Fourth edition

INTERNATIONAL BUSINESS

Stuart Wall Sonal Minocha Bronwen Rees

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Preface: using this book

In the past decade the interconnectedness of our global economy has been brought into sharp focus by the worldwide impact of the so-called 'credit crunch', which many saw as having its origin in the ('subprime') housing market of the USA. Problems which began with excessive lending by financial intermediaries to non-creditworthy house purchasers in the USA quickly escalated into a worldwide recession, brought about by 'financial engineering' which created a wide range of derivative assets based on these high-risk mortgages. The impacts of holding such 'toxic' assets in the portfolios of financial institutions of many countries have been felt by companies and individuals worldwide, with liquidity shortages reducing global demand, output and employment. Similarly, current 'turbulence' in various Middle Eastern, North African and Eastern European countries is having extensive global impacts on production and trade, quite apart from devastating individual lives.

This book is primarily written for students taking modules in *international business* on a range of undergraduate and postgraduate programmes. Any text on international business must, of necessity, span a wide variety of topic areas and embrace a number of different subject disciplines. In that sense it is clearly difficult to locate its boundaries precisely. What we can be sure about is that we are studying a vibrant, ever-changing set of issues and relationships, which will almost certainly have major impacts on all our lives. It could hardly be otherwise when almost one-quarter of the world's recorded output is exported and when changes in business practices or technology in Beijing (China), will have major implications for a workforce as far away as Detroit (USA) or Birmingham (UK)! It has become increasingly clear that a proper understanding of worldwide patterns and trends in international business must draw upon far more than the conventional economic discipline of 'international trade and finance', or the in-depth analysis of 'multinational firm activity', or even the study of key functional areas such as marketing, management, finance and accounting. Important though all these contributions undoubtedly are, attention is increasingly being paid to the often subtle, but highly significant, organisational and cultural characteristics that underpin production and trade in a globalised economy. In fact, today's study of international business draws heavily on disciplines as diverse as law, sociology, anthropology, psychology, politics, history and geography, as well as those previously mentioned.

The first chapter of this text identifies some current patterns and trends, which are of key concern to those engaged in international business, whether from a corporate or national perspective. Chapters 2 to 6 then concentrate on issues that affect most types of international business, whatever their sector of activity, nature of operations or stage reached in the internationalisation process. The principles, practices and institutions underpinning international trading relationships are reviewed, as are a wide variety of external 'environmental factors', which play a key role in determining both the direction and outcome of international business activity. These include political, legal, sociocultural, ethical, ecological, economic and technological factors, all of which shape the environment in which the international business must operate. After considering these 'universal' aspects of international business, the more 'firm-specific' aspects are investigated in Chapters 7 to 10 with an in-depth analysis of the alternative courses of action facing the international business, whether in terms of corporate strategy, human resource management, marketing, accounting and finance, operations management or logistics.

Throughout the text you will find up-to-date case materials to illustrate many of the international issues involved. A number of questions will help direct your thoughts to some of the principles underpinning the facts and events presented in each case study. In a similar vein, you will also find a number of 'pause for thought' sections within the text of each chapter. A number of 'Boxes' are presented to take further some of the analysis presented in the text. You can find full details of any sources referenced within each chapter in the References section at the end of the text.

There is a full range of interactive questions (with solutions) and other teaching support materials in the lecturer encrypted website to accompany this text.

For this fourth edition all data, empirical and case study materials and analysis have been thoroughly updated and revised with a large number of entirely new cases integrated within the text. On occasion the text has been further developed to reflect contemporary debate, as with the more detailed scrutiny of the international financial system and associated accounting conventions and standards in Chapter 10.

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Stuart Wall
Sonal Minocha
Bronwen Rees

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Tables

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Abbreviations

APEC	Asia-Pacific Economic Corporation
ART	Alternative risk transfer
ASB	Accounting Standards Board (London)
ASEAN	Association of South East Asian Nations
B2B	Business-to-business
BIT	Bilateral investment treaties
CAP	Common Agricultural Policy
CCFF	Compensatory and Contingency Financing Facility
CDO	Collateralised debt obligations
CED	Cross elasticity of demand
CFF	Compensatory Financing Facility
CIM	Chartered Institute of Marketing
CIMA	Chartered Institute of Management Accountants (London)
CIS	Commonwealth of Independent States
CJV	Cooperative joint venture
DTT	Double taxation treaties
EAGGF	European Agricultural Guarantee and Guidance Fund
ECU	European Currency Unit
EER	Effective exchange rate
EFF	Extended Fund Facility
EJV	Equity joint venture
EPZ	Export processing zone
ERM	Exchange Rate Mechanism
ERP	Enterprise resource planning
EU	European Union
fdi	Foreign direct investment
FSC	Foreign sales corporation
GAAP	Generally accepted accounting practices
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
GM	Genetically modified
GNP	Gross national product
HICPs	Harmonised Indices of Consumer Prices
HRM	Human resource management
IASB	International Accounting Standards Board
IASs	International Accounting Standards
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IED	Income elasticity of demand
IFC	International Finance Corporation
IHRM	International human resource management
II	Internationalisation index
IJV	International joint venture
ILO	International Labour Office

