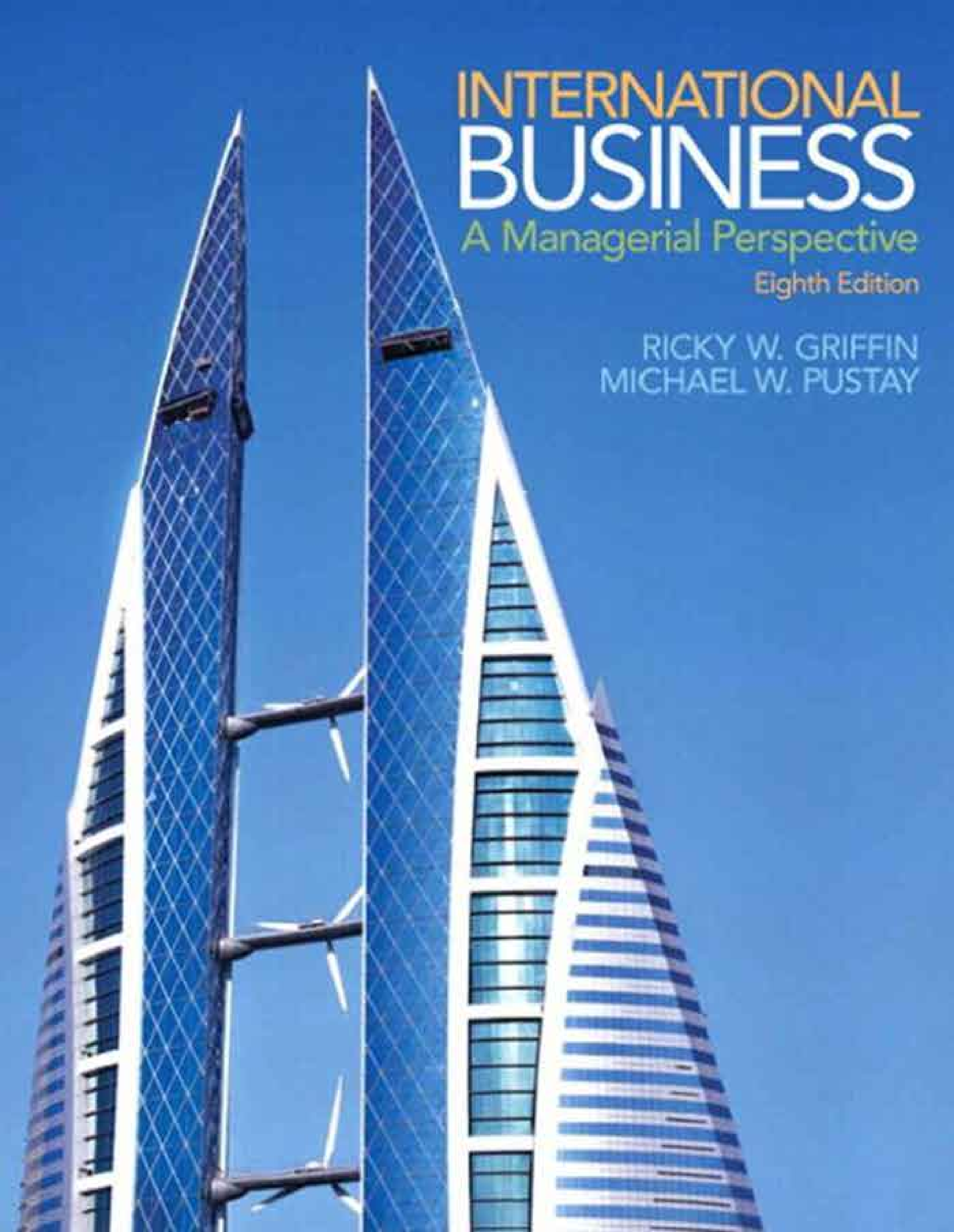
INTERNATIONAL BUSINESS

A Managerial Perspective

Eighth Edition

RICKY W. GRIFFIN
MICHAEL W. PUSTAY



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Texas A&M University

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PEARSON

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To the memory of my father, James P. Griffin, who provided encouragement and guidance in ways he never imagined.

R. W. G.

To the newest member of our family,
Quinlan Claire Murphy Pustay.

M. W. P.

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Maps

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Preface

We've taught International Business courses for 25 years and enjoyed every moment of the experience. From the instructor's perspective, the joy and excitement of the course lies in its importance and dynamism. Its importance cannot be denied. The jobs, careers, and livelihoods of virtually every human being on the planet are affected by international commerce. For some, that commerce represents an opportunity; for others, a threat. Almost a third of the world's economic activity is attributable to international trade, and foreign direct investment has surpassed $20 trillion. Nor can its dynamism be denied. Think of the changes that have occurred in the two years between the publication of the seventh edition and the eighth edition of this text: civil war in Syria, an incipient global currency war, a complete upheaval in world energy markets as a result of hydraulic fracturing, shifts in factory location decisions favoring Mexico over China, a new member joining the European Union, China's aggressive search for natural resource security, Nokia's shifting from mobile market leader to dead-in-the-water (at least in Wall Street's view), to name but a few examples.

