



# GLOBAL BUSINESS

FOURTH EDITION

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# GLOBAL BUSINESS

Fourth Edition

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*To Agnes, Grace, and James*



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# Preface

The first three editions of *Global Business* aspired to set a new standard for international business (IB) textbooks. They have been widely used in Australia, Austria, Brazil, Britain, Canada, China, Denmark, Egypt, France, Hong Kong, India, Indonesia, Ireland, Israel, Lithuania, Macau, Malaysia, Mexico, the Netherlands, Netherlands Antilles, New Zealand, Puerto Rico, Russia, Slovenia, South Africa, South Korea, Spain, Sweden, Switzerland, Taiwan, Thailand, and the United States. Based on the enthusiastic support from more than 30 countries, the first three editions achieved unprecedented success. Available in Chinese and Spanish, *Global Business* has also launched a European adaptation (with Klaus Meyer) and an Indian adaptation (with Deepak Srivastava). In short, *Global Business* is global.

The fourth edition endeavors to achieve even more. It continues the market-winning framework centered on one big question and two core perspectives, and has been thoroughly updated to capture the rapidly moving recent research and events. Written for undergraduate and MBA students around the world, the fourth edition will continue to make IB teaching and learning (1) more engaging, (2) more comprehensive, (3) more fun, and (4) more relevant.

## More Engaging

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

chapters.<sup>1</sup> It is this relentless focus on our big question and core perspectives that enables this book to engage a variety of topics in an integrated fashion. This provides unparalleled continuity in the learning process.

*Global Business* further engages readers through an *evidence-based* approach. I have endeavored to draw on the latest research, as opposed to the latest fads. As an active researcher myself, I have developed the unified framework not because it just popped up in my head when I wrote the book. Rather, this is an extension of my own research that consistently takes on the big question and leverages the two core perspectives.<sup>2</sup>

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

## More Comprehensive

*Global Business* offers the most comprehensive and innovative coverage of IB topics available on the market. Unique chapters not found in other IB textbooks are: Chapter 9 (entrepreneurship and small firms’ internationalization), Chapter 11 (global competitive dynamics), and Chapter 16 (corporate finance and governance).

The most comprehensive topical coverage is made possible by drawing on the latest and most comprehensive range of the research literature. I have accelerated my own

<sup>1</sup> On the integration of these two perspectives, see K. Meyer, S. Estrin, S. Bhaumik, & M. W. Peng, 2009, Institutions, resources, and entry strategies in emerging economies, *Strategic Management Journal*, 30(1): 61–80; D. Zoogah, M. W. Peng, & H. Woldu, 2015, Institutions, resources, and organizational effectiveness in Africa, *Academy of Management Perspectives*, 29(1): 7–31.

<sup>2</sup> For the big question, see M. W. Peng, 2004, Identifying the big question in international business research, *Journal of International Business Studies*, 35(2): 99–108. For the institution-based view, see M. W. Peng, D. Wang, and Y. Jiang, 2008, An institution-based view of international business strategy: A focus on emerging economies, *Journal of International Business Studies*, 39(5): 920–936. For the resource-based view, see M. W. Peng, 2001, The resource-based view and international business, *Journal of Management*, 27(6): 803–829.

research, publishing a total of 30 articles after I finished the third edition.<sup>3</sup> Some of these recent articles appear in top-tier outlets in IB, such as the *Academy of Management Journal* (2012), *Journal of International Business Studies* (2014 and 2016), *Journal of Management Studies* (2012, 2013, and 2015), *Journal of World Business* (2012, 2014, and 2015), and *Strategic Management Journal* (2013, 2015, and 2016). Writing *Global Business* has also enabled me to broaden the scope of my research, publishing recently in top-tier journals in operations (*Journal of Operations Management*), ethics (*Journal of Business Ethics*), entrepreneurship (*Journal of Business Venturing* and *Entrepreneurship Theory and Practice*), and human resources (*International Journal of Human Resource Management*). In addition to my own work, I have also drawn on the latest research of numerous colleagues. The end result is the unparalleled, most comprehensive set of evidence-based insights on the IB market. While citing every article is not possible, I am confident that I have left no major streams of research untouched. Feel free to check the Name Index to verify this claim. (Unfortunately, a number of older references have to be deleted to make room for more recent research.)

Finally, the fourth edition of *Global Business* continues to have a global set of cases contributed by scholars around the world—an innovation on the IB market. Virtually all other IB textbooks have cases written by book authors. In comparison, this book has been blessed by a global community of case contributors who are based in Australia, Austria, Canada, China, Mexico, and the United States. Many are experts who are located in or are from the countries in which the cases take place. For example, we now have a Mexico case penned by two Mexico-based authors (see Integrative Case on Farmacias Similares), and a China case written by a China-based author (see Integrative Case on Ostnor). This edition also features a Russia case contributed by the world's top two leading experts on Russian management (see Integrative Case on Wikimart).

