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Global Business Today

Charles W. L. Hill | G. Tomas M. Hult

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For my mother June Hill, and the memory of my father, Mike Hill

—Charles W. L. Hill

For Gert & Margareta Hult, my parents

—G. Tomas M. Hult

about the authors

Charles W. L. Hill

University of Washington

Charles W. L. Hill is the Hughes M. and Katherine Blake Professor of Strategy and International Business at the Foster School of Business, University of Washington. The Foster School has a Center for International Business Education and Research (CIBER), one of only 17 funded by the U.S. Department of Education.

Professor Hill received his PhD from the University of Manchester in the United Kingdom. In addition to the University of Washington, he has served on the faculties of the University of Manchester, Texas A&M University, and Michigan State University.

Professor Hill has published over 50 articles in peer-reviewed academic journals including the *Academy of Management Journal, Academy of Management Review, Strategic Management Journal,* and *Organization Science.* He has also published several textbooks including *International Business* (McGraw-Hill) and *Global Business Today* (McGraw-Hill). His work is among the most widely cited in international business and strategic management.

Professor Hill has taught in the MBA, Executive MBA, Technology Management MBA, Management, and PhD programs at the University of Washington. During his time at the University of Washington, he has received over 25 awards for teaching excellence, including multiple Charles E. Summer Outstanding Teaching Awards, most recently in 2016.

Professor Hill works on a private basis with a number of organizations. His clients have included Microsoft, where he has been teaching in-house executive education courses for two decades. He has also consulted for a variety of other large companies (e.g., AT&T Wireless, Boeing, BF Goodrich, Group Health, Hexcel, Microsoft, Philips Healthcare, Philips Medical Systems, Seattle City Light, Swedish Health Services, Tacoma City Light, Thompson Financial Services, WRQ, and Wizards of the Coast).

Professor Hill has served on the advisory board of several start-up companies. For recreation, Professor Hill enjoys mountaineering, rock climbing, skiing, and competitive sailing.

G. Tomas M. Hult

Michigan State University

G. Tomas M. Hult is the John W. Byington Endowed Chair, Professor of Marketing and International Business, and Director of the International Business Center in the Eli Broad College of Business at Michigan State University. The Eli Broad College of Business has a Center for International Business Education and Research (CIBER), one of only 17 funded by the U.S. Department of Education. Professor Hult serves as the CIBER Director, and he is also currently President of the 17-university CIBER coalition.

Professor Hult is an elected Fellow of the Academy of International Business (AIB), one of only about 80 scholars worldwide receiving this honor. He also serves as the Executive Director and Foundation President of AIB. Professor Hult serves on the U.S. District Export Council and holds board member positions of the International Trade Center of Mid-Michigan, Global Business Club of Mid-Michigan, and the Sheth Foundation.

Several studies have ranked Professor Hult as one of the most cited scholars in the world in business and management. He has served as editor of *Journal of the Academy of Marketing Science* and has published more than 60 articles in premier business journals, including *Journal of International Business Studies, Academy of Management Journal, Strategic Management Journal, Journal of Management, Journal of Marketing, Journal of the Academy of Marketing Science, Journal of Retailing, Journal of Operations Management, Decision Sciences,* and *IEEE*.

Professor Hult has also published several books: *International Business* (2017), *Second Shift* (2017), *Global Business Today* (2016), *Global Supply Chain Management* (2014), *Total Global Strategy* (2012), and *Extending the Supply Chain* (2005). He is a regular contributor of articles in the popular press (e.g., *Time, Fortune, World Economic Forum, The Conversation*).

Professor Hult is a well-known keynote speaker on international business, international marketing, global supply chain management, global strategy, and marketing strategy. He teaches in doctoral, master's, and undergraduate programs at Michigan State University, and he is a visiting professor at Leeds University (United Kingdom) and Uppsala University (Sweden).

He also teaches frequently in executive development programs and has developed a large clientele of the world's top multinational corporations (e.g., ABB, Albertsons, Avon, BG, Bechtel, Bosch, BP, Defense Logistics Agency, Domino's, FedEx, Ford, FreshDirect, General Motors, Grocery-Gateway, HSBC, IBM, Michigan Economic Development Corporation, Masco, NASA, Raytheon, Shell, Siemens, State Farm, Steelcase, Tech Data, and Xerox).

Tomas Hult is a dual citizen of the United States and Sweden, and lives in Okemos, Michigan, with his wife, Laurie, and their children, Daniel and Isabelle. Tennis, golf, and traveling are his favorite recreational activities.

brief contents

the proven choice for international business

Current. Application Rich, Relevant. Accessible and Student Focused.

Global Business Today (GBT), the worldwide market leader among international business products, has set a new standard for international business teaching. We have focused on creating resources that:

- Are comprehensive, state of the art, and timely.
- Are theoretically sound and practically relevant.
- Focus on applications of international business concepts.
- Tightly integrate the chapter topics throughout.
- Are fully integrated with results-driven technology.
- Take full and integrative advantage of globalEDGE.msu.edu—the Google-ranked #1 web resource for "international business resources."

International Business (now in its 11th edition, 2017), also co-authored by Charles W.L. Hill and G. Tomas M. Hult, is a more comprehensive and case-oriented version that lends itself to the core course in international business for those courses that want a deeper focus on the global monetary system, structure of international business, international accounting, and international finance.

GBT has always endeavored to be current, relevant, application rich, and accessible and student focused. Our goal has always been to cover macro and micro issues equally and in a relevant, practical, accessible, and student focused approach. We believe that anything short of such a breadth and depth of coverage is a serious deficiency. Many of the students in these international business courses will soon be working in global businesses, and they will be expected to understand the implications of international business for their organization's strategy, structure, and functions in the context of the global marketplace. We are proud and delighted to have put together this international business learning experience for the leaders of tomorrow.

