PART 1

Laying Foundations

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Chapters

CHAPTER 1

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Learning Objectives

After studying this chapter, you should be able to

1-1 explain the concepts of international business and global business, with a focus on emerging economies.

1-2 give three reasons why it is important to study global business.

1-3 articulate one fundamental question and two core perspectives in the study of global business.

1-4 identify three ways of understanding what globalization is.

1-5 state the size of the global economy and its broad trends and understand your likely bias in the globalization debate.

Globalizing Business

OPENING CASE

Ethical Dilemma

~~Emerging Markets:~~ Mahindra & Mahindra versus John Deere

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

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

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

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

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

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

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

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

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

As Mahindra enjoyed growing success in America, Deere struggled to gain a foothold in India. Unlike Mahindra, which had innovated both its product and its processes for the US market, Deere tried to tempt Indian farmers with the same product that had underwritten its success at home. The strategy did not work, and Deere was forced to re-engineer its thinking as well as its product.

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

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

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

How do firms such as Mahindra & Mahindra and Deere compete in India, the United States, and elsewhere? What determines the success and failure of these firms—and numerous others—around the world? This book will address these and other important questions on global business.

1-1
Learning Objective
Explain the concepts of international business and global business, with a focus on emerging economies.

1-1 What Is Global Business?

1-1a Defining International Business and Global Business

Traditionally, international business (IB) is defined as a business (or firm) that engages in international (cross-border) economic activities. It can also refer to the action of doing business abroad. The previous generation of IB textbooks almost always takes the foreign entrant's perspective. Consequently, such books deal with issues such as how to enter foreign markets and how to select alliance partners. The most frequently discussed foreign entrant is the multinational enterprise (MNE), defined as a firm that engages in foreign direct investment (FDI) by directly investing in, controlling, and managing value-added activities in other countries.[1] Using our Opening Case, traditional IB textbooks would focus on how MNEs such as Deere enter India by undertaking FDI there. MNEs and their cross-border activities are, of course, important, but they only cover one side of IB—the foreign side. Students educated by these books often come away with the impression that the other side of IB—namely, domestic firms—does not exist. Of course, that is not true. Domestic firms such as Mahindra & Mahindra do not just sit around in the face of foreign entrants. Domestic firms actively compete and/or collaborate with foreign entrants such as International Harvester. Sometimes strong domestic firms such as Mahindra & Mahindra have also gone overseas themselves. Overall, focusing on the foreign entrant side captures only one side of the coin at best.[2]

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

multinational enterprise (MNE)
a firm that engages in foreign direct investment (FDI).

foreign direct investment (FDI)
investment in, controlling, and managing value-added activities in other countries.

There are *two* key words in IB: international (I) and business (B).[3] However, many previous textbooks focus on the international aspect (the foreign entrant) to such an extent that the business part (which also includes domestic business) almost disappears. This is unfortunate, because IB is fundamentally about B in addition to being I. To put it differently, the IB course in the undergraduate and MBA curricula at numerous business schools is probably the *only* one with the word "business" in its title. All other courses you take are labeled management, marketing, finance, and so on, representing one functional area but not the overall picture of business. Does it matter? Of course! It means that your IB course is an *integrative* course that has the potential to provide you with an overall business perspective (rather than a functional view) grounded in a global environment. Consequently, it makes sense that your textbook should give you both the I and B parts, not just the I part.

To cover both the I and the B parts, **global business** is defined in this book as business around the globe—thus, the title of this book is *Global Business* (not IB). In other words, global business includes both (1) international (cross-border) business activities covered by traditional IB books *and* (2) domestic business activities. Such deliberate blurring of the traditional boundaries separating international and domestic business is increasingly important today, because many previously national (domestic) markets are now globalized.

Consider the competition in college textbooks, such as this *Global Business* book you are studying now. Not long ago, competition among college business textbook publishers was primarily on a nation-by-nation basis. The Big Three—South-Western Cengage Learning (our publisher, which is the biggest in the college business textbook market), Prentice Hall, and McGraw-Hill—primarily competed in the United States. A different set of publishers competed in other countries. As a result, most textbooks studied by British students would be authored by British professors and published by British publishers, most textbooks studied by Brazilian students would be authored by Brazilian professors and published by Brazilian publishers, and so on. Now South-Western Cengage Learning (under British and Canadian ownership), Pearson Prentice Hall (under British ownership), and McGraw-Hill (still under US ownership) have significantly globalized their competition, thanks to the rising demand for high-quality business textbooks in English. Around the globe, they are competing against each other in many markets, publishing in multiple languages and versions. For instance, *Global Business* and its sister books, *Global Strategy, GLOBAL* (paperback), and *International Business* (an adaptation for the European market), are published by different subsidiaries in Chinese, Spanish, and Portuguese in addition to English, reaching customers in over 30 countries. Despite such worldwide spread of competition, in each market—down to each school—textbook publishers have to compete locally. In other words, no professor teaches globally, and all students study locally. This means that *Global Business* has to win adoption from every class, every semester. Overall, it becomes difficult to tell in this competition what is international and what is domestic. Thus, "global" seems to be a better word to capture the essence of this competition.

1-1b Global Business and Emerging Economies

Global Business also differs from other books on IB because most focus on competition in developed economies. Here, by contrast, we devote extensive space to competitive battles waged throughout **emerging economies**, a term that has gradually replaced the term "developing countries" since the 1990s. Another commonly used term is **emerging markets** (see PengAtlas Map 1). How important are emerging economies? Collectively, they now contribute approximately 45% of the global **gross domestic product (GDP)**, as shown in Figure 1.1. Note that this percentage is adjusted for **purchasing power parity (PPP)**, which is an adjustment to reflect the differences in cost of living (see In Focus 1.1). Using official (nominal) exchange rates

global business
business around the globe.

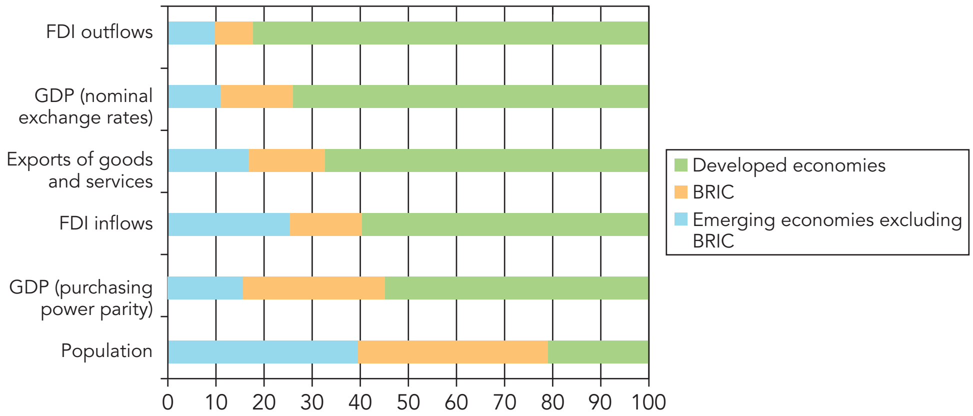
emerging economies
a term that has gradually replaced the term "developing countries" since the 1990s.

emerging markets
a term that is often used interchangeably with "emerging economies."

gross domestic product
the sum of value added by *resident* firms, households, and governments operating in an economy.

purchasing power parity (PPP)
a conversion that determines the equivalent amount of goods and services that different currencies can purchase.

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



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

gross national product (GNP)
GDP plus income from non-resident sources abroad.

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

IN FOCUS 1.1
Setting the Terms Straight

Ethical Dilemma

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

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

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

Table 1.1 Classifying Developed Economies versus Emerging Economies

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

Source: IMF, www.imf.org. The IMF recognizes 182 countries and economies. It labels developed economies "advanced economies" and labels emerging economies "emerging and developing economies."

without adjusting for PPP, emerging economies contribute about 26% of the global GDP. Why is there such a huge difference between the two measures? Because the cost of living (such as housing and haircuts) in emerging economies tends to be lower than that in developed economies. For instance, one dollar spent in Mexico can buy a lot more than one dollar spent in the United States.