## More Fun

If you fear this book must be boring because it draws so heavily on latest research, you are wrong. I have used a clear, engaging, conversational style to tell the “story.” Relative to rival books, my chapters are shorter and more lively. Some earlier users commented that reading *Global Business* is like reading a “good magazine.” A large number of interesting anecdotes have been woven

<sup>3</sup> All my articles are listed at [www.mikepeng.com](http://www.mikepeng.com) and [www.utdallas.edu/~mikepeng](http://www.utdallas.edu/~mikepeng). Go to “Journal Articles.”

into the text. Non-traditional (“outside-the-box”) examples range from ancient Chinese military writings to mutually assured destruction (MAD) strategy during the Cold War, from LEGO toys to Tolstoy’s *Anna Karenina*. Check out the following fun-filled features that spice up the book:

- The rebirth of the East India Company (Chapter 1 Opening Case)
- Testing the Dell theory of peace in East Asia (Emerging Markets 2.2)
- LEGO’s secrets (Chapter 4 Opening Case)
- ANA: Refreshing the parts other airlines cannot reach (In Focus 4.1)
- Why are US exports so competitive? (Chapter 5 Closing Case)
- One multinational versus many national companies (In Focus 6.1)
- Sriracha spices up American food (Chapter 9 Opening Case)
- Mickey goes to Shanghai (Chapter 10 Closing Case)
- Patent wars and shark attacks (Chapter 11 Opening Case)
- Is a diamond (cartel) forever? (In Focus 11.1)
- Can mergers of equals work? (In Focus 12.2)
- Marketing Aflac in the United States and Japan (Chapter 14 Opening Case)
- Dallas versus Delhi (Chapter 15 Closing Case)
- High drama at Hewlett-Packard (HP) (Chapter 16 Opening Case)
- Professor Michael Jensen as an outside director (In Focus 16.2)
- Global warming and Arctic boom (In Focus 17.1)

Finally, the PengAtlas allows you to conduct IB research using informative maps and other geographic tools to enhance your learning. In addition, a series of new videos enhance the multi-media, fun aspects of learning (see below).

## More Relevant

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

As a theme, ethics cuts through the book, with at least one “Ethical Dilemma” feature and a series of Critical

Discussion Questions on ethics in each chapter. Finally, many chapters offer *career* advice for students. For example, Chapter 4 develops a resource-based view of the individual—that is, about you, the student. The upshot? You want to make yourself into an “untouchable,” someone who adds valuable, rare, and hard-to-imitate capabilities indispensable to an organization. In other words, you want to make sure your job cannot be outsourced.

## What’s New in the Fourth Edition?

In addition to the completely updated content, the fourth edition has (1) created a new video package, (2) dedicated more space to emerging economies, (3) enhanced the quantity and variety of cases, and (4) drawn directly on the author’s consulting experience.

First, a new video package has been created that is tightly coupled with the content of the Opening and Closing Cases for *every* chapter. Instructors can ask students to watch such videos before class and answer questions online, or to watch videos as a way to open or close class sessions. In short, students can “watch TV” and gain knowledge.

Second, this edition builds on *Global Business*’ previous strengths by more prominently highlighting emerging economies. At least one Emerging Markets feature is launched in every chapter. Many of the Integrative Cases deal with emerging economies, such as Brazil, China, Cuba, Mexico, Russia, Slovakia, Thailand, and Turkey. Numerous in-chapter features (Opening/Closing Cases, In Focus, and Emerging Markets) deal with emerging economies other than those mentioned previously, such as the Czech Republic, Greenland, Guinea, India, Kenya, Liberia, Nigeria, Poland, Senegal, Sierra Leone, South Africa, Taiwan, Tanzania, and the United Arab Emirates.

Third, in response to students’ and instructors’ enthusiasm about the wide-ranging and globally relevant cases in previous editions, the fourth edition has further enhanced the quantity and variety of cases. The variety has also been enhanced not only in terms of the geographic diversity noted above, but also in terms of the mix of longer cases and shorter cases. In addition, I have pushed myself to more actively participate in case writing. Finally, users of the online MindTap version of the product will have access to Media Cases that pair the Opening and Closing chapter cases with news articles from sources such as the *New York Times*, *The Economist*,

and other leading publications, as well as videos from sources such as the BBC and CBS and access to additional information from *Business Insights*. More information on the MindTap product is discussed later in this Preface.

Finally, I have directly drawn on my recent consulting experience to inject new insights. Chapter 1 Closing Case (“Two Scenarios of the Global Economy in 2050”) is adapted from a major consulting engagement I completed for the UK Government Office for Science as part of its two-year Future of Manufacturing project. Integrative Case 2.2 (“Twelve Recommendations to Enhance UK Export Competitiveness”) is a direct excerpt from the final report submitted (coauthored with Klaus Meyer). Table 3.4 (“Texas Instruments Guidelines on Gifts in China,” which is in the public domain) is shared with me by a consulting client at TI. Overall, I am confident that students can directly benefit from such new insights gained from my consulting engagements with multinationals and governments.

## MindTap

Online resources are transforming many aspects of everyday life and learning is not immune to the impact of technology. Rather than simply take the book pages of *Global Business* and place them on a screen to be accessed via a PC, tablet, or smartphone, we have reset the content and have adapted it to fully utilize the potential that the medium allows. Students can highlight passages, take notes in the MindTap content, and compile their notes for review in the EverNotes app. We have embedded assessments for each chapter as well as provide Flash Cards for all of the key terms that provide feedback to students and provide guidance so that they can address gaps in the course requirements. Faculty can use the results from the quizzes as well as using the Media Cases for assignments (see above) and utilize the assigned student work outside the classroom to benefit from a “flipped learning” approach that can result in more favorable outcomes and more rewarding experiences for students and faculty. Additional apps such as ConnectYard allow faculty to integrate social media capabilities into their course and are especially useful in online and hybrid course delivery.

