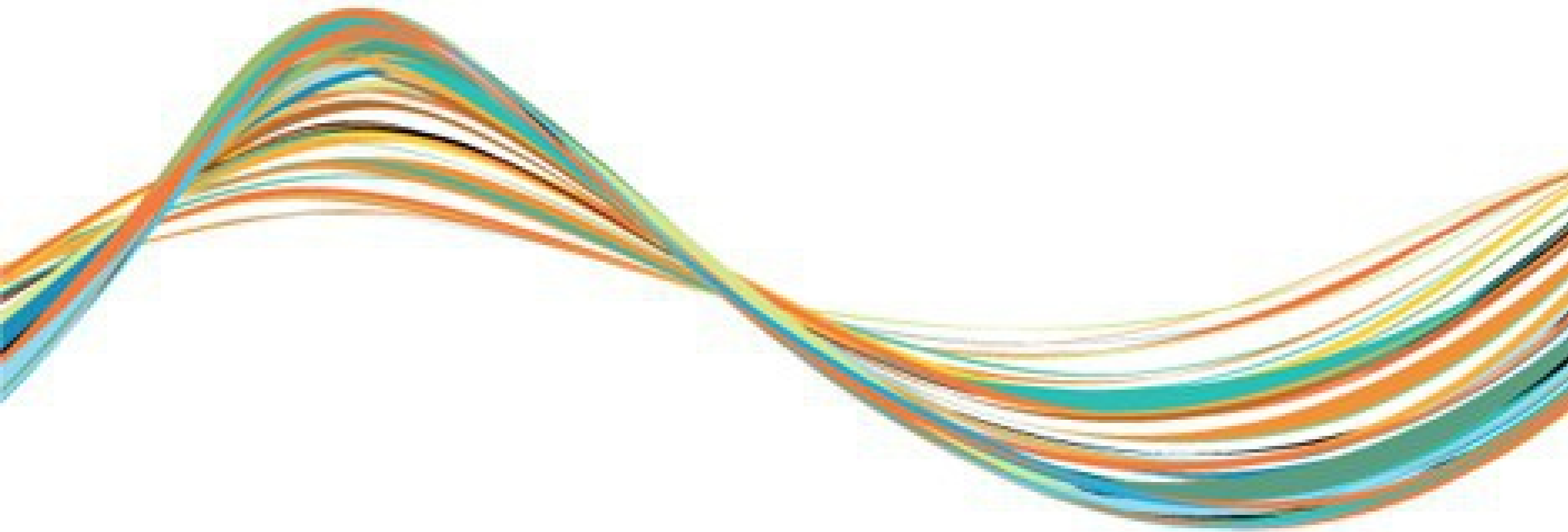
This International Student Edition is for use outside of the U.S.

THIRTEENTH EDITION

INTERNATIONAL BUSINESS

Competing in the Global Marketplace



Charles W.L. Hill

This International Student Edition is for use outside of the U.S.

THIRTEENTH EDITION

INTERNATIONAL BUSINESS

Competing in the Global Marketplace

Charles W.L. Hill

International Business

Competing in the Global Marketplace

13e

Charles W.L. Hill
UNIVERSITY OF WASHINGTON

INTERNATIONAL BUSINESS

This book is printed on acid-free paper.

1 2 3 4 5 6 7 8 9 LWI 21 20

ISBN 978-1-260-57586-6
MHID 1-260-57586-1

Cover Image: *Buslik/Shutterstock*

mheducation.com/highered

For my children, **Elizabeth, Charlotte,** and **Michelle**

—Charles W. L. Hill

about the **AUTHOR**

Charles W. L. Hill
University of Washington

Charles W. L. Hill is the Hughes M. and Katherine Blake Professor of Strategy and International Business in the Foster School of Business at the University of Washington. Professor Hill has taught in the Management, MBA, Executive MBA, Technology Management MBA, 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 the Charles E. Summer Outstanding Teaching Award.

A native of the United Kingdom, Professor Hill received his PhD from the University of Manchester, UK. 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 top academic journals, including the *Academy of Management Journal*, *Academy of Management Review*, *Strategic Management Journal*, and *Organization Science.* Professor Hill 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 works on a private basis with a number of organizations. His clients have included Microsoft, where he taught 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, Philips Healthcare, Philips Medical Systems, Seattle City Light, Swedish Health Services, Tacoma City Light, Thompson Financial Services, WRQ, and Wizards of the Coast). Additionally, Dr. Hill has served on the advisory board of several start-up companies.

For recreation, Professor Hill enjoys skiing and competitive sailing!

brief CONTENTS

McGraw Hill Education
5011111

THE PROVEN CHOICE FOR INTERNATIONAL BUSINESS

RELEVANT. PRACTICAL. INTEGRATED.

It is now more than a quarter of a century since work began on the first edition of *International Business: Competing in the Global Marketplace.* By the third edition the book was the most widely used international business text in the world. Since then its market share has only increased. The success of the book can be attributed to a number of unique features. Specifically, for the thirteenth edition we have developed a learning program that

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

International Business, now in its thirteenth edition, authored by Charles W. L. Hill, is a comprehensive and case-oriented version of our text 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. We cover more and integrated cases in *International Business 13e* and we provide a deeper treatment of the global capital market, the organization of an international business, international accounting, and international finance–topics that are allocated chapters in *International Business 13e* but are not attended to in the shorter treatment of IB in *Global Business Today 11e*.

Like our shorter text, *Global Business Today 11e* (2019), *International Business 13e* focuses on being current, relevant, application rich, 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 13 editions, Dr. Charles Hill has worked hard to adhere to these goals. Since *Global Business Today 9e* (2015), and *International Business 11e* (2017), Charles has been guided not only by his own reading, teaching, and research but also by the invaluable feedback he receives from professors and students around the world, from reviewers, and from the editorial staff at McGraw-Hill Education. His thanks goes 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.

Relevance and comprehensiveness 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 2019, 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. As you can see in Chapter 1 on Globalization, trade across country borders has almost exponentially escalated in the last few years. 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. We take great pride in covering international business for small- and medium-sized enterprises (SMEs), as well as larger multinational corporations. We also take great pride in covering firms from all around the world. Some sixty SMEs and multinational corporations from all six core continents are covered in the chapters' opening cases, closing cases, and/or Management Focus boxes.

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. Plus, with the United Kingdom opting to leave the European Union (Brexit), which has implications past 2019, the election of President Donald Trump in the United States (who espouses views on international trade that break with the long established consensus), and several elections around the world, the globe—in many ways—has paid more attention to nationalistic issues over trade. These topics and many more are integrated into this text for maximum learning opportunities.