From the student's perspective, however, this dynamism—and the sheer breadth of the subject matter—can be intimidating. We discuss every region of the world and draw on every business discipline—accounting, marketing, management, finance, supply chain management, MIS—and numerous liberal arts disciplines—economics, geography, anthropology, sociology, history, international relations, political science, and the law. It's not surprising that students can feel overwhelmed by the magnitude of the course. We have striven to reduce students' fears of not being able to master this extensive material by providing clear, concise discussions of the principle concepts and challenges of international business and by offering numerous examples of these issues in action.

Our vision in writing this book is to prepare students to be effective participants in the worldwide marketplace. That was the vision we laid out in the preface of the first edition of this book, and it remains so in the eighth. We noted that many of the existing textbooks are written in needlessly technical terms and seem to be concerned only with students who are specializing in international business. However, all students—even those who will never have an overseas assignment—need to be knowledgeable about the global economy.

That is why we feel so strongly about our vision for this book. We want students to attain "cultural literacy" in international business. We want them, for example, to be able to speak comfortably with a visiting foreign exchange student or to ask insightful questions of a visiting executive from a foreign-headquartered multinational corporation. For many students, this textbook and the course that it accompanies is just the first step in a long journey to being an effective businessperson and an informed citizen in a globalizing world. We hope in writing this textbook that that first step will be made a bit easier, a bit more informed, and a bit more exciting.

Like the previous seven editions, we have maintained our managerial approach to international business with an emphasis on skills development, emerging markets, and geographical literacy.

New To The Eighth Edition

The eighth edition features new cases, boxes, and analyses reflecting the latest challenges and opportunities confronting international businesses. More specifically, the following content is new or revised to reflect the latest global trends:

- The pressures on multinational organizations to consider the impact of their actions on the natural environment and on the general welfare of society continue to increase. We have introduced a new context box, "**People, Planet, and Profits,**" to address the challenges that international businesses face in promoting their triple bottom lines.

- The international business course at most colleges and universities encompasses both the external environment and the internal environment of international businesses. We have introduced several new boxes and cases and updated others that focus on changes in the external environment that create opportunities and challenges for firms competing in the international market place. These new cases and boxes include discussions of territorial disputes in the South China Sea, upheavals in the world energy market as a result of fracking, the opening up of the fabled Northwest Passage, expansion of the Panama Canal, and the impact of rising wages in China.
- New and updated profiles of the challenges and opportunities provided international firms as they confront and master the complexities of the international marketplace, including new cases and boxes featuring Apple, Huawei, Anglo American PLC, Foxconn, and McDonalds, and updated treatments of LVMH, Lenovo, Tata, Nokia, Disney, Telefónica, Unilever, and Danone, among others.
- New and updated analyses of the impact of globalization on competition within industries, including the global wine industry, the global flower industry, the international cinema market, Germany's Mittelstand, and the international airline industry.
- New and updated cases exploring how firms address cultural, legal, and technological differences among countries. Students gain deeper and more nuanced understandings of the politics, culture, and social problems of individual countries through in-depth examination of issues such as Russia and the rule of law, the European Union's implementation of the Treaty of Lisbon, Brazil and poverty reduction, Japan and its cultural and demographic challenges, the hidden role of the Communist Party in Chinese businesses, U.S. retailers and Chinese consumers, Islamic finance, the GLOBE leadership project, and the growth of unionization activity in China.
- New and updated examples and cases assessing the ethical and social responsibilities of international businesses and international businesspeople, including Foxconn, disposal of e-waste, BP and the Gulf oil spill, green energy and free trade, DuPont's quest for zero waste, Maersk and pollution in Hong Kong harbor, the Chad pipeline, the Siemens bribery scandal, and Grameen Bank.
- New and updated examples of international trade and investment conflicts and the challenges they present international business practitioners, including Huawei's struggles to enter the U.S. market, the global currency war, rare earths, tax shelters, jumbo jet subsidies, sovereign wealth funds, and trade in counterfeit goods.
- The eighth edition also provides up-to-date coverage of the impact of how recent natural disasters and political upheavals have affected international business. Examples include the earthquake and tsunami that shattered Japan and the resultant impact on global supply chains, Toyota's massive recalls and quality problems, and the political unrest that swept through the Middle East beginning in 2011.
- All data and other statistical information in the book have been thoroughly updated, including international trade statistics, exchange rates, and expatriate costs of living in various global business centers.
- New **assisted-graded questions** that students can complete and submit via MyManagementLab are provided at the end of each chapter.
- New **online, interactive simulations** created just for international business courses engage students and help them understand how international business concepts apply in realistic situations. Topics include: globalization, international ethics, legal differences, offshoring, global marketing, and tariffs, subsidies, and quotas. Simulations are accessible in MyManagementLab.

Pedagogically, we have retained four content boxes that highlight coverage of current issues related to technology, entrepreneurship, and conducting business with a global perspective:

VENTURING ABROAD Exposes students to the opportunities and challenges of conducting business outside their home country.

E-WORLD Provides insights into the impact of e-commerce on how business is conducted internationally.