As part of the MindTap product, we are not limited to the page length limitation of a physical book. Students certainly don’t enjoy carrying 1,000-page volumes, and are also frustrated when material included in the book is not assigned by the instructor. Since we are not limited by length online, faculty will also have



access to numerous additional cases that they can select and add to their course. We have also included additional homework assessments and unique pre- and postcourse Global Literacy assessments that can be used to demonstrate student awareness of global business knowledge. We want to thank Anne Magi of the University of Illinois at Chicago for her work on the homework and Global Literacy assessments.

Finally, users of MindTap will also have access to *Business Insights: Global* from Gale, which provides a rich online research tool.

## Support Materials

A full set of support materials is available for students and adopting instructors:

- Product Support Website
- Instructor’s Manual
- Test Bank
- PowerPoint Slides
- MindTap (see above)
- Peng DVD

## Acknowledgments

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 Gongming Qian (Chinese University of Hong Kong, China)  
 Surekha Rao (Indiana University Northwest, USA)  
 Pradeep Ray (University of New South Wales, Australia)  
 Daniel Rottig (Florida Gulf Coast University, USA)  
 Henryk Sterniczuk (University of New Brunswick, Canada)  
 David Stiles (University of Canterbury, New Zealand)  
 Anne Smith (University of Tennessee, USA)  
 Clyde Stoltenberg (Wichita State University, USA)  
 Steve Strombeck (Azusa Pacific University, USA)  
 Vas Taras (University of North Carolina at Greensboro, USA)  
 Rajaram Veliyath (Kennesaw State University, USA)  
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 George White (University of Michigan at Flint, USA)  
 Phil Wilton (University of Liverpool, UK)  
 Xiaohua Yang (University of San Francisco, USA)  
 Andrey Yukhanaev (Northumbria University, UK)  
 Wu Zhan (University of Sydney, Australia)  
 Man Zhang (Bowling Green State University, USA)

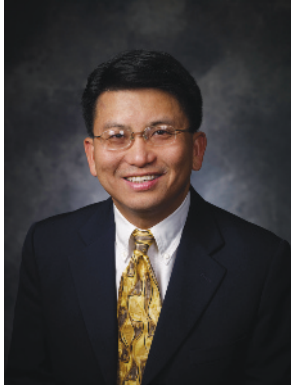
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Last, but by no means least, I thank my wife Agnes, my daughter Grace, and my son James—to whom this book is dedicated. When the first edition was conceived, Grace was three and James one. Now my 13-year-old Grace is already a voracious reader and a prolific writer of young-adult novels, and my 11-year-old James can beat me in chess. Both are competitive swimmers and world travelers, having been to more than 30 countries. As a third-generation professor in my family, I can't help but wonder whether one (or both) of them will become a fourth-generation professor. To all of you, my thanks and my love.



# About the Author



courtesy of Mike Peng

**Mike W. Peng** is the Jindal Chair of Global Business Strategy at the Jindal School of Management, University of Texas at Dallas. He is also a National Science Foundation (NSF) CAREER Award winner and a Fellow of the Academy of International Business (AIB). At UT Dallas, he has been the

number-one contributor to the list of 45 top journals tracked by *Financial Times*, which consistently ranks UT Dallas as a top 20 school in research worldwide.

Professor Peng holds a bachelor's degree from Winona State University, Minnesota, and a PhD degree from the University of Washington, Seattle. He had previously served on the faculty at the Ohio State University, University of Hawaii, and Chinese University of Hong Kong. He has taught in five states in the United States (Hawaii, Ohio, Tennessee, Texas, and Washington), as well as in China, Hong Kong, and Vietnam. He has also held visiting or courtesy appointments in Australia, Britain, China, Denmark, Hong Kong, and the United States, and lectured around the world.

Professor Peng is one of the most-prolific and most-influential scholars in international business (IB). Both the United Nations and the World Bank have cited his work. During the decade 1996–2006, he was the top seven contributor to IB's number-one premier outlet: *Journal of International Business Studies*. In 2015, he received the *Journal of International Business Studies* Decade Award. A *Journal of Management* article found him to be among the top 65 most widely cited management scholars, and an *Academy of Management Perspectives* study reported that he is the fourth most-influential management scholar among professors who obtained their PhD since 1991. Overall, Professor Peng has published more than 120 articles in leading journals, more

than 30 pieces in nonrefereed outlets, and five books. Since the launch of *Global Business*' third edition, he has not only published in top IB journals, such as the *Academy of Management Journal*, *Journal of International Business Studies*, *Journal of World Business*, and *Strategic Management Journal*, but also in leading outlets in entrepreneurship (*Entrepreneurship Theory and Practice*), ethics (*Journal of Business Ethics*), and human resources (*International Journal of Human Resource Management*).

