



# INTERNATIONAL BUSINESS

FOURTH EDITION

Oded Shenkar, Yadong Luo and Tailan Chi



# INTERNATIONAL BUSINESS

This fully revised and updated fourth edition of *International Business* offers an action-focused, practical approach to the topic, helping students understand the global business environment and its repercussions for executives. The book provides thorough coverage, delving into fundamental concepts and theory; the cultural, political, and economic environment; international business strategies; and even functional management areas.

More comprehensive than competing books, this new edition of *International Business* includes:

- A new chapter on the digitalization of the global economy and its implications for firm strategy and organizations.
- New examinations of the forces of de-globalization, implications of rising trade protectionism, challenges of geopolitical conflicts, and a friction framework for understanding the effects of cultural differences.
- Enriched and expanded discussions about potential reconfigurations of global value chains following the COVID-19 pandemic, changing perspectives on the role of the government with renewed attention to industrial policy, shifts in regional integration with the emergence of such new trade blocks as CPTPP and RCEP, and fresh insights on factors influencing a country's balance of payments.
- Strengthened, expanded global cases, examples, and "industry" and "country" mini-cases that give students practical insight into the ways companies actually behave within a competitive, global environment.

Also featuring a companion website with a test bank, PowerPoint slides, and instructor's manual, this book is ideal for students and instructors of any international business course at undergraduate or post-graduate level.

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“This book has an evocative blend of the ‘big picture’ of international business in the age of globalization, and all the key and more specific issues in IB today. These seasoned scholars’ varied cases are not just great fun, but also provide great coverage, from the traditional IB topics to newer ones. The authors’ practical vision is refreshing, eloquently written, and spot on!”

**Mary Ann Von Glinow**, *Knight Ridder Eminent Scholar Chair in International Management, Florida International University, USA;*  
*Former AIB and AOM President*

“Shenkar, Luo and Chi offer excellent, comprehensive coverage of international business in the new global environment. Written by three outstanding researchers, it is practically focused, firmly grounded in cutting edge research, and up-to-date with great student and instructor support.”

**Peter J. Buckley**, *Professor and Director of Business Confucius Institute, University of Leeds, UK*

“For anyone who is interested in learning about international business, this is an excellent book that covers an amazing amount of information in each chapter. It is a basic book written by three experts in the field of IB. They address topics like foreign direct investment theories, country competitiveness, global marketing, managing global R&D, and international entrepreneurship that are important areas for the future. It is rare to find such explanations in one volume. Professors teaching a course on international business will find it an excellent resource for practical and conceptual material.”

**Marjorie A. Lyles**, *Chancellor’s Professor of Global Strategic Management, Indiana University, USA; Former AIB and SMS President*

*4th edition*

# INTERNATIONAL BUSINESS

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To Miriam, Keshet, Joshua, and Rakefet; and to the memory of my parents, Bluma and Joshua—OS

To my family, Cuihua, Edward, and Rosalie—YL

To Susan, Alison, and Zoey; and to the memory of my parents, Biqing Chi and Ruobing Xu—TC



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# Contents

<i>List of Exhibits</i>	xx
<b>1 International Business in an Age of Globalization</b>	<b>1</b>
<i>OPENING CASE: THE COCA-COLA COMPANY</i>	2
An Age of Globalization	3
<i>What Does Globalization Mean to You?</i>	4
The Face of Globalization	5
<i>Who Benefits from Globalization?</i>	6
<i>The Impact of Globalization</i>	9
Globalization in Transition	14
Globalization and International Business	16
<i>What is International Business?</i>	16
<i>International versus Domestic Business</i>	18
<i>INDUSTRY/COUNTRY BOX: SINOSTONE COMES TO ELBERTON</i>	19
<i>Why Expand Internationally?</i>	20
The Structure of this Book	22
<i>Pedagogical Thrust</i>	23
<b>Part I Concepts and Theories in International Business</b>	<b>27</b>
<b>2 International Trade Theory and Application</b>	<b>29</b>
<i>OPENING CASE: BANANA WARS</i>	29
International Trade Theories	30
<i>The Mercantilist Doctrine</i>	31
<i>Absolute Advantage Theory</i>	32
<i>Comparative Advantage Theory</i>	32
<i>Heckscher-Ohlin Theorem</i>	34
<i>The Leontief Paradox</i>	36
<i>Human Skills and Technology-Based Views</i>	36
<i>The Product Life-Cycle Model</i>	38
<i>Infant Industry Argument</i>	40
<i>Linder's Income-Preference Similarity Theory</i>	42
<i>The New Trade Theory</i>	43



*INDUSTRY BOX: THE GLOBAL AUTOMOTIVE INDUSTRY 45**Theory Assessment 45*

## International Trade Patterns 49

*International Trade Volume and Growth 49**Service Trade 50**Trade Measurement 53**Major Exporters and Importers 55**US Trade Partners 56**Trade Balance 60*

## Arguments for Trade Restrictions 62

*The Sovereignty Argument 63**The Lowest Common Denominator Argument 64**Trade Reciprocity and Retaliation against Unfair Trade Practices 64**Optimal Tariff Theory 65*

## Types of Trade Barriers 66

*Tariff Barriers 67**Non-Tariff Barriers 69**COUNTRY BOX: US TRADE POLICIES UNDER THE TRUMP ADMINISTRATION  
AND TRADE WAR WITH CHINA 75*

## Anti-Globalization Backlash and Intensification of Trade Conflicts 78

**3 Foreign Direct Investment Theory and Application****85***OPENING CASE: JAPAN CHANGES ITS MIND ABOUT FDI, BUT NEEDS TO DO  
MORE TO ATTRACT IT 85*

## Definition and Types of Foreign Direct Investment 87

*FDI versus Foreign Portfolio Investment 88**Types of FDI 88**Entry Mode 89**The Strategic Logic of FDI 89*

## How the MNE Benefits from Foreign Direct Investment 90

*Enhancing Efficiency from Location Advantages 90**Improving Performance from Structural Discrepancies 91**Increasing Return from Ownership Advantages 91**Ensuring Growth from Organizational Learning 92*

## The Impact of FDI on the Host (Destination) and Home (Origin) Countries 93

*Employment 93**FDI Impact on Domestic Enterprises in the Host Country 94*

## Current Theories on FDI 96

*Product Life-Cycle Theory 96**Monopolistic Advantage Theory 97*

<i>Internalization Theory and other Transaction Cost-Based Theories</i>	98
<i>The Eclectic Paradigm</i>	100
Learning and Capability-Based Perspectives	102
<i>The Dynamic Capability Perspective</i>	102
<i>The Evolutionary Perspective</i>	103
<i>INDUSTRY BOX: MNEs AND FDI IN THE AUTOMOTIVE INDUSTRY</i>	<i>105</i>
<i>The Real Option Perspective</i>	106
<i>The Integration-Responsiveness Perspective</i>	107
Patterns of FDI	109
<i>Outward FDI</i>	112
<i>Inward FDI</i>	117
FDI Entry Forms	120
The Investment Environment	123
<i>FDI Decision Criteria</i>	124
<i>COUNTRY BOX: FDI IN ISRAEL</i>	<i>125</i>

