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# GLOBAL BUSINESS

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# GLOBAL BUSINESS

Third Edition

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*To Agnes, Grace, and James*



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# Preface

The first two editions of *Global Business* aspired to set a new standard for international business (IB) textbooks. Based on the enthusiastic support from students and instructors in Australia, Brazil, Britain, Canada, China, Egypt, France, Hong Kong, India, Indonesia, Ireland, Israel, Lithuania, Malaysia, Puerto Rico, Russia, Slovenia, South Africa, South Korea, Taiwan, Thailand, and the United States, the first two editions achieved unprecedented success. A Chinese translation is now available and a European adaptation (coauthored with Klaus Meyer) has been successfully launched. In short, *Global Business* is global.

The third edition aspires to do even better. It continues the market-winning framework centered on one big question and two core perspectives pioneered in the first edition, and has been thoroughly updated to capture the rapidly moving research and events of the past few years. Written for undergraduate and MBA students around the world, the third edition will continue to make IB teaching and learning more (1) engaging, (2) comprehensive, (3) fun, and (4) relevant.

## More Engaging

As an innovation in IB textbooks, a unified framework integrates all chapters. Given the wide range of topics in IB, most textbooks present the discipline in a fashion that “Today is Tuesday, it must be Luxembourg.” Very rarely do authors address: “Why Luxembourg today?” More important, why IB? What is the big question in IB? Our unified framework suggests that the discipline can be united by one big question and two core perspectives. The big question is: What determines the success and failure of firms around the globe? To address this question, *Global Business* introduces two core perspectives, (1) the institution-based view and (2) the resource-based view, in *all* chapters. It is this relentless focus on our big question and core perspectives that enables this book to engage a variety of IB topics in an integrated fashion. This provides unparalleled continuity in the learning process.

*Global Business* further engages readers through an *evidence-based* approach. I have endeavored to draw on the latest research rather than the latest fads. As an active researcher myself, I have developed the unified framework not because it just popped up in my head when I wrote the book. Rather, this is an extension of my own research that consistently takes on the big question and leverages the two core perspectives.<sup>1</sup>

<sup>1</sup> For the big question, see M. W. Peng, 2004, Identifying the big question in international business research, *Journal of International Business Studies*, 35: 99–108. For the institution-based view, see M. W. Peng, S. L. Sun, B. Pinkham, & H. Chen, 2009, The institution-based view as a third leg for a strategy tripod, *Academy of Management Perspectives*, 23(3): 63–81; M. W. Peng, D. Wang, & Y. Jiang, 2008, An institution-based view of international business strategy: A focus on emerging economies, *Journal of International Business Studies*, 39: 920–936. For the resource-based view, see M. W. Peng, 2001, The resource-based view and international business, *Journal of Management*, 27: 803–829.

Another vehicle to engage students is debates. Most textbooks present knowledge “as is” and ignore debates. But obviously our field has no shortage of debates. It is the responsibility of textbook authors to engage students by introducing cutting-edge debates. Thus, I have written a beefy “Debates and Extensions” section for *every* chapter.

Finally, this book engages students by packing rigor with accessibility. There is no “dumbing down.” No other competing IB textbook exposes students to an article on how to save Europe by the Managing Director of the International Monetary Fund (In Focus 8.1), a commentary on China’s ten years in the World Trade Organization by the US Ambassador to China (Emerging Markets 8.1), and a *Harvard Business Review* article on China’s outward foreign direct investment (authored by me—Emerging Markets 6.1). These are not excerpts but full-blown, original articles—the first in an IB (and, in fact, in any management) textbook. These highly readable short pieces directly give students a flavor of the original insights.

## More Comprehensive

*Global Business* offers the most comprehensive and innovative coverage of IB topics available on the market. Unique chapters not found in other IB textbooks are:

- Chapter 9 on entrepreneurship and small firms’ internationalization.
- Chapter 11 on global competitive dynamics.
- Chapter 16 on corporate finance and governance.
- Chapter 17 on corporate social responsibility (in addition to one full-blown chapter on ethics, cultures, and norms, Chapter 3).
- Half of Chapter 12 (alliances and acquisitions) deals with the inadequately covered topic of acquisitions. Approximately 70% of market entries based on foreign direct investment (FDI) around the world use acquisitions. Yet, none of the other IB textbooks has a chapter on acquisitions—clearly, a missing gap.

The most comprehensive topical coverage is made possible by drawing on the latest and most comprehensive range of the research literature. Specifically, I have accelerated my own research, publishing a total of 30 articles since 2010 after I finished the second edition.<sup>2</sup> I have drawn on such latest research to inject cutting-edge thinking into the third edition.

In addition, I have also endeavored to consult numerous specialty journals. For example, the trade and finance chapters (Chapters 5–7) draw on the *American Economic Review*, *Journal of Economic Literature*, and *Quarterly Journal of Economics*. The entrepreneurship chapter (Chapter 9) consults with the *Journal of Business Venturing* and *Entrepreneurship Theory and Practice*. The marketing and supply chain chapter (Chapter 14) draws heavily from the *Journal of Marketing*, *Journal of International Marketing*, and *Journal of Operations Management*. The corporate finance and governance chapter (Chapter 16) is visibly guided by research published in the *Journal of Finance* and *Journal of Financial Economics*.