BRINGING THE WORLD INTO FOCUS Helps students understand the historical, cultural, and political contexts of international business.

EMERGING OPPORTUNITIES Highlights challenges and opportunities in emerging international markets.

With the addition of our new box, PEOPLE, PLANET, AND PROFITS, we offer our readers insights into many of the most important issues confronting international business practitioners today.

We also added a valuable new in-chapter feature called IN PRACTICE. You'll find an IN PRACTICE at the end of each major section of every chapter. This feature consists of two concise major "take-away" points from the preceding section and a thought-provoking question for further consideration.

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- **Test Item File** More than 100 questions per chapter are tagged to the Learning Objectives and to the AACSB Learning Standards to help measure whether students are grasping the course content that aligns with AACSB guidelines.
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Acknowledgments

The cover of this book identifies two authors by name. In reality, every edition represents a true team effort involving literally dozens of skilled professionals. Although any and all errors of fact, omission, and emphasis are solely our responsibility, we would be remiss if we did not acknowledge those who contributed to this and previous editions of this book.

We gratefully acknowledge the contributions of Robert McDonald who wrote the The Instructor's Manual and the Test Bank questions. To Ben Mammoun who prepared the PowerPoint Slides to accompany this book.

Thanks go also to our colleagues at other universities who reviewed the manuscript for this edition and previous ones, contributed suggestions, and helped us make this the best international business textbook for students and teachers:

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About the Authors

Ricky W. Griffin holds the Blocker Chair in Business and is Distinguished Professor of Management in Mays Business School at Texas A&M University. He is serving as head of the Department of Management; he previously served as both Executive Associate Dean and Interim Dean. After receiving his Ph.D. from the University of Houston in 1978, he joined the faculty at the University of Missouri–Columbia before moving to Texas A&M University in 1981.

Professor Griffin teaches international management, organizational behavior, human resource management, and general management. He has taught both undergraduate and graduate students, participated in numerous executive training programs, and has lectured in London, Paris, Warsaw, Geneva, Berlin, Johannesburg, Tokyo, Hong Kong, and Sydney. A member of the Academy of Management, he has served as division chair of that group's Organizational Behavior division.

Professor Griffin has written several successful textbooks, including *Management, Organizational Behavior* (with Greg Moorhead), and *Business Essentials* (with Ron Ebert). He is currently conducting research on workplace violence in Canada, job design differences and similarities among firms in Japan, Europe, and the United States, and equity employment practices in South Africa.

Michael W. Pustay holds the Anderson Clayton Professorship in Business Administration and is Professor of Management at Texas A&M University. He currently serves as associate director of the Center for International Business Studies and as associate director of the Center for International Business Education and Research at Texas A&M. Professor Pustay, who has taught international business for more than two decades, focuses his teaching and research efforts on international business and business–government relations. His work has appeared in professional journals such as the *Journal of Management, Southern Economic Journal, Land Economics*, and *Transportation Journal.* He is currently researching the role of regional trading blocs on the world economy and the impact of domestic economic policies on international competition.

Professor Pustay is a member of numerous professional organizations, including the Academy of International Business, the American Economic Association, the Association for Canadian Studies in the United States, and the Transportation Research Forum. He has served as a consultant for a variety of public and private organizations, including the U.S. Department of Transportation, the Small Business Administration, the Civil Aeronautics Board, and Reliant Energy.

PART 1 The World's Marketplaces

CHAPTER 1

An Overview of International Business

PCN Photography/Alamy

AFTER STUDYING THIS CHAPTER, YOU SHOULD BE ABLE TO:

1. Discuss the meaning of international business.
2. Explain the importance of understanding international business.
3. Identify and describe the basic forms of international business activities.
4. Discuss the causes of globalization.
5. Comprehend the growing role of emerging markets in the global economy.

THE BUSINESS OF THE OLYMPICS

Every two years, the world's attention turns to the Olympic Games. Given that international business and the global economy play such a dominant role in the world today, it is not surprising that the Olympics have come to reflect international business at its most intense. The games are governed by the International Olympic Committee (IOC), which is based in Switzerland. The IOC decides where the games will be held and which sports will be represented, and it oversees the selection of judges and referees. Each country that wants to send athletes to compete in the games establishes a national committee to organize its Olympic effort. These committees are supervised by and report to the IOC.

Potential host cities must give elaborate presentations to the IOC and make substantial commitments in terms of facilities, a volunteer workforce, and related organizational support. For example, as part of their winning bids, Japan promised to build a new high-speed rail line between Tokyo and Nagano, the site of the 1998 winter games, while Greece's proposal featured a new ring road, subway system, and airport in Athens for the 2004 Summer Olympics. China invested more than $38 billion on a variety of projects, including 37 new or refurbished sports facilities, transportation improvements, and communications upgrades, for the 2008 Beijing games. The British government spent £9.3 billion to build Olympic facilities and improve the transportation network serving the 2012 games, while the Russian government has budgeted $50 billion for the 2014 Winter Olympics in Sochi.