## 4 The Multinational Enterprise

131

<i>OPENING CASE: JOHNSON &amp; JOHNSON</i>	131
What is a Multinational Enterprise?	132
<i>The Degree of Internationalization</i>	133
<i>History of the MNE</i>	134
The World's Largest MNEs	135
<i>The Growth of Service MNEs</i>	138
The Image of the MNE	141
<i>The MNE in the Public Eye</i>	141
<i>The Borderless Corporation: Myth or Reality?</i>	143
The Competitive Advantage of the MNE	144
<i>Capabilities and Competitive Advantage</i>	144
The MNE from Emerging/Developing Economies (DMNE)	147
<i>The Largest Developing Country MNEs</i>	148
<i>Obstacles Facing MNEs from Developing Economies</i>	150
<i>DMNE Advantage in Global Markets</i>	152
<i>Typical Features of DMNEs</i>	152
<i>COUNTRY BOX: AN ISRAELI FIRM BECOMES THE WORLD'S LARGEST GENERIC DRUG MAKER</i>	<i>155</i>
The Small and Medium-Sized International Enterprise (SMIE)	156
<i>What is an SMIE?</i>	157
<i>Obstacles to SMIE Internationalization</i>	158
<i>SMIE Advantages in Internationalization</i>	161
<i>SMIE Internationalization Features</i>	161
<i>INDUSTRY BOX: INVESTMENT MANAGEMENT AND THE SMIE</i>	<i>167</i>

<b>Part II Endowments and Environments of International Business</b>	<b>173</b>
<b>5 Country Competitiveness</b>	<b>175</b>
<i>OPENING CASE: SINGAPORE'S CHANGING COMPETITIVE ADVANTAGE IN THE HARD DISK DRIVE INDUSTRY</i>	<i>175</i>
Defining Country Competitiveness	177
<i>Country Competitiveness and MNEs</i>	<i>178</i>
Country-Level Determinants	180
<i>Institutional System</i>	<i>180</i>
<i>Infrastructure</i>	<i>183</i>
<i>Macroeconomic Soundness</i>	<i>184</i>
<i>Science, Education, and Innovation</i>	<i>187</i>
<i>Internationalization</i>	<i>190</i>
Industry-Level Determinants	191
<i>INDUSTRY BOX: E-COMMERCE AS AN ELEMENT OF COUNTRY COMPETITIVENESS</i>	<i>195</i>
Firm-Level Determinants	196
Individual-Level Determinants	198
<i>COUNTRY BOX: ITALY: OWNER SNEAKS FACTORY TO POLAND</i>	<i>200</i>
Interplay of the Four-Level Determinants	201
Government Role	202
<i>A Historical Review</i>	<i>202</i>
<i>A Renewed Recognition of Government Role</i>	<i>203</i>
<i>Industrial Policy</i>	<i>205</i>
<b>6 The Cultural Environment</b>	<b>211</b>
<i>OPENING CASE: RENAULT-NISSAN ALLIANCE</i>	<i>211</i>
What is Culture?	213
Culture and International Business	213
<i>Culture Does Not Explain Everything</i>	<i>214</i>
<i>Correlates of Culture</i>	<i>215</i>
National Culture Classifications	219
<i>Hofstede's Dimensions of Culture</i>	<i>222</i>
<i>COUNTRY BOX: TOYOTA—A SHIFT IN TOYOTA'S CORPORATE CULTURE</i>	<i>224</i>
<i>Schwartz's Classification</i>	<i>228</i>
<i>The GLOBE Classification</i>	<i>229</i>
<i>Trompenaars and Hampden-Turner's Classification</i>	<i>229</i>
<i>Other Dimensions of Culture</i>	<i>231</i>
<i>National Culture Clustering</i>	<i>232</i>
<i>Subsistence and Rice Theories</i>	<i>232</i>
<i>Measuring Cultural Differences</i>	<i>234</i>

The Positive Role of Cultural Differences	235
The Friction Framework	235
Corporate Culture	236
Other Layers of Culture	237
<i>Ethnicity</i>	237
<i>Industry</i>	237
<i>Ideology</i>	237
<i>Demographics</i>	238
<i>Cultural Etiquette</i>	238
<i>Cultural Stereotypes</i>	238
<i>Convergence and Divergence</i>	239
<i>INDUSTRY BOX: ISLAMIC FINANCE</i>	242

## **7 The Political and Legal Environment** **249**

<i>OPENING CASE: BOLIVIA NATIONALIZES NATURAL GAS</i>	249
The Political Environment	251
<i>Political System</i>	252
<i>The Institutional Context</i>	256
<i>Geopolitics and International Business Environment</i>	257
The MNE–Government Relationship	259
<i>The MNE Relationship with the Host Government</i>	259
<i>The MNE and its Home Government</i>	262
<i>Coalition Building and Influence Tactics</i>	263
<i>INDUSTRY BOX: MANAGING POLITICS IN THE AUTOMOTIVE INDUSTRY</i>	264
<i>Economic Freedom</i>	264
<i>Political Risk</i>	266
<i>Regional-Level Politics</i>	270
<i>Micro-Region Political Processes</i>	270
The Legal Environment	271
<i>The Institutional Context</i>	271
<i>COUNTRY BOX: INDONESIA: MANUFACTURERS LIFE WEATHERS THE STORM IN INDONESIA</i>	274
<i>Legal Jurisdiction</i>	274
<i>Legal Issues of Interest to the MNE</i>	276

## **Part III Global Markets and Institutions** **285**

### **8 International Economic Integration and Institutions** **287**

<i>OPENING CASE: 3M'S RESPONSE TO EUROPEAN MARKET INTEGRATION</i>	288
International Economic Integration	288
Global-Level Cooperation Among Nations	291

<i>The World Trade Organization (WTO)</i>	292
<i>COUNTRY BOX: RUSSIA JOINS THE WTO</i>	296
<i>The International Monetary Fund (IMF)</i>	297
<i>The World Bank Group</i>	298
<i>Other International Economic Organizations</i>	300
Regional-Level Cooperation Among Nations	302
<i>Postwar Regional Integration</i>	302
<i>North America: The US-Mexico-Canada Agreement (USMCA),     Formerly North American Free Trade Agreement (NAFTA)</i>	305
<i>Europe: The European Union (EU)</i>	307
<i>INDUSTRY BOX: SIEMENS SHARPENS ITS FOCUS TO RESPOND TO THE SINGLE MARKET</i>	311
<i>Asia Pacific</i>	311
<i>Latin America</i>	315
<i>Africa and the Middle East</i>	316
<i>Efficiency-Enhancing and Efficiency-Reducing Effects of Regionalization</i>	318
Commodity-Level Cooperation Among Nations	320
<i>Organization of Petroleum Exporting Countries (OPEC)</i>	320
<i>Other Commodity Agreements</i>	323
Strategic Responses of MNEs	323

## **9 The International Monetary System and Financial Markets 329**

<i>OPENING CASE: FOREIGN EXCHANGE CRISIS IN MEXICO</i>	329
History of the International Monetary System	330
<i>The Gold Standard Period (1876–1914)</i>	332
<i>The Inter-War Years and World War II (1914–1944)</i>	332
<i>The Bretton Woods System (1944–1973)</i>	332
<i>The Post-Bretton Woods System (1973–Present)</i>	333
Contemporary Exchange Rate Systems	338
<i>Fixed-Rate System</i>	338
<i>Crawling Peg System</i>	339
<i>COUNTRY BOX: HONG KONG: SHOULD THE HONG KONG DOLLAR RETAIN     THE FIXED PEG TO THE US DOLLAR?</i>	340
<i>Target-Zone Arrangement</i>	341
<i>Managed Float System</i>	342
<i>Independent Float System</i>	342
<i>Advantages and Disadvantages of the Floating System</i>	342
Determination of Foreign Exchange Rates	344
<i>Foreign Exchange Rate Quotations</i>	345
<i>Gold Standard</i>	346
<i>Purchasing Power Parity (PPP)</i>	347