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

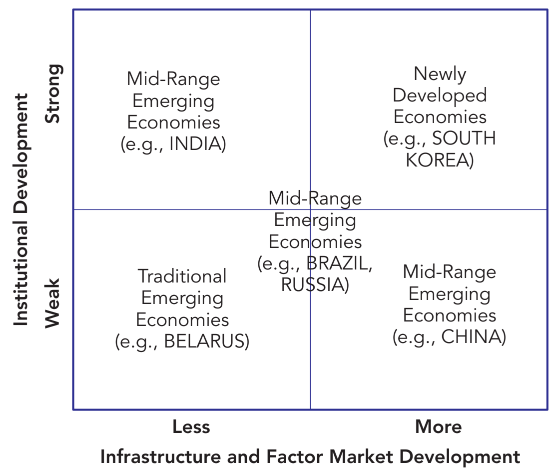
Does it make sense to group so many countries with tremendous diversity in terms of history, geography, politics, and economics together as "emerging economies"? As compared to developed economies, the label of "emerging economies," rightly or wrongly, has emphasized the presumably homogenous nature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

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

BRIC

Brazil, Russia, India, and China

Figure 1.2 **A Typology of Emerging Economies**



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

institutional transitions in many emerging economies.[8] Horizontally, the development of infrastructure and factor markets is also crucial.

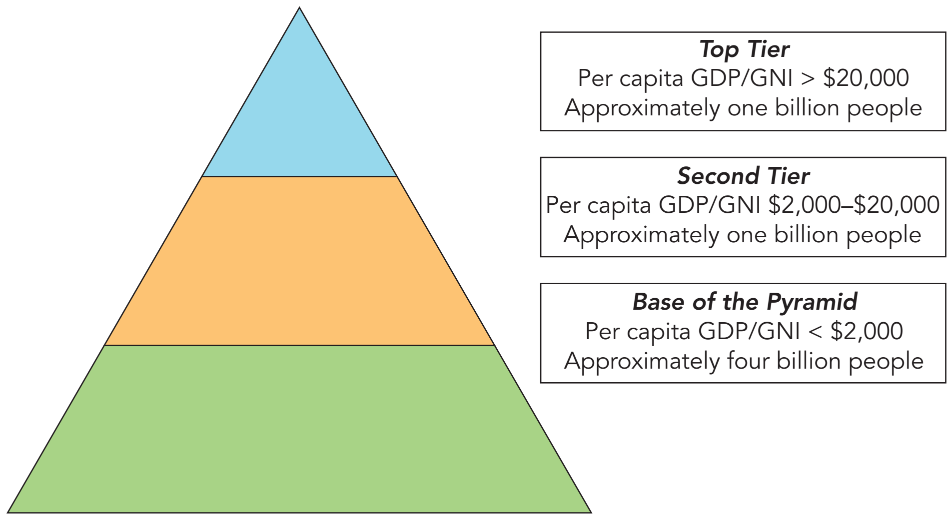
Stereotypical or traditional emerging economies suffer from both the lack of institutional development and the lack of infrastructure and factor market development. Most emerging economies 20 years ago would have fit this description. Today, some emerging economies that have made relatively little progress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

However, a lot has changed. A great deal of institutional development and infrastructure and factor market development have taken place. Such wide-ranging development has resulted in the emergence of a class of *mid-range* emerging economies that differ from both traditional emerging economies and developed economies. For example, the top down approach to government found in China has facilitated infrastructure and factor market development. But China's political and market institutions tend to be underdeveloped relative to physical infrastructure. Alternatively, India has strong political institutions supporting market institutions (although there is still significant corruption in government bureaucracies). While Indian government policy reforms have facilitated better market institutions and associated economic development, world-class physical infrastructure is lacking. In the middle area of Figure 1, Brazil and Russia can be placed as examples. In these mid-range emerging economies, there are some democratic political institutions (despite the recent setback in Russia—see Chapter 2 Opening Case) and some infrastructure and factor market development. Finally, some economies have clearly graduated from the "emerging" phase and become what we call "newly developed economies." South Korea may be an exemplar country as it has more balanced development in both institutional development and infrastructure/factor markets.

1-1c Base of the Pyramid and Reverse Innovation

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

Figure 1.3 **The Global Economic Pyramid**



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

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

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

Triad
North America, Western Europe, and Japan.

base of the pyramid
economies where people make less than $2,000 per capita per year.

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

was competitive not only with Mahindra in India, but also in the United States and elsewhere. In both cases, the origin of new innovations is from the base of the pyramid. The flow of innovation is bottom up—in other words, reverse innovation.

The reverse innovation movement suggests that emerging economies are no longer merely low-cost production locations or attractive new markets (hence the term "emerging markets"). They are also sources of new innovations that may not only grow out of BOP markets, but also have the potential to go uphill to penetrate into the top of the global economic pyramid. In a *Harvard Business Review* article, Jeff Immelt, chairman and CEO of a leading practitioner of reverse innovation, GE, noted:

> To be honest, the company is also embracing reverse innovation for defensive reasons. If GE doesn't come up with innovations in poor countries and take them global, new competitors from the developing world—like Mindray, Suzlon, Goldwind, and Haier—will. . . GE has tremendous respect for traditional rivals like Siemens, Philips, and Rolls-Royce. But it knows how to compete with them; they will never destroy GE. By introducing products that create a new price-performance paradigm, however, the emerging giants very well could. Reverse innovation isn't optional; it is oxygen.[11]

As advised by GE's Immelt, today's students—and tomorrow's business leaders—will ignore the opportunities and challenges at the base of the pyramid at their own peril. This book will help ensure that *you* will not ignore these opportunities.

1-2 Why Study Global Business?

1-2
Learning Objective
Give three reasons why it is important to study global business.

Global business (or IB) is one of the most exciting, most challenging, and most relevant subjects offered by business schools. Why study it? There are at least three compelling reasons why you should study global business—and study hard (Table 1.2).

First, mastering global business knowledge helps advance your employability and career in an increasingly competitive global economy. Take a look at the Opening Day Quiz in Table 1.3. Can you answer all the questions correctly? If not, you will definitely benefit from studying global business.

The answer to Question 1 is empirical—that is, based on data. You should guess first and then look at the label of your shirt yourself or ask a friend to help you. The key here is international trade. Do you wear a shirt made in your own country or another country? Why?

In Question 2, smart students typically ask whether the mobile device (such as a smartphone or an iPad) means the motherboard or the components. My answer is: "I mean the whole device, all the production that went into making

Table 1.2 Why Study Global Business?

• Enhance your employability and advance your career in the global economy
• Better preparation for possible expatriate assignments abroad
• Stronger competence in interacting with foreign suppliers, partners, and competitors and in working for foreign-owned employers in your own country

Table 1.3 Opening Day Quiz

1. Which country made the shirt you are wearing? (A) China (B) Malaysia (C) Mexico (D) Romania (E) US	**2. Which country made your mobile communication device?** (A) China (B) Germany (C) Singapore (D) Taiwan (E) US
3. How many countries does the G-20 have? (A) 20 (B) 21 (C) 22 (D) 19 (E) 18	**4. A 2,000-employee manufacturing plant is closing in a developed economy, and production is moving to an emerging economy. How many of the 2,000 jobs will the company keep?** (A) 0 (B) 5–10 (C) 10–20 (D) 20–30 (E) 30–50

the machine." Then some students would respond: "But they could be made in different countries!" My point exactly. Specifically, the point here is to appreciate the complexity of a global value chain, with different countries making different components and handling different tasks. Such a value chain is typically managed by an MNE, such as Apple, Dell, Foxconn, HP, Lenovo, or Samsung. The capabilities necessary to organize a global supply chain hints at the importance of resources and capabilities—one of the two key themes of this book.