IMF	International Monetary Fund
IMM	International Monetary Market
IPLC	International product life cycle
IPR	Intellectual property rights
ISCT	Integrated Social Contract Theory
LDC	Less-developed country
LIBOR	London Interbank Offer Rate
LIFFE	London International Finance and Futures Exchange
LRAC	Long-run average cost
LSE	London Stock Exchange
M & A	Mergers and acquisitions
MAI	Multilateral agreement on investment
MES	Minimum efficient size
MGQ	Maximum Guaranteed Quantity
MID	Modularity-in-design
MIP	Modularity-in-production
MIU	Modularity-in-use
MNE	Multinational enterprise
NAFTA	North American Free Trade Association
NGO	Non-governmental organisation
OECD	Organisation for Economic Co-operation and Development
OTC	Over the counter
PED	Price elasticity of demand
PEST	Political, economic, social and technological environmental analysis
PESTEL	Political, economic, social, technological, legal and ecological analysis
Plc	Public limited company
PPP	Purchasing power parity
R & D	Research and development
RCEP	Regional Comprehensive Economic Partnership
RER	Real exchange rate
RPI	Retail Price Index
RTA	Regional trading arrangement
RULC	Relative unit labour costs
SAF	Structural Adjustment Facility
SAL	Structural Adjustment Lending
SDR	Special Drawing Right
SEC	Securities and Exchange Commission (USA)
SFF	Supplementary Financing Facility
SIV	Structured investment vehicle
SKU	Stock-keeping unit
SME	Small to medium-sized enterprise
SWF	Sovereign wealth funds
TNI	Transnationality index
TPP	Trans-Pacific Partnership
TRIPS	Trade-Related Aspects of Intellectual Property Rights
TTIP	Transatlantic Trade and Investment Partnership
UNCTAD	United Nations Conference on Trade, Aid and Development
UNIDO	United Nations Industrial Development Organisation
VER	Voluntary export restraint
WIPO	World Intellectual Property Organisation
WOFE	Wholly owned foreign enterprise
WTO	World Trade Organisation

Chapter 1

Introduction to international business

By the end of this chapter you should be able to:

- outline some of the key patterns and trends in international business activity;
- explain the various dimensions of the term 'globalisation';
- examine the role and importance of the multinational enterprise (MNE) in the global economy;
- discuss the contribution of different disciplines to an understanding of international business activity.

Introduction

A useful starting point for a text on international business is to identify some of the more recent patterns and trends in business activity worldwide. Of course, these patterns and trends are in part the *result* of some of the strategic choices taken by firms with an international orientation and in part the *stimulus* for future changes of direction by such firms. We shall examine each of these perspectives in later chapters.

Patterns and trends in international business

Let us first identify some of the more important and measurable trends in international business activity.

Rapid growth in world trade and investment

Figure 1.1 indicates some aspects of the growth in international trade and capital flows using *index numbers* based on 1980 = 1 for exports and foreign direct investment (fdi) respectively. (The term fdi refers to international investment in productive facilities such as plant, machinery and equipment.) Between 1980 and 2014 *world exports* of goods and services have more than doubled in real terms, reaching over $23,000 billion in 2014 and accounting for over 31% of world gross domestic product.