Used in more than 30 countries, Professor Peng's best-selling textbooks, *Global Business*, *Global Strategy*, and *GLOBAL*, are global market leaders that have been translated into Chinese, Portuguese, and Spanish. A European adaptation (with Klaus Meyer) and an Indian adaptation (with Deepak Srivastava) have been successfully launched.

Truly global in scope, Professor Peng's research has investigated firm strategies in Africa, Asia Pacific, Central and Eastern Europe, and North America. He is best known for his development of the institution-based view of strategy and his insights about the rise of emerging economies such as China in global business. With more than 18,000 Google citations and an H-index of 57, he is listed among *The World's Most Influential Scientific Minds* (compiled by Thomson Reuters based on citations covering 21 fields)—in the field of economics and business, he is one of the only 95 world-class scholars listed and the *only* IB textbook author listed.

Professor Peng is active in leadership positions. He has served on the editorial boards of the *AMJ*, *AMP*, *AMR*, *JIBS*, *JMS*, *JWB*, and *SMJ*; and guest-edited a special issue for the *JMS*. At AIB, he co-chaired the AIB/*JIBS* Frontiers Conference in San Diego (2006), guest-edited a *JIBS* special issue (2010), chaired the Emerging and Transition Economies track for the Nagoya conference (2011), and chaired the Richard Farmer Best Dissertation Award Committee for the Washington conference (2012). At the Strategic Management Society (SMS), he was elected to be the Global Strategy Interest Group Chair (2008). He also co-chaired the SMS Special



Conferences in Shanghai (2007) and in Sydney (2014). He served one term as Editor-in-Chief of the *Asia Pacific Journal of Management*. He managed the successful bid to enter the Social Sciences Citation Index (SSCI), which reported *APJM*'s first citation impact to be 3.4 and rated it as the top 18 among 140 management journals (by citation impact factor) for 2010. In recognition of his significant contributions, *APJM* has named its best paper award the Mike Peng Best Paper Award. Currently, he is a Senior Editor at the *Journal of World Business*.

Professor Peng is also an active consultant, trainer, and keynote speaker. He has provided on-the-job training to more than 400 professors. He has consulted and been a keynote speaker for multinational enterprises (such as AstraZeneca, Berlitz, Nationwide, SAFRAN, and Texas Instruments), nonprofit organizations (such as World Affairs Council of Dallas-Fort Worth), educational and funding organizations (such as Canada Research Chair, Harvard Kennedy School

of Government, National Science Foundation of the United States, and Natural Science Foundation of China), and national and international organizations (such as the UK Government Office for Science, US-China Business Council, US Navy, and World Bank).

Professor Peng has received numerous honors, including an NSF CAREER Grant (\$423,000), a US Small Business Administration Best Paper Award, a *JIBS* Decade Award, a (lifetime) Distinguished Scholar Award from the Southwestern Academy of Management, a (lifetime) Scholarly Contribution Award from the International Association for Chinese Management Research (IACMR), and a Best Paper Award named after him. He has been quoted by *The Economist*, *Newsweek*, *Dallas Morning News*, *Smart Business Dallas*, *Atlanta Journal-Constitution*, *The Exporter Magazine*, *The World Journal*, *Business Times* (Singapore), *CEO-CIO* (Beijing), *Sing Tao Daily* (Vancouver), and *Brasil Econômico* (São Paulo), as well as on the Voice of America.



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PART  
**1**

# Laying Foundations



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## Chapters

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



# CHAPTER 1

## IN THE NEWS

Lulu Group Invests in The East India Company

The East India Company Launches in the UAE

Limited Edition Sachin Tendulkar Coins Launched by The East India Company

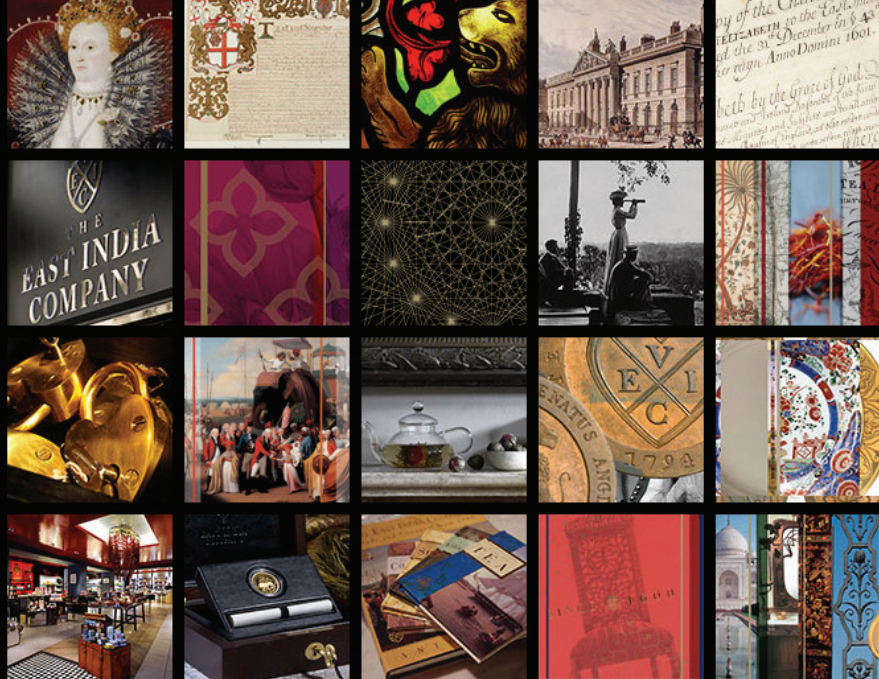
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## Learning Objectives