What's New in the 13th Edition

The success of the first twelve editions of *International Business* 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 twelfth 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. Provide 20 new integrated cases that can be used as additional cases for specific chapters but, more importantly, as learning vehicles across multiple chapters.

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. As before, we are the only text in International Business that ensures that all material is up-to-date on virtually a daily basis. The copyright for the book is 2021 but you are likely using the text in 2020, 2021, or 2022–we keep it updated to each semester you use the text in your course! We are able to do this by integrating globalEDGE features in every chapter. Specifically, 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 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 statistics, figures, and maps to incorporate most recently published data, a chapter-by-chapter selection of changes for the 13th edition include the following:

Chapter 1: Globalization

- New opening case: How the iPhone is made: Apple's Global Production System
- Updated statistics and figures to incorporate the most recent data on global trade flows and foreign direct investment
- Discussion of the implications of recent political trends (Brexit and the Trump Presidency) and what this might mean for cross border trade and investment
- New closing case: General Motors in China

Chapter 2: National Differences In Political, Economic, and Legal Systems

- New opening case: Kenya: An African Lion
- Updated data on corruption
- New closing case: Transformation in Saudi Arabia

Chapter 3: National Differences In Economic Development

- New opening case: Poland: Eastern Europe's Economic Miracle
- Updated maps, figures, and in-text statistics to reflect most recently available data
- Addition of demographic trends to the discussion of Political Economy and Economic Progress
- Updated discussion of the spread of democracy to reflect recent countertrends toward greater authoritarianism in several nations (e.g., Turkey)
- New closing case: Brazil's Struggling Economy

Chapter 4: Differences In Culture

- New opening case: Singapore: One of the World's Most Multicultural Places
- Inclusion of a discussion of patience across cultures
- Revised the foundation that most religions are now pro-business
- New Country Focus: Determining Your Social Class by Birth
- New Country Focus: Turkey, Its Religion, and Politics
- New closing case: China, Hong Kong, Macau, and Taiwan

Chapter 5: Ethics, Corporate Social Responsibility, and Sustainability

- New opening case: Ericsson, Sweden, and Sustainability
- Deepened focus related to United Nations' Sustainable Development Goals
- Core focus on ethics as a lead-in to corporate social responsibility and sustainability issues (e.g., UN's Sustainable Development Goals).
- New closing case: Sustainability Initiatives at Natura, the Bodyshop, and Aesop

Chapter 6: International Trade Theory

- New opening case: A Tale of Two Nations: Ghana and South Korea
- Updated Country Focus on China and currency manipulation
- Reference to Donal Trump's trade policies under section on mercantilism
- New closing case: Trade Wars are Good and Easy to Win
- Updated balance of payments data in the Appendix to reflect 2018 data

Chapter 7: Government Policy and International Trade

- New opening case: American Steel Tariffs
- Updated discussion of the world trading system to reflect recent developments, including Brexit and the trade policies of President Trump

- New closing case: The United States and South Korea Strike a Revised Trade Deal

Chapter 8: Foreign Direct Investment

- New opening case: Starbuck's Foreign Direct Investment
- Updated statistics and figures on foreign direct investment in the world economy to incorporate the most recently available data
- New Management Focus: Burberry Shifts its Entry Strategy in Japan
- New closing case: Geely Goes Global

Chapter 9: Regional Economic Integration

- New opening case: The Cost of Brexit
- Updated discussion of Brexit
- Added discussion of the renegotiation of NAFTA by the Trump administration and the details of the United States–Canada–Mexico Agreement (USCMA)
- Additional discussion of new free trade deals in Africa
- Closing case: NAFTA 2.0: The USCMA

Chapter 10: The Foreign Exchange Market

- New opening case: Managing Foreign Currency Exposure at 3M
- Updated data throughout the chapter to reflect currency exchange rates in 2019.
- New closing case: The Fluctuating Value of the Yuan Gives Chinese Business a Lesson in Foreign Exchange Risk

Chapter 11: The International Monetary System

- New opening case: Pakistan Takes Another IMF Loan
- Updated data and discussion of the floating exchange rate regime through till 2019
- New Country Focus: China's Exchange Rate Regime
- New closing case: Can Dollarization Save Venezuela?

Chapter 12: The Global Capital Market

- New opening case: Chinese IPOs in the United States
- Updated statistics and discussion to reflect most recently available data
- New closing case: Saudi Aramco

Chapter 13: The Strategy of International Business

- New opening case: International Strategy in the Sharing Economy
- Inclusion of materials on the "sharing economy" related to strategy, including a discussion of Airbnb, Uber, Lyft, and Turo
- New Management Focus: IKEA's Global Strategy
- New Management Focus: Unilever's Global Organization
- New closing case: Red Bull, A Leader in International Strategy

Chapter 14: The Organization of International Business

- New opening case: Bird, Lime, and Organizing Globally
- Integration of new materials on the "sharing economy" related to organizations, including a discussion of Bird and Lime

- Deeper focus on small, medium, and sharing economy organizations
- New closing case: Walmart International

Chapter 15: Entering Developed and Emerging Markets

- New opening case: Volkswagen, Toyota, and GM in China
- New scope of the chapter to include entering developed and emerging markets
- Inclusion of a discussion of less developed markets and base-of-the-pyramid
- New closing case: IKEA Entering India, Finally!

Chapter 16: Exporting, Importing, and Countertrade

- New opening case: Higher Education in the U.S. Is about Exporting and International Competitiveness
- Revised material on globalEDGE™ Diagnostic Tools
- New Management Focus: Embraer and Brazilian Importing
- New Management Focus: Exporting Desserts by a Hispanic Entrepreneur
- New Management Focus: Two Men and a Truck
- New closing case: Spotify and SoundCloud

Chapter 17: Global Production and Supply Chain Management

- New opening case: Blockchain Technology and Global Supply Chains
- New material on blockchain technology
- New Management Focus: IKEA Production in China
- New Management Focus: Amazon's Global Supply Chains
- New closing case: Procter & Gamble Remakes Its Global Supply Chains

Chapter 18: Global Marketing and Business Analytics

- New chapter title to signal significant new material on Business Analytics
- New opening case: Marketing Sneakers
- New section on Business Analytics
- Revised section: International Marketing Research
- Inclusion of more social media topics throughout
- New Management Focus: Global Branding, Marvel Studios, and Walt Disney Company
- New Management Focus: Burberry's Social Media Marketing
- New closing case: Fake News and Alternative Facts

Chapter 19: Global Human Resource Management

- New opening case: Evolution of the Kraft Heinz Company
- New section: Building a Diverse Global Workforce
- New Management Focus: AstraZeneca and Global Staffing Policy
- New closing case: Global Mobility at Shell

Chapter 20: Accounting and Finance in the International Business

- New opening case: Pfizer, Novartis, Bayer, and GlaxoSmithKline
- New material on the U.S. corporate tax rate and implications
- New Management Focus: Microsoft and Its Foreign Cash Holdings
- New closing case: Shoprite—Financial Success of a Food Retailer in Africa

Integrated Cases

All of the 20 integrated cases are new for *International Business 13e*. Many of these cases build on previous opening and closing chapter cases that have been revised, updated, and oftentimes adopted a new angle or focus. A unique feature of the opening and closing cases for the chapters as well as the integrated cases at the back-end of the text is that we cover all continents of the world and we do so with regional or country issues and large, medium, and small company scenarios. This makes the 60 total cases we have included in *International Business 13e* remarkably wealthy as a learning program.