<i>Interest Rate Parity (IRP)</i>	348
<i>Foreign Exchange Rate Overshooting</i>	349
<i>Implications for MNEs: Foreign Exchange Forecasting</i>	351
The Balance of Payments	353
<i>BOP Accounts</i>	353
<i>Exchange Rates and BOP Imbalances</i>	356
International Foreign Exchange Markets	359
<i>Landscape of the International Foreign Exchange Market</i>	359
<i>Market Participants and Functions</i>	360
<i>Transaction Forms</i>	360
<i>Foreign Exchange Arbitrage</i>	362
<i>Black Market and Parallel Market</i>	363
International Capital Markets	364
<i>International Money Markets</i>	364
<i>International Bond Markets</i>	365
<i>INDUSTRY BOX: US FIRMS FIND CHEAPER FINANCING FROM FOREIGN SOURCES</i>	365
<i>International Stock Markets</i>	366
<i>International Loan Markets</i>	367
Major International Financial Crises in Recent Times	369
<i>The Asian Financial Crisis</i>	369
<i>The Global Financial Crisis</i>	372

## **Part IV International Business Strategies** 377

### **10 International Entry Strategies** 379

<i>OPENING CASE: DUPONT'S ENTRY STRATEGIES INTO CHINA</i>	379
Dimensions of a Market Entry Strategy	380
International Location Selection ( <i>Where</i> )	382
<i>Locational Determinants</i>	383
<i>COUNTRY BOX: FEDERAL EXPRESS SHIFTS ITS HUB FROM SUBIC BAY TO GUANGZHOU, CHINA</i>	390
<i>Decision Framework</i>	390
Timing of Entry ( <i>When</i> )	393
<i>Uncertainty and Potential for Learning</i>	393
<i>Competitive Preemption and Pioneering Costs</i>	394
<i>Decision Framework</i>	398
Entry Mode Selection ( <i>How</i> )	400
<i>Entry Mode Choices</i>	400
<i>Trade-Centered Entry Modes</i>	401
<i>Transfer-Centered Entry Modes</i>	405

*FDI-Centered Entry Modes* 408  
*Decision Framework* 413  
*Greenfield Investment, Acquisition, and Merger* 415

*INDUSTRY BOX: UNILEVER'S ACQUISITIONS IN LATIN AMERICA* 417  
*The Evolutionary Path* 417

## 11 MNE Organization Structure and Design

423

*OPENING CASE: PROCTER & GAMBLE: WORLDWIDE STRUCTURE* 423

International Strategy and Organization Design 424

*Global Integration and Local Responsiveness* 425

*MNE Strategy and Design* 426

*Subsidiary Roles and Imperatives* 427

MNE Organizational Structures 429

*The National Subsidiary Structure* 429

*The International Division Structure* 430

*The Global Functional Structure* 430

*The Global Geographic Structure* 431

*COUNTRY BOX: INTERNATIONALIZING THE BOARD OF DIRECTORS* 434

*The Global Product Structure* 436

*INDUSTRY BOX: "FORD 2000"* 438

*The Global Matrix Structure* 439

Integrating Global Operations 445

*Tools for Global Integration* 446

*The Transition Challenge* 447

*The Corporate Headquarters* 449

## 12 Building and Managing Global Strategic Alliances (GSAs)

453

*OPENING CASE: THE FORD-VOLKSWAGEN ALLIANCE* 454

Defining Global Strategic Alliances 454

*Types of GSAs* 454

*Rationales for Building GSAs* 456

*Challenges Facing GSAs* 458

Building Global Strategic Alliances 461

*Selecting Local Partners* 461

*Negotiating Alliance Contracts* 465

*Structuring Global Strategic Alliances* 466

*COUNTRY BOX: FUJITSU IN SPAIN: BARRIERS TO ALLIANCE MANAGEMENT* 468

Managing Global Strategic Alliances 469

*Managing Inter-Partner Learning* 470

*Exercising Managerial Control* 471

<i>Heightening Cooperation</i>	474
<i>Thinking Ahead of Exit</i>	476
<i>INDUSTRY BOX: WISDOM GAINED FROM EXPERIENCE IN BUILDING GSAs</i>	478
<b>13 Managing Global Research and Development (R&amp;D)</b>	<b>483</b>
<i>OPENING CASE: INTEL'S R&amp;D NETWORK IN DEVELOPING COUNTRIES</i>	483
Why Globalize R&D?	484
<i>Benefits and Challenges of Global R&amp;D</i>	487
<i>COUNTRY BOX: INDIA: R&amp;D CENTERS OF GLOBAL COMPANIES IN INDIA</i>	490
Designing and Structuring Global R&D	491
<i>Types of Foreign R&amp;D Units</i>	491
<i>Selecting R&amp;D Location</i>	493
<i>INDUSTRY BOX: FORD LOCATES ITS R&amp;D CENTER IN AACHEN, GERMANY</i>	495
<i>Structuring Global R&amp;D Activities</i>	495
Managing and Operating Global R&D	499
<i>Human Resource Management</i>	499
<i>Autonomy Setting</i>	499
<i>Global Planning</i>	500
<i>Communication Improvement</i>	501
Technology Transfer across Borders	503
<b>Part V Functional International Business Areas</b>	<b>509</b>
<b>14 Financial Management for Global Operations</b>	<b>511</b>
<i>OPENING CASE: MINIMIZING EXPOSURE IN RTZ</i>	511
Why Learn Financial Management?	512
International Trade Finance	514
<i>International Trade Payment</i>	514
<i>Export Financing</i>	519
Financing for Global Business	523
<i>Intercompany Financing</i>	524
<i>Equity Financing</i>	524
<i>Debt Financing</i>	525
<i>Local Currency Financing</i>	526
<i>Financing Decisions</i>	527
Managing Foreign Exchange Risk and Exposure	528
<i>Foreign Exchange Risk and Exposure</i>	528
<i>Transaction and Economic Exposures</i>	529
<i>Managing Transaction Exposure</i>	531
<i>Managing Economic (Operating) Exposure</i>	535



*INDUSTRY BOX: NETTING IN PHILIPS* 538

Global Coordination of Exposure Management 539

*COUNTRY BOX: INDIA FACES DILEMMA ON FOREIGN EXCHANGE HEDGING* 541

Working Capital Management 542

Cash Management 542

Foreign Receivable Management 543

## **15 International Accounting for Global Operations**

**547**

*OPENING CASE: MULTATIONALS FACE HEFTIER TAX FOR FOREIGN OPERATIONS* 547

Country Differences in Accounting 548

Why Accounting Systems Differ Among Countries 548

*INDUSTRY BOX: ACCOUNTING DIVERSITY IN SIEMENS* 553

National Accounting Zones 553

International Accounting Harmonization 554

International Accounting Standards 557

*COUNTRY BOX: AUSTRALIA: ACCOUNTING IN AUSTRALIA* 559

Foreign Currency Translation 559

Commonly Used Translation Methods 561

Harmonization of Translation Methods 563

International Accounting Information Systems 564

Transfer Pricing and Taxation Strategies 566

Why Transfer Pricing? 566

Transfer Pricing Techniques 567

Transfer Pricing Regulations and Penalties 568

Tax Havens, Treaties, and Strategies 569

Tax Havens 570

Tax Treaties 571

Other Tax Strategies for MNEs 571

## **16 Global Marketing and Supply Chain**

**575**

*OPENING CASE: DOMINO'S PIZZA* 575

The International Marketing Challenge 576

Assessing Market Potential 578

The Luxury Market 581

Globalization and Localization in International Markets 581

Globalization Forces 582

Localization Forces 584

Product Adaptation 585

*COUNTRY BOX: KIMCHI WARS* 588

Country-of-Origin Effect 589

<i>Branding</i>	591
<i>Channel Decisions</i>	596
<i>Promotion</i>	598
<i>Marketing Alliances</i>	599
The Global Supply Chain	600
<i>The Globalization of Supply Chains</i>	602
<i>Global Sourcing</i>	603
<i>Customizing the Supply Chain</i>	603
<i>Packaging</i>	605
<i>Transportation Modes</i>	605
<i>Crossing National Borders</i>	609
<i>INDUSTRY BOX: GLOBAL LOGISTICS AT WAL-MART</i>	609