After studying this chapter, you should be able to

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

# Globalizing Business

## OPENING CASE

### EMERGING MARKETS: The Rebirth of the East India Company

Before picking up this book, the majority of readers are likely to have already heard of the East India Company. Yes, we are talking about *the* East India Company, the colonial trading company that created British India, founded Hong Kong and Singapore, and introduced tea, coffee, and chocolate to Britain and large parts of the world. Wait a minute—as you scratch your head over your rusty memory from history books—wasn't the company dead? Yes, it was dead—or, technically, dissolved or nationalized in 1874 by the British government. But, no, it was not dead.

After a hiatus of more than 130 years, the East India Company was reborn and relaunched in 2005 by a visionary and entrepreneurial Indian businessman, Sanjiv Mehta. With permissions granted by the UK Treasury for an undisclosed sum of money, Mumbai-born Mehta became the sole owner, chairman, and CEO of the *new* East India Company, with the rights to use the name and original trademarks. His goals were to unlock and strengthen the potential value of the world's first multinational and the world's first global brand. In 2010, with much fanfare, the East India Company launched its first luxury fine foods store in the prestigious Mayfair district of London. In 2014, the East India Company set up a new boutique inside London's most prestigious department store, Harrods—a format called “store in store.” The initial products included

premium coffees and teas, artisan sweet and savory biscuits, an exquisite range of chocolates, and gourmet salts and sugars. While the old company obviously never had a website, the new one proudly announced on its website:

We see our role as bringing together the best the world has to offer; to create unique goods that help people to explore and experience what's out there. Products that help people see their world in a different and better light. Products that have the power to amaze and astonish . . . The East India Company made a wide range of elusive, exclusive, and exotic ingredients familiar, affordable, and available to the world; ingredients which today form part of our daily and national cuisines. Today we continue to develop and market unique and innovative products that breathe life into the history of the Company. We trade foods crafted by artisans and specialists from around the world, with carefully sourced ingredients, unique recipes, and distinguished provenances.

Just like the old East India Company, the new company is a “born global” enterprise, which immediately declared its intention to expand globally upon its launch. By 2014, it had expanded throughout Europe (Austria, Finland, France, Germany, the Netherlands, Norway, and Spain), Asia Pacific (Australia, China,

Hong Kong, Japan, Malaysia, and South Korea), and the Middle East (Kuwait and Qatar). Its online store can deliver anywhere worldwide. Overall, in the first five years since 2005, the East India Company spent US\$15 million to develop its new business. In 2011, the Mahindra Group, one of India's most respected business houses, acquired a minority stake in the East India Company. After receiving capital injection from Mahindra, the East India Company announced that it would invest US\$100 million in the next five years to grow the iconic brand.

What had made the (old) East India Company such a household name? Obviously, the products it traded had to deliver value to be appreciated by customers around the world. At its peak, the company employed a third of the British labor force, controlled half of the world's trade, issued its own coins, managed an army of 200,000, and ruled 90 million Indians. Its organizational capabilities were awesome. Equally important were its political abilities to leverage and control the rules of the game around the world, ranging from managing politicians back home in the UK to manipulating political intrigues in

India. Granted a royal charter by Queen Elizabeth I in 1600, the old East India Company certainly benefitted from formal backing of the state. Informally, the brand still resonates with the 2.5 billion people in the British Commonwealth, especially Indians. Mehta was tremendously moved by the more than 14,000 e-mails from Indians all over the world wishing him well when he announced the acquisition. In his own words: "I have not created the brand, history has created it. I am just the curator of it."

Blending continuity and change, the saga of the East India Company continues. Mehta said he believed the East India Company was the Google of its time. But one reporter suggested, "Google is in fact the East India Company of its modern era. Let's see if Google is still around and having the same impact in 400 years' time."

Sources: Based on (1) *Arabian Business*, 2014, The empire strikes back, October 4, [www.arabianbusiness.com](http://www.arabianbusiness.com); (2) East India Company, 2014, EIC today, [www.theeastindiacompany.com](http://www.theeastindiacompany.com); (3) East India Company, 2014, History, [www.theeastindiacompany.com](http://www.theeastindiacompany.com); (4) East India Company, 2014, Press, [www.theeastindiacompany.com](http://www.theeastindiacompany.com); (5) East India Company, 2014, History of fine foods, [www.eicfinefoods.com](http://www.eicfinefoods.com); (6) *Economist*, 2011, The Company that ruled the waves, December 17; (7) *Economist*, 2014, Hidden gems, April 12.

How do firms such as the old and the new East India Company compete around the world? How do they deal with the various rules of the game? What capabilities do they have? How do they enter new markets? What determines their success and failure? This book will address these and other important questions.

### Learning Objective

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

### International business (IB)

(1) A business (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.