- Globalization of BMW, Rolls-Royce, and the MINI
- The Decline of Zimbabwe
- Economic Development in Bangladesh
- The Swatch Group and Cultural Uniqueness
- Woolworths' Corporate Responsibility Strategy
- The Trans Pacific Partnership (TPP) is Dead: Long Live the CTPP!
- Boeing and Airbus Are in a Dogfight over Illegal Subsidies
- FDI in the Indian Retail Sector
- Free Trade in Africa
- The Mexican Peso, the Japanese Yen, and Pokemon Go
- Egypt and the IMF
- Alibaba's Record-Setting IPO
- Sony Corporation: Still a Leader Globally?
- Organizational Architecture at P&G
- Cutco Corporation--Sharpening Your Market Entry
- Tata Motors and Exporting
- Alibaba and Global Supply Chains
- Best Buy Doing a Turnaround Again
- Sodexo: Building a Diverse Global Workforce
- Tesla, Inc.--Subsidizing Tesla Automobiles Globally

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 **Did You Know**? feature 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 author 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**. 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 12). We also integrate macro themes in covering the micro chapters (Chapters 13 through 20).

ACCESSIBLE AND INTERESTING

The international business arena is fascinating and exciting, and we have tried to communicate our enthusiasm for it to the student. Learning is easier and better if the subject matter is communicated in an interesting, informative, and accessible manner. One technique we have used to achieve this is weaving interesting anecdotes into the narrative of the text, that is, stories that illustrate theory.

Most chapters also have a **Country Focus** box that provides background on the political, economic, social, or cultural aspects of countries grappling with an international business issue.

ACKNOWLEDGMENTS

Numerous people deserve to be thanked for their assistance in preparing this book. First, thank you to all the people at McGraw-Hill Education who have worked with us on this project:

Peter Jurmu, Portfolio Manager
Haley Burmeister, Product Developer
Nicole Young, Senior Marketing Manager
Julia Blankenship, Marketing Coordinator

Harvey Yep, Content Project Manager (Core)
Keri Johnson, Content Project Manager (Assessment)
Sandy Ludovissy, Senior Buyer
Egzon Shaqiri, Designer
Carrie Burger, Content Licensing Specialist

Second, our thanks go to the reviewers who provided good feedback that helped shape this book:

Yimai Lewis, Georgia State University
Long S. Le, Santa Clara University
Clare R. Greenlaw, Jr., Southern New Hampshire University – COCE
Richard Ajayi, University of Central Florida
Hussain Ahmad, Hofstra University
Erica Kovacs, Indiana University
Marta Szabo White, Georgia State University
C. Jayachandran, Montclair State University, NJ
T.S. Gardner, UNC Wilmington
Marcel Zondag, Western Michigan University
Mamoun Benmamoun, Saint Louis University
Manveer Mann, Montclair State University
Jose Luis Daniel, Saint Xavier University
Walter C. van Hoof, San Jose State University,
San Jose, CA
Riikka M. Sarala, UNC Greensboro
Samuel Okoroafo, University of Toledo, Toledo, Ohio
Pamela S. Evers, University of North Carolina Wilmington

A special thanks to David Closs and David Frayer for allowing us to borrow elements of the sections on Strategic Roles for Production Facilities; Make-or-Buy Decisions; Global Supply Chain Functions; Coordination in Global Supply Chains; and Interorganizational Relationships for Chapter 15 of this text from Tomas Hult, David Closs, and David Frayer (2014), *Global Supply Chain Management*, New York: McGraw-Hill.

McGraw Hill connect®

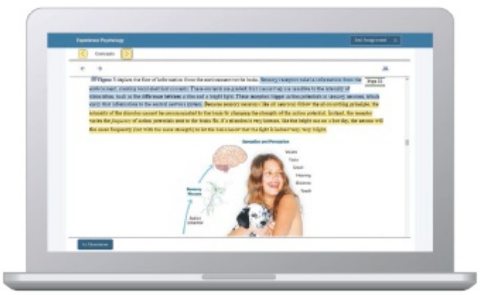
FOR INSTRUCTORS

You're in the driver's seat.

Want to build your own course? No problem. Prefer to use our turnkey, prebuilt course? Easy. Want to make changes throughout the semester? Sure. And you'll save time with Connect's auto-grading too.

65%

Less Time Grading



Laptop: McGraw-Hill; Woman/dog: George Doyle/Getty Images

They'll thank you for it.

Adaptive study resources like SmartBook® 2.0 help your students be better prepared in less time. You can transform your class time from dull definitions to dynamic debates. Find out more about the powerful personalized learning experience available in SmartBook 2.0 at **www.mheducation.com/highered/connect/smartbook**

Make it simple, make it affordable.

Connect makes it easy with seamless integration using any of the major Learning Management Systems—Blackboard®, Canvas, and D2L, among others—to let you organize your course in one convenient location. Give your students access to digital materials at a discount with our inclusive access program. Ask your McGraw-Hill representative for more information.

Padlock: Jobalou/Getty Images

Solutions for your challenges.

A product isn't a solution. Real solutions are affordable, reliable, and come with training and ongoing support when you need it and how you want it. Our Customer Experience Group can also help you troubleshoot tech problems—although Connect's 99% uptime means you might not need to call them. See for yourself at **status.mheducation.com**

Checkmark: Jobalou/Getty Images

SUPPORT AT every step

FOR STUDENTS

Effective, efficient studying.

Connect helps you be more productive with your study time and get better grades using tools like SmartBook 2.0, which highlights key concepts and creates a personalized study plan. Connect sets you up for success, so you walk into class with confidence and walk out with better grades.

Study anytime, anywhere.