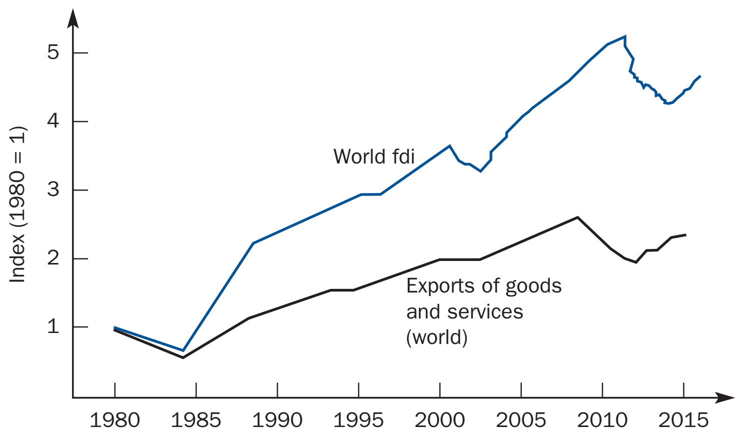

Figure 1.1 Changes in trade and capital flows

Source: World Bank, UNCTAD (various years).

Put another way, global exports of goods and services have increased at the astonishing rate of almost 5% per year in real terms between 1980 and 2014. It is worth noting that, while the developed 'high-income economies' (GNP of $12,616 per capita or more) have accounted for most of this growth in absolute value of global exports, the developing 'low-income economies' (GNP of $1,035 or less) have substantially increased their share of global exports, with the developing economies' exports rising at an above average 6% per annum in real terms between 1980 and 2014. This trend has resulted in the *exports-to-GDP ratio* of the 'developing economies' rising much faster than that of the 'developed economies'. As a result the export:GDP ratio of developing economies now exceeds that of the developed economies, with exports accounting for some 25% of GDP in developing economies in 2014, but only some 24% of GDP in developed economies at that date. The contribution of developing economies to international business is an issue we return to at various points in this text.

During the same time period flows of *world foreign direct investment* have increased over fivefold in real terms since 1980, reaching around $1,500 billion in 2014, some $200 billion below the previous peak year in 2007. Figure 1.2 provides more detail on this growth in world fdi inflows over the period 1995–2014. The developed, developing and transition economies, the latter including South East Europe and the Commonwealth of Independent States (Russia and states of the former Soviet Union), have all seen continued growth in inward fdi, despite occasional global dips, as in the 2000–03, 2007–09 and 2011–12 periods.

Rapid growth in cross-border mergers and acquisitions

There has been a rapid growth in cross-border mergers and acquisitions (M&A) since 1990. Between 1990 and 2013 the value of global cross-border M&A has risen sharply, rising more than eightfold to reach over $1,000 billion per annum in 2007, before falling back in the subsequent recessionary period. Much of this activity has been concentrated in financial services, insurance, life sciences, telecommunications and the media, with M&A being a key factor in accounting for the rise in fdi noted in Figures 1.1 and 1.2.

Largely as a result of cross-border mergers and associated 'greenfield investment' we can see from Table 1.1 that in 2013 the 100 largest MNEs were highly integrated within the global

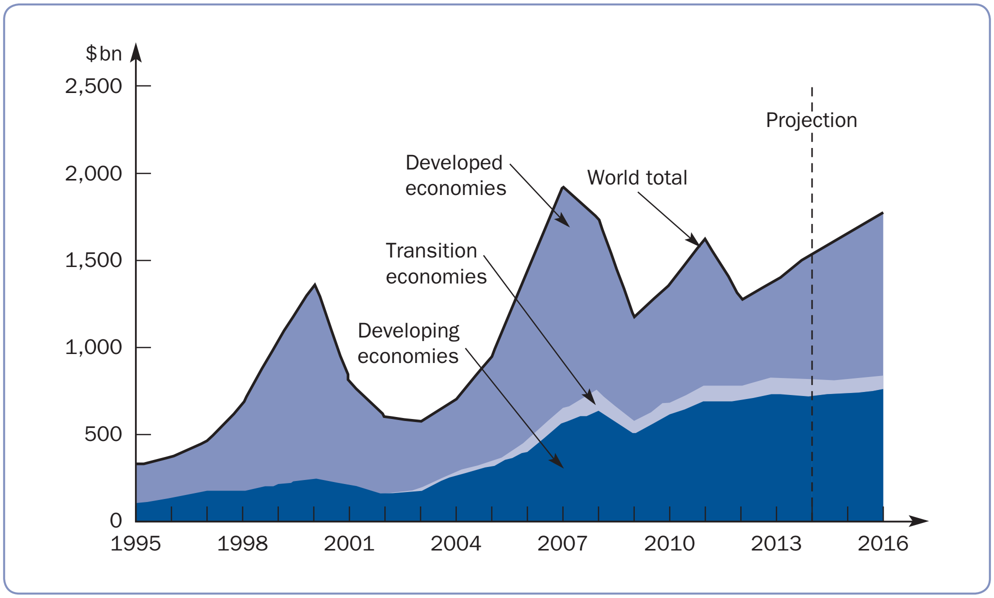

Figure 1.2 **FDI inflows: global and by groups of economies 1995–13 and projections 2014–16**
Source: *World Development Report* (2014), p. xiii.

economy with foreign assets making up 59% of their total assets, foreign sales 65% of their total sales and foreign employment 57% of their total employment. We review the contribution of MNEs to international business activity in much greater detail later in this chapter (pp. 30–36) and in Chapter 7.