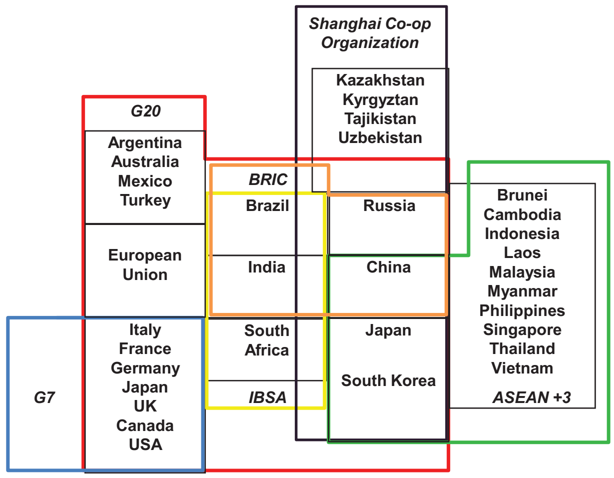
Question 3 is deceptively simple. Unfortunately, 100% of my own students—ranging from undergraduates to PhDs—*miss* it. Surprise! The Group of 20 (G-20) only has 19 member countries. The 20th member is the European Union (EU)—a regional bloc, not a single country. Ideally, *why* the G-20 is formed in such an interesting way will make you more curious about how the rules of the game are made around the world. In this case, why are 19 countries in, but numerous others are out? What is special about the EU? Why are other regional blocs not included in the G-20? What about the G-7? What about other groups of countries (see Figure 1.4)? A focus on the rules of the game—more technically, institutions—is another key theme of the book.

peng atlas

Question 4 will really frighten you. Some students would typically clarify: "Do you mean the few security guards looking after the closed plant?" "Not necessarily," I would point out. "The question is: How many jobs will be kept by the *company*?" Students would eventually get it: even adding a few jobs as security guards at the closed plant, the most optimistic estimates are that only 30 to 50 jobs may be kept. Yes, you guessed it, these jobs typically are high-level positions such as the CEO, CFO, CIO, factory director, and chief engineer. These managers will be sent by the MNE to start up operations in an emerging economy. You need to realize that in a 2,000-employee plant, even if you may be the 51st-highest-ranked employee, your fate may be the same as the 2,000th employee. You really need to work hard and work smart to position yourself as one of the top 50 (preferably one of the top 30). Doing well in this class and mastering global business knowledge may help make it happen.

Group of 20 (G-20)
The group of 19 major countries plus the European Union (EU) whose leaders meet on a biannual basis to solve global economic problems.

Figure 1.4 **Country Groupings in the 21st Century**



Source: Adapted from C. Dhanaraj & T. Khanna, 2011, Transforming mental models on emerging markets (p. 696), *Academy of Management Learning and Education*, 10(4): 684-701. G7 = Group of Seven; G20 = Group of Twenty; BRIC = Brazil, Russia, India, and China; IBSA = India-Brazil-South Africa Dialogue Forum; Shanghai Co-op Organization = Shanghai Co-operation Organization; ASEAN = Association of Southeast Asian Nations. © Academy of Management.

In addition to the first reason to equip you with relevant knowledge, the second compelling reason why you should study global business is related to Question 4. Because many ambitious students aspire to join the top ranks of large firms, expertise in global business is often a prerequisite. Today, it is increasingly difficult, if not impossible, to find top managers at large firms without significant global competence. Of course, eventually hands-on global experience, not merely knowledge acquired from this course, will be required. However, mastery of the knowledge of, and demonstration of interest in, global business during your education will set you apart as a more ideal candidate to be selected as an **expatriate manager** (or "expat")—a manager who works abroad—to gain such an experience (see Chapter 15 for details).

expatriate manager

a manager who works abroad, or "expat" for short.

international premium

a significant pay raise when working overseas.

wavebreakmedia ltd/2010/Used under license from Shutterstock.com

What are some of the benefits you may enjoy as an expatriate manager?

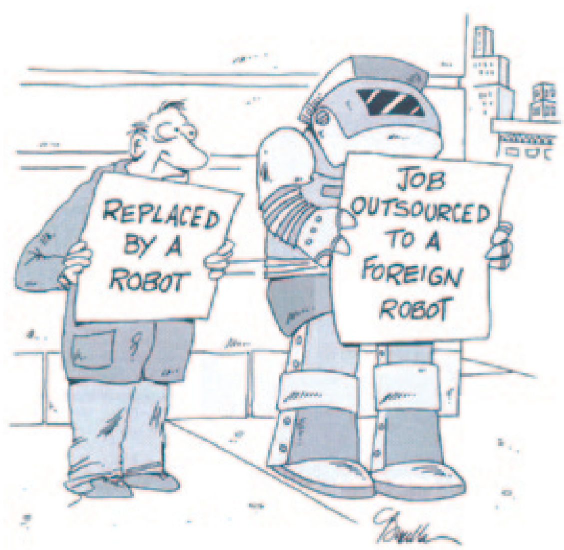
Thanks to globalization, low-level jobs not only command lower salaries but are also more vulnerable. However, high-level jobs, especially those held by expats, are both financially rewarding and relatively secure. Expats often command a significant **international premium** in compensation—a significant pay raise when working overseas. In US firms, an expat's total compensation package is approximately $250,000 to $300,000 (including perks and benefits; not all is take-home pay). When they return to the United States after a tour of duty (usually two to three years), a firm that does not provide attractive career opportunities to experienced expats often finds they are lured away by competitor firms. Competitor firms also want to globalize their business, and tapping into the expertise and experience of these former expats makes such expansion more likely to succeed. And yes, to hire away these internationally experienced managers, competitor firms have to pay an even larger premium. This indeed is a virtuous cycle.

This hypothetical example is designed to motivate you to study hard so that someday, you may become one of these sought-after globe-trotting managers. But even if you don't want to be an expat, we assume that you don't want to join the army of the unemployed due to factory closings and business failures.

Lastly, even if you do not aspire to compete for the top job at a large company and instead work at a small firm or are self-employed, you may find yourself dealing with foreign-owned suppliers and buyers, competing with foreign-invested firms in your home market, or perhaps even selling and investing overseas. Alternatively, you may find yourself working for a foreign-owned firm, your domestic employer acquired by a foreign player, or your unit ordered to shut down for global consolidation. Any of these is a likely scenario, because approximately 80 million people worldwide—including 18 million Chinese, six million Americans, and one million British—are employed by foreign-owned firms. Understanding how global business decisions are made may facilitate your own career in such firms. If there is a strategic rationale to downsize your unit, you want to be prepared and start polishing your résumé right away. In other words, it is your career that is at stake. Don't be the last in the know!

In short, in this age of global competition, "how do you keep from being Bangalored or Shanghaied" (that is, having your job being outsourced to India or China)?[12] To avoid the fate humorously portrayed in Figure 1.5, a good place to

Figure 1.5 **Jobs Outsourced**



Source: *Harvard Business Review*, 2012, April: 34.

start is to study hard and do well in your IB course. Also, don't forget to put this course on your résumé!

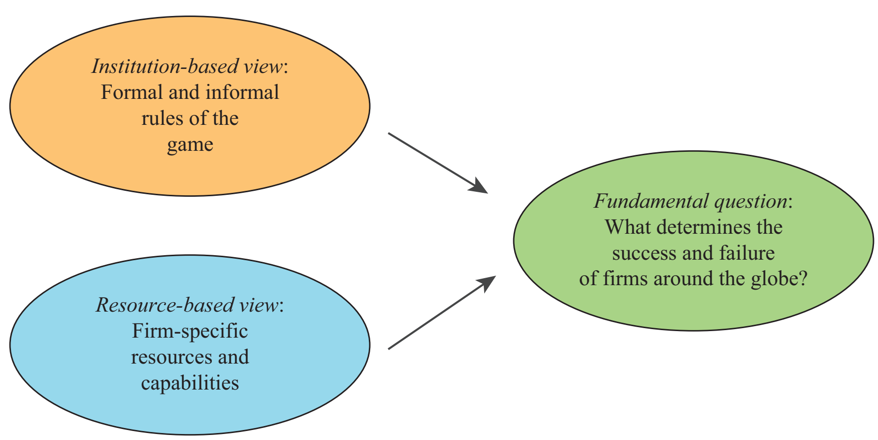
1-3
Learning Objective
articulate one fundamental question and two core perspectives in the study of global business.

1-3 A Unified Framework

Global business is a vast subject area. It is one of the few courses that will make you appreciate why your university requires you to take a number of seemingly unrelated courses in general education. We will draw on major social sciences, such as economics, geography, history, political science, psychology, and sociology. We will also draw on a number of business disciplines, such as strategy, finance, and marketing. The study of global business is thus very interdisciplinary. It is quite easy to lose sight of the forest while scrutinizing various trees or even branches. The subject is not difficult, and most students find it to be fun. The number-one student complaint (based on previous student feedback) is that there is an overwhelming amount of information. Honestly, this is also *my* number-one complaint as your author. You may have to read and learn this material, but I have to bring it all together in a way that is understandable and in a (relatively) compact book that does not go on and on and on for 900 pages.