Over the years, and through now 10 editions, Dr. Charles Hill has worked hard to adhere to these goals. Since the ninth edition, Charles' coauthor, Dr. Tomas Hult, follows the same approach. In deciding what changes to make, we have been guided not only by our own reading, teaching, and research but also by the invaluable feedback we received from professors and students around the world, from reviewers, and from the editorial staff at McGraw-Hill Education. Our thanks go out to all of them.

Comprehensive and Up-to-Date

To be relevant and comprehensive, an international business package must

- Explain how and why the world's cultures, countries, and regions differ.
- Cover economics and politics of international trade and investment.
- Tackle international issues related to ethics, corporate social responsibility, and sustainability.
- Explain the functions and form of the global monetary system.
- Examine the strategies and structures of international businesses.
- Assess the special roles of the various functions of an international business.

Comprehensiveness and up-to-date also require coverage of the major theories. It has always been a goal to incorporate the insights gleaned from recent academic scholarship into the book. Consistent with this goal, insights from the following research, as a sample of theoretical streams used in the book, have been incorporated:

- New trade theory and strategic trade policy.
- The work of Nobel Prize–winning economist Amartya Sen on economic development.
- Samuel Huntington's influential thesis on the "clash of civilizations."
- Growth theory of economic development championed by Paul Romer and Gene Grossman.
- Empirical work by Jeffrey Sachs and others on the relationship between international trade and economic growth.
- Michael Porter's theory of the competitive advantage of nations.
- Robert Reich's work on national competitive advantage.
- The work of Nobel Prize–winner Douglass North and others on national institutional structures and the protection of property rights.
- The market imperfections approach to foreign direct investment that has grown out of Ronald Coase and Oliver Williamson's work on transaction cost economics.
- Bartlett and Ghoshal's research on the transnational corporation.
- The writings of C. K. Prahalad and Gary Hamel on core competencies, global competition, and global strategic alliances.
- Insights for international business strategy that can be derived from the resource-based view of the firm and complementary theories.
- Paul Samuelson's critique of free trade theory.
- Conceptual and empirical work on global supply chain management—logistics, purchasing (sourcing), operations, and marketing channels.

In addition to including leading-edge theory, in light of the fast-changing nature of the international business environment we have made every effort to ensure that this product is as up-to-date as possible. A significant amount has happened in the world since we began revisions of this book. By 2016, almost $4 trillion per day were flowing across national borders. The size of such flows fueled concern about the ability of short-term speculative shifts in global capital markets to destabilize the world economy.

The world continued to become more global. Several Asian economies, most notably China and India, continued to grow their economies at a rapid rate. New multinationals continued to emerge from developing nations in addition to the world's established industrial powers. Increasingly, the globalization of the world economy affected a wide range of firms of all sizes, from the very large to the very small. And unfortunately, global terrorism and the attendant geopolitical risks keep emerging in various places globally, many new and inconceivable just a decade ago. These represent a threat to global economic integration and activity.

WHAT'S NEW IN THE 10TH EDITION The success of the first nine editions of *Global Business Today* was based in part on the incorporation of leading-edge research into the text, the use of the up-to-date examples and statistics to illustrate global trends and enterprise strategy, and the discussion of current events within the context of the appropriate theory. Building on these strengths, our goals for the 10th edition have focused on the following:

1. Incorporate new insights from scholarly research.
2. Make sure the content covers all appropriate issues.
3. Make sure the text is up-to-date with current events, statistics, and examples.
4. Add new and insightful opening and closing cases in most chapters.
5. Incorporate value-added globalEDGE™ features in every chapter.
6. Connect every chapter to a focus on managerial implications.
7. Incorporate a new *Did You Know?* feature in every chapter that links to mini-video cases.

As part of the overall revision process, changes have been made to every chapter in the book. All statistics have been updated to incorporate the most recently available data, which typically refer to 2014 and 2015. For example, new examples, cases, and boxes have been added and older examples updated to reflect new developments.

Importantly, every chapter of the 10th edition of *Global Business Today* has again incorporated value-added globalEDGE™ features in every chapter. The Google number-one-ranked globaledge.msu.edu site (for "international business resources") is used in each chapter to add value to the chapter material and provide up-to-date data and information. This feature was added for the ninth edition, and the marketplace (e.g., professors, instructors, and students) really liked the practical and up-to-date materials covered via globalEDGE™ and the integration into *Global Business Today*. This GBT-*globalEDGE™* integration keeps chapter material constantly and dynamically updated for teachers who want to infuse globalEDGE™ material into the chapter topics, and it keeps students abreast of current developments in international business.