More liberalised markets on a global scale

We noted in Figures 1.1 and 1.2 the rapid growth of foreign direct investment (fdi) and its relevance for cross-border mergers and acquisitions by multinational enterprises. Table 1.2 uses data from the United Nations Conference on Trade, Aid and Development (UNCTAD) to indicate the growth in regulatory changes affecting fdi by national governments. We can see

Table 1.1 **Snapshot of the world's 100 largest MNEs, 2013**

Variable	2013	Percentage change
Assets ($bn)		
Foreign	8,035	+2.0
Total	13,656	+2.0
Foreign to total (%)	59	2.0
Sales ($bn)		
Foreign	6,057	+3.0
Total	9,321	+4.0
Foreign to total (%)	65	−1.0
Employment (000)		
Foreign	9,810	+0.0
Total	17,292	+2.0
Foreign to total (%)	57	+2.7

Source: Adapted from *World Investment Report* 2014 (UNCTAD), Copyright © 2014 United Nations. Used by permission of the United Nations.

Table 1.2 National regulatory changes, 1993–2013

Item	1993	1997	2001	2005	2009	2013
Number of countries that introduced change	56	76	52	78	47	59
Number of regulatory changes	100	150	97	144	88	87
More favourable to fdi (liberalisation/promotion)	99	134	85	118	61	61
Less favourable to fdi (restriction/regulation)	1	16	2	25	23	23
Neutral/indeterminate	–	–	10	1	4	3

Source: Adapted from *World Investment Report* (UNCTAD 2014), p. 106.

that the overwhelming majority of these changes are regarded as being 'more favourable' to fdi flows, although there has been an increase in the number (and percentage) of regulatory changes 'less favourable' to fdi since 2001.

More globally dispersed value chains

With more market liberalisation comes increased worldwide competition which, together with rapid technological change, has placed increased pressures on large firms to adopt the most efficient and appropriate production and marketing locations if they are to survive and prosper. With improved international communications helping MNEs to co-ordinate and control geographically dispersed activities, including service functions, the result has been an increased propensity for MNEs to shift certain production and service activities to low-cost centres overseas. Put another way, MNEs are engaged in an unending search for increased competitive advantage in terms of costs, resources, logistics and markets and are increasingly willing to reconfigure the geographical locations of their activities accordingly.

Pause for thought 1.1

Can you give one or more recent examples of MNEs adjusting the geographical location of their production or support activities?

We can, for example, use the so-called *Transnationality Index* (TNI) to illustrate the increased international dispersion of production and service activities by multinational enterprises. The TNI is a simple average of three ratios for a multinational enterprise, namely foreign assets:total assets, foreign sales:total sales and foreign employment:total employment. As we note below (Table 1.9, p. 34), whereas for the world's largest 100 MNEs this average across the three ratios was only 51.1% in 1990, by 2012 the average had risen sharply to 60.8%, indicating a rapid growth in international orientation by the top 100 global MNEs. We return to this issue in more detail below (pp. 30–36) and in Chapter 7.

Bi-polar to tri-polar (triad)

The old *bi-polar* world economy, which was dominated by North America and Europe, has moved on to a *tri-polar* world economy dominated by the 'triad' of North America, the European Union and South-East Asia. These three regions now account for around 80% of the total value of world exports and 84% of world manufacturing value added.