To make your learning more focused, more manageable, and (hopefully) more fun, in this section we will develop a unified framework (shown in Figure 1.6). This will provide great continuity to facilitate your learning. Specifically, we will discipline ourselves by focusing on only one most fundamental question and two core perspectives. A fundamental question acts to define a field and to orient the attention of students, practitioners, and scholars in a certain direction. Our "big question" is: *What determines the success and failure of firms around the globe?*[13] To answer this question, we will introduce only two core perspectives throughout this book: (1) an institution-based view and (2) a resource-based view.[14] The remainder of this section outlines this framework.

Figure 1.6 **A Unified Framework for Global Business**



1-3a One Fundamental Question

What is it that we do in global business? Why is it so important that practically all students in business schools around the world are either required or recommended to take this course? While there are certainly a lot of questions to raise, a relentless interest in what determines the success and failure of firms around the globe serves to focus the energy of our field. Global business is fundamentally about not limiting yourself to your home country. It is about treating the entire global economy as your potential playground (or battlefield). Some firms may be successful domestically but fail miserably overseas. Other firms successfully translate their strengths from their home markets to other countries. If you were expected to lead your firm's efforts to enter a particular foreign market, wouldn't you want to find out what drives the success and failure of other firms in that market?

Overall, the focus on firm performance around the globe defines the field of global business (or IB) more than anything else. Numerous other questions and topics all relate in one way or another to this most fundamental question. Therefore, all chapters in this book will be centered on this consistent theme: What determines the success and failure of firms around the globe?

1-3b First Core Perspective: An Institution-Based View[15]

An institution-based view suggests that the success and failure of firms are enabled and constrained by institutions. By institutions, we mean the rules of the game. Doing business around the globe requires intimate knowledge about both formal rules (such as laws) and informal rules (such as values) that govern competition in various countries. If you establish a firm in a given country, you will work within that country's institutional framework, which consists of the formal and informal institutions that govern individual and firm behavior. Firms that do not do their homework and thus remain ignorant of the rules of the game in a certain country are not likely to emerge as winners.

Formal institutions include laws, regulations, and rules. For example, Hong Kong's laws are well-known for treating all comers, whether from neighboring mainland China (whose firms are still technically regarded as "non-domestic") or far-away Chile, the same as they treat indigenous Hong Kong firms. Such equal treatment enhances the potential odds for foreign firms' success. It is thus not surprising that Hong Kong attracts a lot of outside firms. Other rules of the game discriminate against foreign firms and undermine their chances for success. India's recent attraction as a site for FDI was only possible after it changed its FDI regulations from confrontational to accommodating. Prior to 1991, India's rules severely discriminated against foreign firms. As a result, few foreign firms bothered to show up, and the few that did had a hard time. For example, in the 1970s, the Indian government demanded that Coca-Cola either hand over the recipe for its secret syrup, which it does not even share with the US government, or get out of India. Painfully, Coca-Cola chose to leave India. Its return to India since the 1990s speaks volumes about how much the rules of the game have changed in India.

Informal institutions include cultures, ethics, and norms. They also play an important part in shaping the success and failure of firms around the globe. For example, individualistic societies, particularly the English-speaking countries such as Australia, Britain, and the United States, tend to have a relatively higher level of entrepreneurship as reflected in the number of business start-ups. Why? Because the act of founding a new firm is a widely accepted practice in individualistic societies. Conversely, collectivistic societies such as Japan often have a hard time fostering entrepreneurship. Most people there refuse to stick their neck out to found new businesses because it is contrary to the norm.[16]

Overall, an institution-based view suggests that institutions shed a great deal of light on what drives firm performance around the globe.[17] Next, we turn to our second core perspective.

1-3c Second Core Perspective: A Resource-Based View[18]

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

The resource-based view helps overcome this drawback. While the institution-based view primarily deals with the *external* environment, the resource-based view focuses on a firm's *internal* resources and capabilities. It starts with a simple observation: In harsh, unattractive environments, most firms either suffer or exit. However, against all odds, a few superstars thrive in these environments. For example, despite the former Soviet Union's obvious hostility toward the United States during the Cold War, PepsiCo began successfully operating in the former Soviet Union in the 1970s (!). Most of the major airlines have been losing money since September 11, 2001. But a small number of players, such as Southwest in the United States, Ryanair in Ireland, and Hainan Airlines in China, have been raking in profits year after year. In the fiercely competitive fashion industry, Zara has been defying gravity (see In Focus 1.2). How can these firms succeed in such challenging environments? What is special about them? A short answer is that PepsiCo, Southwest, Ryanair, Hainan, and Zara must have certain valuable and unique *firm-specific* resources and capabilities that are not shared by competitors in the same environments.

Doing business outside one's home country is challenging. Foreign firms have to overcome a **liability of foreignness**, which is the *inherent* disadvantage that foreign firms experience in host countries because of their non-native status.[19] Just think about all the differences in regulations, languages, cultures, and norms. Think about the odds against Mahindra & Mahindra when it tried to eat some of John Deere's lunch in the American heartland (see the Opening Case). Against such significant odds, the primary weapons that foreign firms such as Mahindra & Mahindra employ are *overwhelming* resources and capabilities that can offset their liability of foreignness.[20] Today, many of us take it for granted that the best-selling car in the United States rotates between the Toyota Camry and the Honda Civic, that Coca-Cola is the best-selling soft drink in Mexico, and that Microsoft Word is the world's number-one word-processing software. We really shouldn't. Why? Because it is *not* natural for these foreign firms to dominate non-native markets. These firms must possess some very rare and powerful firm-specific resources and capabilities that drive these remarkable success stories and are the envy of their rivals around the globe. This is a key theme of the resource-based view, which

liability of foreignness
the *inherent* disadvantage that foreign firms experience in host countries because of their non-native status.

IN FOCUS 1.2

Zara Deviates from Industry Norms

Ethical Dilemma

Zara is one of the hottest fashion chains. Founded in 1975, Zara's parent, Inditex, has become a leading global apparel retailer. Since its initial public offering (IPO) in 2001, Inditex quadrupled its sales (to $19.1 billion or €13.8 billion) and profits. It doubled the number of its stores of eight brands, of which Zara contributes two-thirds of total sales. Zara succeeds by first breaking and then rewriting industry rules—also known as industry norms.

Rule number one: The origin of a fashion house usually carries some cachet. However, Zara does not hail from Italy or France—it is from Spain. Even within Spain, Zara is not based in a cosmopolitan city like Barcelona or Madrid. It is headquartered in Arteixo, a town of only 25,000 people in a remote corner of northwestern Spain that a majority of this book's readers would have never heard of. Yet, Zara is active not only throughout Europe, but also in Asia and North America. As of 2012, the total number of stores is over 4,200 in 64 countries. Zara stores occupy some of the priciest top locations: Champs-Elysées in Paris, Ginza in Tokyo, Fifth Avenue in New York, Galleria in Dallas, and Huaihai Road in Shanghai.

Rule number two: Avoid stock-outs (a store running out of items in demand). Zara's answer? Occasional shortages contribute to an urge to buy now. With new items arriving at stores *twice* a week, experienced Zara shoppers know that "If you see something and don't buy it, you can forget about coming back for it because it will be gone." The small batch of merchandise during a short window of opportunity for purchasing motivates shoppers to visit Zara stores more frequently. In London, shoppers visit other stores an average of four times a year, but frequent Zara 17 times a year. There is a good reason to do so: Zara makes about 20,000 items per year, about triple what Gap does. "At Gap, everything is the same," says one Zara fan, "and buying from Zara, you'll never end up looking like someone else."

Rule number three: Bombarding shoppers with ads is a must. Gap and H&M spend on average 3% to 4% of their sales on ads. Zara begs to differ: It

Bloomberg/Getty Images.com

devotes just 0.3% of its sales to ads. The high traffic in the stores alleviates some needs for advertising in the media, most of which only serves as a reminder to visit the stores.

Rule number four: Outsource. Gap and H&M do not own any production facilities. However, outsourcing production (mostly to Asia) requires a long lead time, usually several months. Again, Zara has decisively deviated from the norm. By concentrating (more than half of) its production in-house (in Spain, Portugal, and Morocco), Zara has developed a super-responsive supply chain. It designs, produces, and delivers a new garment to its stores worldwide in a mere 15 *days*, a pace that is unheard of in the industry. The best speed the rivals can achieve is two *months*. Outsourcing may not necessarily be "low cost," because errors in prediction can easily lead to unsold inventory, forcing retailers to offer steep discounts. The industry average is to offer 40% discounts across all merchandise. In contrast, Zara sells more at full price and, when it discounts, it averages only 15%.