In addition to updating all descriptive statistics, figures, and maps to incorporate most recently published data, a chapter-by-chapter selection of changes for the 10th edition include the following:

CHAPTER 1: GLOBALIZATION

- New Opening Case: Uber, Going Global from Day One
- New Management Focus: Boeing's Global Production System
- New Management Focus: The Dalian Wanda Group
- New Closing Case: Medical Tourism and the Globalization of Health Care

CHAPTER 2: NATIONAL DIFFERENCES IN POLITICAL, ECONOMIC, AND LEGAL SYSTEMS

- New Opening Case: Economic Transformation in Vietnam
- New Country Focus: Putin's Russia
- New Country Focus: Corruption in Brazil
- New Closing Case: Venezuela under Hugo Chavez and Beyond

CHAPTER 3: NATIONAL DIFFERENCES IN ECONOMIC DEVELOPMENT

- New Opening Case: The Political and Economic Evolution of Indonesia
- New Closing Case: Political and Economic Reform in Myanmar

CHAPTER 4: DIFFERENCES IN CULTURE

- New Opening Case: World Expo 2020 in Dubai, UAE
- Revised focus on business and culture
- New Closing Case: Best Buy and eBay in China

CHAPTER 5: ETHICS, CORPORATE SOCIAL RESPONSIBILITY, AND SUSTAINABILITY

- New Opening Case: UNCTAD Sustainable Development Goals
- Revised focus on corporate social responsibility and sustainability
- New Management Focus: Apple's Manufacturing—Always Ethical?
- Revised Closing Case: Making Toys Globally

CHAPTER 6: INTERNATIONAL TRADE THEORY

- New Opening Case: The Trans Pacific Partnership
- New Closing Case: Creating the World's Biggest Free Trade Zone
- The appendix, International Trade and the Balance of Payments, has been updated to include the most recently available balance-of-payments data

CHAPTER 7: GOVERNMENT POLICY AND INTERNATIONAL TRADE

- New Opening Case: Is China Dumping Its Excess Steel Production?
- New section: Multilateral and Bilateral Trade Agreements
- New Closing Case: Sugar Subsidies Drive Candy Makers Abroad

CHAPTER 8: FOREIGN DIRECT INVESTMENT

- New Opening Case: Burberry Shifts Its Strategy in Japan
- New Closing Case: Volkswagen in Russia

CHAPTER 9: REGIONAL ECONOMIC INTEGRATION

- New Opening Case: The Push Toward Free Trade in Africa
- New section: Regional Trade Blocs in Africa
- New Closing Case: Regional Trade Deals and the Mexican Auto Industry

CHAPTER 10: THE FOREIGN EXCHANGE MARKET

- New Opening Case: Apple's Earnings Hit by the Strong Dollar
- New Management Focus: Embraer and the Gyrations of the Brazilian Real
- New Closing Case: Subaru's Sales Boom Thanks to Weaker Yen

CHAPTER 11: THE INTERNATIONAL MONETARY SYSTEM

- New Opening Case: China's Exchange Rate Regime
- New Country Focus: The IMF and Iceland's Economic Recovery
- New Closing Case: The IMF and Ukraine's Economic Crisis

CHAPTER 12: THE STRATEGY OF INTERNATIONAL BUSINESS

- New Opening Case: AB InBev and Beer Globally
- New Management Focus: Ford Creating Value
- Revision of Management Focus boxes
- New Closing Case: IKEA and Its Strategy of International Business

CHAPTER 13: ENTERING FOREIGN MARKETS

- New Opening Case: Cutco Corporation—Sharpening Your Market Entry
- Revision to Entry Modes section
- Revision of Management Focus boxes
- New Closing Case: Starbucks' Foreign Entry Strategy

CHAPTER 14: EXPORTING, IMPORTING, AND COUNTERTRADE

- New Opening Case: Two Men and a Truck
- Added readiness to export and import material
- New Management Focus: Ambient Technologies and the Panama Canal
- Revision of Management Focus boxes
- Added material on globalEDGE™ Diagnostic Tools
- New Closing Case: Exporting Desserts

CHAPTER 15: GLOBAL PRODUCTION AND SUPPLY CHAIN MANAGEMENT

- New Opening Case: Amazon—A Leader in Global Supply Chain Management
- Revised integration of the supply chain (logistics, purchasing, production, and operations)
- Revised section on Global Supply Chain Functions
- New Management Focus: H&M and Their Order Timing
- Revision of Management Focus boxes
- Revised Closing Case: Apple: The Best Supply Chains in the World?

CHAPTER 16: GLOBAL MARKETING AND R&D

- New Opening Case: Domino's Global Marketing
- Revised section Configuring the Marketing Mix
- New Management Focus: Global Branding of Marvel's Movies
- Revision of Management Focus boxes
- New Closing Case: Burberry's Reinventing Its Global Marketing

CHAPTER 17: GLOBAL HUMAN RESOURCE MANAGEMENT

- Revised Opening Case: A Global Team at Mary Kay Inc.
- Revision of Management Focus boxes
- New Closing Case: Siemens and Global Competitiveness

Beyond Uncritical Presentation and Shallow Explanation

Many issues in international business are complex and thus necessitate considerations of pros and cons. To demonstrate this to students, we have adopted a critical approach that presents the arguments for and against economic theories, government policies, business strategies, organizational structures, and so on.

Related to this, we have attempted to explain the complexities of the many theories and phenomena unique to international business so the student might fully comprehend the statements of a theory or the reasons a phenomenon is the way it is. We believe that these theories and phenomena are explained in more depth in this work than they are in the competition, which seem to use the rationale that a shallow explanation is little better than no explanation. In international business, a little knowledge is indeed a dangerous thing.

Practical and Rich Applications

We have always believed that it is important to show students how the material covered in the text is relevant to the actual practice of international business. This is explicit in the later chapters of the book, which focus on the practice of international business, but it is not always obvious in the first half of the book, which considers macro topics. Accordingly, at the end of each chapter in Parts Two, Three, and Four—where the focus is on the environment of international business, as opposed to particular firms—there is a section titled **Focus on Managerial Implications**. In this section, the managerial implications of the material discussed in the chapter are clearly explained. Additionally, most chapters have at least one **Management Focus** box. The purpose of these boxes is to illustrate the relevance of chapter material for the practice of international business.