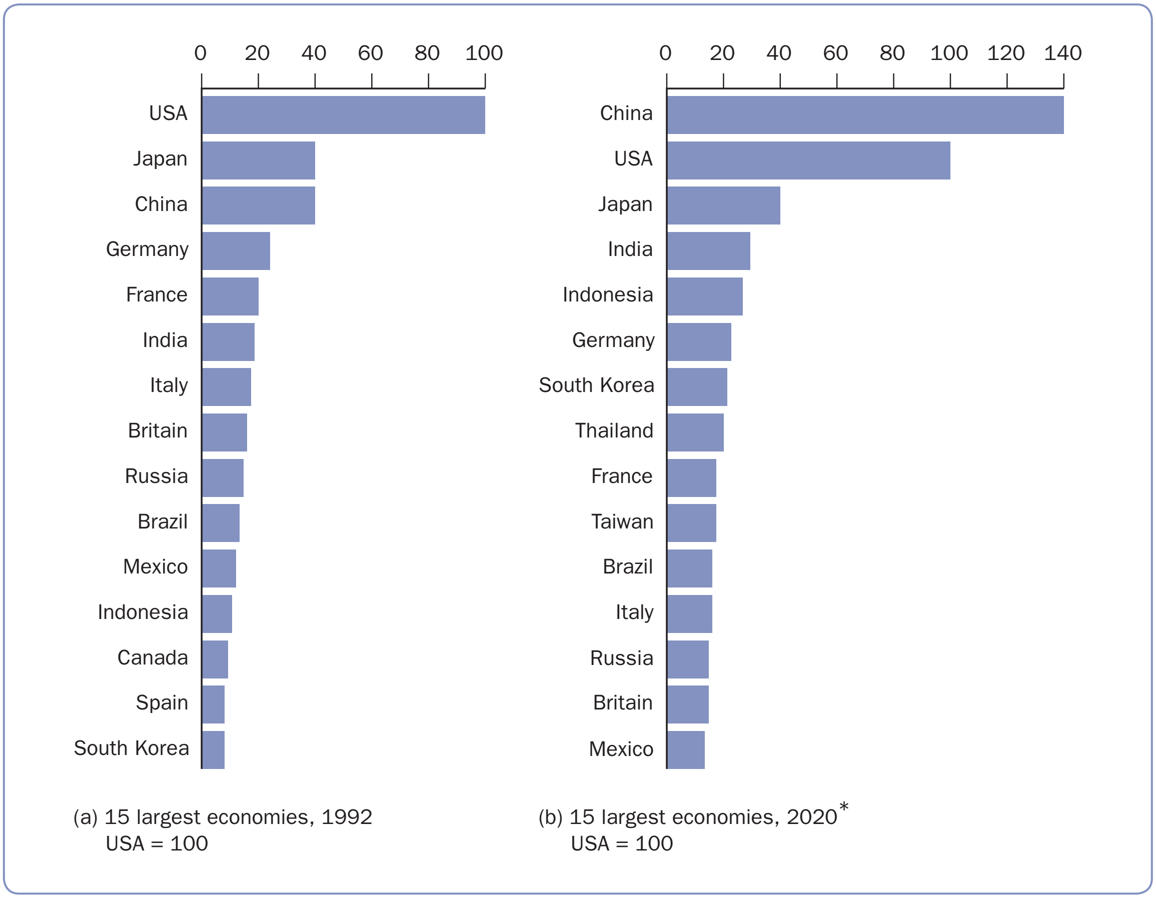

Figure 1.3 **Growth of the global economy, 1992–2020 (index number, USA = 100)**

*Forecasts assume countries grow at regional rates projected in the World Bank's *Global Economic Prospects* Report.
Source: World Bank and author's own work.

The inclusion of the third leg of the triad, namely East and South-East Asia, is further reinforced by projections into the future. Figure 1.3 provides some World Bank projections for changes in national contributions to the world economy over the period 1992–2020. Although in terms of market size the global economy is currently dominated by the rich industrial economies of the USA, Japan, Germany, France, Italy and the UK, it is projected that by 2020 economies such as China, India, Indonesia, South Korea, Thailand and Taiwan will all have moved into the 'top ten'. This is an important pattern, suggesting that the attention of market-oriented companies will be increasingly drawn to these regions.

Growth of regional trading arrangements

As we note in Chapter 3, there has been a rapid growth in regional trading blocs and in associated regional trading arrangements (RTAs), which give preferential treatment to trade in goods and services between members of these blocs. Only countries *within* the particular regional trading bloc (e.g. the EU, NAFTA) benefit from these RTAs, which have increased substantially in number over the past decade or so. This has led to the growth of 'insiderisation', i.e. attempts by MNEs to locate productive facilities inside these various regional trading blocs in order to avoid the protective and discriminatory barriers which would otherwise face their exports to countries within these blocs.

In fact there is now a movement towards 'mega-regional' integration initiatives, with three major developments underway in 2014, as can be seen from Figure 1.4.