### Foreign direct investment (FDI)

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

## 1-1 What Is Global Business?

### 1-1a Defining International Business and Global Business

Traditionally, **international business (IB)** is defined as a business (firm) that engages in international (cross-border) economic activities. It can also refer to the action of doing business abroad. The previous generation of IB textbooks almost always takes the foreign entrant's perspective. Consequently, such books deal with issues such as how to enter foreign markets and how to select alliance partners. The most frequently discussed foreign entrant is the **multinational enterprise (MNE)**, defined as a firm that engages in **foreign direct investment (FDI)** by directly investing in, controlling, and managing value-added activities in other countries.<sup>1</sup> Of course, MNEs and their cross-border activities are important. But they only cover one aspect of IB—the foreign side. Students educated by these books often come away with the impression that the other aspect of IB—namely, domestic firms—does not exist. Obviously, this is not true. Domestic firms do not just sit around in the face of foreign entrants. They often actively compete and/or collaborate with foreign entrants in their markets.

Sometimes, strong domestic firms have also gone overseas themselves. Overall, focusing on the foreign entrant side captures only one side of the coin at best.<sup>2</sup>

There are *two* key words in IB: international (I) and business (B).<sup>3</sup> However, many previous textbooks focus on the international aspect (the foreign entrant) to such an extent that the business part (which also includes domestic business) almost disappears. This is unfortunate, because IB is fundamentally about B (business) 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 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 can provide you with an overall business perspective (rather than a functional view) grounded in a global environment. Therefore, 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 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—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 Cengage Learning (under British and Canadian ownership), Pearson Prentice Hall (under British ownership), and McGraw-Hill (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 more than 30 countries. Despite such worldwide spread of competition, in each market—down to each school—textbook publishers have to compete locally. Since no professor teaches globally and all students study locally, this means *Global Business* has to win adoption 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 of them focus on competition in developed economies. Here, by contrast, we devote extensive space to competitive battles waged throughout **emerging economies**, a term that

### Global business

Business around the globe.

### Emerging economy

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



**Emerging market**

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

**Purchasing power parity (PPP)**

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

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 command 48% of world trade, attract 60% of FDI inflows, and generate 40% FDI outflows. Overall, emerging economies contribute approximately 50% of the global gross domestic product (GDP).<sup>4</sup> In 1990, they accounted for less than one-third of a much smaller world GDP. 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 without adjusting for PPP, emerging economies contribute about 30% of the global GDP. Why is there such a huge difference

**IN FOCUS 1.1****SETTING THE TERMS STRAIGHT**

GDP, GNP, GNI, PPP—there is a bewildering variety of acronyms that are used to measure economic development. It is useful to set these terms straight before proceeding. **Gross domestic product (GDP)** is measured as the sum of value added by *resident* firms, households, and governments operating in an economy. For example, the value added by foreign-owned firms operating in Mexico would be counted as part of Mexico’s GDP. However, the earnings of *non-resident* sources that are sent back to Mexico (such as earnings of Mexicans who do not live and work in Mexico, and dividends received by Mexicans who own non-Mexican stocks) are not included in Mexico’s GDP. One measure that captures this is **gross national product (GNP)**. 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 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 US\$81,276 based on official (nominal) exchange rates—a *lot higher* than the official US per capita GDP of US\$53,001. However, everything is more expensive in Switzerland. A Big Mac costs US\$6.83 in Switzerland versus US\$4.80 in the United States. Thus, Switzerland’s per capita GDP based on PPP shrinks to US\$53,977—only slightly higher than the US per capita GDP based on PPP of US\$53,001 (the IMF uses the United States as a benchmark in PPP calculation, which does not change from the nominal number).

One of the most recent and probably most important debates concerns the size of the Chinese GDP. Calculations based on the nominal exchange rates would find China’s GDP to be 47% of the US GDP. But new calculations based on PPP released by the World Bank in 2014 reported China’s GDP to be 87% as large as the US GDP. Given that the Chinese economy grows a lot more quickly than the US economy, some experts believe that China may become the world’s largest economy by the time you read this book—as opposed to in the next decade or so (see the Closing Case). 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) *Bloomberg Businessweek*, 2014, Recognizing China’s clout, May 12: 14; (2) *Economist*, 2014, Calculating European GDP, August 23: 68–69; (3) *Economist*, 2014, The dragon takes wing, May 3: 65; (4) *Economist*, 2014, The Big Mac index, July 26: 61; (5) International Monetary Fund, 2014, *Report for Selected Countries and Subjects (PPP Valuation of Country GDP)*, October, Washington, DC.



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, US\$1 spent in Mexico can buy a lot more than US\$1 spent in the United States.

Of many emerging economies, Brazil, Russia, India, and China—commonly referred to as **BRIC**—command more attention. With the addition of South Africa, BRIC becomes **BRICS**. As a group, BRICS countries have 40% of the world’s population, cover a quarter of the world’s land area, and contribute more than 25% of global GDP (on a PPP basis). In addition to BRICS, other interesting terms include BRICM (BRIC + Mexico), BRICET (BRIC + Eastern Europe and Turkey), and Next Eleven (N-11—consisting of Bangladesh, Egypt, Indonesia, Iran, Korea, Mexico, Nigeria, Pakistan, the Philippines, Turkey, and Vietnam).