A new **Did You Know?** feature in each chapter challenges students to view the world around them through the lens of international business (e.g., Did you know that sugar prices in the United States are much higher than sugar prices in the rest of the world?). The authors recorded short videos explaining the phenomenon.

In addition, each chapter begins with an **opening case** that sets the stage for the chapter and ends with a **closing case** that illustrates the relevance of chapter material for the practice of international business.

To help students go a step further in expanding their application-level understanding of international business, each chapter incorporates two **globalEDGE research tasks** designed and written by Tomas Hult. The exercises dovetail with the content just covered.

Integrated Progression of Topics

A weakness of many texts is that they lack a tight, integrated flow of topics from chapter to chapter. This book explains to students in Chapter 1 how the book's topics are related to each other. Integration has been achieved by organizing the material so that each chapter builds on the material of the previous ones in a logical fashion.

PART ONE Chapter 1 provides an overview of the key issues to be addressed and explains the plan of the book. Globalization of markets and globalization of production is the core focus.

PART TWO Chapters 2 through 4 focus on country differences in political economy and culture, and Chapter 5 on ethics, corporate social responsibility, and sustainability issues in international business. Most international business textbooks place this material at a later point, but we believe it is vital to discuss national differences first. After all, many of the central issues in international trade and investment, the global monetary system, international business strategy and structure, and international business functions arise out of national differences in political economy and culture.

PART THREE Chapters 6 through 9 investigate the political economy of global trade and investment. The purpose of this part is to describe and explain the trade and investment environment in which international business occurs.

PART FOUR Chapters 10 and 11 describe and explain the global monetary system, laying out in detail the monetary framework in which international business transactions are conducted.

PART FIVE In Chapters 12 and 13, attention shifts from the environment to the firm. In other words, we move from a macro focus to a micro focus at this stage of the book. We examine strategies that firms adopt to compete effectively in the international business environment.

PART SIX In Chapters 14 through 17, the focus narrows further to investigate business functions and related operations. These chapters explain how firms can perform their key functions—exporting, importing, and countertrade; global production; global supply chain management; global marketing; global research and development (R&D); human resource management—to compete and succeed in the international business environment.

Throughout the book, the relationship of new material to topics discussed in earlier chapters is pointed out to the students to reinforce their understanding of how the material comprises an integrated whole. We deliberately bring a management focus to the macro chapters (Chapters 1 through 11). We also integrate macro themes in covering the micro chapters (Chapters 12 through 17).

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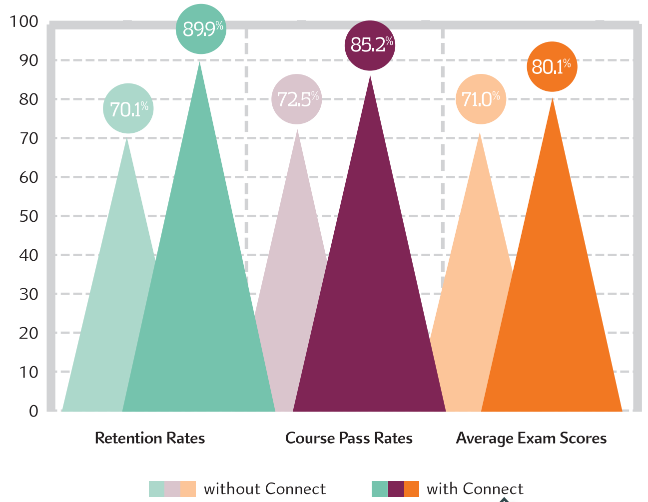

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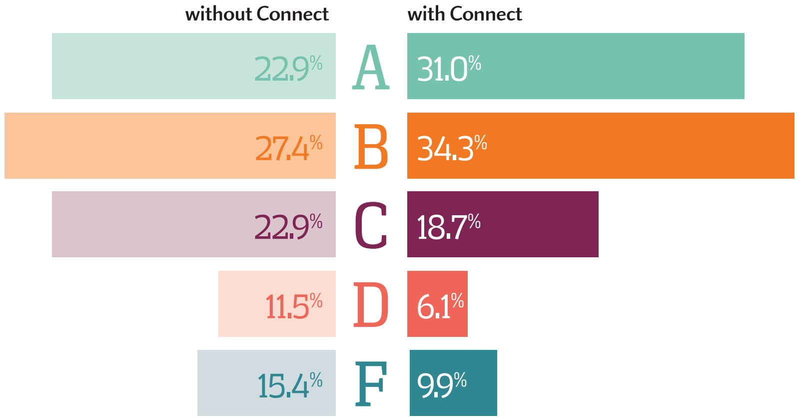

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contents

Global Business Today

Part 1 Introduction and Overview

Globalization

1

learning objectives

After reading this chapter, you will be able to:

LO1-1 Understand what is meant by the term *globalization*.

LO1-2 Recognize the main drivers of globalization.

LO1-3 Describe the changing nature of the global economy.

LO1-4 Explain the main arguments in the debate over the impact of globalization.

LO1-5 Understand how the process of globalization is creating opportunities and challenges for management practice.

Source: © Carl Court/Getty Images

Uber: Going Global from Day One

opening case

Uber, the controversial San Francisco–based ride for hire service, has made a virtue out of disrupting the established taxi business. From a standing start in 2009, the company has spread across the globe like wildfire. Uber's strategy has been to focus on major metropolitan areas around the world. By early 2016, this strategy had taken Uber into 375 cities in 68 countries. The privately held company is rumored to be generating annual revenues of around $10 billion.