The infighting among countries to be selected as the games' host is vicious. French President Jacques Chirac's pique over London's selection instead of Paris as the host for the 2012 Summer Olympics intensified the squabbles between France and the United Kingdom over European Union (EU) policies dealing with agriculture, taxation, and foreign affairs. China threatened a trade war with the United States after the U.S. Senate passed a resolution that hurt Beijing's chances to host the summer games in 2000, a prize eventually seized by Sydney, Australia. (Beijing was later awarded the 2008 games.) After Salt Lake City lost its bid for the 1998 games, the city's local organizing committee launched a massive campaign to procure the 2002 games. Unfortunately, its efforts included widespread gift-giving and the lavish entertaining of IOC delegates, which crossed ethical boundaries. As these facts became public, they triggered a worldwide cry for reform of the IOC.

Why would a city want to host the Olympic Games? Most compete for the privilege because the games would thrust them into the international spotlight and promote economic growth. Further, the tourism benefits are long lived; for example, skiers, skaters, and snowboarders continue to enjoy the facilities at previous Olympic sites such as Turin, Nagano, Lillehammer, Calgary, Albertville, and Lake Placid, pouring money into the local economies long after the Olympic torch has been extinguished. The games also are frequently a catalyst for improving a city's infrastructure. For instance, the high-speed rail line between Tokyo and Nagano halves the travel time between the two cities—a benefit that continues for local residents and for future visitors, as does Athens's new ring road, airport, and subway system. London's Olympic Village was converted to 2,800 apartments after the completion of the 2012 games, providing much-needed housing in one of the world's most expensive real estate markets.

Because of the high cost of running the Olympics, both the IOC and national Olympic committees are always alert for ways to generate revenue. Television coverage provides one significant source of revenue. NBC paid $1.27 billion for the U.S. broadcast rights for the 2000 Sydney summer games and the 2002 Salt Lake City winter games. It then shelled out an additional $2.3 billion to lock up the U.S. broadcast rights for the 2004, 2006, and 2008 games and paid $2.2 billion for the 2010 and 2012 games—even though their sites had not yet been determined. The broadcaster followed a similar strategy in 2011, successfully offering $4.38 billion for rights to broadcast the 2014, 2016, 2018, and 2020 games in the United States. Broadcast rights for Europe, Australia, Asia, and the rest of the Americas sold for smaller but still breathtaking amounts to local broadcasters. NBC and these broadcasters, in turn, sold advertising time to companies eager to market their goods to Olympic fans throughout the world.

Not surprisingly, capturing viewers in emerging markets is an important part of the IOC's growth strategy. CCTV, the state-owned TV network, paid $100 million for local broadcasting rights for the 2008 Beijing Olympics. Bidding for TV spots on Chinese television was intense. Yili, a Chinese milk producer, paid CCTV $2.7 million for four 15-second advertisements for the Chinese market; in comparison, NBC charged $800,000 for 30-second commercials in the U.S. market.

Another important source of revenue for the IOC and for national committees is corporate sponsors, who wish to capture the prestige and visibility of being associated with the games. The highest-profile level—and, at $60 to $80 million, the most expensive—is that of "worldwide partner," a designation valuable to firms that market their products to consumers throughout the world, such as Coca-Cola, McDonalds, Acer, Panasonic, and Samsung. The primary benefit of worldwide partnership is that the partners get priority advertising space during Olympic broadcasts, if they choose to buy it. The worldwide partnership program generated $957 million during the 2009–2012 Olympic cycle.[1] ■

The millions of dollars spent on the Olympics by television networks and corporate advertisers reflect the internationalization of business—the result of the desire of firms such as Coca-Cola, Panasonic, and Samsung to market their products to consumers worldwide. The forces that have made the Olympics a growing international business are the same forces that affect firms worldwide as they compete in domestic and foreign markets. Changes in communications, transportation, and information technology not only facilitate domestic firms' foreign expansion but also aid foreign companies in their invasion of the domestic market. These trends have accelerated during the past decade as a result of the explosive growth of e-commerce, the reduction in trade and investment barriers sponsored by organizations such as the World Trade Organization and the EU, and the growing importance of emerging markets such as China and India.

The global economy profoundly affects your daily life, from the products you buy to the prices you pay to the interest rates you are charged to the kind of job you hold. By writing this book, we hope to help you become more comfortable and effective in this burgeoning international business environment. To operate comfortably in this environment, you need to learn the basic ideas and concepts—the common body of knowledge—of international business. Further, you must understand how these ideas and concepts affect managers as they make decisions, develop strategies, and direct the efforts of others. You also need to be conversant with the fundamental mechanics and ingredients of the global economy and how they affect people, businesses, and industries. You need to understand the evolution of the global economy and the complex commercial and political relationships among Asia, Europe, North America, and the rest of the world.

To help ensure your future effectiveness in the international business world, we plan to equip you with the knowledge, insights, and skills that are critical to your functioning in a global economy. To that end, we have included hundreds of examples to help demonstrate how international businesses succeed—and how they sometimes fail. You also will read tips and extended examples about global companies in special features called "Bringing the World into Focus," "E-World," "Emerging Opportunities," "People, Planet, and Profits," and "Venturing Abroad," and you will have the chance to practice your growing skills in end-of-chapter exercises titled "Building Global Skills."