The end result is the unparalleled, most comprehensive set of evidence-based insights on the IB market. While citing every article is not possible, I am confident

<sup>2</sup>All my articles are listed at [www.mikepeng.com](http://www.mikepeng.com) and [www.utdallas.edu/~mikepeng](http://www.utdallas.edu/~mikepeng). Go to “Journal Articles.”

that I have left no major streams of research untouched. Feel free to check the Name Index to verify this claim.

Finally, the third edition of *Global Business* continues to have a global set of cases contributed by scholars around the world—an innovation on the IB market. Virtually all other IB textbooks have cases written by book authors. In comparison, this book has been blessed by a global community of case contributors who are based in Austria, Brazil, China, France, Germany, Hong Kong, India, and the United States. Many are experts who are located in, or are from, the countries in which the cases take place. For example, we now have a Brazil case penned by a Brazil-based author (see the Integrative Case on Jobek do Brasil), and two China cases written by China-based authors (see the Integrative Cases on Geely’s acquisition of Volvo and Sino Iron in Australia). This edition also features a Russia case contributed by the world’s top two leading experts on Russian management (see the Integrative Case on Wikimart). The end result is an unparalleled, diverse collection of case materials that will significantly enhance IB teaching and learning around the world.

## More Fun

If you fear that this book must be very boring because it draws so heavily on current research, you are wrong. I have used a clear, engaging, conversational style to tell the “story.” Relative to rival books, my chapters are generally more lively and shorter. Some reviewers have commented that reading *Global Business* is like reading a “good magazine.” A large number of interesting anecdotes have been woven into the text. In addition to examples from the business world, non-traditional (“outside-the-box”) examples range from ancient Chinese military writings to mutually assured destruction (MAD) strategy during the Cold War, from Shakespeare’s *The Merchant of Venice* to Tolstoy’s *Anna Karenina*. Popular movies such as *A Few Good Men*, *Devil’s Advocate*, and *Legally Blonde* are also featured. In addition, numerous Opening Cases, Closing Cases, and In Focus boxes spice up the book. Check out the following fun-filled features:

- Partying in Saudi Arabia (Chapter 3 Opening Case)
- Adding value to the dirtiest job online (In Focus 4.2)
- Why are US exports so competitive? (Chapter 5 Opening Case)
- A sticky business in Singapore (In Focus 5.1)
- Cry for me, Argentina (Chapter 6 Closing Case)
- The Greek tragedy (Chapter 8 Closing Case)
- The world’s best place to make Viagra (In Focus 10.1)
- A fox in the hen house (In Focus 11.2)
- Brazil’s Whopper deal (Emerging Markets 12.2)
- Mickey goes to Shanghai (Chapter 13 Opening Case)
- Wolf wars (Chapter 17 Closing Case)
- Milton Friedman goes global (Emerging Markets 17.1)

There is one Video Case from BBC News to support every chapter. While virtually all competing books have some videos, none has a video package that is so integrated with the learning objectives of *every* chapter.

Finally, as a new feature introduced since the second edition, PengAtlas allows you to conduct IB research using informative maps and other geographic and cultural literacy tools to enhance your learning.

## More Relevant

So what? Chapters in most textbooks leave students to figure out the crucial “So what?” question for themselves. In contrast, I conclude every chapter with an action-packed section titled “Management Savvy.” Each section has at least one table (or one teachable slide) that clearly summarizes the key learning points from a *practical* standpoint. No other competing IB book is so savvy and so relevant.

Further, ethics is a theme that cuts through the book, with at least one “Ethical Dilemma” feature and a series of Critical Discussion Questions on ethics in each chapter. Finally, many chapters offer *career* advice for students. For example:

- Chapter 1 In Focus 1.3 directly addresses a question many students would ask: What language and what fields should I study?
- Chapter 4 develops a resource-based view of the individual—that is, about you, the student. The upshot? You want to make yourself into an “untouchable” who adds valuable, rare, and hard-to-imitate capabilities indispensable to an organization. In other words, you want to make sure your job cannot be outsourced.
- Chapter 15 offers tips on how to strategically and proactively invest in your career now—as a student—for future international career opportunities.

## What’s New in the Third Edition?

Most importantly, the third edition has (1) highlighted the executive voice by drawing more heavily from CEOs and other business leaders, (2) dedicated more space to emerging economies, and (3) enhanced the quantity and variety of cases.

First, since *Global Business* aims to train a new generation of global business leaders, the third edition has featured more extensive quotes and perspectives from global business leaders. These are longer and more visibly prominent break-out quotes—not merely single quotes typically embedded (or “buried”) in paragraphs. In Chapter 1 alone, you will enjoy such insightful quotes from (1) GE’s current chairman and CEO and (2) GE’s former chairman and CEO. In later chapters, the following global business leaders will share their thoughts with you:

Applied Materials’ human resource executive  
 Argentina’s president  
 Bayer North America’s CEO  
 Dow Chemical’s CEO  
 IBM’s CEO  
 IBM’s chief procurement officer  
 IMF’s managing director—*a full article*  
 TNK-BP’s chairman and CEO and Alfa Group’s founder  
 US Ambassador to China—*a full article*  
 US Secretary of Justice (representing the Department of Justice’s challenge of AT&T’s proposed merger with T-Mobile)  
 US Secretary of Treasury (on the US-China Strategic and Economic Dialogue)  
 Whole Foods’ co-founder and CEO  
 WTO’s director-general

Second, this edition builds on *Global Business*’s previous strengths by more prominently highlighting global business challenges in and out of emerging economies. This is both a reflection of the global realities in which emerging economies have



played a more prominent role and a reflection of my own strong research interest in emerging economies. Specifically, in the third edition, (1) a new Emerging Markets in-chapter feature is launched in every chapter, and (2) 18 out of 23 (78%) of the longer Integrative Cases deal with emerging economies (including one case on Central and Eastern Europe, two cases each on Africa, Brazil, Russia, and India, and six on China).