At the core of Uber's business is a smartphone app that allows customers to hail a ride from the comfort of their own home, a restaurant, or a bar stool. The app shows cars in the area, notifies the rider when a car is on the way, and tracks the progress of the car on screen using GPS mapping technology. The rider pays via the app using a credit card, so no cash changes hands. The driver takes 80 percent of the fee and Uber 20 percent. The price for the ride is determined by Uber using an algorithm that sets prices in order to match the demand for rides with the supply of cars on the road. Thus if demand exceeds supply, the price for a ride will rise, inducing drivers to get on the road. Uber does not own any cars. Its drivers are independent contractors with their own vehicles. The company is in effect a twenty-first century version of an old-style radio taxi dispatch company. Interestingly, Uber's founders got their idea for the app-based service one snowy night in Paris when they were unable to find a taxi.

Historically, taxi markets around the globe have been tightly regulated by metropolitan authorities. The stated purpose of these regulations has often included (1) limiting the supply of taxis in order to boost demand for other forms of public transportation, (2) limiting the supply of taxis in order to reduce traffic congestion, (3) ensuring the safety of riders by only allowing licensed taxis to offer rides, (4) ensuring that the prices charged are "fair," and (5) guaranteeing a reasonable rate of return to the owners of taxi licenses.

In practice, widespread restrictions on the supply of taxi licenses have created shortages in many cities, making it difficult to find a taxis, particularly at busy periods. In New York, the number of licenses barely increased from 11,787 in 1945 to 13,437 in 2014, even though the population expanded significantly. In Paris, the number of licenses was 14,000 in 1937, and had only increased to 15,900 by 2014, even though both the population and the number of visitors to the city had surged. The number of taxis in Milan was frozen between 1974 and 2014, despite Milan having a ratios of taxis to inhabitants that was one of the lowest for any major city. Whenever metropolitan authorities have tried to increase the number of taxis in a city, they have often been meet by strong resistance from established taxi companies. When the French

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tried to increase the number of taxis in Paris in 2007, a strike among transportation workers shut down the city and forced the government to back off.

Uber's strategy has been to break these regulations, establishing its service first, and then fighting attempts by regulators to shut the service down. In pursuing this strategy, Uber has often used social networks to enlisted the support of its riders, getting them to pressure local governments to change their regulations and allow Uber to continue offering its service. In many cities, the strategy has worked, even in the face of protests from established taxi companies and their drivers. In London, for example, when taxi drivers went on strike to pressure the government to restrict Uber, Uber reported a surge in downloads for its app and thousands of new riders.

However, this confrontational strategy has not always worked well. The government of Vancouver, Canada, reacted to the unauthorized entry of Uber by banning it outright. So did the local authorities in Brussels in Belgium, Delhi in India, and a host of other cities around the globe. In Paris, the government has tried to limit Uber by imposing several restrictions that make it harder for Uber to do business there. To complicate matters, Uber drivers in Paris have unionized—something that they cannot do in the United States due to their status as independent contractors. They went on strike when Uber tried to lower fares. Similar protests by Uber drivers have occurred in other cities. Overall, there is a sense that Uber's abrasive strategy has not always worked well, particularly outside of the United States where locals see Uber as a brash American startup that pays scant attention to local laws, customs, and culture.

Uber is also witnessing the emergence of local rivals in some countries, such as India and China, where startups using a smartphone app and a business model similar to Uber are gaining traction. In China, local rival Didi Kuaidi has raised $4 billion in venture capital and claims that by mid-2016, it will be operating in over 400 cities in China. Didi already has a 90 percent market share in Beijing, where the company fields over 1 million daily ride requests.

Sources: Alyson Shontel, "Uber Is Generating a Staggering Amount of Revenue," *Business Insider*, November 15, 2014. Carmel DeAmicic, "Leaked Doc: Uber Nears $2 Billion in Revenue," Recode, August 21, 2015. Kara Swisher, "Uber and Uber Man," *Vanity Fair*, December 2014. Nitish Kulkarni, "Uber Hits Roadblock in India After Being Denied Permission to Operate in Delhi," Tech Crunch, September 16, 2015. Brian Solomon, "Uber Seems to Be Getting Its Butt Kicked in China," *Forbes*, December 1, 2015.

Introduction

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

The rise of Uber discussed in the opening case is one illustration of the trend toward globalization. From a standing start in 2009, Uber has built a global ride for hire taxi service that by early 2016 could be found in over 357 cities in 68 countries. Uber customers visiting London, New York, Athens, Paris, or Hong Kong can now quickly find rides by using the Uber app on their smartphone. Uber has rapidly built a global brand. Its strategy was to go global from day one. In doing so, it is similar to many other modern technology business such as Facebook, Google, and Amazon that have also rapidly built a global presence. At the same time, it has not always been smooth sailing for Uber. Local authorities have banned or placed tight restrictions on Uber's service in many cities around the world. Uber's brash American ways have not always endeared themselves to local regulators, drivers, and customers. It is perhaps true, as critics have noted, that Uber might have done even better internationally if it had adapted its entry strategy to take local differences in regulations, culture, and political realities into account. This matters not only because it may have slowed down Uber's growth rate but also because it has opened the doors to foreign rivals who have used similar technology to Uber but seem more adept at working with local regulators and drivers.

More generally, globalization now has an impact on almost everything we do. The average American, for example, might drive to work in a car that was designed in Germany and assembled in Mexico by Ford from components made in the United States and Japan, which were fabricated from Korean steel and Malaysian rubber. He may have filled the car with gasoline at a Shell service station owned by a British-Dutch multinational company. The gasoline could have been made from oil pumped out of a well off the coast of Africa by a French oil company that transported it to the United States in a ship owned by a Greek shipping line. While driving to work, the American might talk to his stockbroker (using a hands-free, in-car speaker) on an Apple iPhone that was designed in California and assembled in China using chip sets produced in Japan and Europe, glass made by Corning in Kentucky, and memory chips from South Korea. He could tell the stockbroker to purchase shares in Lenovo, a multinational Chinese PC manufacturer whose operational headquarters is in North Carolina and whose shares are listed on the New York Stock Exchange.