## **17 Global Human Resource Management** **619**

<i>OPENING CASE: MANAGING GLOBAL HUMAN RESOURCES AT HSBC</i>	619
Strategic IHRM	621
Staffing the MNE	623
<i>The Globalization of Boards of Directors</i>	623
<i>INDUSTRY BOX: AIRLINE PILOTS GO GLOBAL</i>	625
<i>COUNTRY BOX: KOREAN COMPANIES SEEK GLOBAL TALENT</i>	626
<i>Staffing the MNE Ranks</i>	626
<i>Country-Specific Issues</i>	629
The Expatriate Workforce	629
<i>Types and Distribution of Expatriates</i>	629
<i>Using Expatriates: Pros and Cons</i>	630
<i>Expatriate Failure</i>	631
<i>Expatriate Selection</i>	632
<i>Preparing for a Foreign Assignment</i>	633
<i>Compensation</i>	635
<i>Culture and Compensation</i>	641
<i>Repatriation</i>	642
HRM in International Affiliates	643
<i>Human Resource Problems in Foreign Affiliates</i>	643

## **Part VI Emerging Issues in International Business** **651**

### **18 Digital Connectivity and Global Strategies** **653**

<i>OPENING CASE: IBM ACQUIRES RED HAT TO SHARPEN DIGITAL GLOBAL CONNECTIVITY</i>	653
Internet and Global E-Commerce	654
Digital Global Connectivity	655

<i>What Is Digital Global Connectivity?</i>	655
<i>New Forms of Digital Global Connectivity</i>	657
<i>INDUSTRY BOX: SIEMENS'S DIGITAL GLOBAL STRATEGY</i>	659
How Digital Globalization Changes International Business	660
<i>Intangible Commerce Booms</i>	660
<i>Knowledge Diffusion Grows</i>	661
<i>Digital Infrastructure Vitalizes</i>	661
<i>Mini-MNEs Rise</i>	662
<i>Global Consumers Shake Up</i>	662
<i>Emerging Economies Leapfrog</i>	662
<i>Global Business Ecosystems Thrive</i>	663
Rewards and Risks of Digital Global Connectivity	664
<i>Rewards from Digital Global Connectivity</i>	664
<i>Risks from Digital Global Connectivity</i>	666
Assessing Digital Infrastructure	669
<i>Physical Digital Infrastructure</i>	669
<i>Science, Education, and Innovation in Digitization</i>	669
<i>COUNTRY BOX: DIGITAL INFRASTRUCTURE IN THE PHILIPPINES AND MALAYSIA</i>	671
<i>Institutional and Regulatory Environment of Digitalization</i>	672
Building Digital Global Connectivity Capabilities	674
Global Business Platforms	677
<i>INDUSTRY BOX: EQUINIX AS A GLOBAL PLATFORM</i>	679

## 19 Global Sustainability and Social Responsibility

683

<i>OPENING CASE: SHELL'S BRENT SPAR PROJECT</i>	683
Global Sustainability	684
Corporate Social Responsibility in International Business	686
<i>MNE Social Responsibilities</i>	688
<i>INDUSTRY BOX: SOCIAL IMPACT ASSESSMENT STEPS AT SHELL</i>	691
<i>Global Guidelines and Mandates</i>	692
<i>A Culture of Social Responsibility</i>	692
<i>Auditing and Assessing MNE Social Responsibility</i>	694
Corruption in International Business	694
<i>Definition and Magnitude of Corruption</i>	694
<i>The Origins of Corruption</i>	695
<i>Drawbacks of Corruption</i>	696
<i>Corruption Rankings</i>	696
Types of Corrupt Practices	698
<i>Smuggling</i>	698
<i>Money Laundering</i>	699
<i>Piracy and Counterfeiting</i>	699

<i>Bribe Paying</i>	700
<i>The Foreign Corrupt Practices Act (FCPA)</i>	701
<i>The Globalization of the Fight Against Corruption</i>	702
<i>COUNTRY BOX: DRUG COMPANIES FACE BRIBERY PROBE ON PAYMENTS TO OFFICIALS OF FOREIGN EMERGING MARKETS</i>	703
<b>20 International Entrepreneurship</b>	<b>707</b>
<i>OPENING CASE: WILL ENTREPRENEURSHIP HELP JAPAN REGAIN ITS LOST DECADES?</i>	707
Defining International Entrepreneurship	708
Comparative Entrepreneurship	709
<i>Culture and Entrepreneurship</i>	714
<i>Funding New Ventures</i>	714
Cross-Border Entrepreneurship	718
<i>Internationalizing the Born Global Enterprise</i>	721
<i>INDUSTRY BOX: ISRAELI START-UPS IN THE GLOBAL MARKETPLACE</i>	722
<i>Index</i>	727

## LIST OF EXHIBITS

1.1	Globalization Scores of Selected Countries, 2018	6
1.2	The World's Most Globalized Countries/Territories, 2018	7
1.3	Average Incomes of Different Income Groups and Their Shares in National Income, the United States, 1979–2016	11
1.4	Total Income Growth by Percentile Across All World Regions, 1980–2019	12
1.5	Global Inequality, 1988–2013	13
2.1	Labor-Hours Required to Produce One Unit of a Good	32
2.2	Labor-Hours Required to Produce One Unit of a Good	33
2.3	Opportunity Costs for Producing Wine and Cloth	33
2.4	Illustration of a Trade Policy Change on Different Socioeconomic Groups	35
2.5	Product Life-Cycle Model of International Trade—Innovating Country	39
2.6	Product Life-Cycle Model of International Trade—Imitating Country	39
2.7	Leading Exporters and Importers of Automotive Products (Billion Dollars and Percentage) Top 15 Exporters	46
2.8	World Merchandise Trade Volume by Major Product Group, 1980–2018	50
2.9	Part 1 World Merchandise Exports by Region and Selected Economy, 1949–2019 (Billion Dollars and Percentage)	51
	Part 2 World Merchandise Imports by Region and Selected Economy, 1949–2019 (Billion Dollars and Percentage)	52
2.10	Trade in Commercial Services of the Selected Countries in 2019 (Million Dollars)	54
2.11a	Top Ten Leading Exporters and Importers in World Merchandise Trade in 2019 (Million Dollars)	55
2.11b	Top Ten Leading Exporters and Importers in World Trade in Commercial Services in 2019 (Million Dollars)	55
2.12	Merchandise Trade of the United States by Region and Economy, 2019 (Billion Dollars and Percentage)	57
2.13a	US Exports to China (Top Ten Commodities)	58
2.13b	US Imports from China (Top Ten Commodities)	59
2.14a	Current Account Balances of Selected Countries	61
2.14b	Trade Balances as Percentages of GDP for Selected Countries	62
2.15	New Tariff Initiatives by the Trump Administration	76
3.1	Backward Linkages between Foreign Affiliates and Local Enterprises and Organizations	95
3.2	Global Cross-Border Capital Flows, 2014–2018 (Percent of GDP)	110
3.3	Global FDI Flows and Stocks (1980–2019)	110