- *Transatlantic Trade and Investment Partnership* (TTIP) which is being negotiated between the US and EU, accounting for some 30% of global fdi flows.
- *Trans-Pacific Partnership* (TPP) which is being negotiated between the US and a range of other mainly Pacific located countries, accounting for some 32% of global fdi flows.
- *Regional Comprehensive Economic Partnership* (RCEP) which is being negotiated between the ten ASEAN member states (see p. 100) and their six free trade agreement partners. This group accounts for some 24% of global fdi flows.

Certainly there is evidence to support the belief of MNEs that being inside such blocs confers considerable advantages. For example Roberts and Deichmann (2008) found that spillovers of growth between members of RTAs averaged around 14% in the period

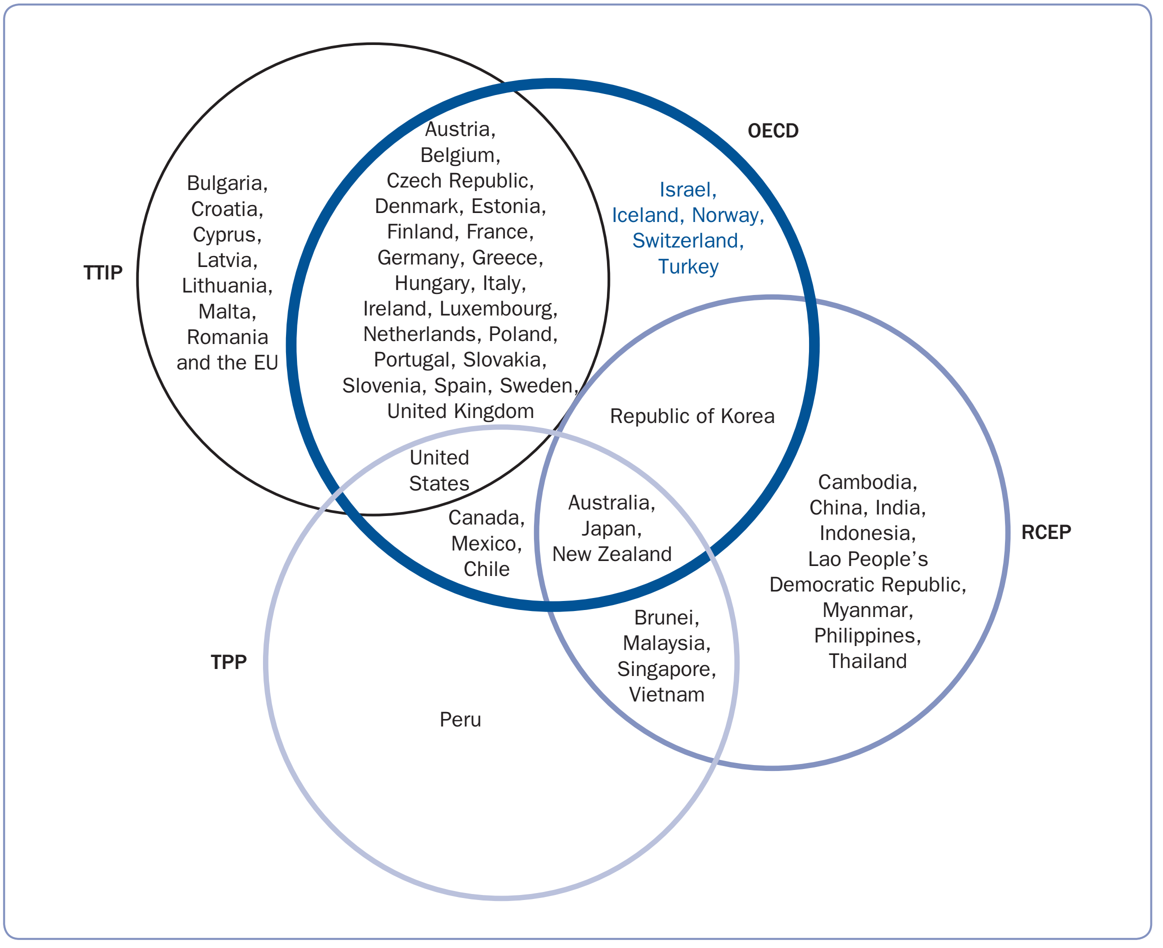

Figure 1.4 Participation in key megaregionals and OECD membership

Source: *World Investment Report* (2014), Figure 7, p. xxiv.