This is the world in which we live. It is a world where the volume of goods, services, and investments crossing national borders has expanded faster than world output for more than half a century. It is a world where more than $5 trillion in foreign exchange transactions are made every day, where $19 trillion of goods and $5 trillion of services are sold across national borders every year.[1] It is a world in which international institutions such as the World Trade Organization and gatherings of leaders from the world's most powerful economies continue to work for even lower barriers to cross-border trade and investment. It is a world where the symbols of material and popular culture are increasingly global: from Coca-Cola and Starbucks to Sony PlayStations, Facebook, Netflix video streaming service, IKEA stores, and Apple iPads and iPhones. It is also a world in which vigorous and vocal groups protest against globalization, which they blame for a list of ills from unemployment in developed nations to environmental degradation and the Westernization or Americanization of local culture.

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

As globalization unfolds, it is transforming industries and creating anxiety among those who believed their jobs were protected from foreign competition. Historically, while many workers in manufacturing industries worried about the impact foreign competition might have on their jobs, workers in service industries felt more secure. Now, this too is changing. Advances in technology, lower transportation costs, and the rise of skilled workers in developing countries imply that many services no longer need to be performed where they are delivered. Today, many individual U.S. tax returns are compiled in India. Indian accountants, trained in U.S. tax rules, perform work for U.S. accounting firms.[2] They access individual tax returns stored on computers in the United States, perform routine calculations, and save their work so that it can be inspected by a U.S. accountant,

What Will Happen to the United States?

The United States has the largest and most technologically powerful economy in the world, with a per capita GDP (gross domestic product) of $49,100. The 2013 GDP was valued at $16.72 trillion. Most of the labor force (79.4 percent) is employed in the services sector, with 19.5 percent employed in manufacturing industries, and only 1.1 percent in the agricultural area. China, India, and the European Union have labor forces larger than that of the United States, which ranks fourth in the world. Data show that the United States has become much more of a service economy over the years. Will the United States continue to increase its service sector at the cost of manufacturing and agriculture?

Source: U.S. Central Intelligence Agency, *World Factbook,* March 3, 2014. www.cia.gov.

who then bills clients. As the best-selling author Thomas Friedman has argued, the world is becoming flat.[3] People living in developed nations no longer have the playing field tilted in their favor. Increasingly, enterprising individuals based in India, China, or Brazil have the same opportunities to better themselves as those living in western Europe, the United States, or Canada.

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

LO 1-1
Understand what is meant by the term *globalization.*

What Is Globalization?

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

globalization
Trend away from distinct national economic units and toward one huge global market.

globalization of markets
Moving away from an economic system in which national markets are distinct entities, isolated by trade barriers and barriers of distance, time, and culture, and toward a system in which national markets are merging into one global market.

THE GLOBALIZATION OF MARKETS

The **globalization of markets** refers to the merging of historically distinct and separate national markets into one huge global marketplace. Falling barriers to cross-border trade and investment have made it easier to sell internationally. It has been argued for some time that the tastes and preferences of consumers in different nations are beginning to converge on some global norm, thereby helping create a global market.[4] Consumer products such as Citigroup credit cards, Coca-Cola soft drinks, video games, McDonald's hamburgers, Starbucks coffee, IKEA furniture, and Apple iPhones are frequently held up as prototypical examples of this trend. The firms that produce these products are more than just benefactors of this trend; they are also facilitators of it. By offering the same basic product worldwide, they help create a global market.

A company does not have to be the size of these multinational giants to facilitate, and benefit from, the globalization of markets. In the United States, for example, according to the International Trade Administration, more than 295,000 small and medium-size firms with fewer than 500 employees exported in 2013, accounting for 98 percent of the companies that exported that year. More generally, exports from small and medium-sized companies accounted for 33 percent of the value of U.S. exports of manufactured goods in 2013.[5] Typical of these is B&S Aircraft Alloys, a New York company whose exports account for 40 percent of its $8 million annual revenues.[6] The situation is similar in several other nations. For example, in Germany, the world's largest exporter, a staggering 98 percent of small and midsize companies have exposure to international markets, via either exports or international production.[7]

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Despite the global prevalence of Citigroup credit cards, McDonald's hamburgers, Starbucks coffee, and IKEA stores, it is important not to push too far the view that national markets are giving way to the global market. As we shall see in later chapters, significant differences still exist among national markets along many relevant dimensions, including consumer tastes and preferences, distribution channels, culturally embedded value systems, business systems, and legal regulations. Uber, for example, the fast-growing ride for hire service, is finding that it needs to refine its entry strategy in many foreign cities in order to take differences in the regulatory regime into account (see the Opening Case). These differences frequently require companies to customize marketing strategies, product features, and operating practices to best match conditions in a particular country.

The most global of markets are not typically markets for consumer products—where national differences in tastes and preferences can still be important enough to act as a brake on globalization—but markets for industrial goods and materials that serve universal needs the world over. These include the markets for commodities such as aluminum, oil, and wheat; for industrial products such as microprocessors, DRAMs (computer memory chips), and commercial jet aircraft; for computer software; and for financial assets from U.S. Treasury bills to Eurobonds and futures on the Nikkei index or the euro. That being said, it is increasingly evident that many newer high-technology consumer products, such as Apple's iPhone, are being successfully sold the same way the world over.