Third, in response to students' and professors' enthusiasm about the wide-ranging and globally relevant cases in previous editions, the third edition has further enhanced the quantity and variety of cases. The number of Integrative Cases has increased from 15 to 23—a 53% increase. The variety has also been enhanced not only in terms of the geographic diversity noted above, but also in terms of the mix of longer cases and shorter cases. In addition, I have pushed myself to participate more actively in case writing. Therefore, I am very proud to report that of the 23 Integrative Cases in the third edition, I personally wrote 10 (43%). This compares very favorably to the one Integrative Case out of a total of 15 that I personally authored in the second edition (representing a mere 7%).

Of course, in addition to these new features, every chapter has been thoroughly updated. Of the 23 Integrative Cases, 19 (83%) are new to this edition. PengAtlas maps have also been updated to capture the latest statistics.

The new BBC News Video Cases provide current, real-world examples of key course topics. The set covers such diverse countries as Brazil, China, Cuba, Dubai, India, Thailand, and Uruguay, and features a broad array of industries from high-tech manufacturing to goat farming.

## Support Materials

A full set of supplements is available for students and adopting instructors, all designed to facilitate ease of learning, teaching, and testing.

**Global Business CourseMate.** Cengage Learning's Global Business CourseMate brings course concepts to life with interactive learning, study, and exam preparation tools that support the printed textbook. Through this website, available for an additional fee, students will have access to their own set of PowerPoint® slides, flashcards, and games, as well as the Learning Objectives and Glossary for quick reviews. A set of auto-gradable, interactive quizzes (prepared by Timothy R. Muth of Florida Institute of Technology) will allow students to instantly gauge their comprehension of the material. The quizzes are all tagged to the book's Learning Objectives, Bloom's taxonomy, and national standards. Finally, Global Business CourseMate includes interactive maps that delve more deeply into key concepts presented in the book.



**Product Support Website.** The flashcards, Learning Objectives, and Glossary are available for quick reference on our complimentary student product support website.

**Webtutor on BlackBoard® and Webtutor on WebCT.™** Available on two different platforms, *Global Business* Webtutor enhances students' understanding of the material by featuring the Opening Cases and Video Cases, as well as the Glossary, study flashcards, and interactive maps that delve more deeply into key concepts presented in the book.

**CengageNOW™ Course Management System.** Designed by instructors for instructors, CengageNOW™ mirrors the natural teaching workflow with an



easy-to-use online suite of services and resources, all in one program. With this system, instructors can easily plan their courses, manage student assignments, automatically grade, teach with dynamic technology, and assess student progress with pre- and post-tests tagged to course outcomes and national standards. For students, study tools include flashcards, PowerPoint® slides, media quizzes, guided cases, and a set of quizzes based on interactive maps that enhance comprehension of the material and develop cultural and geographic literacy. Diagnostic tools create a personalized study plan for each student that focuses their study efforts. CengageNOW™ operates seamlessly with WebCT™, Blackboard®, and other course management tools.

**Global Economic Watch.** Cengage Learning's Global Economic Watch helps instructors bring these pivotal current events into the classroom through a powerful, continuously updated online suite of content, discussion forums, testing tools, and more. The Watch, a first-of-its-kind resource, stimulates discussion and understanding of the global downturn with easily integrated teaching solutions:

- A thorough overview and timeline of events leading up to the global economic crisis are included in the ebook module, *Impact of the Global Economic Crisis on Small Business*
- A content-rich blog of breaking news, expert analysis, and commentary—updated multiple times daily—plus links to many other blogs
- A powerful real-time database of hundreds of relevant and vetted journal, newspaper, and periodical articles, videos, and podcasts—updated four times every day
- Discussion and testing content, PowerPoint® slides on key topics, sample syllabi, and other teaching resources

History is happening now, so bring it into the classroom with The Watch at [www.cengage.com/thewatch](http://www.cengage.com/thewatch).

**Instructor's Resource CD (IRCD).** Instructors will find all of the teaching resources they need to plan, teach, grade, and assess student understanding and progress at their fingertips with this all-in-one resource for *Global Business*. The IRCD contains:

- Instructor's Manual—This valuable, time-saving Instructor's Manual includes comprehensive resources to streamline course preparation, including teaching suggestions, lecture notes, answers to all chapter questions, and Integrative Case discussion guides. Also included are discussion guidelines and answers for the Video Cases, prepared by Carol Decker.
- Test Bank—The *Global Business* Test Bank in ExamView® software allows instructors to create customized texts by choosing from 35 True/False, 35 Multiple Choice, and at least 8 short answer/essay questions for each of the 17 chapters. Ranging in difficulty, all questions have been tagged to the text's Learning Objectives, Bloom's taxonomy, and other national standards to ensure that students are meeting the course criteria.
- PowerPoint® Slides—This comprehensive set of more than 250 Powerpoint® slides will assist instructors in the presentation of the chapter material, enabling students to synthesize key global concepts.

**Global Business DVD.** Perhaps one of the most exciting and compelling bonus features of this program, these 17 short and powerful video clips, produced by BBC

News, provide current and relevant real-world examples. The set covers such diverse countries as Brazil, China, Cuba, Dubai, India, Thailand, and Uruguay, and features a broad array of industries from high-tech manufacturing to goat farming.