3.4	Selected Indicators of FDI and International Production, 1990–2019	111
3.5	FDI Inward Stock, by Region and Economy, 1990–2019 (US\$ Millions)	113
3.6	FDI Inflows, by Region and Economy, 1990–2019 (US\$ Millions)	115
3.7	FDI Inflows into Developed Economies, by Component, 2015–2019 (Billions of Dollars and Percent)	118
3.8	Internationalization Statistics of 100 Largest Non-Financial TNCs, Worldwide and from Developing and Transition Economies, 2016–2018	119
3.9	Cross-Border M&As and Greenfield Projects, 1990–2019 (Number of Deals and Value)	121
4.1	Transnationality Index of Top 100 Global MNEs, by Decade, 1990–2019	134
4.2	The World's Top 50 Non-Financial MNEs, Ranked by Foreign Assets, 2019	136
4.3	Number of Fortune Global 500 Companies from China, Europe, Japan, and the US, and their Revenues, 2020	139
4.4	The World's Top 20 Banks, 2020 (Based on Total Assets, Billion Dollars)	140
4.5	The World's Largest Airlines by Revenue Passenger-Kilometers (RPKs)	141
4.6	The Top 50 Non-Financial DMNEs, Ranked by Foreign Assets, 2018	148
4.7	Country/Industry Composition of the 100 Largest DMNEs, 2018	151
4.8a	Top Ten Barriers to SME Internationalization as Reported by OECD Member Economies	158
4.8b	Top Seven Challenges to Chinese SMEs in Investing Overseas	159
4.9a	Main Reasons for EU SMEs to Have Foreign Subsidiaries/Joint Ventures Abroad	163
4.9b	Reasons for Chinese SMEs to Invest Abroad	163
5.1	Determinants of Country Competitiveness	180
5.2	Country-Level Determinants of Country Competitiveness	181
5.3	Economic Growth and Growth Variability of Selected Economies, 2012–2019, Listed from Left to Right by the WEF Score on Macroeconomic Stability	188
5.4	Industry-Level Determinants of Country Competitiveness	194
5.5	Firm-Level Determinants of Country Competitiveness	198
5.6	Individual-Level Determinants of Country Competitiveness	199
5.7	Global Competitiveness of Selected Economies, Listed by the Average of Each Economy's Ratings in the WEF Global Competitiveness Index (2019) and IMD World Competitiveness Scoreboard (2020)	207
6.1	Languages of the World	216
6.2	Major Language Families of the World	217
6.3	Major Religions of the World	220
6.4	Power Distance: Country Examples and Organizational Implications	222
6.5	Rank Distinctions among the Japanese	223
6.6	Uncertainty Avoidance: Country Examples and Organizational Implications	223
6.7	Individualism/Collectivism: Country Examples and Organizational Implications	225
6.8	Masculinity/Femininity: Country Examples and Organizational Implications	226

6.9 Long-Term Orientation (LTO): Country Examples and Organizational Implications	227
6.10 LTO Score Ranking by Country	227
6.11 Hofstede and Schwartz Dimension Comparisons	230
6.12 Culture Clusters of the World	233
6.13 Americans from A to Z	240
6.14 Cultural Clustering of Nations, 1985 and 2013	241
7.1 Government Effectiveness, Control of Corruption, HDI, and GDP Growth of Selected Countries, Listed by Democracy Index (High to Low)	255
7.2 Market Efficiency and Economic Freedom of Selected Countries, Listed by the Average of WEF and HE Ratings	265
7.3 Political Stability and Security, Listed by the Average of Ratings by the World Bank (WB) and World Economic Forum (WEF)	268
7.4 Rule of Law and Efficiency of Legal Framework, Listed by the Average of WB and WEF Ratings	273
8.1 Forces Stimulating International Economic Integration	291
8.2 Multilateral Negotiations Under GATT/WTO	292
8.3 Summary of Specialized International Economic Organizations	301
8.4 Selected Regional Integration Agreements (as of August 2020)	303
8.5 Map of the EU	309
8.6 ASEAN+6	312
8.7 Regional Integration in the Americas	317
8.8 Regional Integration in Africa	318
8.9 OPEC Shares of World Oil Production and Oil Reserves, 2019	321
9.1 World Currency Events, 1973–2020	335
9.2 Frequently Used Foreign Exchange Control Measures	338
9.3 Sample Countries Using Different Exchange Rate Systems	343
9.4 Spot and Forward Quotations between the US Dollar and Euro	346
9.5 Foreign Exchange Rate Overshooting	350
9.6 Balance of Payments for the Four Largest Economies of the World, 2019 (in Millions of Dollars)	354
9.7 International Financial Markets	359
9.8 Factors Used in Sovereign Rating by Standard & Poor's	368
10.1 Value Chain	381
10.2 Locational Determinants	389
10.3 Advantages and Disadvantages of Early Movers	398
10.4 International Entry Modes	413
11.1 Nestlé's Organizational Chart	433
11.2 Samsung's Organizational Chart	440
11.3 Caterpillar's Organizational Chart	442

11.4	The Organizational Chart of the Ford Motor Company	443
11.5	The Organizational Chart of Ford Americas	444
11.6	Ford 2000 Organization	448
12.1	Key Issues Underlying Building GSAs	460
12.2	The Five-Cs Scheme of Partner Selection	461
12.3	Major Issues and Terms During Alliance Contract Negotiations	466
12.4	Managing Global Strategic Alliances	469
12.5	How to Maintain Managerial Control over Alliance Activities	472
13.1	World's Top 50 MNEs by Global R&D Investment	486
13.2	Leading Countries in Intellectual Property Development	488
13.3	Leading Global Innovation Hubs Outside Silicon Valley/San Francisco Bay Area	494
13.4	Organizational Models for Global R&D	496
14.1	Process of Using Letter of Credit (L/C)	516
14.2	Documents against Payment (D/P) Flow	518
14.3	Documents against Acceptance (D/A) Flow	518
14.4	Sources of Financing Global Operations	523
14.5	Tapping Wall Street: Three Stages for Non-US MNEs to be Traded in the United States	525
14.6	Framework of Managing Foreign Exchange Exposure	532
14.7	Forward Hedging Example	532
15.1	Forces Shaping a Country's Accounting System	552
15.2	Selected Economies Using the Five Major Accounting Models	555
15.3	Glossary of Foreign Currency Translation Terms	560
15.4	Foreign Currency Translation Methods	562
15.5	Process Tree in Foreign Currency Translation	564
16.1	Relationship between the Price of the Big Mac and GDP Per Capita in Selected Markets	579
16.2	Relationship between Vehicle Ownership and GNI Per Capita	580
16.3	Product Adjustments at McDonald's	587
16.4	Top Global Brands, Listed by Interbrand's <i>Best Global Brands 2019</i>	592
16.5	Transport Infrastructure Rankings and Scores of 60 Selected Economies, 2019	608
17.1	Model of Strategic International Human Resource Management (SIHRM)	621
17.2	Phases of Internationalization and IHRM	622
17.3	Nestlé's Board of Directors 2020	624
17.4	Average Hourly Manufacturing Labor Cost in US\$	628
17.5	Hardship Evaluation for an Expatriate in Bangalore, India	637
17.6	International Compensation Calculation	638
17.7	Estimation of Total Assignment Cost	638
17.8	Expatriate Compensation Systems	640