In many global markets, the same firms frequently confront each other as competitors in nation after nation. Coca-Cola's rivalry with PepsiCo is a global one, as are the rivalries between Ford and Toyota; Boeing and Airbus; Caterpillar and Komatsu in earthmoving equipment; General Electric and Rolls-Royce in aero engines; Sony, Nintendo, and Microsoft in video-game consoles; and Samsung and Apple in smartphones. If a firm moves into a nation not currently served by its rivals, many of those rivals are sure to follow to prevent their competitor from gaining an advantage.[8] As firms follow each other around the world, they bring with them many of the assets that served them well in other national markets—their products, operating strategies, marketing strategies, and brand names—creating some homogeneity across markets. Thus, greater uniformity replaces diversity. In an increasing number of industries, it is no longer meaningful to talk about "the German market," "the American market," "the Brazilian market," or "the Japanese market"; for many firms, there is only the global market.

THE GLOBALIZATION OF PRODUCTION

The **globalization of production** refers to the sourcing of goods and services from locations around the globe to take advantage of national differences in the cost and quality of **factors of production** (such as labor, energy, land, and capital). By doing this, companies hope to lower their overall cost structure or improve the quality or functionality of their product offering, thereby allowing them to compete more effectively. For example, Boeing has made extensive use of outsourcing to foreign suppliers. Consider Boeing's 777: eight Japanese suppliers make parts for the fuselage, doors, and wings; a supplier in Singapore makes the doors for the nose landing gear; three suppliers in Italy manufacture wing flaps; and so on.[9] In total, some 30 percent of the 777, by value, is built by foreign companies. And, for its most recent jet airliner, the 787, Boeing has pushed this trend even further; some 65 percent of the total value of the aircraft is outsourced to foreign companies, 35 percent of which goes to three major Japanese companies.

globalization of production
Trend by individual firms to disperse parts of their productive processes to different locations around the globe to take advantage of differences in cost and quality of factors of production.

factors of production
Inputs into the productive process of a firm, including labor, management, land, capital, and technological know-how.

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

Early outsourcing efforts were primarily confined to manufacturing activities, such as those undertaken by Boeing and Apple. Increasingly, however, companies are taking advantage of modern communications technology, particularly the Internet, to outsource service activities to low-cost producers in other nations. The Internet has allowed hospitals to outsource some radiology work to India, where images from MRI scans and the like are read at night while U.S. physicians

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Boeing's Global Production System

Executives at the Boeing Corporation, America's largest exporter, say that building a large commercial jet aircraft like the 747 or 787 involves bringing together more than a million parts in flying formation. Forty-five years ago, when the early models of Boeing's venerable 737 and 747 jets were rolling off the company's Seattle-area production lines, foreign suppliers accounted for only 5 percent of those parts on average. Boeing was vertically integrated and manufactured many of the major components that went into the planes. The largest parts produced by outside suppliers were the jet engines, where two of the three suppliers were American companies. The lone foreign engine manufacturer was the British company Rolls-Royce.

Fast-forward to the modern era, and things look very different. In the case of its latest aircraft, the super-efficient 787 Dreamliner, 50 outside suppliers spread around the world account for 65 percent of the value of the aircraft. Italian firm Alenia Aeronautica makes the center fuselage and horizontal stabilizer. Kawasaki of Japan makes part of the forward fuselage and the fixed trailing edge of the wing. French firm Messier-Dowty makes the aircraft's landing gear. German firm Diehl Luftahrt Elektronik supplies the main cabin lighting. Sweden's Saab Aerostructures makes the access doors. Japanese company Jamco makes parts for the lavatories, flight deck interiors, and galleys. Mitsubishi Heavy Industries of Japan makes the wings. KAA of Korea makes the wing tips. And so on.

Why the change? One reason is that 80 percent of Boeing's customers are foreign airlines, and to sell into those nations, it often helps to be giving business to those nations. The trend started in 1974 when Mitsubishi of Japan was given contracts to produce inboard wing flaps for the 747. The Japanese reciprocated by placing big orders for Boeing jets. A second rationale was to disperse component part production to those suppliers who are the best in the world at their particular activity. Over the years, for example, Mitsubishi has acquired considerable expertise in the manufacture of wings, so it was logical for Boeing to use Mitsubishi to make the wings for the 787. Similarly, the 787 is the first commercial jet aircraft to be made almost entirely out of carbon fiber, so Boeing tapped Japan's Toray Industries, a world-class expert in sturdy but light carbon-fiber composites, to supply materials for the fuselage. A third reason for the extensive outsourcing on the 787 was that Boeing wanted to unburden itself of some of the risks and costs associated with developing production facilities for the 787. By outsourcing, it pushed some of those risks and costs onto suppliers, who had to undertake major investments in capacity to ramp up to produce for the 787.

So what did Boeing retain for itself? Engineering design, marketing and sales, and final assembly are done at its Everett plant north of Seattle, all activities where Boeing maintains it is the best in the world. Of major component parts, Boeing made only the tail fin and wing to body fairing (which attaches the wings to the fuselage of the plane). Everything else was outsourced.

As the 787 moved through development in the 2000s, however, it became clear that Boeing had pushed the outsourcing paradigm too far. Coordinating a globally dispersed production system this extensive turned out to be very challenging. Parts turned up late, some parts didn't "snap together" the way Boeing had envisioned, and several suppliers ran into engineering problems that slowed down the entire production process. As a consequence, the date for delivery of the first jet was pushed back more than four years, and Boeing had to take millions of dollars in penalties for late deliveries. The problems at one supplier, Vought Aircraft in North Carolina, were so severe that Boeing ultimately agreed to acquire the company and bring its production in-house. Vought was co-owned by Alenia of Italy and made parts of the main fuselage.