Download the free ReadAnywhere app and access your online eBook or SmartBook 2.0 assignments when it's convenient, even if you're offline. And since the app automatically syncs with your eBook and SmartBook 2.0 assignments in Connect, all of your work is available every time you open it. Find out more at **www.mheducation.com/readanywhere**

> ***"I really liked this app—it made it easy to study when you don't have your text-book in front of you."***
>
> - Jordan Cunningham,
> Eastern Washington University

Calendar: owattaphotos/Getty Images

No surprises.

The Connect Calendar and Reports tools keep you on track with the work you need to get done and your assignment scores. Life gets busy; Connect tools help you keep learning through it all.

Learning for everyone.

McGraw-Hill works directly with Accessibility Services Departments and faculty to meet the learning needs of all students. Please contact your Accessibility Services office and ask them to email accessibility@mheducation.com, or visit **www.mheducation.com/about/accessibility** for more information.

Top: Jenner Images/Getty Images, Left: Hero Images/Getty Images, Right: Hero Images/Getty Images

CONTENTS

part two

National Differences

part three

The Global Trade and Investment Environment

Page xx

part six

International Business Functions

CHAPTER 17

Global Production and Supply Chain Management 498

CHAPTER 18

Global Marketing and Business Analytics 528

part seven

Integrative Cases

Page xxvi

International
Business
Competing in the Global Marketplace

13e

part one 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.

Qilai Shen/In Pictures Ltd./Corbis/Getty Images

How the iPhone Is Made: Apple's Global Production System

OPENING CASE

In its early days, Apple usually didn't look beyond its own backyard to manufacture its devices. A few years after Apple started making its Macintosh computer back in 1983, Steve Jobs bragged that it was "a machine that was made in America." As late as the early 2000s, Apple still manufactured many of its computers at the company's iMac plant in Elk Grove, California. Jobs often said that he was as proud of the Apple's manufacturing plants as he was of the devices themselves.

By 2004, however, Apple had largely turned to foreign manufacturing. The shift to offshore production and assembly reached its peak with the iconic iPhone, which Apple first introduced in 2007. The iPhone contains hundreds of parts, an estimated 90 percent of which are manufactured abroad. Advanced semiconductors come from Germany and Taiwan, memory from Korea and Japan, display panels and circuitry from Korea and Taiwan, rare metals from Africa and Asia, and the gyroscope used for tracking the iPhone's orientation comes from Switzerland. Apple's major subcontractor, the Taiwanese multinational firm, Foxconn, assembles half of all the iPhones sold in the world today at a huge factory in China. Foxconn also has factories devoted to iPhone assembly at several other locations, including Brazil and India. Another Taiwanese-based company, Pegatron, also assembles iPhones for Apple at a factory in China.

Apple still employs some 80,000 people in the United States, and it has kept important activities at home, including product design, software engineering, and marketing. Furthermore, Apple claims that its business supports another 450,000 jobs at U.S.-based suppliers. For example, the glass for the iPhone is manufactured at Corning's U.S. plants in Kentucky, Analog Devices in Massachusetts produces chips that enable the iPhone's touch display, and a Texas Instruments plant in Maine makes electronic components that go in the iPhone. However, over 1.5 million people are involved in the engineering, building, and final assembly of its products *outside* of the United States, many of them working at subcontractors like Foxconn.

When explaining its decision to assemble the iPhone in China, Apple cites a number of factors. While it is true that labor costs are lower in China, Apple executives point out that labor costs only account for a small portion of the total value of its products and are not the main driver of location decisions. Far more important, according to Apple, is the ability of its Chinese subcontractors to respond very quickly to requests from Apple to scale production up and down. In a famous illustration of this capability, back in 2007 Steve Jobs demanded that a glass screen replace the plastic screen on his prototype iPhone. Jobs didn't like the look and feel of plastic screens, which at the time were standard in the industry, nor did he like the way they scratched easily. This last-minute change in the design of the iPhone put Apple's market introduction date at risk. Apple had selected Corning to manufacture large panes of strengthened glass, but finding a manufacturer that could cut those panes into millions of iPhone screens wasn't easy. Then, a bid arrived from a Chinese factory. When the Apple team visited the factory, they found that the plant's owners were already constructing a new wing to cut the glass and were installing equipment. "This is in case you give us the contract," the manager said. The plant also had a warehouse full of glass samples for Apple, and a team of engineers available to work with Apple. They had built onsite dormitories so the factory could run three shifts seven days a week to meet Apple's demanding production schedule. The Chinese company got the bid.

Another critical advantage of China for Apple was that it was much easier to hire engineers there. Apple calculated that about 8,700 industrial engineers were needed to oversee and guide the 200,000 assembly-line workers involved in manufacturing the original iPhone. The company had estimated it would take as long as nine months to find that many engineers in the United States. In China, it took 15 days.

Also important is the clustering together of factories in China. Many of the factories providing components for the iPhone are located close to Foxconn's assembly plant. As one executive noted, "The entire supply chain is in China. You need a thousand rubber gaskets? That's the factory next door. You need a million screws? That factory is a block away. You need a screw made a little bit different? That will take three hours."[*]

All this being said, there are drawbacks to outsourcing to China. Several of Apple's subcontractors have been targeted for their poor working conditions. Criticisms include low pay of line workers, long hours, mandatory overtime for little or no additional pay, and poor safety records. Some former Apple executives say there is an unresolved tension within the company: Executives want to improve working conditions within the factories of subcontractors, such as Foxconn, but that dedication falters when it conflicts with crucial supplier relationships or the fast delivery of new products. In addition, Apple's outsourcing decisions have been criticized by President Trump, who argues that the company is guilty of moving U.S. jobs overseas. While Apple disagrees with this assessment, it has responded by increasing its investment in U.S. facilities. In 2018, for example, the company announced it would invest $30 billion over five years to create 20,000 new Apple jobs in the United States. Most of these jobs, however, are expected to be in software development and data center operations, not manufacturing and assembly.

*C. Duhigg and K. Bradsher, "How U.S. Lost Out on iPhone Work." *The New York Times*, January 22, 2012.

Sources: Sam Costello, "Where Is the iPhone Made?" *Lifewire*, July 14, 2018; David Barboza, "How China Built iPhone City with Billions in Perks for Apple's Partner," *The New York Times*, December 29, 2016; Gu Huini, "Human Costs Are Built into iPad in China," *The New York Times*, January 26, 2012; Chuck Jones, "Apple's $350 Billion US Contribution Was Already on the Cards," *Forbes*, January 19, 2018.

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 have moved toward a world in which barriers to cross-border trade and investment have declined; 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*.

