter 6), foreign exchange (Chapter 7), and global and regional integration (Chapter 8). Part III 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), and finally to manage corporate social responsibility (Chapter 14).

Most of you were probably surprised by the Opening Case on the global nature of your textbook. Globalization is fascinating, isn't it? This book will reduce the element of surprise by providing a roadmap as you embark on this journey. Welcome aboard!

CLOSING CASE

ETHICAL DILEMMA

GLOBAL BUSINESS AND EMERGING ECONOMIES

The bulk of IB takes place among developed economies. Also referred to as high-income countries, Western (plus Japanese) economies, and the First World, these countries contribute approximately three quarters of the global GDP by official exchange rates. The United Nations defines these 54 countries as having per capita incomes in excess of $9,000. Is it appropriate to continue to focus on them in the 21st century?

The term "emerging economies" has caught on since the 1990s for what was previously referred to as developing countries, low-income nations, and the Third World. One side of the globalization debate argues that emerging economies are the markets of tomorrow, so they are also frequently labeled "emerging markets." This argument is both true *and* false. Emerging economies consist of 156 countries that account for 84% of the world's population but only approximately 26% of its GDP by official exchange rates. Some of them grow rapidly, whereas many others will actually shrink. In short, much of the base of the global economic pyramid will remain the base. Advocates for emerging economies concede that the relative economic firepower of even some of the largest emerging economies is limited. For example, Russia's GDP is smaller than Italy's and Mexico's GDP is smaller than that of Texas.

© ULI DECK/dpa/Landov

The growth potential of certain emerging economies is exciting, particularly Brazil, Russia, India, and China—commonly referred to as BRIC. During the Industrial Revolution, it took America and Britain 50 years to double their GDP. Today, China is achieving that in a single decade. At present, the United States has more than 900 cars for every 1,000 people of driving age, and Western Europe and Japan have over 600 cars. But in Russia, the figure is about 200, in Brazil around 130, in China about 30, and in India fewer than ten. Obviously, the room for growth in BRIC is huge. If Western firms want to grow, they will have to participate in such growth.

At present, FDI inflows to emerging economies command about one third of global FDI inflows. Since FDI inflows to emerging economies trail behind those to developed economies, the argument goes, Western firms need to *disproportionately* invest in emerging economies. To support this argument, experts note that emerging economies already command 50% of global GDP, measured at PPP, as Exhibit 1.1 shows. More than half of world GDP *growth* now comes from emerging economies, whose per capita GDP grew 4.6% annually in the decade ending 2007. (For comparison, developed economies averaged 2% per capita annual GDP growth in the same period.) When car sales in the United States, Europe, and Japan dropped to low points in 2008, worldwide car sales nevertheless broke a record, hitting about 59 million cars, thanks to emerging economies led by BRIC. A case in point: In the third quarter of 2008, Daimler's Mercedes car division *increased* its profit by 1% despite the financial crisis. The leading cause was strong sales in Russia. Overall, more job descriptions for CEOs in Western MNEs now call for explicit business experience on the ground in emerging economies. Boards increasingly are looking for CEOs with passports showing frequent visits to BRIC.

On the other hand, strong arguments have been made against aggressively moving into emerging economies given the uncertainties. Emerging economies often experience tremendous booms and busts. The Asian miracle was suddenly replaced by a major crisis in 1997. Central and Eastern Europe experienced the euphoria of the fall of communism in 1989, but that was quickly replaced by a deep recession worsened by the Russian default in 1998. In the last decade, every major Latin American economy was hit by a significant economic crisis: Mexico (1995), Brazil (1998), Argentina (2002), and Venezuela (2006). China has been periodically hit by crises, ranging from SARS (2003) to the product safety mess (2007). In 2008, most emerging economies suffered from financial turmoil, leading some of them to be labeled "submerging economies."

Overall, emerging economies represent the classic combination of high risk and (potentially) high return. A sensible strategy for

Western MNEs is to strike a balance between developed and emerging economies. Strong performance in emerging economies may significantly contribute to the *worldwide* corporate bottom line. Volkswagen, for instance, now sells more cars in China than in Germany and derives approximately one third of its worldwide profits from China alone. In the Middle East, General Electric (GE) is working on water desalination systems at $0.001 per millimeter, which, according to GE's CEO Jeff Immelt, is "off-the-charts low cost." Immelt continued, "We will never hit that in the US. But we'll hit it someplace outside. And the second we do, a huge market is going to open up inside as well." Likewise, GE is working in China on a magnetic resonance imaging (MRI) scanner that could cut its price in half. "At the right cost point, you not only sell it in China," Immelt commented, "you open up a market among the 35% of US hospitals that today cannot afford to have an MR scanner."

However, the expertise of Western MNEs requires significant adaptation. What sells to high-income customers doesn't always translate in emerging or undeveloped markets. For example, all-in-one shampoo and conditioner is of little relevance to customers who have never used either. Entering emerging economies with a warehouse-style retail format, such as COSTCO and Sam's Club, suitable for markets with a high level of car ownership is unlikely to reach the masses in markets where car ownership is low.

Despite significant differences, emerging economies have enough common underlying logic to justify developing an alternative business model based on price/value trade-offs different from those in developed economies. GM and Honda are racing to develop $5,000 entry-level cars for China. Given the inability of these MNEs to profitably produce such models in the United States and Japan, imagine the profit potential these developed-in-China models may have back home where entry-level cars now sell for $10,000.

To the extent Western MNEs often find it tough going in these unfamiliar territories, it is not surprising that the hearts, minds, and wallets of customers in emerging economies are being captured by some new MNEs headquartered in emerging economies, called Third World multinationals or dragon multinationals. In India, Tata Motors has unleashed a "one lakh" car (one lakh is 100,000 rupees, roughly $2,500). In the Philippines, Jollibee beats the mighty McDonald's and is now venturing out to Southeast Asia and the Middle East. Out of China, Lenovo aspires to become the king of the personal computer hill. In a nutshell, there is money to be made in and out of emerging economies. The million dollar challenge for global business in the 21st century is: How to make such money?

Sources: "A global love affair," *Economist*, 15 November 2008; J. Mathews, "Dragon multinationals as new features of globalization in the 21st century," *Asia Pacific Journal of Management*, 23 (2006): 5–27; K. Meyer, S. Estrin, S. Bhaumik, and M. W. Peng, "Institutions, resources, and entry strategies in emerging economies," *Strategic Management Journal*, 30 (2009): 61–80; T. Tong, J. Reuer, and M. W. Peng, "International joint ventures and the value of growth options," *Academy of Management Journal* 51 (2008): 1014–1029; M. Wright, I. Filatotchev, R. Hoskisson, and M. W. Peng, "Strategy research in emerging economies," *Journal of Management Studies* 42 (2005): 1–33.

BY THE NUMBERS

size in US dollars of the world economy at the beginning of the 21st century **55** trillion

people worldwide employed by foreign-owned firms **80** million

percent growth of world output between 1999 and 2000 **23**

number of the world's top economic entities that are companies **47**

percent of per capita GDP growth in emerging economies in 2007 **4.6**

number of *Fortune 500* Global 500 firms in China **18**