1970–2000. In other words, every 1% increase in the average growth rate of RTA partners brought a ‘growth bonus’ of 0.14% to other members of the RTA. In Europe and East Asia, where historically regional integration has been strongest, the average growth spillover was even larger at around 0.17% over the period 1970–2000. In a similar vein, as regards the benefits of membership of a regional trading bloc, Frankel (1997) noted that during the early 1990s, intra-regional trade within one such regional trading bloc – the Andean community of Bolivia, Colombia, Ecuador, Peru and Venezuela – was 2.7 times higher than the levels of national income and geographic separation of those economies would have led us to expect.

Growth of bilateral investment and trade treaties

Nor is it only within the broad-based regional trading blocs that preferential treatment is available to participating countries and companies. For example, there has been a rapid growth in *bilateral* (*two-country*) *investment and trade treaties,* which can take various forms, the major ones being *bilateral investment treaties* (BITs) and *double taxation treaties* (DTTs). Over 2,600 BITs had been notified to the World Trade Organisation (WTO) by 2014 which, while they may encourage foreign direct investment (fdi) flows between the two countries concluding the investment treaty, arguably discriminate against fdi flows involving countries that are *not* signatories to the BIT. Similarly, around 2,700 DTTs had been notified to the WTO by 2014, again arguably reducing tax rates and stimulating investments and trade between the two countries involved, but creating a complex patchwork of investment and taxation regimes which are difficult to manage on a global scale. We consider the impact of such bilateral treaties in more detail in Chapter 3.

Growth of sovereign wealth funds (SWFs)

Sovereign wealth funds (SWFs) are government-owned investment vehicles managed separately from the official reserves of the country. They have usually been accumulated by those governments as the result of high global commodity prices for their exports. High energy (e.g. oil), food and other primary product prices over recent years have meant that an estimated $5,000 billion is now available for potential investment by countries such as the United Arab Emirates, Saudi Arabia, Dubai, Kuwait, China, Norway, the Russian Federation and Singapore, amongst others. The SWFs will often be invested in projects with higher risks but higher expected future returns. Professional portfolio management techniques are often adopted with a view to generating a sustainable future income stream via investments in bonds, equities and other assets. In 2009 Barclays Bank raised $7 billion of funds from this source rather than accept UK government funding to help it cope with the liquidity crisis of the ‘credit crunch’ (see Chapter 10, p. 355). In 2014 there were 70 SWFs in 44 countries with assets ranging in value from $20 million (São Tomé and Príncipe) to more than $500 billion in the United Arab Emirates.

Growth of ‘defensive techniques’ to combat global insecurity

The global growth of foreign direct investment and the increasingly ‘footloose’ activities of MNEs have already been documented as widely used indicators of globalisation. Many commentators have also drawn attention to parallels between the rapid growth in formal, legal cross-border relationships and the rapid growth in a wide range of illegal cross-border relationships. Some of the characteristics of globalisation reviewed in Box 1.2 (p. 16) are seen as conducive to such growth, especially the weakening of power and control by nation states and the proliferation of new, less detectable methods of communication.

While a proper investigation of so complex an issue is beyond the scope of this section, we can perhaps draw attention to what many believe is a new global business environment since 11 September 2001 (9/11), which is perhaps the date most closely associated with the advent of global insecurity. The additional insurance premiums required since 9/11 is one important indicator of the costs to international business of such 'defensive techniques', as are the monetarised values for the increased time costs to individuals and businesses of additional security-related delays as well as the extra costs associated with more security-related personnel and equipment. For example, it has been estimated that the *actual* growth of global GDP has fallen since 9/11 by around 1% per annum relative to the previously *projected* growth.

Pause for thought 1.2

Can you suggest which sectors/industries have been the main 'losers' with the heightened concerns over global terrorism and which the main 'beneficiaries'?

Changing area patterns of international costs

Of particular interest to international business location is the area pattern of *international labour costs,* both wage and non-wage (employers' social security contributions, holiday pay, etc.). Comparable data is notoriously difficult to derive, both within broad geographical regions and between such regions. In any case it is not just overall labour costs that are important but these costs in relation to labour productivity. For example, if labour costs double but labour productivity doubles, then labour costs per unit of output remain the same. We return to this idea of Relative Unit Labour Costs below (p. 9).

The Boston Consulting Group (BCG) has constructed the *Global Manufacturing Cost-Competitiveness Index* to show how the production costs in the world's ten largest goods-exporting countries have changed, relative to the US, in the ten years from 2004 to 2014. The four key components of the Index are labour costs per hour, labour productivity (output per hour), energy costs per unit output and national currency exchange rates vis-à-vis the US dollar.

Figure 1.5 uses index numbers (US = 100) to compare manufacturing costs per unit of output across the top ten export economies over the period 2004 to 2014.