Rule number five: Strive for efficiency through large batches. In contrast, Zara intentionally deals with small batches. Because of its flexibility, Zara does not worry about "missing the boat" for a season. When new trends emerge, Zara can react quickly. More interestingly, Zara runs its supply chain like clockwork with a fast but predictable rhythm: Every store places orders on Tuesday/Wednesday and Friday/Saturday. Trucks and cargo flights run on established schedules—like a bus service. From Spain, shipments

IN FOCUS 1.2 (continued)

reach most European stores in 24 hours, US stores in 48 hours, and Asian stores in 72 hours. Not only do store staff know exactly when shipments will arrive, regular customers know it too, thus motivating them to check out the new merchandise more frequently on those days, which are known as "Z days" in some cities.

Zara has no shortage of competitors. Why has no one successfully copied its business model of "fast fashion"? "I would love to organize our business like Inditex [Zara's parent]," noted an executive from Gap, "but I would have to knock my company down and rebuild it from scratch." This does not mean Gap and other rivals are not trying to copy Zara. The question is how long it takes for rivals to out-Zara Zara.

Sources: Based on (1) *BusinessWeek*, 2009, 100 best global brands, September 28: 44-60; (2) *BusinessWeek*, 2006, Fashion conquistador, September 4: 38-39; (3) *Economist*, 2012, Fashion forward, March 24: 63-64; (4) K. Ferdows, M. Lewis, & J. Machuca, 2004, Rapid-fire fulfillment, *Harvard Business Review*, November: 104-110; (5) www.zara.com.

focuses on how winning firms acquire and develop such unique and enviable resources and capabilities and how competitor firms imitate and then innovate in an effort to outcompete the winning firms.

1-3d A Consistent Theme

Given our focus on the fundamental question of what determines the success and failure of firms around the globe, we will develop a unified framework by organizing the material in every chapter according to the two core perspectives, namely, the institution-based and resource-based views. With our unified framework—an innovation in IB textbooks—we will not only explore the global business "trees," but also see the global business "forest."

1-4
Learning Objective
Identify ~~two~~ ways of understanding what globalization is.

1-4 What Is Globalization?

Globalization, generally speaking, is the close integration of countries and peoples of the world. This abstract five-syllable word is now frequently heard and debated. Those who approve of globalization count its contributions to include greater economic growth and standards of living, increased technology sharing, and more extensive cultural integration. Critics argue that globalization undermines wages in rich countries, exploits workers in poor countries, grants MNEs too much power, and destroys the environment. So, what exactly is globalization? This section outlines three views on globalization, recommends the pendulum view, and introduces the idea of semiglobalization.

1-4a Three Views on Globalization

Depending on what sources you read, globalization could be

- a new force sweeping through the world in recent times
- a long-run historical evolution since the dawn of human history
- a pendulum that swings from one extreme to another from time to time

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

An understanding of these views helps put the debate about globalization in perspective. First, opponents of globalization suggest that it is a new phenomenon beginning in the late 20th century, driven by recent technological innovations and a Western ideology focused on exploiting and dominating the world through MNEs. The arguments against globalization focus on environmental stress, social injustice, and sweatshop labor but present few clearly worked-out alternatives to the present economic order. Nevertheless, anti-globalization advocates and protesters often argue that globalization needs to be slowed down, if not stopped.[21]

A second view contends that globalization has always been part and parcel of human history. Historians are debating whether globalization started 2,000 or 8,000 years ago. The earliest traces of MNEs have been discovered in Assyrian, Phoenician, and Roman times.[22] International competition from low-cost countries is nothing new. In the first century A.D., the Roman emperor Tiberius was so concerned about the massive quantity of low-cost Chinese silk imports that he imposed the world's first known import quota of textiles.[23] Today's most successful MNEs do not come close to wielding the historical clout of some MNEs, such as Britain's East India Company during colonial times. In a nutshell, globalization is nothing new and will probably always exist.

A third view suggests that globalization is the "closer integration of the countries and peoples of the world which has been brought about by the enormous reduction of the costs of transportation and communication, and the breaking down of artificial barriers to the flows of goods, services, capital, knowledge, and (to a lesser extent) people across borders."[24] Globalization is neither recent nor one-directional. It is, more accurately, a process similar to the swing of a pendulum.

1-4b The Pendulum View on Globalization

The pendulum view probably makes the most sense because it can help us understand the ups and downs of globalization. The current era of globalization originated in the aftermath of World War II, when major Western countries committed to global trade and investment. However, between the 1950s and the 1970s, this view was not widely shared. Communist countries, such as China and the Soviet Union, sought to develop self-sufficiency. Many non-communist developing countries, such as Brazil, India, and Mexico, focused on fostering and protecting domestic industries. But refusing to participate in global trade and investment ended up breeding uncompetitive industries. In contrast, four developing economies in Asia—Hong Kong, Singapore, South Korea, and Taiwan—earned their stripes as the "Four Tigers" by participating in the global economy. They became the *only* economies once recognized as less developed (low-income) by the World Bank to have subsequently achieved developed (high-income) status (see Table 1.1).

Inspired by the Four Tigers, more and more countries and regions—such as China in the late 1970s, Latin America in the mid-1980s, Central and Eastern Europe in the late 1980s, and India in the 1990s—realized that joining the world economy was a must. As these countries started to emerge as new players in the world economy, they become collectively known as "emerging economies." As a result, globalization rapidly accelerated.

However, globalization, like a pendulum, is unable to keep going in one direction. Rapid globalization in the 1990s and the 2000s saw some significant backlash. First, the rapid growth of globalization led to the historically inaccurate view that globalization is new. Second, it created fear among many people in developed economies that they would lose jobs. Emerging economies not only seem to attract many low-end manufacturing jobs away from developed economies, but they also increasingly appear to threaten some high-end jobs. Finally, some factions in emerging economies complained against the onslaught of MNEs, alleging that they destroy local companies as well as local cultures, values, and environments.

While small-scale acts of vandalizing McDonald's restaurants are reported in a variety of countries, the December 1999 anti-globalization protests in Seattle and the September 2001 terrorist attacks in New York and Washington have been undoubtedly the most visible and most extreme acts of anti-globalization forces at work. As a result, international travel was curtailed, and global trade and investment flows slowed in the early 2000s. Then in the mid-2000s, however, worldwide GDP, cross-border trade, and per capita GDP all soared to historically high levels.

Unfortunately, the party suddenly ended in 2008. The 2008–2009 global economic crisis was unlike anything the world had seen since the Great Depression (1929–1933). The year 2008 showed, for better or worse, how interconnected the global economy has become. Deteriorating housing markets in the United States, fueled by unsustainable subprime lending practices, led to massive government bailouts of financial services firms. Initially, most of the world probably shared the sentiment expressed by Brazilian President Luiz Inacio Lula da Silva that the crisis would be "Bush's crisis" (referring to President George W. Bush) and would have nothing to do with "us." However, the crisis quickly spread around the world, forcing numerous governments to bail out their own troubled banks. Global output, trade, and investment plummeted, while unemployment skyrocketed. The 2008–2009 crisis became known as the Great Recession. Rightly or wrongly, many people blamed globalization for the Great Recession.

After unprecedented intervention in developed economies where governments ended up being many banks' largest shareholders, confidence was growing that the global economy had turned the corner and that the recession was ending.[25] However, starting in 2010, the Greek debt crisis and then the broader PIGS debt crisis ("PIGS" refers to Portugal, Ireland or Italy, Greece, and Spain) erupted. Fiscally more responsible EU countries that adopted the euro as the common currency, such as Germany and France, felt compelled to bail out the countries in crisis. The already slow recovery in Europe thus became slower, and unemployment hovered at very high levels (see Chapter 8).

Overall, economic recovery is likely to be slow in developed economies, whereas emerging economies are likely to rebound faster. The recession reminds all firms and managers of the importance of risk management—the identification and assessment of risks and the preparation to minimize the impact of high-risk, unfortunate events.[26] As a technique to prepare and plan for multiple scenarios (either high risk or low risk), scenario planning is now extensively used by firms around the world.[27] For example, many European firms have been preparing for a possible (but unlikely) scenario that Greece (or Germany) may leave the euro zone. As far as the direction of economic globalization is concerned, the recovery may see more protectionist measures, since the stimulus packages and job creation schemes of various governments often emphasize "buy national" (such as "buy American") and "hire locals." In short, the pendulum is swinging back.