17.9	Management Education Requirements across Foreign Affiliates	645
18.1	Top 20 Countries with the Highest Numbers of Internet Users	655
18.2	Digital Software Technologies Developed by SAP	657
18.3	Rewards and Risks of Digital Global Connectivity	668
18.4	Elements of Physical Digital Infrastructure	670
18.5	Global Connectivity Index—Country Rankings 2018	673
19.1	World’s 30 Most Sustainable Corporations	687
19.2	An Analysis of Levi Strauss & Co.’s Terms of Engagement with Partners in Global Sourcing	693
19.3	Countries with the Lowest Perceived Corruption (Higher Values) and Highest Perceived Corruption (Lower Values), 2020	697
20.1	Japan’s Low Rating on the Ease of Starting a Business	710
20.2	Percentage of 18–64 Population Who Are Either a Nascent Entrepreneur or Owner-Manager of a New Business	712
20.3	Key Factors Affecting How Entrepreneurship Processes Differ Across Countries	713
20.4	Venture Capital Investments as a Percentage of GDP in Selected Countries	715
20.5	Informal Employment as Percentage of Total Non-Agricultural Employment	717
20.6	Ease of Starting a Business	719

# 1

# International Business in an Age of Globalization

## Do You Know?

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- 1 What is globalization? Why is globalization important even to firms that do not have any international involvement at present? How does globalization affect the consumer and the employee?
  - 2 What are the benefits of globalization, and what are its costs and risks, both real and perceived? Why has there been a backlash against globalization in recent years?
  - 3 What do the terms “international business,” “international transaction,” “international trade,” and “international investment” mean? Can you distinguish between the multinational enterprise (MNE) and the international firm?
  - 4 What are the differences between international business and domestic business? What is the source of these differences?
  - 5 Why do firms expand globally? What do they hope to gain and what hazards do they face? Does every firm seek identical goals or face the same obstacles and opportunities when expanding into international markets?
-

## OPENING CASE

### THE COCA-COLA COMPANY

Atlanta-based Coca-Cola Company, a manufacturer, distributor, and marketer of non-alcoholic beverages, is one of the first examples that comes to mind when people think of a global company. With almost 500 beverage brands, and sales in more than 200 countries, few other companies can match Coca-Cola's worldwide presence or the visibility of its products, particularly its flagship Coke, which has become the symbol of a global product. Studies show that the brand enjoys the highest name recognition in the world. The Coca-Cola Company ranked 59th on the Fortune 500 list (up 11 slots from 2011), with roughly \$46.54 billion in revenue and \$8.57 billion in profit. The company, which first sold trademark-registered Coke in the United States in 1886, relied on international markets for 78 percent of its gallon volume in 2011. At 44.2 percent of the total, net operating revenue was highest for North America in the same year, followed by the Pacific with 11.7 percent, and 10.3 percent for Europe.

Coca-Cola normally sells concentrate, based on the recipe that Dr. John Pemberton invented over a hundred years ago and that has been kept secret ever since, to local bottlers that prepare the beverage and distribute it in their respective markets. However, in some countries it does not grant bottlers full manufacturing rights. Unlike its domestic contracts, its international agreements are limited in time, allowing for termination at the company's discretion, and marketing support, while common, is not provided in all markets. True to the now famous slogan, "think global, act local," the company preserves a coherent marketing theme, yet also adapts product taste and operations to local markets. The "think global, act local" slogan embodies what may be the central dilemma in international business: the need to maintain global strategic focus and leverage scale advantages, while allowing for adaptation to local circumstances in everything from product specifications to packaging and distribution. The company's most global function—advertising—avoids themes that would be controversial in local markets. This is in contrast to its rival Pepsi, which, for example, irked religious circles in Israel with ads showing monkeys as human ancestors. Both its secret concentrate recipe and its marketing know-how are considered key factors in its global success. In addition, the company also achieves cost savings by purchasing certain raw materials centrally in large quantities for its global operations and by siting bottling plants locally (thus reducing shipping costs), particularly in locations where labor and land costs are lower.

Coca-Cola's global success has ruffled some feathers. A few years ago, the European Commission rejected its bid to acquire a French beverage maker, pointing out that it already had a majority share in European Union (EU) markets. More recently, the Chinese Ministry of Commerce blocked its attempt to acquire a privately owned beverage company in China, also on anti-monopoly grounds. The company's argument that it has a tiny share of the total market—defined as all liquids consumed, including water—has fallen on deaf ears. Efforts to promote a global image did not prevent the company from being identified and labeled an American icon, making it a lightning rod for criticism and attacks by anti-US and

anti-globalization activists. In 2001, Coca-Cola's facilities were bombed by Muslim rebels in India and by Maoist guerrillas in Nepal. In the years that followed, Coca-Cola has been the target of protests against US policies in Serbia, Europe, and the Arab world, among others.

*Source: Coca Cola Annual Report 2011; Fortune Magazine 500 list 2012; media reports.*

## An Age of Globalization

“Globalization” has become one of the buzzwords of modern times. People see its manifestations all around them, from the Coke can in a small village store in Africa, to McDonald's golden arches in a Chinese city, to an article in the local newspaper about the outsourcing of software maintenance to India or the shifting of a call center to Canada. Opinions regarding the impact of globalization vary widely, ranging from praise for its association with rising living standards, to condemnation of its ill effects such as industrial pollution and rising income inequality. On the evening news you may hear praise for globalization from a farmer who has just concluded a contract for a large shipment of soybeans to China, only to see it followed by coverage of an anti-globalization demonstration outside a trade conference. So, what is globalization, and why does it generate such diverse and often emotional reactions?

In line with the diversity of opinion, globalization has been defined in numerous ways. In this book, we define **globalization** as the acceleration and extension of the interdependence of economic and business activities across national boundaries. Simply put, this means that a development on one side of the globe will have consequences on another. It is easy to see the impact within a particular industry, for instance, the automotive industry. US-based makers of auto parts such as Delphi and Visteon have been pushed to restructure by pressure from low-cost producers in Asia, Mexico, and Eastern Europe, who can make the same automotive components for less. Volkswagen has demanded concessions from its German workforce as a condition for keeping production local. Closer to home, the price you pay at the pump is partially determined by energy demand in other countries, with soaring consumption in China and India accounting for much of the doubling of oil prices between 2004 and 2006. This interdependence will not go away. So, both the ongoing process and outcome of globalization have profound implications for not only the economic policies of governments, but also for the strategies of firms around the world. The US National Intelligence Council notes in its 2020 Project Report that “certain aspects of globalization, such as the growing global connectedness, are not likely to go away,” and that this will have far reaching consequences for the expansion of international business:

Interdependence has widened the reach of multinational business, enabling smaller firms as well as large multinationals to market across borders and bringing heretofore non-traded services into the international arena.<sup>1</sup>

## *What Does Globalization Mean to You?*

To the consumer, globalization means more choices, generally lower prices (but not always, as the example of gas prices shows), and an increasingly blurred national identity for products and services. Send a package from New York to London via DHL, and you have contributed to the revenue of the German Postal Service. Buy a Swedish Volvo, and you have increased the revenue of its Chinese owner, Geely Automobile Holdings Limited. Buy a Jaguar, and you have contributed to the bottom line of its Indian owner, Tata Motors. Buy a Dodge, and you have purchased a product of Italian-based Fiat. Buy a foreign brand, and you may find out that it is manufactured in the United States: Honda Civics in Ohio, Mercedes M class in Alabama, Nissan pickup trucks in Tennessee. If you prefer to buy Canadian, you can choose between a GM or a Ford vehicle manufactured in Canada; or you can settle for the Mercedes M class, made in the United States, but advertised in Canada as “made by a Canadian”—alluding to the manager of a US plant. If you are an Australian consumer who wants to buy a locally produced vehicle, you can select between three locally produced foreign brands: Holden (a GM brand whose design is influenced by its German subsidiary Opel), a Ford, or a Toyota. These Australian operations also export to other countries while facing more competition from imports as local tariffs are reduced.