What Is International Business?

International business consists of business transactions between parties from more than one country. Examples of international business transactions include buying materials in one country and shipping them to another for processing or assembly, shipping finished products from one country to another for retail sale, building a plant in a foreign country to capitalize on lower labor costs, or borrowing money from a bank in one country to finance operations in another. The parties involved in such transactions may include private individuals, individual companies, groups of companies, or governmental agencies.

How does international business differ from domestic business? Simply put, domestic business involves transactions occurring within the boundaries of a single country, whereas international business transactions cross national boundaries. International business can differ from domestic business for a number of other reasons, including the following:

- The countries involved may use different currencies, forcing at least one party to convert its currency into another.
- The legal systems of the countries may differ, forcing one or more parties to adjust their practices to comply with local law. Occasionally, the mandates of the legal systems may be incompatible, creating major headaches for international managers.
- The cultures of the countries may differ, forcing each party to adjust its behavior to meet the expectations of the other.
- The availability of resources differs by country. One country may be rich in natural resources but poor in skilled labor, whereas another may enjoy a productive, well-trained workforce but lack natural resources. Thus, the way products are produced and the types of products that are produced vary among countries. ("Bringing the World into Focus" provides additional insights into these issues.)

In most cases, the basic skills and knowledge needed to be successful are conceptually similar whether one is conducting business domestically or internationally. For example, the need for marketing managers to analyze the wants and desires of target audiences is the same regardless

BRINGING THE WORLD INTO FOCUS

BORDERS DO MATTER

A decade ago, many self-proclaimed business gurus announced the coming of the boundaryless global economy—one in which national borders were superfluous and irrelevant. It would be hard to find a concept more naïve or oblivious to the realities of doing business internationally. The simple truth is that boundaries and national borders do matter. Nations, defined by those boundaries, have different legal systems and different laws. They have different political systems and social structures. Cultural values differ among the citizens of different nations. Taxes, the price of labor, land, and other resources, and the requirements for establishing a business vary across nations. If we did not have borders, the need for a separate international business course would disappear. We could just study business.

The CAGE model developed by Pankaj Ghemawat, of IESE Business School in Barcelona, is a useful framework for understanding the operating challenges facing international businesses because of these national differences:

- C*ultural distance* (the "C" in CAGE) refers to differences in cultural, linguistic, religious, and social values that can affect the way firms do business within a country. Chapter 4 focuses on important elements of these cultural differences.
- A*dministrative distance* refers to differences in the public administration of countries. It can be affected by past colonial ties, common legal heritages, use of a common currency, political alliances, or attitudes toward the proper balancing between the role of the private sector and the role of the public sector. Chapter 3 focuses on many of these differences.
- G*eographic distance* refers to the physical, communications, and transportation links between countries and how the geographic connectedness of countries affects their economic integration. Chapter 2 focuses on the economic geography of the world marketplace.
- E*conomic distance* refers to the differences in the economic resource bases of countries. Although natural resources are a component of economic distance, human resources, infrastructure, creation of new knowledge, and promotion of technological innovation are in fact much more important causes of economic distance. Chapter 6 analyzes how these economic differences affect the nature and level of countries' participation in the global marketplace.

One of the primary challenges facing international business practitioners is formulating and implementing strategies that recognize and then use these differences to create competitive advantages for their firms. This may be as simple as purchasing labor-intensive inputs from countries where wages are low to reduce the costs of necessary components. It may be as complex as restructuring how the firm is organized or how it does business to benefit from global efficiencies while respecting and responding to local culture, laws, and social norms.

Sources: Based on Pankaj Ghemawat, "Distance Still Matters," *Harvard Business Review*, September 2001; Pankaj Ghemawat, "Managing Differences: The Central Challenge of Global Strategy," *Harvard Business Review*, March 2007.

of whether the managers are engaged in international business or domestic business. However, although the concepts may be the same, there is little doubt that the complexity of skills and knowledge needed for success is far greater for international business than for domestic business. International businesspeople must be knowledgeable about cultural, legal, political, and social differences among countries. They must choose the countries in which to sell their goods and from which to buy inputs. International businesses also must coordinate the activities of their foreign subsidiaries, while dealing with the taxing and regulatory authorities of their home country and all the other countries in which they do business.

In Practice

- When doing business internationally, business persons must be aware of the differences between their home market and the host market.
- The CAGE model provides a useful framework for classifying these differences, or "distances," as Ghemawat calls them.

For further consideration: Which element of "distance" is most important—cultural, administrative, geographic, or economic? Or does "importance" vary according to the issue at hand?

Why Study International Business?