Like the proverbial elephant, globalization is seen by everyone yet rarely comprehended. The sudden ferocity of the 2008–2009 crisis surprised everybody—ranging from central bankers to academic experts. Remember all of us felt sorry

risk management

the identification and assessment of risks and the preparation to minimize the impact of high-risk, unfortunate events.

scenario planning

a technique to prepare and plan for multiple scenarios (either high or low risk).

when we read the story of a bunch of blind men trying to figure out the shape and form of the elephant. We really shouldn't. Although we are not blind, our task is more challenging than the blind men who study a standing animal. Our beast—globalization—does not stand still and often rapidly moves, back and forth (!). Yet, we try to live with it, avoid being crushed by it, and even attempt to profit from it. Overall, relative to the other two views, the view of globalization as a pendulum is more balanced and more realistic. In other words, globalization has both rosy and dark sides, and it changes over time.

1-4c Semiglobalization

Despite the debate over it, globalization is not complete. Do we really live in a globalized world? Are selling and investing abroad just as easy as at home? Obviously not. Most measures of market integration, such as trade and FDI, have recently scaled new heights but still fall far short of pointing to a single, globally integrated market. In other words, what we have may be labeled **semiglobalization**, which is more complex than extremes of total isolation and total globalization. Semiglobalization suggests that barriers to market integration at borders are high but not high enough to insulate countries from each other completely.[28]

Semiglobalization calls for more than one way of doing business around the globe. Total isolation on a nation-state basis would suggest localization—a strategy of treating each country as a unique market. So an MNE marketing products to 100 countries will need to come up with 100 versions of local cars or drinks. This approach is clearly too costly. Total globalization, on the other hand, would lead to standardization—a strategy of treating the entire world as one market. The MNE in our previous example can just market one version of "world car" or "world drink." But the world obviously is not that simple. Between total isolation and total globalization, semiglobalization has no single right strategy, resulting in a wide variety of experimentations. Overall, (semi)globalization is neither to be opposed as a menace nor to be celebrated as a panacea; it is to be *engaged*.

1-5 Global Business and Globalization at a Crossroads

1-5
Learning Objective
State the size of the global economy and its broad trends and understand your likely bias in the globalization debate.

Twenty-first century business leaders are facing an enormous challenge. This book provides a basic guide to meeting that challenge. As a backdrop for the remainder of this book, this section makes two points. First, a basic understanding of the global economy is necessary. Second, it is important to critically examine your own personal views and biases regarding globalization.

1-5a A Glance at the Global Economy

The global economy at the beginning of the 21st century is an approximately $60 trillion economy (total global GDP calculated at official, nominal exchange rates). While there is no need to memorize a lot of statistics, it is useful to remember this $60 trillion figure to put things in perspective.

One frequent observation in the globalization debate is the enormous size of MNEs. If the largest MNE, Wal-Mart, were an independent country, it would be the 22nd largest economy—its sales are smaller than Indonesia's GDP but larger

semiglobalization
a perspective that suggests that barriers to market integration at borders are high, but not high enough to insulate countries from each other completely.

Table 1.4 Recent Changes in the *Fortune* Global 500

	2005	2006	2007	2008	2009	2010
Developed economies						
United States	170	162	153	140	139	133
European Union	165	165	170	163	161	149
Japan	70	67	64	68	71	68
Switzerland	12	13	14	15	15	15
Canada	14	16	14	14	11	11
Australia	8	8	8	9	8	8
Emerging economies						
China	20	24	29	37	46	61
India	6	6	7	7	8	8
Brazil	4	5	5	6	7	7
Russia	5	4	5	8	6	7
BRIC	35	39	46	58	67	83

Sources: The most recent *Fortune* Global 500 list (for 2010) was published in *Fortune*, July 25, 2011.

than Poland's. The sales of the largest EU-based MNE, BP, were larger than the GDP of each of the following EU member countries: Norway, Denmark, Greece, and Ireland. The sales of the largest Asia Pacific–based MNE, Sinopec, were larger than the GDP of each of the following Asia Pacific countries: Malaysia, Singapore, and New Zealand. Today, over 77,000 MNEs control at least 770,000 subsidiaries overseas.[29] Total annual sales for the largest 500 MNEs exceed $20 trillion (about one third of global output). Table 1.4 documents the change in the makeup of the 500 largest MNEs. In general, MNEs from the Triad dominate the list. The United States has generally contributed about one third of these firms, and has experienced some reduction in numbers recently. The EU has maintained a reasonably steady share of about one third of these firms. From its heyday in the 1990s, Japan has experienced the most dramatic variation (roughly corresponding to its economic boom and bust with several years of delay).

Among MNEs from emerging economies, those from BRIC contribute 83 firms to the Fortune Global 500 list, which is more than the number of Fortune Global firms from Japan. In particular, MNEs from China have come on strong.[30] Beijing is now headquarters to 41 *Fortune* Global 500 firms, more than New York's 27. MNEs based in emerging economies are often regarded as "Third World multinationals," "dragon multinationals," or simply "emerging multinationals."[31] Clearly, Western rivals cannot afford to ignore these new MNEs, and students studying this book need to pay attention to these emerging multinationals.

1-5b The Globalization Debate and You

As a future business leader, you are not a detached reader (see In Focus 1.3). The globalization debate directly affects *your* future.[32] Therefore, it is imperative

IN FOCUS 1.3
What Language and What Fields Should I Study?

Ethical Dilemma

On September 3, 2007, Markéta Straková of Tabor, the Czech Republic, wrote to *BusinessWeek* columnists Jack Welch and Suzy Welch:

> I am thinking of studying Portuguese, but in your opinion, what language should I learn to succeed in the world of business? And what fields of study hold the most potential?

Jack Welch was the former chairman and CEO of General Electric (GE), and Suzy Welch was the former editor of *Harvard Business Review*. They wrote back in the same issue of *BusinessWeek*:

> You're on to something with Portuguese, since it will give you a leg up in several markets with good potential, such as Brazil and some emerging African nations. Spanish is also a good choice, as it will allow you to operate with more ease throughout Latin America, and, increasingly, the United States. But for our money—and if you can manage the much higher order of commitment—Chinese is the language to learn. China is already an economic powerhouse. It will only gain strength. Anyone who can do business there with the speed and intimacy that fluency affords will earn a real competitive edge.
>
> As for what to study—and if you want to be where the action is now and for the next couple of decades—consider the industries focused on alternative sources of energy. Or learn everything you can about the confluence of three fields: biotechnology, information technology, and nanotechnology. For the foreseeable future, the therapies, machines, devices, and other products and services that these fields bring to market will revolutionize society—and business.
>
> That said, when it comes to picking an education field and ultimately a career, absolutely nothing beats pursuing the path that truly fascinates your brain, engages your energy, and touches your soul. Whatever you do, do what turns your crank. Otherwise your job will always be just work, and how dreary is that?

Source: J. Welch & S. Welch, 2007, Ideas: The Welch way (p. 104), *BusinessWeek*, September 3: 104.

that you participate in the globalization debate instead of letting other people make decisions on globalization that will significantly affect your career, your consumption, and your country. It is important to know your own biases when joining the debate. By the very act of taking an IB course and reading this book, you probably already have some pro-globalization biases, compared to non-business majors elsewhere on campus and the general public in your country.

You are not alone. In the last several decades, most executives, policy makers, and scholars in both developed and emerging economies, who are generally held to be the elite in these societies, are biased toward acknowledging the benefits of globalization. Although it has long been known that globalization carries both benefits and costs, many of the elite have failed to take into sufficient account the social, political, and environmental costs associated with globalization. However, just because the elite share certain perspectives on globalization does *not* mean that most other members of the society share the same views. Unfortunately, many of the elite fail to understand the limits of their beliefs and mistakenly assume that the rest of the world thinks like them. To the extent that powerful economic and political institutions are largely controlled by the elite in almost every country, it is not surprising that some anti-globalization groups, feeling powerless, end up resorting to unconventional tactics such as mass protests to make their point.

Shalunts/Shutterstock

Why do protestors like these object to globalization?