At the same time, recent political events have raised some questions about the inevitability of the globalization process. The exit of the United Kingdom from the European Union (Brexit), the renegotiation of the North American Free Trade Agreement (NAFTA) by the Trump Administration, and trade disputes between the United States and many of its trading partners, including most notably China, have all contributed to uncertainty about the future of globalization.

While the world seems unlikely to pull back significantly from globalization, there is no doubt that the benefits of globalization are more in dispute now than at any time in the last half century. This is a new reality, albeit perhaps a temporary one, but it is one the international business community will have to adjust to.

The opening case illustrates how one company, Apple, has taken advantage of globalization. Apple has created a global supply chain to efficiently produce its icon iPhone. While product design and software development are undertaken in California, component parts are manufactured all over the world, and the final product is assembled for Apple by Foxconn in factories in China, Brazil, India, and elsewhere. In configuring the production system of the iPhone in this manner, Apple is trying to partner with the most efficient subcontractors, wherever in the world they might reside. Apple could not have configured its production system in this manner had it not been for the systematic reductions in barriers to cross-border trade and investment that have occurred over the last half century.

At the same time, Apple has been criticized by President Trump for placing too much productive activity outside of the United States. Moreover, trade disputes between the United States and China have raised the possibility that China may at some point not be the optimal location for assembling the iPhone. Apple has started to adjust its strategy to account for the potential risks here, establishing assembly operations outside of China (in India, for example), increasing its investment in the United States (in 2018, Apple announced it would invest $30 billion over five years in U.S. facilities, creating 20,000 new jobs in the process), and working with U.S.-based suppliers to help them become efficient Apple partners (Apple has established a $5 billion fund to help those suppliers upgrade their capabilities). Thus, Apple is taking advantage of globalization, and simultaneously hedging against any possible pullback from the level of globalization that existed in 2016, which for now at least may have been a high-water mark, albeit a temporary one.

Proponents of increased global trade argue that cross-cultural engagement and trade across country borders is the future and that returning back to a nationalistic perspective is the past. On the other hand, the nationalistic argument rests in citizens wanting their country to be sovereign, self-sufficient as much as possible, and basically in charge of their own economy and country environment. We will touch on many aspects of this debate throughout this text’s 20 integrated chapters.

Globalization now has an impact on almost everything we do. For example, an American medical doctor—let’s call her Laurie—might drive to work at her pediatric office in a sports utility vehicle (SUV) that was designed in Stuttgart, Germany, and assembled in Leipzig, Germany, and Bratislava, Slovakia, by Porsche from components from parts suppliers worldwide, which in turn were fabricated from Korean steel and Malaysian rubber. Laurie may have filled her 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, Laurie might talk to her 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. Perhaps on her way, Laurie might 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. In many cases, we simply do not know, or perhaps even care, where a product was designed and where it was made. Just a couple of decades ago, “Made in the USA” or “Made in Germany” had strong meaning and referred to something. The U.S. often stood for quality, and Germany often stood for sophisticated engineering. Now the country of origin for a product has given way to, for example, “Made by BMW,” and the company is the quality assurance platform, not the country. In many cases, it goes even beyond the company to the personal relationship a customer has developed with a representative of the company, and so we focus on what has become known as CRM (Customer Relationship Management).

Whether it is still the quality associated with the country of origin of a product, or the assurance given by a specific company regardless of where they manufacture their product, we live in 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 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. The symbols of material culture and popular culture are increasingly global, from Coca-Cola and Starbucks, to Sony PlayStation, Facebook, Netflix video streaming service, IKEA stores, and Apple iPads and iPhones. 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 cultures. These protesters come from environmental groups, which have been around for some time, but more recently also from nationalistic groups focused on their countries being more sovereign.

For businesses, the globalization process has 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. 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. 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. As best-selling author Thomas Friedman has argued, the world is becoming "flat."[1] 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 these issues 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 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.

What Is Globalization?

LO1-1

Understand what is meant by the term *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.

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.[2] Consumer products such as Citigroup credit cards, Coca-Cola soft drinks, Sony 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 300,000 small and medium-sized firms with fewer than 500 employees account for 98 percent of the companies that export. More generally, exports from small and medium-sized companies account for 33 percent of the value of U.S. exports of manufactured goods.[3] Typical of these is B&S Aircraft Alloys, a New York company whose exports account for 40 percent of its $8 million annual revenues.[4] The situation is similar in several other nations. For example, in Germany, a staggering 98 percent of small and midsize companies have exposure to international markets, via either exports or international production. Since 2009, China has been the world's largest exporter, sending more than $2 trillion worth of products and services last year to the rest of the world.

global EDGE INTERNATIONAL BUSINESS RESOURCES

globalEDGE™ has been the world's go-to site online for global business knowledge since 2001. Google typically ranks the site number 1 for "international business resources" from anywhere in the world you access it. Created by a 30-member team in the International Business Center in the Broad College of Business at Michigan State University under the supervision of Dr. Tomas Hult and Dr. Tunga Kiyak, globalEDGE™ is a knowledge resource that connects international business professionals worldwide to a wealth of information, insights, and learning resources on global business activities.

The site offers the latest and most comprehensive international business and trade content for a wide range of topics. Whether conducting extensive market research, looking to improve your international knowledge, or simply browsing, you're sure to find what you need to sharpen your competitive edge in today's rapidly changing global marketplace. The easy, convenient, and free globalEDGE™ website's tagline is "Your Source for Global Business Knowledge." Take a look at the site at **globaledge.msu.edu**. We will use globalEDGE throughout this text for exercises, information, data, and to keep every facet of the text up-to-date on a daily basis!

Page 7

Despite the global prevalence of Citigroup credit cards, McDonald's hamburgers, Starbucks coffee, and IKEA stores, for example, 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 it needs to refine its entry strategy in many foreign cities in order to take differences in the regulatory regime into account. Such 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. They are markets for industrial goods and materials that serve universal needs the world over. These include 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.[5] 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 first introduced in 1995: 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.[6] 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.

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 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.

Page 8

MANAGEMENT FOCUS

Boeing's Global Production System

Executives at the Boeing Corporation, America's largest exporter, say that building a large commercial jet aircraft like the 787 Dreamliner involves bringing together more than a million parts in flying formation. Half a century 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 Boeing's 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, 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: M. Ehrenfreund, "The Economic Reality Behind the Boeing Plane Trump Showed Off," *The Washington Post*, February 17, 2017; 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; and 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.

Page 9

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 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 more than $100 billion.

Did You Know?

Did you know that trade as a percentage of GDP for the U.S. has nearly tripled since 1960?

Visit your instructor’s Connect® course and click on your eBook or SmartBook® to view a short video explanation from the author.