Similar trends can be observed in the service sector. The mortgage on your US property might be underwritten by Swiss bank UBS, your life insurance by French insurer AXA. Your retirement funds might be invested in the stock of Swiss food giant Nestlé and Japanese electronics maker Sony, or managed by German-based Deutsche Bank. The advertisement enticing you to buy Cincinnati-based P&G’s Pampers may have been conceived by the UK’s Saatchi & Saatchi, but the graphic work may have been done in India. If you buy at your local Wal-Mart, chances are that much of the products on the shelves are made outside the country; Wal-Mart’s imports from China, for instance, exceed those of the United Kingdom. Even the student sitting next to you may well be a foreign national, as might be the patient waiting next to you in the hospital clinic. You may take your next vacation in Mexico, rather than in Florida; just remember to take your Chinese-manufactured iPhone along for the ride.

In addition to offering a dizzying array of consumer products and services, globalization affects your career prospects. At times, it will also limit your opportunities, as when the transcription of medical records is outsourced to India; at other times, especially if you are better educated, globalization will greatly expand your career choices and opportunities. It is increasingly possible that you will join one of the many foreign firms in the United States upon graduation, or that you will be assigned to work in another country by a US-, local-, or a third-country foreign firm. If you are considering employment with a foreign firm, you may want to know whether the recruiting company tends to open its senior-most ranks to other than its own nationals. If in doubt, look for foreign names on the list of members of the board of directors, which provide a good indication of how open the company is to non-natives. Whether you work for a domestic or a foreign corporation, you will not only have to consider a foreign assignment, but will spend time negotiating, entertaining, coaching, and learning from foreign executives and employees. How well you perform these tasks will determine the rest of your career, as companies are increasingly on the lookout for individuals who can successfully operate globally.

## Interim Summary

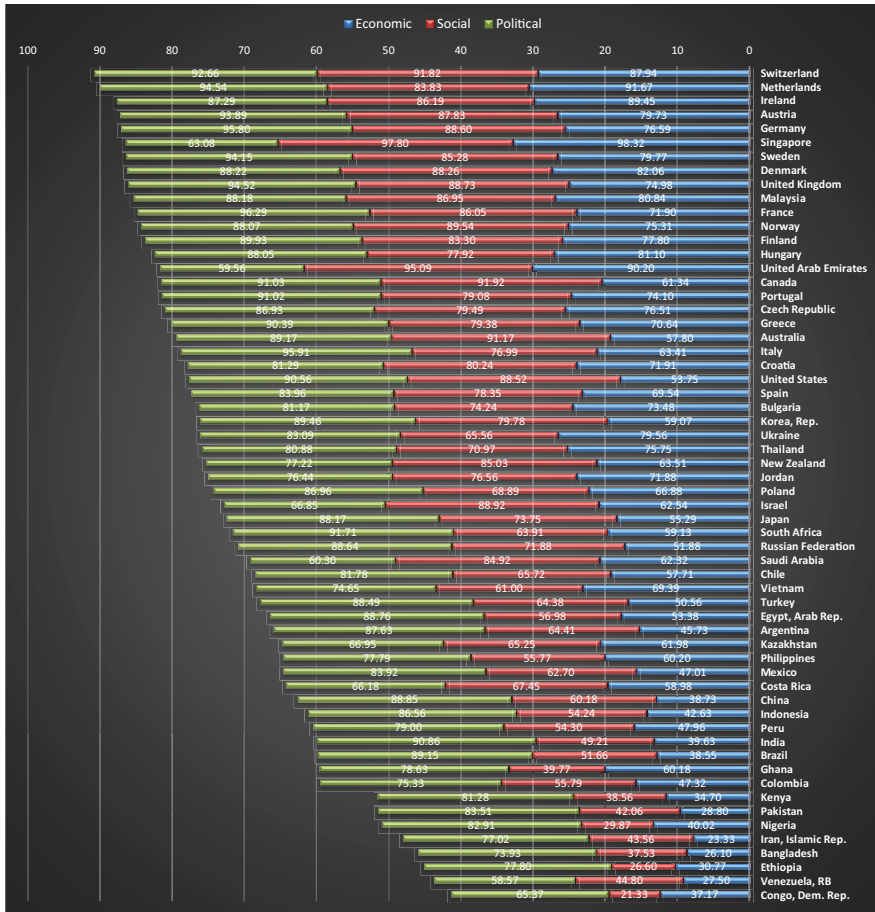
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- 1 **Globalization is the accelerated interdependence of economic and business activities across national boundaries.**
  - 2 **Globalization influences the availability and pricing of products and services around the world, while often blurring their source and identity.**
  - 3 **Globalization affects your career opportunities and the skills you will need to be successful.**
- 

## The Face of Globalization

KOF Swiss Economic Institute publishes a Globalization Index on the extent of a country's integration with the rest of the world along three dimensions (economic, social, and political). Economic integration scores are based on a country's trade and foreign investment, discussed later in Chapters 2 and 3 of this book. Social integration scores are composed of such indicators as the number of Internet users, international travel and tourism, international telephone and mail traffic, and foreign population. Finally, political engagement scores are composed as a combination of membership in international organizations, participation in UN Security Council missions, the number of international treaties ratified, and the number of embassies in the country. In addition, the KOF index considers both *de facto* globalization (economic, social, and political exchanges with the rest of the world) and *de jure* globalization (regulations and institutions that affect the exchanges). Exhibit 1.1 shows the ratings of 60 countries according to their *de facto* globalization scores.

Exhibit 1.2 lists the 30 most globalized countries/territories of the world in 2018 according to the overall Globalization Index and on each of the three dimensions. Switzerland is in first place overall. The United States is in 23rd place, with its high levels of global integration along the social and political dimensions counterbalanced by its relatively low level of economic integration (typical of countries with large domestic markets), where the US does not even place in the top 50. Indeed one could argue that, in a global environment, being large is sometimes a liability in the sense that it allows firms to neglect international markets for too long. A well-known study of globalization was published in *Foreign Policy* magazine in 2005.<sup>2</sup> The study did not find a strong relation between globalization and the propensity to suffer terrorist attacks on one's soil, discounting speculation that opening up to the outside world invites security risks. However, the study did find a relation between globalization and public education spending, especially in the developing world. In other words, success in a global, knowledge-based economy depends on having an educated workforce. Elsewhere, a *New York Times* Op-Ed noted that countries that ranked high on the Globalization Index had higher economic and political stability (see Chapter 7), more flexible labor markets, better regulation, and less corruption (see Chapter 19).<sup>3</sup>



**Exhibit 1.1**  
Globalization Scores of Selected Countries, 2018

Source: KOF Index of Globalization 2020. Gygli, Savina, Florian Haelg, Niklas Potrafke and Jan- Egbert Sturm (2019): The KOF Globalisation Index – Revisited, Review of International Organizations, 14(3), 543–574 <https://doi.org/10.1007/s11558-019-09344-2>. The methodology is based on Axel Dreher, “Does globalization affect growth? Evidence from a new Index of Globalization,” *Applied Economics*, 38, 10, 2006, 1091–1110.