Many of the opponents of globalization are **nongovernmental organizations (NGOs)** such as environmentalists, human rights activists, and consumer groups. Ignoring them will be a grave failure when doing business around the globe. Instead of viewing NGOs as opponents, many firms view them as partners. NGOs do raise a valid point when they insist that firms, especially MNEs, should have a broader concern for the various stakeholders affected by the MNEs' actions around the world. At present, this view is increasingly moving from the peripheral to the mainstream (see Chapters 3 and 17).

It is certainly interesting, and perhaps alarming, to note that as would-be business leaders who will shape the global economy in the future, current business school students already exhibit values and beliefs in favor of globalization similar to those held by executives, policy makers, and scholars and different from those held by the general public. Shown in Table 1.5, US business students have significantly more positive (almost one-sided) views toward globalization than the general public. While these data are based on US business students, my lectures around the world suggest that most business students around the world—regardless of their nationality—seem to share such positive views on globalization. This is not surprising. Both self-selection to study business and socialization within the curriculum, in which free trade is widely regarded as positive, may lead to certain attitudes in favor of globalization. Consequently, business students tend to focus more on the economic gains of globalization and less on its darker sides.

nongovernmental organization (NGO)
an organization that is not affiliated with governments.

Current and would-be business leaders need to be aware of their own biases embodied in such one-sided views toward globalization. Since business schools aspire to train future business leaders by indoctrinating students with the dominant values that managers hold, these results suggest that business schools may have largely succeeded in this mission. However, to the extent that current managers (and professors) have strategic blind spots, these findings are potentially alarming. They reveal that business students already share these blind spots. Despite possible self-selection in choosing to major in business, there is no denying

Table 1.5 Views on Globalization: General Public versus Business Students

Percentage answering "good" for the question: Overall, do you think globalization is *good* or *bad* for	General public[1] (N = 1,024)	Business students[2] (N = 494)
US consumers like you	68%	96%
US companies	63%	77%
The US economy	64%	88%
Strengthening poor countries' economies	75%	82%

Sources: Based on (1) A. Bernstein, 2000, Backlash against globalization, *BusinessWeek*, April 24: 43; (2) M. W. Peng & H. Shin, 2008, How do future business leaders view globalization? (p. 179), *Thunderbird International Business Review*, 50 (3): 175-182. All differences are statistically significant.

that student values are shaped, at least in part, by the educational experience that business schools provide. Knowing such limitations, business school professors and students need to work especially hard to break out of this mental straitjacket.

In order to combat the widespread tendency to have one-sided, rosy views, a significant portion of this book is devoted to the numerous debates that surround globalization.[33] Beyond the globalization debate that this chapter considers, debates are systematically introduced in *every* chapter to provoke more critical thinking and discussion. Virtually all textbooks uncritically present knowledge "as is" and ignore the fact that the field is alive with numerous debates. No doubt, debates drive practice and research forward. Therefore, it is imperative that you be exposed to cutting-edge debates and encouraged to form your own views. In addition, ethics is emphasized throughout the book. A featured Ethical Dilemma can be found in every chapter. Two whole chapters are devoted to ethics, norms, and cultures (Chapter 3) and corporate social responsibility (Chapter 17).

Organization of the Book

This book has four parts. Part I is *foundations*. Following this chapter, Chapters 2, 3, and 4 address the two leading perspectives—namely, institution-based and resource-based views. Part II covers *tools*, focusing on trade (Chapter 5), foreign investment (Chapter 6), foreign exchange (Chapter 7), and global and regional integration (Chapter 8). Part III sheds light on *strategy*. We start with the internationalization of small, entrepreneurial firms (Chapter 9), followed by ways to enter foreign markets (Chapter 10), to manage competitive dynamics (Chapter 11), to make alliances and acquisitions work (Chapter 12), and to strategize, structure, and learn (Chapter 13). Finally, Part IV builds *excellence in different functional areas:* marketing and supply chain (Chapter 14), human resource management (Chapter 15), finance and corporate governance (Chapter 16), and corporate social responsibility (Chapter 17).

CHAPTER SUMMARY

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

- IB is typically defined as (1) a business (firm) that engages in international (cross-border) economic activities, and (2) the action of doing business abroad.
- Global business is defined in this book as business around the globe.
- This book has gone beyond competition in developed economies by devoting extensive space to competitive battles waged in emerging economies and the base of the global economic pyramid.
- An interesting recent development out of emerging economies is reverse innovation.

1.2 Give three reasons why it is important to study global business

- Enhance your employability and advance your career in the global economy by equipping yourself with global business knowledge.
- Better preparation for possible expatriate assignments abroad.
- Stronger competence in interacting with foreign suppliers, partners, and competitors and in working for foreign-owned employers in your own country.

1.3 Articulate one fundamental question and two core perspectives in the study of global business.

- IB's most fundamental question is: What determines the success and failure of firms around the globe?
- The two core perspectives are (1) the institution-based view and (2) the resource-based view.
- We develop a unified framework by organizing materials in *every* chapter according to the two perspectives guided by the fundamental question.

1.4 Identify three ways of understanding what globalization is

- Some view globalization as a recent phenomenon, and others believe that it has been a one-directional evolution since the dawn of human history.
- We suggest that globalization is best viewed as a process similar to the swing of a pendulum.

1.5 State the size of the global economy and its broad trends, and understand your likely bias in the globalization debate.

- MNEs, especially large ones from developed economies, are sizable economic entities.
- Current and would-be business leaders need to be aware of their own hidden pro-globalization bias.

KEY TERMS

Base of the pyramid ~~00~~
BRIC ~~00~~
Expatriate manager (expat) ~~00~~
Foreign direct investment (FDI) ~~00~~
Global business ~~00~~
Globalization ~~00~~
~~Gross domestic product 00~~
Gross domestic product (GDP) ~~00~~
Gross national income (GNI) ~~00~~
Gross national product (GNP) ~~00~~
Group of 20 (G-20) ~~00~~
Emerging economies ~~00~~
Emerging markets ~~00~~
International business ~~00~~
International premium ~~00~~
Liability of foreignness ~~00~~
Multinational enterprise (MNE) ~~00~~
Nongovernmental organization (NGO) ~~00~~
Purchasing power parity (PPP) ~~00~~
Reverse innovation ~~00~~
Risk management ~~00~~
Scenario planning ~~00~~
Semiglobalization ~~00~~
Triad ~~00~~

REVIEW QUESTIONS

1. **What is the traditional definition of IB? How is global business defined in this book?**
2. **Compare PengAtlas Maps 2.1 (Top Merchandise Importers and Exporters), 2.2 (Top Service Importers and Exporters), and 2.3 (FDI Inflows and Outflows) and note that the United States is number one in all categories except one. What is it? Many people feel that is a big problem, do you? In your opinion, what–if anything–should be done about that?**
3. **Compare PengAtlas Maps 2.1 (Top Merchandise Importers and Exporters), 2.2 (Top Service Importers and Exporters), and 2.3 (FDI Inflows and Outflows) once again and note the BRIC countries that are referenced in this chapter. Which of the BRIC countries is most often among the categories in**

those maps? Do you think that the long-term trend will be for that country to continue to become more important and perhaps surpass the United States, or do you that it may decline, and one of the other BRIC countries will become more important? Why?

4. ***ON CULTURE:*** **Not all people in your country support globalization, and some say it is because they feel that globalization is an economic threat. However, to what extent ~~could it be~~ they may also feel that it is a threat to their culture? What about you? To what extent do you feel that globalization is either an economic or cultural threat to your country?**
5. **Discuss the importance of emerging economies in the global economy. Use current news.**
6. **What is your interest in studying global business? How do you think it may help you succeed in the future?**
7. **If you were to work as an expatriate manager, where would you like to go, and what type of work would you like to do? Why?**
8. **How would you describe an institution-based view of global business?**
9. **How would you describe a resource-based view of global business?**
10. **After comparing the three views of globalization, which seems the most sensible to you and why?**
11. **What is semiglobalization, and what factors contribute to it?**
12. **Do those who protest against globalization make any valid point(s) that all people, whether for or against globalization, should consider?**
13. **You may view yourself as objective and neutral regarding globalization, but do you sense any bias that you may have, one way or the other? What bias most likely exists on the part of other students taking this course?**
14. **Given the size of the global economy and the size of some of the large corporations, do you think it is possible to carve out a niche that you can exploit as a small businessperson? Or do you feel that the most practical way to participate in the global economy is to do so as an employee or manager in a global corporation?**

CRITICAL DISCUSSION QUESTIONS

1. **A classmate says: "Global business is relevant for top executives such as CEOs in large companies. I am just a lowly student who will struggle to gain an entry-level job, probably in a small domestic company. Why should I care about it?" How do you convince your classmate that global business is something to care about?**
2. ***ON CULTURE:*** **Thomas Friedman, in his book *The World is Flat* (2005), suggests that the world is flattening—meaning that it is increasingly interconnected by new technology such as the Internet. This can raise the poor from poverty, nurture a worldwide middle class, and even spread democracy. On the other hand, this presents significant challenges for developed economies, whose employees may feel threatened by competition from low-cost countries. How does this flattening world affect you?**
3. ***ON ETHICS:*** **What are some of the darker sides (in other words, costs) associated with globalization? How can business leaders make sure that the**

benefits of their various actions (such as outsourcing) outweigh their drawbacks (such as job losses in developed economies)?