**Instructor Product Support Website.** For those instructors who prefer to access supplements online, the Instructor's Manual, PowerPoint® slides, and Test Bank are also available through the instructor's product support website.

## Acknowledgments

As *Global Business* launches its third edition, I first want to thank all the customers—professors, instructors, and students around the world who have made the book's success possible. A special thank-you goes to my friend and colleague, Klaus Meyer (China Europe International Business School), who spearheaded the development of *International Business*, which was tailored for European (or, more broadly, European, Middle Eastern, and African [EMEA]) students. Klaus has made *Global Business* more global.

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MWP

*December 1, 2012*



# About the Author

**Mike W. Peng** is the Jindal Chair of Global Business Strategy at the Jindal School of Management, University of Texas at Dallas, a National Science Foundation CAREER Award winner, and a Fellow of the Academy of International Business. He is also Executive Director of the Center for Global Business, which he founded. At UT Dallas, he has been the number-one contributor to the 45 top journals tracked by *Financial Times*, which has ranked UT Dallas as a top-20 school in research worldwide and its MBA and EMBA programs increasingly in the top tier.

Professor Peng holds a bachelor's degree from Winona State University, Minnesota, and a PhD degree from the University of Washington, Seattle. Between 2005 and 2011, he was the first Provost's Distinguished Professor at UT Dallas, a chair position that was created to attract him to join the faculty. He had previously been an associate professor (with tenure) at the Ohio State University. Prior to that, he had served on the faculty at the Chinese University of Hong Kong and the University of Hawaii. He has taught in five states in the United States (Hawaii, Ohio, Tennessee, Texas, and Washington) as well as China, Hong Kong, and Vietnam. He has also held visiting or courtesy appointments in Australia, Britain, China, Denmark, Hong Kong, and the United States. In addition to these countries, he has presented papers in Austria, Brazil, France, Germany, Japan, Macau, Puerto Rico, Singapore, South Korea, Switzerland, and Taiwan.

Professor Peng is one of the most prolific and most influential scholars in international business (IB). During the decade 1996–2006, he was the top-seven contributor to IB's number-one premier outlet: *Journal of International Business Studies*. His research is also among some of the most widely cited—both the United Nations and the World Bank have cited his work. A *Journal of Management* article found him to be among the top 65 most widely cited management scholars, and an *Academy of Management Perspectives* study found him to be the fourth most influential management scholar both inside and outside of academia (measured by academic citations and non-edu Google webpages) among professors who obtained their PhD since 1991. Overall, Professor Peng has published over 100 articles in leading journals, over 30 pieces in non-refereed outlets, and five books. Since the launch of *Global Business's* second edition, he has published not only in top IB journals, such as the *Academy of Management Journal*, *Journal of International Business Studies*, *Journal of World Business*, and *Strategic Management Journal*, but also in leading outlets in operations (*Journal of Operations Management*), entrepreneurship (*Journal of Business Venturing* and *Entrepreneurship Theory and Practice*), and human resources (*International Journal of Human Resource Management*).

Professor Peng's market leading textbooks, *Global Business*, *Global Strategy*, and *GLOBAL*, are studied in over 30 countries and have been translated into Chinese, Spanish, and Portuguese. A European adaptation, *International Business* (with Klaus Meyer), has been successfully launched.

Professor Peng is active in leadership positions. He has served on the editorial boards of *AMJ*, *AMR*, *JIBS*, *JMS*, *JWB*, and *SMJ*, and guest-edited a special



courtesy of Mike Peng



issue for the *JMS*. At the Academy of International Business (AIB), he co-chaired the AIB/*JIBS* Frontiers Conference in San Diego (2006), guest-edited a *JIBS* special issue (2010), chaired the Emerging and Transition Economies track for the Nagoya conference (2011), and chaired the Richard Farmer Best Dissertation Award Committee for the Washington conference (2012). In 2012, he was elected to be a Fellow of the AIB, joining a distinguished group of about 80 senior scholars who made most significant contributions to IB. At the Strategic Management Society (SMS), he was elected to chair the Global Strategy Interest Group. He also co-chaired the SMS Special Conference on China in Shanghai (2007). He served one term as Editor-in-Chief of the *Asia Pacific Journal of Management*. During his editorial tenure, he managed the doubling of submission numbers and the successful bid to enter the Social Sciences Citation Index (SSCI), which reported *APJM's* first citation impact to be 3.36 and rated it as the top 18 among 140 management journals for 2010.

Professor Peng is also an active consultant, trainer, and keynote speaker. He has provided on-the-job training to over 300 professors. He has consulted and been a keynote speaker for multinational enterprises (such as AstraZeneca, Berlitz, KOSTA, Nationwide, SAFRAN, and Texas Instruments), non-profit organizations (such as Greater Dallas Asian American Chamber of Commerce and World Affairs Council of Dallas-Fort Worth), educational and funding organizations (such as Harvard University Kennedy School of Government, Hong Kong Research Grants Council, National Science Foundation of the United States, Social Sciences and Humanities Research Council of Canada, and the University of Memphis), and national and international organizations (such as the US-China Business Council, US Navy, and World Bank).