There are many different reasons why today's students need to learn more about international business. First, almost any large organization you work for will have international operations or be affected by the global economy. You need to understand this increasingly important area to better assess career opportunities and to interact effectively with other managers. For example, in your first job assignment, you could be part of a project team that includes members from

Mexico, Uruguay, Canada, and the United States. A basic grasp of international business would help you understand more fully why the team was formed, what the company expects it to accomplish, and how you might most effectively interact with your colleagues. You also need to study international business because you may eventually work for a firm that is owned by a corporation headquartered in another country. For instance, 5.3 million U.S. citizens work for U.S. affiliates of foreign-owned corporations, and foreign subsidiaries of U.S. corporations employ 11.1 million Europeans, Asians, Africans, Australians, Canadians, and Latin Americans.[2]

Small businesses also are becoming more involved in international business. If one day you start your own business, you may find yourself using foreign-made materials or equipment, competing with foreign firms, and perhaps even selling in foreign markets. The growth of e-commerce has also opened up new opportunities for small businesses. Previously, to enter foreign markets, firms often needed to painstakingly build distribution networks and brand recognition country by country, a process that many times favored large firms over small ones. Today, a well-developed website can draw the business of consumers throughout the world without the need to establish a physical presence in each country, making it easier for small businesses to participate in the international marketplace. The Internet may also help small businesses cut their costs, allowing them to better compete against their larger rivals. Consider the Lee Hung Fat Garment Factory, a family-owned Hong Kong manufacturer. It slashed its costs of communicating with its foreign customers by one-third by relying on the Internet rather than faxes and telephone calls. Instead of express mailing product samples to its customers, the company uses a digital camera to transmit photos of garment mock-ups over the Internet. Company managers estimate they save 15 to 20 percent in design costs using this technology.[3]

Another reason for you to study international business is to keep pace with your future competitors. Business students in Europe have traditionally learned multiple languages, traveled widely, and had job experiences in different countries. Many of their programs require them to spend one or more semesters in different countries. Asian students, too, are actively working to learn more about foreign markets and cultures, especially those of North American and European countries. These students, training to become managers, will soon be in direct competition with you, either in jobs with competing companies or in positions within your own company. You need to ensure that your global skills and knowledge will aid your career, rather than allow their absence to hinder it.

You also need to study international business to stay abreast of the latest business techniques and tools because no single country has a monopoly on good ideas. For example, Japanese firms pioneered inventory management techniques such as **just-in-time (JIT) systems**. Under JIT, suppliers are expected to deliver necessary inputs just as they are needed. Similarly, European firms such as Volvo and Japanese firms such as Honda were among the first to experiment with such labor practices as empowerment, quality circles, autonomous work groups, and cross-functional teams to raise the productivity and satisfaction of their workforces. Managers who remain ignorant of the innovations of their international competitors are bound to fail in the global marketplace.

Finally, you need to study international business to obtain cultural literacy. As global cultures and political systems become even more intertwined than they are now, understanding and appreciating the similarities and differences of the world's peoples will become increasingly important. You will more often encounter colleagues, customers, suppliers, and competitors from different countries and cultural backgrounds. Knowing something about how and where their countries and companies fit into the global economy can help you earn their respect and confidence as well as give you a competitive edge in dealing with them. Conversely, if you know little or nothing about the rest of the world, you may come across as provincial, arrogant, or simply inept. This holds true regardless of whether you are a manager, a consumer, or just an observer of world events.

In Practice

- Studying international business is critical if you want to be an effective manager. You need global skills and knowledge to compete successfully with peers inside and outside your organization.
- The growth of the Internet and e-commerce allows even the smallest business to compete in international markets, as well as to be vulnerable to foreign competition.

For further consideration: Can you think of a business or trade in your country that is not affected by international business activity?

International Business Activities

Historically, international business activity first took the form of exporting and importing (see "Bringing the World into Focus"). However, in today's complex world of international commerce, numerous other forms of international business activity are also common.

BRINGING THE WORLD INTO FOCUS

THE EARLY ERA OF INTERNATIONAL BUSINESS

International business originally consisted of international trade. Trade between nations can be traced back as far as 2000 B.C.E., when tribes in northern Africa took dates and clothing to Babylonia and Assyria in the Middle East and traded them for spices and olive oil. This trade continued to expand over the years, encompassing more regions and a growing list of resources and products. Even the Olympic Games have their roots in this early era, with the first games being held in Greece in 776 B.C.E. By 500 B.C.E. Chinese merchants were actively exporting silk and jade to India and Europe, and common trade routes were being established.

Success in international trade often led to political and military power. First Greece and then the Roman Empire prospered in part because of exploitation of international trade. Ancient wars were fought to maintain trade dominance. For example, the North African city of Carthage became an international business center that rivaled Rome in the third century B.C.E., as merchants from Europe brought precious metals and glass to trade for the grains, ivory, and textiles offered by African merchants. Over a period of 100 years, Rome fought three bloody wars with Carthage to maintain its trade supremacy, finally defeating the Carthaginians in 146 B.C.E. The victorious Romans burned the city and plowed salt into the soil so that crops could not grow, to ensure that Carthage would never again rise as a rival.

During the Middle Ages, Italy became a focal point for international business because of its central location in what was then the world market. The political and military strength of Venice, Genoa, and Florence reflected their roles as major centers of international commerce and banking that linked trade routes between Europe and China. In 1453 these trade routes were severed when the Turks conquered Constantinople (now Istanbul) and gained control of the Middle East. Europe's trade with China had been particularly profitable, so European governments became interested in finding new ocean routes to the Far East. Backed by the Spanish government, Christopher Columbus sailed west from Europe looking for such routes. His landing in the Caribbean islands served instead to identify an important new source of resources and, eventually, led to the colonization of the Americas by European countries.