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.”[7] 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 Dreamliner, 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.

TEST PREP

Use SmartBook to help retain what you have learned. Access your Instructor’s Connect course to check out SmartBook or go to **learnsmartadvantage.com** for help.

Nevertheless, the globalization of markets and production will probably continue. Modern firms are important actors in this trend, their 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 75 years, 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 2019, 164 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.

Page 10

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 seven decades since their creation, both institutions have emerged as significant players in the global economy. The World Bank is the less controversial of the two sister institutions. It has focused on making low-interest loans to cash-strapped governments in poor nations that wish to undertake significant infrastructure investments (such as building dams or roads).

The IMF is often seen as the lender of last resort to nation-states whose economies are in turmoil and whose currencies are losing value against those of other nations. During the past two decades, for example, the IMF has lent money to the governments of troubled states including Argentina, Indonesia, Mexico, Russia, South Korea, Thailand,

and Turkey. More recently, the IMF took a proactive role in helping countries cope with some of the effects of the 2008–2009 global financial crisis. IMF loans come with strings attached, however; in return for loans, the IMF requires nation-states to adopt specific economic policies aimed at returning their troubled economies to stability and growth. These requirements have sparked controversy. Some critics charge that the IMF's policy recommendations are often inappropriate; others maintain that by telling national governments what economic policies they must adopt, the IMF, like the WTO, is usurping the sovereignty of nation-states. We will look at the debate over the role of the IMF in Chapter 11.

The **United Nations (UN)** was established October 24, 1945, by 51 countries committed to preserving peace through international cooperation and collective security. Today, nearly every nation in the world belongs to the United Nations; membership now totals 193 countries. When states become members of the United Nations, they agree to accept the obligations of the UN Charter, an international treaty that establishes basic principles of international relations. According to the charter, the UN has four purposes: to maintain international peace and security, to develop friendly relations among nations, to cooperate in solving international problems and in promoting respect for human rights, and to be a center for harmonizing the actions of nations. Although the UN is perhaps best known for its peacekeeping role, one of the organization's central mandates is the promotion of higher standards of living, full employment, and conditions of economic and social progress and development—all issues that are central to the creation of a vibrant global economy. As much as 70 percent of the work of the UN system is devoted to accomplishing this mandate. To do so, the UN works closely with other international institutions such as the World Bank. Guiding the work is the belief that eradicating poverty and improving the well-being of people everywhere are necessary steps in creating conditions for lasting world peace.[8]

Another institution in the news is the **Group of Twenty (G20)**. Established in 1999, the G20 comprises the finance ministers and central bank governors of the 19 largest economies in the world, plus representatives from the European Union and the European Central Bank. Collectively, the G20 represents 90 percent of global GDP and 80 percent of international global trade. Originally established to formulate a coordinated policy response to financial crises in developing nations, in 2008 and 2009 it became the forum through which major nations attempted to launch a coordinated policy response to the global financial crisis that started in America and then rapidly spread around the world, ushering in the first serious global economic recession since 1981.

Drivers of Globalization

LO1-2

Recognize the main drivers of globalization.

Two macro factors underlie the trend toward greater globalization.[9] The first is the decline in barriers to the free flow of goods, services, and capital that has occurred in recent decades. The second factor is technological change, particularly the dramatic developments in communication, information processing, and transportation technologies.

DECLINING TRADE AND INVESTMENT BARRIERS

During the 1920s and 1930s, many of the world's nation-states erected formidable barriers to international trade and foreign direct investment. **International trade** occurs when a firm exports goods or services to consumers in another country. **Foreign direct investment (FDI)** occurs when a firm invests resources in business activities outside its home country. Many of the barriers to international trade took the form of high tariffs on imports of manufactured goods. The typical aim of such tariffs was to protect domestic industries from foreign competition. One consequence, however, was "beggar thy neighbor" retaliatory trade policies, with countries progressively raising trade barriers against each other. Ultimately, this depressed world demand and contributed to the Great Depression of the 1930s.

Having learned from this experience, the advanced industrial nations of the West committed themselves after World War II to progressively reducing barriers to the free flow of goods, services, and capital among nations.[10] This goal was enshrined in the General Agreement on Tariffs and Trade. Under the umbrella of GATT, eight rounds of negotiations among member states worked to lower barriers to the free flow of goods and services. The first round of negotiations went into effect in 1948. The most recent negotiations to be completed, known as the Uruguay Round, were finalized in December 1993. The Uruguay Round further reduced trade barriers; extended GATT to cover services as well as manufactured goods; provided enhanced protection for patents, trademarks, and copyrights; and established the World

Trade Organization to police the international trading system.[11] Table 1.1 summarizes the impact of GATT agreements on average tariff rates for *manufactured* goods among several developed nations. As can be seen, average tariff rates have fallen significantly since 1950 and now stand at about 2.0–3.0 percent. Comparable tariff rates in 2017 for China and India were about 8 percent. This represents a sharp decline from 16.2 percent for China in 2000, and 33.6 percent for India in 2000. It's also important to note that in addition to the global efforts of the GATT and WTO, trade barriers have also been reduced by bilateral and regional agreements between two or more nations. For example, the European Union has reduced trade barriers between its member states, the North American Free Trade Agreement reduced trade barriers between the United States, Mexico, and Canada, and a free trade agreement between the United States and South Korea has reduced trade barriers between those two nations. In the early 1990s, there were less than 50 such agreements in place. Today, there are around 300 such agreements.

	1913	1950	1990	2018
France	21%	18%	5.9%	1.9%
Germany	20	26	5.9	1.9
Italy	18	25	5.9	1.9
Japan	30	—	3.3	2.1
Netherlands	5	11	5.9	1.9
Sweden	20	9	5.9	1.9
United Kingdom	—	23	5.9	1.9
United States	44	14	5.7	3.0

TABLE 1.1 Average Tariff Rates on Manufactured Products as Percentage of Value

Sources: The 1913–1990 data are from "Who Wants to Be a Giant?" *The Economist: A Survey of the Multinationals*, June 24, 1995, pp. 3–4. The 2018 data are from the *World Development Indicators*, World Bank.

Figure 1.1 charts the growth in the value of world merchandised trade and world production between 1960 and 2018 (the most recent year for which data are available). The data are adjusted to take out the effect of inflation and is indexed at a value of 100 in 1960 to allow for an "apples to apples" comparison. What you can see from the chart is that between 1960 and 2018 the value of the world economy (adjusted for inflation) increased 9.4 times, while the value of international trade in merchandised goods increased 22.4 times. This actually underestimates the growth in trade, because trade in services has also been growing rapidly in recent decades. By 2018, the value of world trade in merchandised goods was 19.5 trillion, while the value of trade in services was $5.8 trillion.