Figure 1.5 indicates some important shifts in cost competitiveness over the past decade. For example China's cost advantage over the US has fallen from 14% (100% against 86%) to only 4% (100% against 96%), hardly surprising when Chinese average labour costs have almost trebled over the ten-year period, far exceeding growth in Chinese labour productivity and thereby raising labour costs per unit output. The ten-point rise in the Chinese cost-competitiveness index over the past decade vis-à-vis the US is higher for China (in absolute and percentage terms) than the rise for eight out of the other nine countries. Clearly China's manufacturing cost competitiveness has therefore declined against these other eight countries also.

The US can be seen to be the second most competitive manufacturing location out of the ten largest global exporters, with the UK broadly maintaining its cost competitiveness with the US over the past decade, and the Netherlands becoming marginally more cost competitive. Figure 1.5 suggests that the other major manufacturing nations of Western Europe have become even less cost competitive with the US over the past decade, as well as becoming less cost competitive with the UK and the Netherlands.

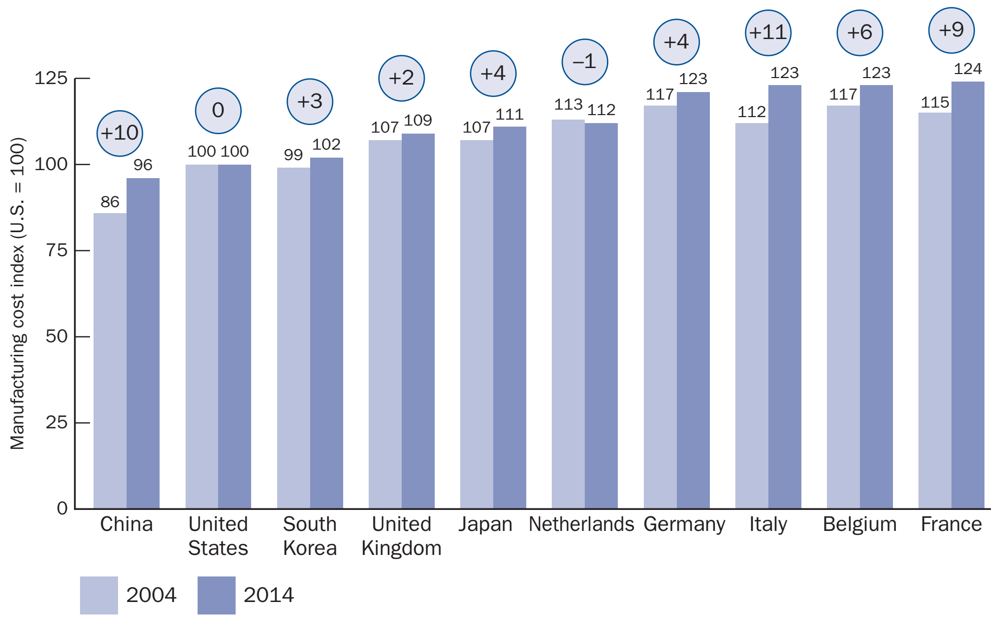

Figure 1.5 How global manufacturing cost competitiveness has shifted over the past decade

Source: Boston Consulting Group (BCG), *Analysis of the World's Largest Manufacturing Economies*, April 2014.

Table 1.3 uses the same BCG Index as that for Figure 1.5 but provides a broader coverage of the world's top 25 export economies in terms of cost competitiveness in 2014.

The data in Table 1.3 reveals some striking changes in manufacturing cost competitiveness. Mexico is now less expensive than China as a manufacturing location; Brazil is now a high-cost location for manufacturing; the UK is the lowest-cost location for manufacturing throughout Western Europe. Indeed, this BCG data challenges a number of simple, long-held assumptions that North America and Western Europe are high-cost locations and Asia and Latin America are low-cost locations. What is becoming increasingly clear is that there are low- and high-cost locations in *all* geographical regions of the world and that multinationals and others making global investment and locational decisions must do so on the basis of cost-related contemporary evidence, rather than basing such decisions on 'inherited wisdom' as to low-cost geographical locations!

Pause for thought 1.3

What other conclusions might be drawn from the data in Figure 1.3?

Labour costs and labour productivity

A more complete assessment of true labour costs would use the idea of Relative Unit Labour Costs (RULC), which are explored further in Box 1.1. Three of the four elements included in the BCG Index are also included in this, the most widely used indicator of international competitiveness.