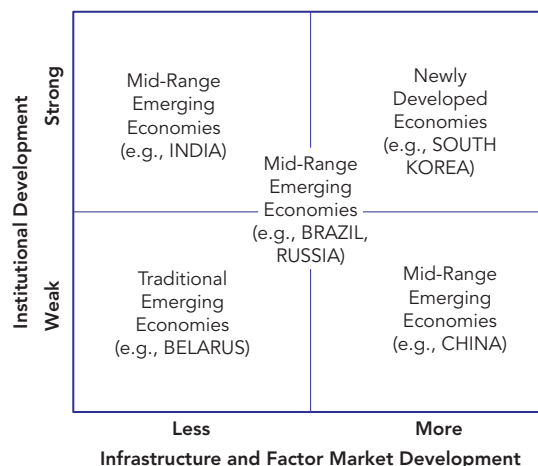
Does it make sense to group together as “emerging economies” so many countries with tremendous diversity in terms of history, geography, politics, and economics? As compared to developed economies, the label of “emerging economies,” rightly or wrongly, has emphasized the presumably homogenous nature of so many different countries. While this single label has been useful, more recent research has endeavored to enrich it. Specifically, the two dimensions illustrated in Figure 1.1 can help us differentiate various emerging economies.<sup>5</sup> Vertically, the development of market-supporting political, legal, and economic institutions has been noted as a crucial dimension of institutional transitions. Horizontally, the development of infrastructure and factor markets is also crucial.

Traditional (or stereotypical) 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 still have made relatively little progress along these two dimensions (such as Belarus and Zimbabwe).

However, much has changed. A great deal of institutional development and infrastructure and factor market development has taken place. Such wide-ranging development has resulted in the emergence of a class of *mid-range* emerging economies



**Figure 1.1** 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 (p. 1297), *Journal of Management Studies*, 50: 1295–1321.

#### Gross domestic product (GDP)

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

#### 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.

#### BRIC

Brazil, Russia, India, and China.

#### BRICS

Brazil, Russia, India, China, and South Africa.

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. 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 1.1, Brazil and Russia are examples, with democratic political institutions 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 is such an exemplar country.

Overall, the **Great Transformation** of the global economy is embodied by the tremendous shift in economic weight and engines of growth toward emerging economies in general and BRIC(S) in particular.<sup>6</sup> Led by BRIC(S), emerging economies accomplished “the biggest economic transformation in modern economy,” according to the *Economist*.<sup>7</sup> In China, per capita income doubled in about ten years, an achievement that took Britain 150 years and the United States 50 years as they industrialized.<sup>8</sup> Throughout emerging economies, China is not alone. While groupings such as BRIC(S) and N-11 are always arbitrary, they serve a useful purpose—namely, highlighting the economic and demographic scale and trajectory that enable them to challenge developed economies in terms of weight and influence in the global economy.

Of course, the Great Transformation is not a linear story of endless and uniform high-speed growth. All BRIC(S) countries and most emerging economies have experienced some significant slowdown recently.<sup>9</sup> It is possible that they may not be able to repeat their extraordinary growth sprints of the decade between 1998 (the Asian economic crisis) and 2008 (the global financial crisis). For example, in 2007, Brazil accomplished an annual economic growth of 6%, Russia 8%, India 10%, and China 14%. In 2017, they would be lucky to achieve half of these enviable growth rates. However, it seems that emerging economies *as a group* are destined to grow both their absolute GDP and their percentage of world GDP relative to developed economies. The debate centers on how much and how quickly (or slowly) such growth will be in the future (see the Closing Case).

### Great Transformation

Transformation of the global economy that is embodied by the tremendous shift in economic weight and engines of growth toward emerging economies in general and BRIC(S) in particular.

### Triad

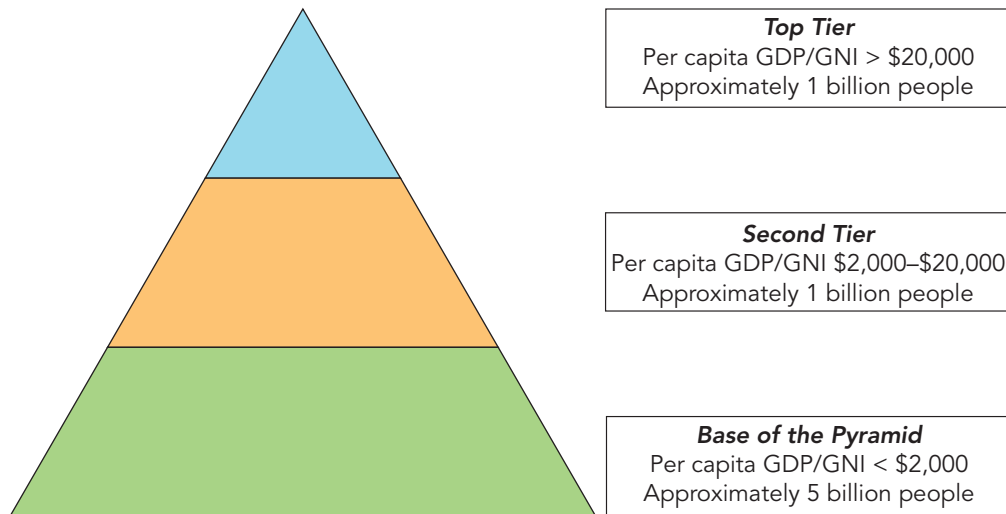
North America, Western Europe, and Japan.