Professor Peng has attracted close to \$1 million in external funding. His honors include a National Science Foundation CAREER Grant, a US Small Business Administration Best Paper Award, a (lifetime) Distinguished Scholar Award from the Southwestern Academy of Management, and a (lifetime) Scholarly Contribution Award from the International Association for Chinese Management Research. He has been quoted in *The Economist*, *Newsweek*, *Dallas Morning News*, *Smart Business Dallas*, *Atlanta Journal-Constitution*, *The Exporter Magazine*, *The World Journal*, *Business Times* (Singapore), *Sing Tao Daily* (Vancouver), and *Brasil Econômico* (São Paulo), and on the Voice of America.



**PART**  
**1**

# Laying Foundations



Digital Art/Spirit/Corbis

## Chapters

- 1 Globalizing Business
- 2 Understanding Formal Institutions: Politics, Laws, and Economics
- 3 Emphasizing Informal Institutions: Cultures, Ethics, and Norms
- 4 Leveraging Resources and Capabilities

# CHAPTER 1



India Pictures RM/Dinodia Photos/Alamy Limited

## Learning Objectives

After studying this chapter, you should be able to

- 1-1** explain the concepts of international business and global business, with a focus on emerging economies.
- 1-2** give three reasons why it is important to study global business.
- 1-3** articulate one fundamental question and two core perspectives in the study of global business.
- 1-4** identify three ways of understanding what globalization is.
- 1-5** state the size of the global economy and its broad trends and understand your likely bias in the globalization debate.

# Globalizing Business

## O P E N I N G C A S E

### EMERGING MARKETS: Mahindra & Mahindra versus John Deere

In 1994, when Mahindra & Mahindra (M&M) arrived in the United States, it was already a powerhouse in its native India. The company, founded as a steelmaker in 1945, had entered the agriculture market nearly 20 years later, partnering with International Harvester to manufacture a line of sturdy 35-horsepower tractors under the Mahindra name.

The Mahindra tractors became very popular in India. They were affordably priced and fuel efficient, two qualities highly valued by thrifty Indian farmers, and the machines were sized appropriately for small Indian farms. Over the years, M&M continued to innovate to perfect its offerings, and its tractors proliferated throughout India's vast agricultural regions. The Mahindra brand became well established and respected. By the mid-1990s, the company was one of India's top tractor manufacturers—and it was ready for new challenges. The lucrative US market beckoned.

When Mahindra USA (MUSA) opened for business, Deere & Company—famous for its John Deere brand—was the dominant player. Deere's bread and butter were enormous machines ranging as high as 600 horsepower for industrial-scale agribusiness. Rather than trying to develop a product that could compete head-on with Deere, M&M aimed for a smaller agricultural niche, one in which it could grow and make the most of its strengths.

Mahindra figured its little tractor would be perfect for hobby farmers, landscapers, and building contractors. The machine was sturdy, extremely reliable, and priced to sell. With a few modifications for the US market—such as supersized seats and larger brake pedals to accommodate larger American bodies—Mahindra was good to go.

But the company was far from home and hardly a household name. The few Americans who had heard of the brand thought of it variously as "red," "foreign," or "cheap." Even domestic competitors were barely aware of the newcomer. Deere gave more of its attention to Case and New Holland than to Mahindra. Flying below the radar, MUSA decided to make its mark through personalized service.

MUSA built close relationships with small dealerships, particular family-run operations. Rather than saddle dealers with expensive inventory, MUSA allowed them to run on a just-in-time basis, offering to deliver a tractor within 24 to 48 hours of receiving the order. MUSA also facilitated financing. In return, Mahindra benefited from the trust the dealers enjoyed in their communities.

MUSA also built close relationships with customers. Some 10% to 15% of M&M tractor buyers got phone calls from the company's president, who asked whether they were pleased with the buying experience and their new tractors. The company also offered special incentives—horticultural scholarships,



for example—to neglected market segments such as female hobby farmers.

This high-touch strategy paid off handsomely. MUSA's US sales growth averaged 40% per year from 1999 to 2006. This prompted David C. Everitt, president of Deere's agricultural division, to remark that Mahindra "could someday pass Deere in global unit sales."

Deere responded with short-lived—and seemingly desperate—cash incentives to induce Mahindra buyers to trade for a Deere. This had the unintended effect of promoting M&M's brand ("And we didn't even pay for it," said Anjou Choudhari, CEO of M&M's farm equipment sector from 2005 to 2010). Mahindra fired back with an ad featuring the headline: "Deere John, I have found someone new."

As Mahindra enjoyed growing success in America, Deere struggled to gain a foothold in India. Unlike

Mahindra, which had innovated both its product and its processes for the US market, Deere tried to tempt Indian farmers with the same product that had underwritten its success at home. The strategy did not work, and Deere was forced to re-engineer its thinking as well as its product.

"We gave a wake-up call to John Deere," noted Choudhari. "Our global threat was one of the motivations for Deere to design a low-horsepower tractor—in India and for India."

In the meantime, M&M has become the number-one tractor maker worldwide, as measured by units sold.

Source: This case was written by Professors **Vijay Govindarajan** and **Chris Trimble** (both at the Tuck School of Business, Dartmouth College). It was an excerpt from V. Govindarajan & C. Trimble, 2012, *Reverse Innovation* (pp. 10–11), Boston: Harvard Business Review Press.

How do firms such as Mahindra & Mahindra and Deere compete in India, the United States, and elsewhere? 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

### Learning Objective

Explain the concepts of international business and global business, with a focus on emerging economies.

### International business (IB)

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

### Multinational enterprise (MNE)

A firm that engages in foreign direct investment (FDI).

### Foreign direct investment (FDI)

Investment in, controlling, and managing value-added activities in other countries.