### Who Benefits from Globalization?

One of the main arguments against globalization is that it confers benefits on rich nations at the expense of poor ones. Before we discuss this argument, let us take a look at the relationship between development level and globalization. It is evident from Exhibit 1.2 that some developed nations (e.g., Japan) obtain only moderate globalization scores, while some developing and emerging economies (e.g., the Czech Republic and Malaysia) obtain respectable scores. Still, the overall relationship is quite clear: The 12 nations that score highest on globalization are all developed economies, while the bottom half is occupied by developing and emerging economies. This does not mean that globalization brings no value

## Exhibit 1.2 The World's Most Globalized Countries/Territories, 2018

Overall Rank	Country	Overall Score	Economic Rank	Country	Economic Score	Social Rank	Country	Social Score	Political Rank	Country	Political Score
1	Switzerland	91.19	1	Singapore	94.00	1	Luxembourg	91.91	1	Italy	98.26
2	Netherlands	90.71	2	Netherlands	88.66	2	Monaco	91.13	2	France	98.17
3	Belgium	90.59	3	Belgium	88.54	3	Norway	90.76	3	Germany	97.96
4	Sweden	89.93	4	Luxembourg	88.30	4	Switzerland	90.42	4	United Kingdom	97.90
5	United Kingdom	89.84	5	Hong Kong, China	88.21	5	United Kingdom	90.15	5	Spain	97.46
6	Austria	88.85	6	Ireland	87.97	6	Canada	89.81	6	Netherlands	97.33
7	Germany	88.60	7	Switzerland	86.79	7	Sweden	89.17	7	Sweden	97.26
8	Denmark	88.26	8	Malta	86.50	8	Ireland	88.50	8	Switzerland	96.37
9	Finland	87.70	9	Estonia	86.27	9	Singapore	88.42	9	Belgium	96.27
10	France	87.25	10	United Arab Emirates	85.95	10	Andorra	88.41	10	Austria	95.96
11	Norway	86.17	11	Denmark	84.46	11	Austria	87.72	11	Portugal	93.84
12	Spain	85.70	12	Cyprus	84.28	12	Australia	87.58	12	Finland	93.82
13	Czech Republic	85.60	13	Czech Republic	84.04	13	Liechtenstein	87.50	13	Denmark	93.77
14	Hungary	84.98	14	Sweden	83.35	14	Germany	87.37	14	United States	93.62
15	Portugal	84.72	15	Slovak Republic	83.07	15	New Zealand	86.89	15	Russian Federation	93.05
16	Canada	84.64	16	Finland	82.97	16	Belgium	86.84	16	India	92.96
17	Ireland	84.47	17	Austria	82.86	17	Denmark	86.55	17	Turkey	92.47
18	Estonia	83.77	18	Hungary	82.69	18	San Marino	86.49	18	Canada	92.41
19	Slovak Republic	83.72	19	Bahrain	82.54	19	Cyprus	86.45	19	Greece	91.95

*continued*



Exhibit 1.2 *continued*

Overall Rank	Country	Overall Score	Economic Rank	Country	Economic Score	Social Rank	Country	Social Score	Political Rank	Country	Political Score
20	Singapore	83.62	20	Mauritius	82.16	20	Finland	86.32	20	Hungary	91.85
21	Luxembourg	83.60	21	Latvia	82.08	21	Netherlands	86.15	21	Egypt, Arab Rep.	91.83
22	Italy	83.37	22	Georgia	82.02	22	Macao, China	86.13	22	Argentina	91.66
23	United States	82.41	23	United Kingdom	81.47	23	Iceland	86.12	23	Poland	91.61
24	Greece	82.38	24	Germany	80.49	24	Israel	85.85	24	Korea, Rep.	91.16
25	Australia	81.99	25	Portugal	80.17	25	Hong Kong, China	85.76	25	Romania	91.11
26	Malaysia	81.49	26	Lithuania	79.56	26	France	85.51	26	China	90.61
27	Croatia	81.42	27	France	78.06	27	United States	85.47	27	Norway	90.23
28	Lithuania	81.34	28	Montenegro	78.06	28	Lithuania	85.25	28	Australia	90.21
29	Poland	81.33	29	Bulgaria	77.82	29	Estonia	85.00	29	Czech Republic	90.16
30	Slovenia	81.14	30	Norway	77.53	30	Bahamas, The	84.93	30	Ukraine	89.24

Source: KOF Index of Globalization 2020. Gygli, Savina, Florian Haelg, Niklas Potrafke and Jan- Egbert Sturm (2019): The KOF Globalisation Index – Revisited, Review of International Organizations, 14(3), 543–574 <https://doi.org/10.1007/s11558-019-09344-2>. The methodology is based on Axel Dreher, “Does globalization affect growth? Evidence from a new Index of Globalization,” *Applied Economics*, 38, 10, 2006, 1091–1110.

to the developing world; on the contrary, integration into the global economy may well pave the route to economic growth and prosperity, as the case of China, one of the world's fastest growing economies, shows clearly. In contrast, countries that fail to integrate into the global economy face the prospect of falling further behind. Two related factors tend to limit the extent of benefit that poor countries can gain from globalization. One is the presence of serious deficiencies in domestic economic and politico-legal governance (e.g., civil conflict, macroeconomic mismanagement, lack of property rights protection, and corruption) that prevent the country from exploiting its advantages in international trade and that deter foreign investment. The other is the lack of trained personnel for effective participation in international economic institutions such as the International Monetary Fund, the World Trade Organization, and the World Bank.

The good news is that the share of developing countries in world merchandise trade is rising to its highest level in more than 50 years, and the trade growth of the 49 least developed countries (LDCs) exceeds the global average. It is also important to realize that many of the manifestations of globalization in wealthy nations end up helping poorer economies. For instance, when a Singaporean tourist is visiting Laos, he is in effect increasing the export sales of Laos by purchasing such services as hotel stays and tours. And while wages in developing country factories are low by developed nation standards, employees of foreign affiliates in developing economies are paid, on average, far more than those employed by domestic firms. While some local firms are unable to compete with large foreign corporations and exit the market, others take advantage of the learning opportunities associated with multinational presence and upgrade their capabilities, thus positioning themselves as future global players. If large multinational firms seem an exclusive club of rich nations, they are now joined by multinationals from developing economies. In 2000, for the first time ever, multinational firms from developing nations made it into the ranks of the top 100 global multinationals.<sup>4</sup> According to a more recent UN report from 2012, firms from Mexico, China, Brazil, and other developing nations continue to break into the top multinational ranks, with new contenders like China-based Lenovo growing rapidly.<sup>5</sup>

## *The Impact of Globalization*

A common lamentation against globalization is that it deprives nations of their sovereignty. This will supposedly occur because of the growing power of international institutions such as the World Trade Organization (WTO) or the International Monetary Fund (IMF), whose officials are not elected by popular vote (see Chapter 8). Yet, while the WTO has assumed a conflict resolution role that was previously the domain of bilateral negotiations, its resolutions are based on consensus, meaning that the vote of the smallest nation counts as much as that of the largest. The most important decisions regarding international trade are still made by governments, and trade relations are governed by bilateral agreements negotiated and monitored by sovereign governments. And, while mega-multinational corporations abound, small firms remain viable players that have a role in the global economy. As you will see in Chapter 4, small firms in the United States and in many other countries have actually increased their share of national exports over the last decade.

Another complaint against globalization is that it comes at the expense of the environment. Environmentalists accuse firms of relocating their operations abroad solely for reasons