### Base of the pyramid (BoP)

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

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

The global economy can be viewed as a pyramid (Figure 1.2). The top consists of about one billion people with per capita annual income of US\$20,000 or higher. These are mostly people who live in the developed economies in the **Triad**, which consists of North America, Western Europe, and Japan. Another one billion people earning US\$2,000 to US\$20,000 per year make up the second tier. The vast majority of humanity—about five billion people—earn less than US\$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 BoP markets.<sup>10</sup> An increasing number of such low-income countries have shown a great deal of economic opportunities as income levels have risen. More Western MNEs, such as General Electric (GE), are investing aggressively in the BoP and leveraging their investment to tackle markets in both emerging and developed economies.

**Figure 1.2** 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*, Philadelphia: Wharton School Publishing, 111.

One interesting recent development out of emerging economies is **reverse innovation**—an innovation that is adopted first in emerging economies and then diffused around the world.<sup>11</sup> Traditionally, innovations are generated by Triad-based multinationals, with the needs and wants of rich customers at the top of the pyramid in mind. When such multinationals entered lower-income economies, they tended to simplify the product features and lower 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 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.<sup>12</sup> (Mahindra & Mahindra is now so committed to the United States that it sponsors bull-riding tournaments in Texas.) 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 was competitive with Mahindra & Mahindra not only in India, but also in the United States and elsewhere. In both cases, the origin of new innovations is from the BoP. The flow of innovation is bottom-up—in other words, reverse innovation.

### Reverse innovation

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



India Pictures RM/Dinodia Photos/Alamy Limited

Does this Mahindra & Mahindra tractor developed from a BoP market have potential elsewhere?

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. For example, a Chinese start-up, Xiaomi, has recently dethroned Samsung and Apple in the smartphone market in both China and India, selling its smartphones for only US\$100 (see Emerging Markets 1.1). Relative to a feature-rich US\$600 Apple iPhone or a US\$500 Samsung Galaxy, a Xiaomi phone is merely good enough. It is 3G-capable and has a solid processor, a passable camera, and barely decent but expandable memory (8 GB), which can be expanded to 64 GB with cheap SD cards. But its performance is certainly more than 20% of an Apple or a Samsung. Thus, to customers in the BoP and beyond, Xiaomi’s reverse innovation delivers tremendous value relative to its price. 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.<sup>13</sup>

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

### Learning Objective

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

## 1-2 Why 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? Table 1.1 outlines three compelling reasons.

First, you don’t want to be a loser. 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 1.2. 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?

**Table 1.1** 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 1.2** Opening Day Quiz**1. Which country made the shirt you are wearing?**

- (A) China (D) Romania  
 (B) Malaysia (E) US  
 (C) Mexico

**2. Which country made your mobile device?**

- (A) China (D) Taiwan  
 (B) Germany (E) US  
 (C) Singapore

**3. How many member countries does the G-20 have?**

- (A) 20 (D) 19  
 (B) 21 (E) 18  
 (C) 22

**4. Which city has the largest number of *Fortune* Global 500 company headquarters? (operational headquarters where top executives go to work, not place of registration)**

- (A) Beijing (D) New York  
 (B) Hong Kong (E) Tokyo  
 (C) London

**5. 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 (D) 20–30  
 (B) 5–10 (E) 30–50  
 (C) 10–20

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 the machine.” Then some students 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. It is likely the tiny components inside your mobile device have crossed borders a dozen or more times. 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 out? What is special about the EU? Why are other regional blocs not included in the G-20? A focus on the rules of the game—more technically, institutions—is another key theme of the book.

Question 4 is interesting. Most of my own students pick New York, which has the *third*-largest number of headquarters of *Fortune* Global 500 companies (measured by sales). Beijing now has 52 *Fortune* Global 500 headquarters, followed by 41 in Tokyo, which until recently dethroned by Beijing had had the largest cluster of *Fortune*

**Group of 20 (G-20)**

The group of 19 major countries plus the EU whose leaders meet on a biannual basis to solve global economic problems.





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Do you know Beijing now has the world's largest number of *Fortune* Global 500 headquarters?

Global 500 headquarters. In comparison, New York has 20 such headquarters (17 in New York City and three outside the city).<sup>14</sup> The rise of Beijing is indicative of the changing global economic winds, which have propelled China to become the world's second-largest economy in the years between the second and third editions of this book. To gain a better understanding of global economy, you need to pay more attention to companies based in Beijing (and in China and other emerging economies).

Question 5 will really frighten you. Some students typically clarify: "Do you mean the few security guards looking after the closed plant?" "Not necessarily," I point out. "The question is: How many jobs will be kept by the *company*?" Students 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 that happen.

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 5. 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 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 ("expat")**—a manager who works abroad—to gain such an experience (see Chapter 15 for details).

Thanks to globalization, low-level jobs not only command lower salaries, but are also more vulnerable.<sup>15</sup> 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 US\$250,000 to US\$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 them to be 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 globetrotting managers. But even if you

#### **Expatriate manager (expat)**

A manager who works abroad.

#### **International premium**

A significant pay raise when working overseas.