As this colonization took place, new avenues of trade opened. Settlers throughout the Americas sold raw materials, precious metals, and grains to Europe in exchange for tea, manufactured goods, and other commodities. Most of the American territories eventually became independent countries and important contributors to the world economy.

Another phenomenon of great importance to international business developed during the colonial period and the subsequent Age of Imperialism: the growth of foreign direct investment (FDI) and multinational corporations (MNCs), both of which involve foreigners supplying and controlling investments in a host country. European capitalists from such imperialist powers as the United Kingdom, France, the Netherlands, Spain, Belgium, and Portugal nurtured new businesses in their colonial empires in the Americas, Asia, and Africa, establishing networks of banking, transportation, and trade that persist to this day. The earliest of these firms included the Dutch East India Company (established in 1600), the British East India Company (1602), and the Hudson's Bay Company (1670). These and latter-day trading companies, such as Jardine Matheson Holdings, Ltd., owned copper mines, tea and coffee estates, jute and cotton mills, rubber plantations, and the like as part of their global trading empires.

During the nineteenth century, the invention and perfection of the steam engine, coupled with the spread of railroads, dramatically lowered the cost of transporting goods over land and thereby made larger factories more economical. This development in turn broadened the extent of FDI. The forerunners of such large contemporary MNCs as Unilever, Ericsson, and Royal Dutch Shell took their first steps on the path to becoming international giants by investing in facilities throughout Asia, Europe, and the Americas during this period. New inventions promoting technological change further stimulated FDI. For example, in 1852 Samuel Colt built a factory in Great Britain to produce his famous firearms, and later in the century Dunlop built factories in Belgium, France, and Japan to exploit its tire-making expertise.

Michael Pustay

During the fifth century B.C., international commerce was dominated by Athens and its allies. The Peloponnesian War (431–404 B.C.) brought an end to Athens's power and prosperity. Today's visitors to the Acropolis are reminded of the poignant words of Edgar Allan Poe:

On desperate seas long wont to roam . . . /Thy Naiad airs have brought me home /To the glory that was Greece, /And the grandeur that was Rome.

Sources: Based on S. D. Chapman, "British-based investment groups before 1914," *Economic History Review*, vol. 38 (1985), pp. 230–235; John H. Dunning, *Multinational Enterprises and the Global Economy* (Wokingham, England: Addison-Wesley Publishing Company, 1993), p. 3; Simcha Ronen, *Comparative and Multinational Management* (New York: John Wiley & Sons, 1986).

Exporting and Importing

Exporting is the selling of products made in one's own country for use or resale in other countries. **Importing** is the buying of products made in other countries for use or resale in one's own country. Exporting and importing activities often are divided into two groups. One group of activities is trade in goods—tangible products such as clothing, computers, and raw materials. Official U.S. government publications call this type of trade **merchandise exports and imports**; the British often refer to it as *visible trade*. The other group of activities is trade in services—intangible products such as banking, travel, and accounting activities. In the United States this type of trade is called **service exports and imports**; in the United Kingdom it is often called *invisible trade*.

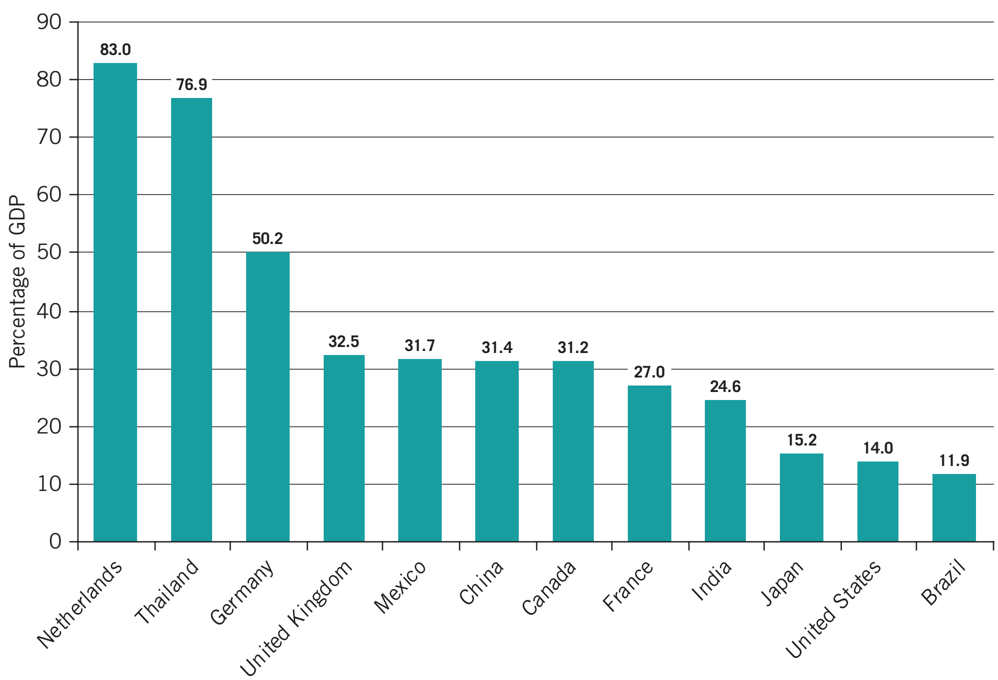
Exports are often critical to a firm's financial health. For example, in 2012, 54 percent of Boeing's $81.7 billion in sales were to foreign customers, creating tens of thousands of jobs at the company and thousands more at the factories of its parts suppliers. International sales often are equally important to smaller firms, such as Task Force Tips, an Indiana manufacturer of fire hose nozzles, which exports one-third of its production.[4] Trade is important to countries as well. As Figure 1.1 shows, exporting accounts for more than three-quarters of the gross domestic products (GDP) of the Netherlands and Thailand, and over 30 percent of the GDPs of Canada, China, Germany, Mexico, and the United Kingdom.