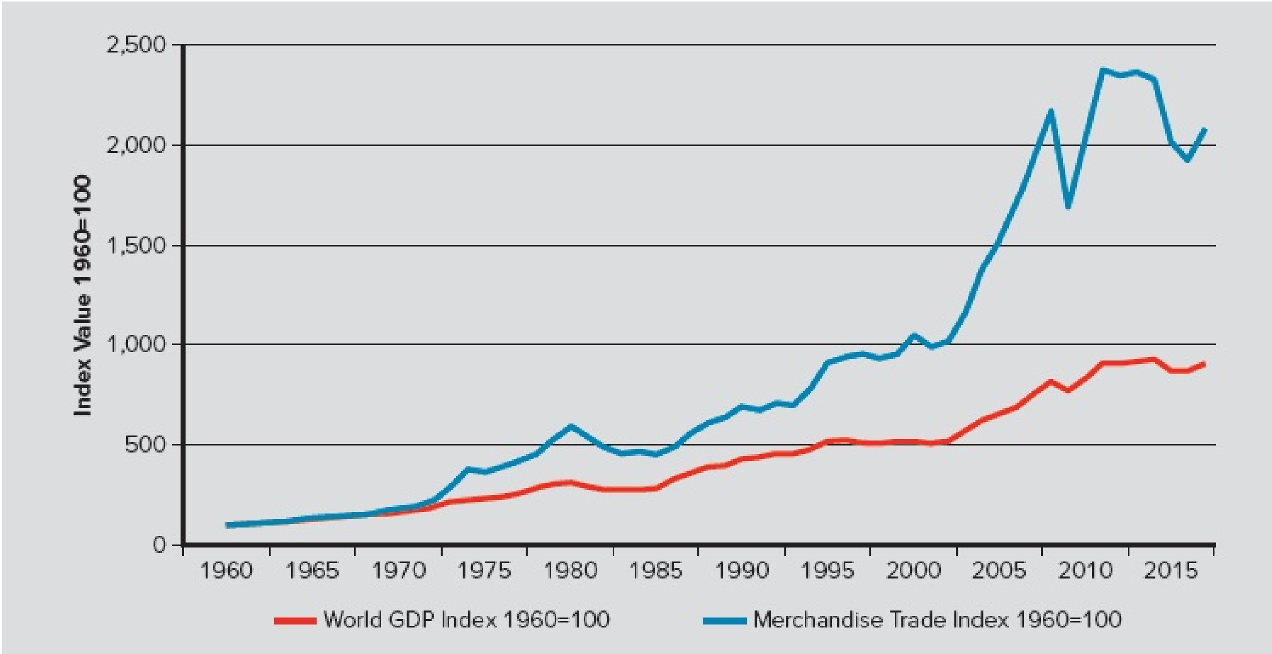


FIGURE 1.1 Value of world merchandised trade and world production 1960–2019.

Sources: World Bank, 2019; World Trade Organization, 2019; United Nations, 2019.

Not only has trade in goods and services been growing faster than world output for decades, so has the value of foreign direct investment, in part due to reductions in barriers limiting FDI between countries. According to UN data, some 80 percent of the more than 1,500 changes made to national laws governing foreign direct investment since 2000 have created a more favorable environment. Partly due to such liberalization, the value of FDI has grown significantly over the last 30 years. In 1990, about $244 billion in foreign investment was made by enterprises. By 2018, that figure had increased to $1.3 trillion. As a result of sustained cross-border investment, by 2018 the sales of foreign affiliates of multinational corporations reached $27 trillion, almost $8 trillion more than the value of international trade in 2018, and these affiliates employed some 76 million people.[12]

The fact that the volume of world trade has been growing faster than world GDP implies several things. First, more firms are doing what Boeing does with the 777 and 787: dispersing parts of their production process to different locations around the globe to drive down production costs and increase product quality. Second, the economies of the world's nation-states are becoming ever more intertwined. As trade expands, nations are becoming increasingly dependent on each other for important goods and services. Third, the world has become significantly wealthier in the last two decades. The implication is that rising trade is the engine that has helped pull the global economy along.

BCFC/Shutterstock

The globalization of markets and production and the resulting growth of world trade, foreign direct investment, and imports all imply that firms are finding their home markets under attack from foreign competitors. This is true in China, where U.S. companies such as Apple, General Motors, and Starbucks are expanding their presence. It is true in the United States, where Japanese automobile firms have taken market share away from General Motors and Ford over the past three decades, and it is true in Europe, where the once-dominant Dutch company Philips has seen its market share in the consumer electronics industry taken by Japan's Panasonic and Sony and Korea's Samsung and LG. The growing integration of the world economy into a single, huge marketplace is increasing the intensity of competition in a range of manufacturing and service industries.

However, declining barriers to cross-border trade and investment cannot be taken for granted. As we shall see in subsequent chapters, demands for "protection" from foreign competitors are still often heard in countries around the world, including the United States. Although a return to the restrictive trade policies of the 1920s and 1930s is unlikely, it is not clear whether the political majority in the industrialized world favors further reductions in trade barriers. Indeed, the global financial crisis of 2008–2009 and the associated drop in global output that occurred led to more calls for trade barriers to protect jobs at home. The election of Donald Trump to the Presidency of the United States in 2017 can be seen as a continuation of this counter trend, because Trump ran on a platform advocating higher trade barriers to protect American companies from unfair foreign competition. If trade barriers decline no further, this may slow the rate of globalization of both markets and production.

ROLE OF TECHNOLOGICAL CHANGE

The lowering of trade barriers made globalization of markets and production a theoretical possibility. Technological change has made it a tangible reality. Every year that goes by comes with unique and oftentimes major advances in communication, information processing, and transportation technology, including the explosive emergence of the "Internet of Things."

Communications

Perhaps the single most important innovation since World War II has been the development of the microprocessor, which enabled the explosive growth of high-power, low-cost computing, vastly increasing the amount of information that can be processed by individuals and firms. The microprocessor also underlies many recent advances in telecommunications technology. Over the past 30 years, global communications have been revolutionized by developments in satellite, optical fiber, wireless technologies, and of course the Internet. These technologies rely on the microprocessor to encode, transmit, and decode the vast amount of information that flows along these electronic highways. The cost of microprocessors continues to fall, while their power increases (a phenomenon known as **Moore's law**, which predicts that the power of microprocessor technology doubles and its cost of production falls in half every 18 months).[13]

The Internet

The explosive growth of the Internet since 1994, when the first web browser was introduced, has revolutionized communications and commerce. In 1990, fewer than 1 million users were connected to the Internet. By 1995, the figure had risen to 50 million. By 2018, the Internet had 4 billion users, or 52 percent of the global population.[14] It is no surprise that the Internet has developed into the information backbone of the global economy.