## 1-1 What Is Global Business?

### 1-1a Defining International Business and 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. The 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.<sup>1</sup> Using our Opening Case, traditional IB textbooks would focus on how MNEs such as Deere enter India by undertaking FDI there. MNEs and their cross-border activities are, of course, important, but they only cover 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. Of course, that is not true. Domestic firms such as Mahindra & Mahindra do not just sit around in the face of foreign entrants. Domestic firms actively compete and/or collaborate with foreign entrants such as International Harvester. Sometimes strong domestic firms such as Mahindra & Mahindra have also gone overseas themselves. Overall, focusing on the foreign entrant side captures only one side of the coin at best.<sup>2</sup>

There are *two* key words in IB: international (I) and business (B).<sup>3</sup> However, many previous textbooks focus on the international aspect (the foreign entrant) to such an 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* one with the word “business” in its 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 (rather than 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.

To cover both the I and the B parts, **global business** is defined in this book as business around the globe—thus, the title of this book is *Global Business* (not IB). In other words, global business includes both (1) international (cross-border) business activities covered by traditional IB books *and* (2) domestic 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.

Consider the competition in college textbooks, such as this *Global Business* book you are studying now. Not long ago, competition among college business textbook publishers was primarily on a nation-by-nation basis. The Big Three—South-Western Cengage Learning (our publisher, which is the biggest in the college business textbook market), Prentice Hall, and McGraw-Hill—primarily competed in the United States. A different set of publishers competed in other countries. As a result, most textbooks studied by British students would be authored by British professors and published by British publishers, most textbooks studied by Brazilian students would be authored by Brazilian professors and published by Brazilian publishers, and so on. Now South-Western Cengage Learning (under British and Canadian ownership), Pearson Prentice Hall (under British ownership), and McGraw-Hill (still under US ownership) have significantly globalized their competition, thanks to the rising demand for high-quality business textbooks in English. Around the globe, they are competing against each other in many markets, publishing in multiple languages and versions. For instance, *Global Business* and its sister books, *Global Strategy*, *GLOBAL* (paperback), and *International Business* (an adaptation for the European market), 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 Business* has to win adoption from every class, every semester. Overall, it becomes difficult to tell in this competition what is international and what is domestic. Thus, “global” seems to be a better word to capture the essence of this competition.

## 1-1b Global Business and Emerging Economies

*Global Business* also differs from other books on IB 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** (see PengAtlas Map 1.1). How important are emerging economies? Collectively, they now contribute approximately 45% of the global **gross domestic product (GDP)**, as shown in Figure 1.1. Note that this percentage is adjusted for **purchasing power parity (PPP)**, which is an adjustment to reflect the differences in cost of living (see In Focus 1.1). Using official (nominal) exchange rates

### Global business

Business around the globe.

### Emerging economies

A term that has gradually replaced the term “developing countries” since the 1990s.

### Emerging markets

A term that is often used interchangeably with “emerging economies.”

### Gross domestic product (GDP)

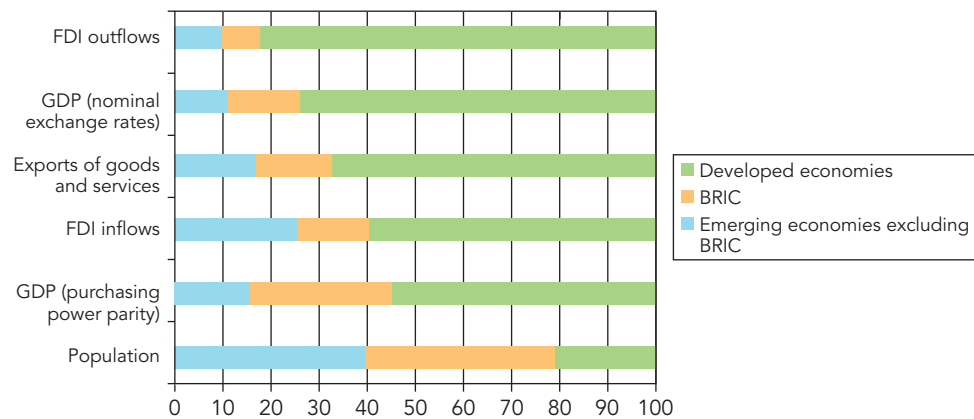
The sum of value added by *resident* firms, households, and governments operating in an economy.

### Purchasing power parity (PPP)

A conversion that determines the equivalent amount of goods and services that different currencies can purchase.



**Figure 1.1** The Contributions of Emerging Economies Relative to Developed Economies (World %)



Sources: Data extracted from (1) United Nations, 2011, *World Investment Report 2011*, New York and Geneva: UN; (2) World Bank, 2012, *World Development Indicators database*, Washington: World Bank. All data refer to 2011.

### Gross national product (GNP)

GDP plus income from non-resident sources abroad.

### Gross national income (GNI)

GDP plus income from non-resident sources abroad. GNI is the term used by the World Bank and other international organizations to supersede the term GNP.



## IN FOCUS 1.1

### Setting the Terms Straight

GDP, GNP, GNI, PPP—there is a bewildering variety of acronyms that are used to measure economic development. It is useful to set these terms straight before proceeding. Gross domestic product (GDP) is measured as the sum of value added by *resident* firms, households, and governments operating in an economy. For example, the value added by foreign-owned firms operating in Mexico would be counted as part of Mexico's GDP. However, the earnings of *non-resident* sources that are sent back to Mexico (such as earnings of Mexicans who do not live and work in Mexico and dividends received by Mexicans who own non-Mexican stocks) are not included in Mexico's GDP. One measure that captures this is **gross national product (GNP)**. More recently, the World Bank and other international organizations have used a new term, **gross national income (GNI)**, to supersede GNP. Conceptually, there is no difference between GNI and GNP. What exactly is GNI/GNP? It comprises GDP plus income from non-resident sources abroad.