International Investments

The second major form of international business activity is **international investments**—capital supplied by residents of one country to residents of another. Such investments are divided into two categories: foreign direct investments and foreign portfolio investments. **Foreign direct investments (FDI)** are investments made for the purpose of actively controlling property, assets, or companies located in host countries. (The country in which the parent company's headquarters is located is called the **home country**; any other country in which the company operates is known as a **host country**.) An example of an FDI is the purchase of all the common stock of the UK's Cadbury PLC by Kraft. After the purchase Kraft installed its own executives to oversee Cadbury's operations and integrate them into Kraft's global procurement and marketing programs.

FIGURE 1.1

Exports of Goods and Services as a Percentage of GDP for Some Key Countries (2011 data)



Source: Based on World Bank data (www.worldbank.org).

Foreign portfolio investments (FPI) are purchases of foreign financial assets (stocks, bonds, and certificates of deposit) for a purpose other than control. An example of a portfolio investment is the purchase of 1,000 shares of Sony's common stock by a Danish pension fund. With this investment the pension fund is trying to raise the rate of return on its asset portfolio rather than control Sony's decision making. For the same reason many investors in recent years have bought shares of mutual funds that specialize in foreign stocks and bonds.

Other Forms of International Business Activity

International business activity can also take other forms. Licensing, franchising, and management contracts are among the most important. **International licensing** is a contractual arrangement in which a firm in one country licenses the use of its intellectual property (patents, trademarks, brand names, copyrights, or trade secrets) to a firm in a second country in return for a royalty payment. The Walt Disney Company may permit a German clothing retailer to market children's pajamas embroidered with Mickey Mouse's smiling face in return for a percentage of the company's sales. **International franchising**, a specialized form of international licensing, occurs when a firm in one country (the franchisor) authorizes a firm in a second country (the franchisee) to use its operating systems as well as its brand names, trademarks, and logos in return for a royalty payment. For example, McDonald's Corporation franchises its fast-food restaurants worldwide. Finally, an **international management contract** is an arrangement wherein a firm in one country agrees to operate facilities or provide other management services to a firm in another country for an agreed-on fee. Management contracts are common, for instance, in the upper end of the international hotel industry. Hoteliers such as Marriott and Hilton often do not own the expensive hotels that bear their brand names throughout the world but rather operate them under management contracts.

A firm that engages in any of these types of transactions can be labeled an international business. More formally, we can define an **international business** as any organization that engages in cross-border commercial transactions with individuals, private firms, or public sector organizations. But note that we have also used the term *international business* to mean cross-border commercial transactions. Whenever you see this term, you need to determine, from the context in which it is being used, whether it is referring to a general process involving transactions across borders or to a single organization engaging in specific transactions across borders.

The term **multinational corporation (MNC)** is used to identify firms that have extensive involvement in international business. A more precise definition of an MNC is a firm "that engages in FDI and owns or controls value-adding activities in more than one country."[5] In addition to owning and controlling foreign assets, MNCs typically buy resources in a variety of countries, create goods or services in a variety of countries, and then sell those goods and services in a variety of countries. MNCs generally coordinate their activities from a central headquarters but may also allow their affiliates or subsidiaries in foreign markets considerable latitude in adjusting their operations to local circumstances. Because some large MNCs, such as accounting partnerships and Lloyd's of London, are not true corporations, some writers distinguish between multinational corporations and **multinational enterprises (MNEs)**. Further, not-for-profit organizations, such as the IOC and the International Red Cross, are not true enterprises, so the term **multinational organization (MNO)** can be used when one wants to refer to both not-for-profit and profit-seeking organizations. Table 1.1 lists the world's largest corporations in 2012.

In Practice

- Trade between individuals, tribes, and then nations has occurred for thousands of years. Throughout the centuries, the desire to control trade and trade routes has often been the cause of conflict between countries.
- The most important modes of international commerce include international trade and international investing, as well as more specialized business activities like licensing, franchising, and management contracts.

For further consideration: Analyze the information in Table 1.1. How would you characterize the world's largest corporations? How would you characterize the relative changes in their sizes?