In North America alone, e-commerce retail sales were $517 billion in 2018 (up from almost nothing in 1998), while global e-commerce sales reached $2.5 trillion.[15] Viewed globally, the Internet has emerged as an equalizer. It rolls back some of the constraints of location, scale, and time zones.[16] The Internet makes it much easier for buyers and sellers to find each other, wherever they may be located and whatever their size. It allows businesses, both small and large, to expand their global presence at a lower cost than ever before. Just as important, it enables enterprises to coordinate and control a globally dispersed production system in a way that was not possible 25 years ago.

Transportation Technology

In addition to developments in communications technology, several major innovations in transportation technology have occurred since the 1950s. In economic terms, the most important are probably the development of commercial jet aircraft and superfreighters and the introduction of *containerization*, which simplifies transshipment from one mode of transport to another. The advent of commercial jet travel, by reducing the time needed to get from one location to another, has effectively shrunk the globe. In terms of travel time, New York is now “closer” to Tokyo than it was to Philadelphia in the colonial days.

Containerization has revolutionized the transportation business, significantly lowering the costs of shipping goods over long distances. Because the international shipping industry is responsible for carrying about 90 percent of the *volume* of world trade in goods, this has been an extremely important development.[17] Before the advent of containerization, moving goods from one mode of transport to another was very labor intensive, lengthy, and costly. It could take days and several hundred longshore workers to unload a ship and reload goods onto trucks and trains. With the advent of widespread containerization in the 1970s and 1980s, the whole process can now be executed by a handful of longshore workers in a couple of days. As a result of the efficiency gains associated with containerization, transportation costs have plummeted, making it much more economical to ship goods around the globe, thereby helping drive the globalization of markets and production. Between 1920 and 1990, the average ocean freight and port charges per ton of U.S. export and import cargo fell from $95 to $29 (in 1990 dollars).[18] Today, the typical cost of transporting a 20-foot container from Asia to Europe carrying more than 20 tons of cargo is about the same as the economy airfare for a single passenger on the same journey.

Implications for the Globalization of Production

As transportation costs associated with the globalization of production have declined, dispersal of production to geographically separate locations has become more economical. As a result of the technological innovations discussed earlier, the real costs of information processing and communication have fallen dramatically in the past two decades. These developments make it possible for a firm to create and then manage a globally dispersed production system, further facilitating the globalization of production. A worldwide communications network has become essential for many international businesses. For example, Dell uses the Internet to coordinate and control a globally dispersed production system to such an extent that it holds only three days’ worth of inventory at its assembly locations. Dell’s Internet-based system records orders for computer equipment as they are submitted by customers via the company’s website and then immediately transmits the resulting orders for components to various suppliers around the world, which have a real-time look at Dell’s order flow and can adjust their production schedules accordingly. Given the low cost of airfreight, Dell can use air transportation to speed up the delivery of critical components to meet unanticipated demand shifts without delaying the shipment of final product to consumers. Dell has also used modern communications technology to outsource its customer service operations to India. When U.S. customers call Dell with a service inquiry, they are routed to Bangalore in India, where English-speaking service personnel handle the call.

Implications for the Globalization of Markets

In addition to the globalization of production, technological innovations have facilitated the globalization of markets. Low-cost global communications networks, including those built on top of the Internet, are helping create electronic global marketplaces. As noted earlier, low-cost transportation has made it more economical to ship products around the world, thereby helping create global markets. In addition, low-cost jet travel has resulted in the mass movement of people between countries. This has reduced the cultural distance between countries and is bringing about some convergence of consumer tastes and preferences. At the same time, global communications networks and global media are creating a worldwide culture. U.S. television networks such as CNN and HBO are now received in many countries, Hollywood films are shown the world over, while non-U.S. news networks such as the BBC and Al Jazeera also have a global footprint. In any society, the media are primary conveyors of culture; as global media develop, we must expect the evolution of something akin to a global culture. A logical result of this evolution is the emergence of global markets for consumer products. Clear signs of this are apparent. It is now as easy to find a McDonald's restaurant in Tokyo as it is in New York, to buy an iPad in Rio as it is in Berlin, and to buy Gap jeans in Paris as it is in San Francisco.

Despite these trends, we must be careful not to overemphasize their importance. While modern communications and transportation technologies are ushering in the "global village," significant national differences remain in culture, consumer preferences, and business practices. A firm that ignores differences among countries does so at its peril. We shall stress this point repeatedly throughout this text and elaborate on it in later chapters.

TEST PREP

Use SmartBook to help retain what you have learned. Access your Instructor's Connect course to check out SmartBook or go to **learnsmartadvantage.com** for help.

The Changing Demographics of the Global Economy

LO1-3

Describe the changing nature of the global economy.

Hand in hand with the trend toward globalization has been a fairly dramatic change in the demographics of the global economy over the past decades. Half a century ago, four facts described the demographics of the global economy. The first was U.S. dominance in the world economy and world trade picture. The second was U.S. dominance in world foreign direct investment. Related to this, the third fact was the dominance of large, multinational U.S. firms on the international business scene. The fourth was that roughly half the globe—the centrally planned economies of the communist world—was off-limits to Western international businesses. All four of these facts have changed rapidly.

THE CHANGING WORLD OUTPUT AND WORLD TRADE PICTURE

In the early 1960s, the United States was still, by far, the world's dominant industrial power. In 1960, the United States accounted for 38.3 percent of world output, measured by gross domestic product (GDP). By 2018, the United States accounted for 24 percent of world output, with China now at 15.2 percent of world output and the global leader in this category (see Table 1.2). The United States was not the only developed nation to see its relative standing slip. The same occurred to Germany, France, Italy, the United Kingdom, and Canada—these are just a few examples. All were nations that were among the first to industrialize globally.

Country	Share of World Output in 1960 (%)	Share of World Output Today (%)	Share of World Exports Today (%)
United States	38.3%	24.0%	8.2%
Germany	8.7	4.6	7.1
France	4.6	3.2	2.8
Italy	3.0	2.4	2.4
United Kingdom	5.3	3.3	2.3
Canada	3.0	2.0	2.2
Japan	3.3	6.0	3.6
China	NA	15.2	11.1

TABLE 1.2 Changing Demographics of World Output and World Exports

Sources: Output data from World Bank database, 2019. Trade data from WTO Statistical Database, 2019.