4. ***ON ETHICS:*** **Some argue that aggressively investing in emerging economies is not only economically beneficial but also highly ethical, because it could lift many people out of poverty (see the Closing Case). However, others caution that in the absence of reasonable hopes of decent profits, rushing to emerging economies is reckless. How would you participate in this debate?**

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GLOBAL ACTION

1. **Chemical companies are among the largest firms worldwide. Two approaches to evaluating their operations are by capital spending and by research and development (R&D) spending. Access a resource that provides this information about top global chemical producers. Then compare the top five capital-spending and R&D-spending chemical companies. Are any companies found on both lists? What insights does this information provide?**
2. **One important aspect of globalization is the fundamental stability of the global economic order currently in place. Thus, FDI intentions can be influenced by its perceived sustainability to some degree. Identify the three most important issues related to global economic stability over the next 20 years. Be sure to discuss the sample surveyed to provide the appropriate frame of reference for discussion.**

VIDEO CASE

After watching the video on New Balance, discuss the following:

1. **What will determine the success or failure of New Balance?**
2. **What view of globalization is suggested through the New Balance Company?**
3. **What impact will emerging economies and the Trans-Pacific Partnership have on New Balance?**
4. **With regard to New Balance, what are the costs and benefits of globalization?**
5. **Is globalization the solution to profitability?**

CLOSING CASE

Ethical Dilemma

EMERGING MARKETS: Direct Selling at the Base of the Pyramid

Consumers in remote areas of emerging economies have limited opportunities to buy global brands, and even fewer opportunities to connect to the supply chains of MNEs. Direct sales companies such as Avon are growing their markets and profits by tapping the potential of buyers and sellers at the base of the pyramid. An estimated one billion consumers, between the poorest of the poor and the rising middle class, spend up to one-third of their income on personal care items, electronics, and snack food. These consumers often differ greatly in interests and behaviors from consumers in urban centers. By working in direct sales, millions of women are gaining skills and experience as micro-entrepreneurs, and while doing so, are changing social norms and ideas of global beauty.

Direct sales companies employ more than two million people in Brazil. A team of researchers took an in-depth look at women who work in direct sales in the municipality of Ponta de Pedras, on Marajó Island in the remote lower Amazon. This local economy revolves largely around seasonal agricultural production of the açaí fruit, with almost no job opportunities for women before MNE direct sales companies entered the marketplace. Traveling to homes by canoe and by road, the women sell beauty products from US-based Avon and the more expensive Brazil-based Natura, and inexpensive household goods and clothing from the Brazilian catalog company Hermes. In an area with approximately 12,000–13,000 female residents, Avon has around 175 direct sales representatives, Hermes counts around 200, and Natura has between 15 and 20.

The MNE direct sales companies overcome roadblocks by leveraging the representatives' keen awareness of local consumer tastes, brand preferences, and complex local business norms and practices. The representatives disseminate information about new products and translate product information into terms that are relevant to their customers. To be effective, they identify meaningful segments, within which they exercise some flexibility in suppressing or promoting differences between the global brands and the local products. Almost all of the women consider their work "successful" if they are able to make a small profit or break even. Most direct sales representatives earn on average 80 *reais* (approximately $35) per order, which they typically send in once a month or every other month. For direct sales representatives in Ponta de Pedras, the income they earn is not meant to support their family, but it is a crucial secondary income over which they have sole control. They use this money to provide clothing for their children and to purchase new products for themselves, which can translate into a sense of empowerment and an enhanced role in the family and community. Soon after building their initial network, many representatives start to represent other companies. Since the economy revolves around the agricultural season, there is also a season for increased sales. This seasonal cycle is one of their most difficult challenges. The only way to make any sales in Ponta de Pedras is to offer informal credit, typically allowing customers to pay up front for one-half or one-third of the cost, and then pay the remaining amount owed at a later date. As the local Avon coordinator stated, "If she doesn't sell on credit, she's not going to sell anything. All of her products will stay with her."

Product catalogs and television commercials promote the glamour of the cosmetics and beauty products in Brazil, but some representatives and customers have very little exposure to television, print media and the Internet, or urban lifestyles. The identification with values and brands falls along a continuum from global to local. This identification is affected by the levels of exposure to media, the degree of urban-rural circulation, and the patterns of ~~rural urban~~ communication. Building from their community roots, the sales representatives create a channel for discussing the relevant differences between local, traditional products and modern, global consumer brands. Local values can be expressed with the simultaneous identification of global and local standards. For example, perfumes, colognes, soaps, and lotions are the most popular beauty products in Ponta de Pedras, and most residents purchase these products from both Avon and Natura representatives. Smelling good is culturally very important in the Amazon, coinciding with other practices such as frequent bathing—on average, three to four times per day. Make-up and cosmetics, on the other hand, do not connect nearly as much with local values, but wearing make-up is an index of identification with global beauty standards.

The direct sales representatives play a bridging role between local and global ideals of beauty and fashion. Through interpersonal discussions, these female entrepreneurs form and leverage a successful system in which customers can simultaneously identify with global ideals of beauty and femininity, and express their locally based differences, ideals, and values. This system is more dynamic, interactive, and customized than what traditional, store-based retailing offers. Overall, the direct sales networks in remote areas reconcile local and global values on beauty and femininity for customers, create stronger brand relationships to the benefit of the ~~MNCs~~ and help to improve the income and quality of life of the many individuals involved.

H. John Maier Jr./Contributor/Getty Images

CASE DISCUSSION QUESTIONS:

1. What are the advantages to a consumer in the remote Amazon of buying a beauty product from a direct sales representative, over buying the product from a retail store in the nearest town?
2. What are some of the "rules of game" affecting an Avon representative in the remote Amazon?
3. Natura and Avon are direct competitors in this market. Compare and contrast their resources and capabilities.
4. ***ON ETHICS:*** Avon knows that many of its sellers will not make large profits. Comment on the ethics of the business model.
5. ***ON ETHICS:*** Some critics question whether it is ethical to aggressively market "non-essentials" (such as cosmetics) to very low income customers who may end up spending up to one-third of their income on such items. What do you think?

Sources: This case was written by Professors **Jessica Chelekis** (Middle Tennessee State University) and **Susan M. Mudambi** (Temple University). © Jessica Chelekis and Susan M. Mudambi. Reprinted with permission. It was based on (1) J. Chelekis & S. M. Mudambi, 2010, MNCs and micro-entrepreneurship in emerging economies: The case of Avon in the Amazon, *Journal of International Management*, 16: 412-424; (2) R. Wilk, 1995, The local and the global in the political economy of beauty: From Miss Belize to Miss World, *Review of International Political Economy*, 2(1): 117–134; (3) World Federation of Direct Selling Associations (WFDSA), 2009, International statistics, http://www.wfdsa.org/statistics.

NOTES

[**Journal acronyms**] **AMP**—*Academy of Management Perspectives*; **AMR**—*Academy of Management Review;* **APJM**—*Asia Pacific Journal of Management;* **BW**—*BusinessWeek* (before 2010) or *Bloomberg Businessweek* (since 2010); **GSJ**—*Global Strategy Journal;* **HBR**—*Harvard Business Review;* **JBV**—*Journal of Business Venturing;* **JIBS**—*Journal of International Business Studies;* **JIM**—*Journal of International Management;* **JM**—*Journal of Management;* **JMS**—*Journal of Management Studies;* **JWB**— *Journal of World Business;* **MBR**—*Multinational Business Review;* **MIR**—*Management International Review;* **SMJ**—*Strategic Management Journal*

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