While GDP, GNP, and now GNI are often used as yardsticks of economic development, differences in cost of living make such a direct comparison less meaningful. A dollar of spending in, say, Thailand can buy a lot more than in Japan. Therefore, conversion based on purchasing power parity (PPP) is often necessary.

The PPP between two countries is the rate at which the currency of one country needs to be converted into that of a second country to ensure that a given amount of the first country's currency will purchase the same volume of goods and services in the second country (see Chapter 7 for details). According to the International Monetary Fund (IMF), the Swiss per capita GDP is \$81,161 based on official (nominal) exchange rates—*higher* than the US per capita GDP of \$48,387. However, everything is more expensive in Switzerland. A Big Mac costs \$6.81 in Switzerland versus \$4.20 in the United States. Thus, Switzerland's per capita GDP based on PPP becomes \$43,370—*lower* than the US per capita GDP based on PPP, \$48,387 (the IMF uses the United States as benchmark in PPP calculation). On a worldwide basis, measured at official exchange rates, emerging economies' share of global GDP is approximately 26%. However, measured at PPP, it is about 43% of the global GDP. Overall, when you read statistics about GDP, GNP, and GNI, always pay attention to whether these numbers are based on official exchange rates or PPP, which can make a huge difference.

Sources: Based on (1) *Economist*, 2012, Big Mac index, January 14: 93; (2) *Economist*, 2006, Grossly distorted picture, February 11: 72; (3) International Monetary Fund, 2012, *World Economic Outlook*, April, Washington, DC: IMF.

**Table 1.1** Classifying Developed Economies versus Emerging Economies

33 developed economies as classified by the International Monetary Fund (IMF)		
Australia	Hong Kong	Portugal
Austria	Iceland	Singapore
Belgium	Ireland	Slovak Republic
Canada	Israel	Slovenia
Cyprus	Italy	South Korea
Czech Republic	Japan	Spain
Denmark	Luxembourg	Sweden
Finland	Malta	Switzerland
France	Netherlands	Taiwan
Germany	New Zealand	United Kingdom
Greece	Norway	United States
All the other 149 economies are classified by the IMF as emerging economies		

Source: IMF, [www.imf.org](http://www.imf.org). The IMF recognizes 182 countries and economies. It labels developed economies “advanced economies” and labels emerging economies “emerging and developing economies.”

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 instance, one dollar spent in Mexico can buy a lot more than one dollar spent in the United States.

Table 1.1 lists the 33 countries that are classified as “developed economies.” The rest of the world (more than 150 countries) can be broadly labeled as “emerging economies.” Of these emerging economies, Brazil, Russia, India, and China—commonly referred to as **BRIC**—command more attention. As a group, they generate 17% of world exports, absorb 16% of FDI inflows, and contribute 28% of world GDP (on a PPP basis). Commanding a lion’s share, BRIC contribute 62% of the GDP of all emerging economies (on a PPP basis). BRIC also generate 8% of world FDI outflows. MNEs from BRIC (such as Mahindra & Mahindra in the Opening Case) are increasingly visible in making investments and acquiring firms around the world.<sup>4</sup> Clearly, major emerging economies (especially BRIC) and their firms have become a force to be reckoned with in global business.<sup>5</sup> In addition to BRIC, other interesting terms include BRICS (BRIC + South Africa), BRICM (BRIC + Mexico), and BRICET (BRIC + Eastern Europe and Turkey).

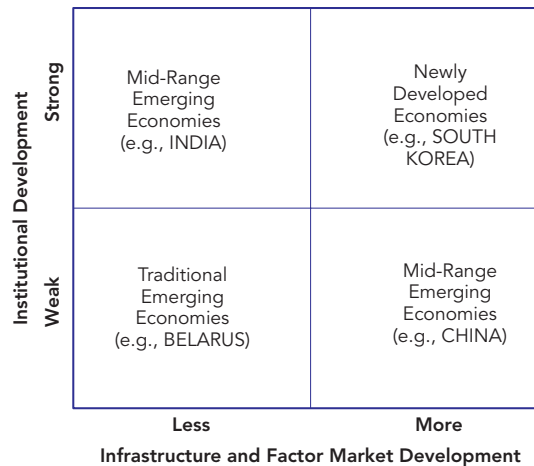
Does it make sense to group so many countries with tremendous diversity in terms of history, geography, politics, and economics together as “emerging economies”? As compared to developed economies, the label of “emerging economies,” rightly or wrongly, has emphasized the presumably homogenous nature of so many different countries. While this single label has been useful, more recent research has endeavored to enrich it.<sup>6</sup>

Specifically, the two dimensions illustrated in Figure 1.2 can help us differentiate various emerging economies.<sup>7</sup> Vertically, the development of market-supporting political, legal, and economic institutions has been noted as a crucial dimension of

### BRIC

Brazil, Russia, India, and China.



**Figure 1.2** A Typology of Emerging Economies

Source: Adapted from R. Hoskisson, M. Wright, I. Filatotchev, & M. W. Peng, 2013, Emerging multinationals from mid-range economies: The influence of institutions and factor markets, *Journal of Management Studies* (in press).