There are now signs that Boeing is rethinking some of its global outsourcing policy. For its next jet, a new version of its popular wide-bodied 777 jet, the 777X, which will use the same carbon-fiber technology as the 787, Boeing will bring wing production back in-house. Mitsubishi and Kawasaki of Japan produce much of the wing structure for the 787 and for the original version of the 777. However, recently Japan's airlines have been placing large orders with Airbus, breaking with their traditional allegiance to Boeing. This seems to have given Boeing an opening to bring wing production back in-house. Boeing executives also note that Boeing has lost much of its expertise in wing production over the last 20 years due to outsourcing, and bringing it back in-house for new carbon-fiber wings might enable Boeing to regain these important core skills and strengthen the company's competitive position.

Sources: K. Epstein and J. Crown, "Globalization Bites Boeing," *Bloomberg Businessweek,* March 12, 2008; H. Mallick, "Out of Control Outsourcing Ruined Boeing's Beautiful Dreamliner," *The Star,* February 25, 2013; P. Kavilanz, "Dreamliner: Where in the World Its Parts Come From," *CNN Money,* January 18, 2013; S. Dubois, "Boeing's Dreamliner Mess: Simply Inevitable?," *CNN Money,* January 22, 2013; A. Scott and T. Kelly, "Boeing's Loss of a $9.5 Billion Deal Could Bring Jobs Back to the U.S.," *Business Insider,* October 14, 2013.

sleep; the results are ready for them in the morning. Many software companies, including Microsoft, now use Indian engineers to perform test functions on software designed in the United States. The time difference allows Indian engineers to run debugging tests on software written in the United States when U.S. engineers sleep, transmitting the corrected code back to the United States over secure Internet connections so it is ready for U.S. engineers to work on the following day. Dispersing value-creation activities in this way can compress the time and lower the costs required to develop new software programs. Other companies, from computer makers to banks, are outsourcing customer service functions, such as customer call centers, to developing nations where labor is cheaper. In another example from health care, workers in the Philippines transcribe American medical files (such as audio files from doctors seeking approval from insurance companies for performing a procedure). Some estimates suggest the outsourcing of many administrative procedures in health care, such as customer service and claims processing, could reduce health care costs in America by as much as $70 billion.[10]

The economist Robert Reich has argued that as a consequence of the trend exemplified by companies such as Boeing, Apple, and Microsoft, in many cases it is becoming irrelevant to talk about American products, Japanese products, German products, or Korean products. Increasingly, according to Reich, the outsourcing of productive activities to different suppliers results in the creation of products that are global in nature, that is, "global products."[11] But as with the globalization of markets, companies must be careful not to push the globalization of production too far. As we will see in later chapters, substantial impediments still make it difficult for firms to achieve the optimal dispersion of their productive activities to locations around the globe. These impediments include formal and informal barriers to trade between countries, barriers to foreign direct investment, transportation costs, issues associated with economic and political risk, and the sheer managerial challenge of coordinating a globally dispersed supply chain (an issue for Boeing with the 787, as discussed in the Management Focus). For example, government regulations ultimately limit the ability of hospitals to outsource the process of interpreting MRI scans to developing nations where radiologists are cheaper.

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

The Emergence of Global Institutions

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

The **World Trade Organization (WTO)** (like the GATT before it) is primarily responsible for policing the world trading system and making sure nation-states adhere to the rules laid down in trade treaties signed by WTO member states. As of 2016, 162 nations that collectively accounted for 98 percent of world trade were WTO members, thereby giving the organization enormous scope and influence. The WTO is also responsible for facilitating the establishment of additional multinational agreements among WTO member states. Over its entire history, and that of the GATT before it, the WTO has promoted the lowering of barriers to cross-border trade and investment. In doing so, the WTO has been the instrument of its member states, which have sought to create a more open global business system unencumbered by barriers to trade and investment between countries. Without an institution such as the WTO, the globalization of markets and production is unlikely to have proceeded as far as it has. However, as we shall see in this chapter and in Chapter 7 when we look closely at the WTO, critics charge that the organization is usurping the national sovereignty of individual nation-states.

The **International Monetary Fund (IMF)** and the **World Bank** were both created in 1944 by 44 nations that met at Bretton Woods, New Hampshire. The IMF was established to maintain order in the international monetary system; the World Bank was set up to promote economic development. In the more than six decades since their creation, both institutions have emerged as significant players in the global economy. The World Bank is the

General Agreement on Tariffs and Trade (GATT)
International treaty that committed signatories to lowering barriers to the free flow of goods across national borders and led to the WTO.

World Trade Organization (WTO)
The organization that succeeded the General Agreement on Tariffs and Trade (GATT) as a result of the successful completion of the Uruguay Round of GATT negotiations.

International Monetary Fund (IMF)
International institution set up to maintain order in the international monetary system.

World Bank
International institution set up to promote general economic development in the world's poorer nations.

Can the International Court of Justice Be Effective?

The International Court of Justice (www.icj-cij.org) is the principal judicial organ of the United Nations (UN). Of the six principal organs of the UN, it is the only one not located in New York (United States); instead, the seat of the Court is at the Peace Palace in The Hague (Netherlands). The court's role is to settle, in accordance with international law, legal disputes submitted to it by countries and to give advisory opinions on legal questions referred to it by authorized United Nations organs and specialized agencies. But, how effective can the UN International Court of Justice really be in the global marketplace with its many legal systems?

Source: www.icj-cij.org/court.