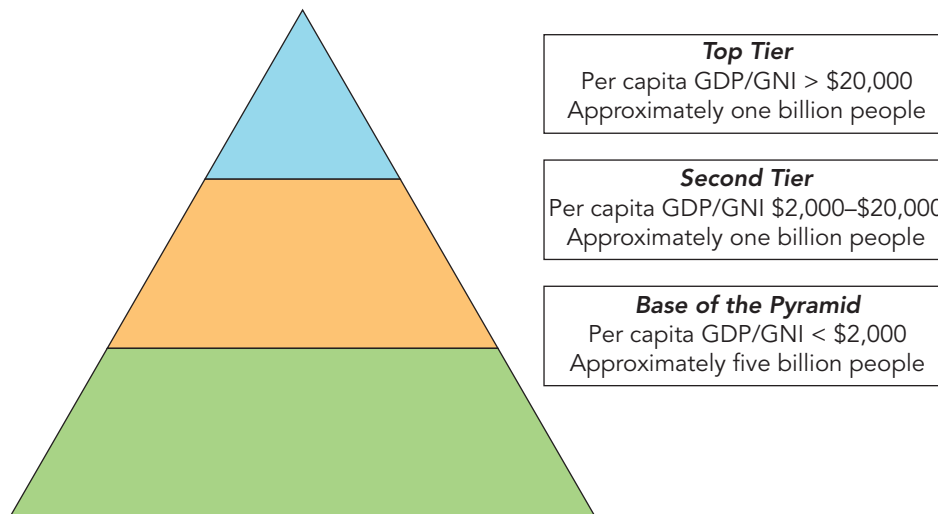
institutional transitions in many emerging economies.<sup>8</sup> Horizontally, the development of infrastructure and factor markets is also crucial.

Stereotypical or traditional emerging economies suffer from both the lack of institutional development and the lack of infrastructure and factor market development. Most emerging economies 20 years ago would have fit this description. Today, some emerging economies that have made relatively little progress along these two dimensions (such as Belarus and Zimbabwe) still exist.

However, a lot has changed. A great deal of institutional development and infrastructure and factor market development have taken place. Such wide-ranging development has resulted in the emergence of a class of *mid-range* emerging economies that differ from both traditional emerging economies and developed economies. For example, the top down approach to government found in China has facilitated infrastructure and factor market development. But China's political and market institutions tend to be underdeveloped relative to physical infrastructure. Alternatively, India has strong political institutions supporting market institutions (although there is still significant corruption in government bureaucracies). While Indian government policy reforms have facilitated better market institutions and associated economic development, world-class physical infrastructure is lacking. In the middle area of Figure 1.2, Brazil and Russia can be placed as examples. In these mid-range emerging economies, there are some democratic political institutions (despite the recent setback in Russia—see Chapter 2 Opening Case) and some infrastructure and factor market development. Finally, some economies have clearly graduated from the “emerging” phase and become what we call “newly developed economies.” South Korea may be an exemplar country as it has more balanced development in both institutional development and infrastructure/factor markets.

### 1-1c Base of the Pyramid and Reverse Innovation

The global economy can be viewed as a pyramid (Figure 1.3). The top consists of about one billion people with per capita annual income of \$20,000 or higher.

**Figure 1.3** The Global Economic Pyramid

Sources: Adapted from (1) C. K. Prahalad & S. Hart, 2002, The fortune at the bottom of the pyramid, *Strategy+Business*, 26: 54-67; (2) S. Hart, 2005, *Capitalism at the Crossroads* (p. 111), Philadelphia: Wharton School Publishing.

These are mostly people who live in the developed economies in the **Triad**, which consists of North America, Western Europe, and Japan. Another billion people earning \$2,000 to \$20,000 per year make up the second tier. The vast majority of humanity—about five billion people—earn less than \$2,000 per year and comprise the **base of the pyramid (BOP)**. Most MNEs focus on the top and second tiers and end up ignoring the base of the pyramid.<sup>9</sup> An increasing number of such low-income countries have shown a great deal of economic opportunities as income levels have risen (see the Closing Case). More Western MNEs, such as GE, are investing aggressively in the base of the pyramid and leveraging their investment to tackle markets in both emerging and developed economies.

One interesting recent development out of emerging economies is **reverse innovation**—an innovation that is adopted first in emerging economies and then diffused around the world.<sup>10</sup> Traditionally, innovations are generated by Triad-based multinationals with the needs and wants of rich customers at the top of the pyramid in mind. When such multinationals entered lower-income economies, they tended to simplify the product features and lower the prices. In other words, the innovation flow is *top down*. However, as Deere & Company found out in India, its large-horsepower tractors designed for American farmers were a poor fit for the very different needs and wants of Indian farmers. Despite Deere's efforts to simplify the product and reduce the price, the price was still too high in India. Instead, Mahindra & Mahindra brought its widely popular small-horsepower tractors that were developed in India to the United States, and carved out a growing niche that eventually propelled it to be the world's largest tractor maker by units sold (see the Opening Case). In response, Deere abandoned its US tractor designs and "went native" in India, by launching a local design team charged with developing something from scratch—with the needs and wants of farmers in India (or, more broadly, in emerging economies) in mind. The result was a 35-horsepower tractor that

#### Triad

North America, Western Europe, and Japan.

#### Base of the pyramid (BOP)

Economies where people make less than \$2,000 per capita per year.

#### Reverse innovation

An innovation that is adopted first in emerging economies and is then diffused around the world.