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FOURTEENTH EDITION

INTERNATIONAL BUSINESS

Competing in the Global Marketplace

McGraw Hill

Charles W.L. Hill

International Business

Competing in the Global Marketplace

14e

Charles W. L. Hill

UNIVERSITY OF WASHINGTON

Mc Graw Hill

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

—Charles W. L. Hill

about the AUTHOR

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Charles W. L. Hill is a Professor of Management in the Foster School of Business at the University of Washington. Professor Hill has taught in the MBA, Executive MBA, Technology Management MBA, and PhD programs at the University of Washington. His teaching responsibilities include strategic management, international business, and microeconomics. During his time at the University of Washington, he has received over 25 awards for teaching excellence, including the Charles E. Summer all faculty Outstanding Teaching Award.

A native of the United Kingdom, Professor Hill received his PhD from the University of Manchester, UK. In addition to the University of Washington, he has served on the faculties of the University of Manchester, Texas A&M University, and Michigan State University.

Professor Hill has published over 50 articles in top academic journals, including the *Academy of Management Journal, Academy of Management Review, Strategic Management Journal,* and *Organization Science.* Professor Hill has also published several textbooks, including *International Business* (McGraw-Hill) and *Global Business Today* (McGraw-Hill). His work is widely cited in international business and strategic management. A recent study that measured scholarly influence based on cumulative citations between 1996 and 2019 ranked Professor Hill in the top 1 percent of all scholars in the world across 22 major disciplines.

Professor Hill works on a private basis with a number of organizations. His clients have included Microsoft, where he taught in-house executive education courses for two decades. He has also consulted for a variety of other large companies (e.g., AT&T Wireless, Boeing, BF Goodrich, Group Health, Hexcel, Philips Healthcare, Philips Medical Systems, Seattle City Light, Swedish Health Services, Tacoma City Light, Thompson Financial Services, WRQ, and Wizards of the Coast). Additionally, Dr. Hill has served on the advisory board of several start-up companies.

For recreation, Professor Hill enjoys skiing and competitive sailing!

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THE PROVEN CHOICE FOR INTERNATIONAL BUSINESS

RELEVANT. PRACTICAL. INTEGRATED.

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

- Is comprehensive, state of the art, and timely.
- Is theoretically sound and practically relevant.
- Focuses on applications of international business concepts.
- Maintains a tight integrated flow between chapters.
- Focuses on the implications of international business concepts for management practice.
- Makes important theories accessible and interesting to students.
- Incorporates ancillary resources that turbo-charge the text and make it easier to teach your course.

Over the years, and through now fourteen editions, I have worked hard to adhere to these goals. It has not always been easy. An enormous amount has happened over the last 25 years, both in the real world of economics, politics, and business, and in the academic world of theory and empirical research. Often I have had to significantly rewrite chapters, scrap old examples, bring in new ones, incorporate new theory and evidence into the book, and phase out older theories that are less relevant to the modern and dynamic world of international business. That process continues in the current edition. As noted later, there have been significant changes in this edition, and that will no doubt continue to be the case in the future. In deciding what changes to make, I have been guided not only by my own reading, teaching, and research, but also by the invaluable feedback I receive from professors and students around the world who use the book, from reviewers, and from the editorial staff at McGraw Hill. My thanks go out to all of them.

COMPREHENSIVE AND UP-TO-DATE

To be relevant and comprehensive, an international business package must

- Explain how and why the world's cultures, countries, and regions differ.
- Cover economics and politics of international trade and investment.
- Tackle international issues related to ethics, corporate social responsibility, and sustainability.
- Explain the functions and form of the global monetary system.
- Examine the strategies and structures of international businesses.
- Assess the special roles of the various functions of an international business.

Relevance and comprehensiveness also require coverage of the major theories. It has always been a goal to incorporate the insights gleaned from recent academic scholarship into the book. Consistent with this goal, insights from the following research, as a sample of theoretical streams used in the book, have been incorporated:

- New trade theory and strategic trade policy.
- The work of Nobel Prize–winning economist Amartya Sen on economic development.
- Samuel Huntington's influential thesis on the "clash of civilizations."
- Growth theory of economic development championed by Paul Romer and Gene Grossman.
- Empirical work by Jeffrey Sachs and others on the relationship between international trade and economic growth.
- Michael Porter's theory of the competitive advantage of nations.
- Robert Reich's work on national competitive advantage.
- The work of Nobel Prize–winner Douglass North and others on national institutional structures and the protection of property rights.

- The market imperfections approach to foreign direct investment that has grown out of Ronald Coase and Oliver Williamson's work on transaction cost economics.
- Bartlett and Ghoshal's research on the transnational corporation.
- The writings of C. K. Prahalad and Gary Hamel on core competencies, global competition, and global strategic alliances.
- Insights for international business strategy that can be derived from the resource-based view of the firm and complementary theories.
- Paul Samuelson's critique of free trade theory.
- Recent empirical work of multiple academics, including Paul Romer, Jeffrey Sachs, and David Autor, on the economic consequences of freer trade.
- Conceptual and empirical work on global supply chain management—logistics, purchasing (sourcing), operations, and marketing channels.

In addition to including leading-edge theory and empirical research, in light of the fast-changing nature of the international business environment, I have made every effort to ensure that this product is as up-to-date as possible. A significant amount has happened in the world since the first edition of this book. For much of the last 70 years, the world has moved toward a rules-based multinational order that has governed cross-border trade and investment. The goal has been to lower barriers to international trade and investment, allowing countries to benefit from the gains to trade. The result has been greater globalization and a fertile environment in which international businesses could thrive. Perhaps the high point of this movement was the establishment of the World Trade Organization (WTO) in 1995 and the decade that followed. Since 2016, however, the world has lurched away from this consensus. Most notably, under the leadership of President Donald Trump, America unilaterally raised trade barriers and entered into a trade war with China. President Biden seems to be charting a similar course to President Trump on trade with China. The fact that the two largest economies in the world, which together account for around 40 percent of global economic activity, are engaged in a significant and ongoing trade dispute, has created huge uncertainties for international businesses. The competitive environment has fundamentally changed. To compound matters, emergence in early 2020 of the SARS-CoV-2 virus that causes the COVID-19 disease has resulted in a global pandemic that has massively disrupted global supply chains and thrown the global economy into a deep recession. In this edition, I discuss the implications of these developments for the global economy and the practice of international business. The world has changed, and the text of the book reflects this reality.

What's New in the 14th Edition

The success of the first thirteen editions of *International Business* was based in part on the incorporation of leading-edge research into the text, the use of the up-to-date examples and statistics to illustrate global trends and enterprise strategy, and the discussion of current events within the context of the appropriate theory. Building on these strengths, our goals for the twelfth edition have focused on the following:

1. Incorporate new insights from scholarly research.
2. Make sure the content covers all appropriate issues.
3. Make sure the text is up-to-date with current events, statistics, and examples.
4. Add new and insightful opening and closing cases in most chapters.
5. Incorporate value-added globalEDGE™ features in every chapter.
6. Connect every chapter to a focus on managerial implications.
7. Provide 20 new integrated cases that can be used as additional cases for specific chapters but, more importantly, as learning vehicles across multiple chapters.
8. Add a new feature to the managerially focused chapters of the book (Chapters 13–20) that looks at how changes in the macro environment affect international business practice.

As part of the overall revision process, changes have been made to every chapter in the book. All statistics have been updated to incorporate the most recently available data. Important current events have been incorporated into the text and discussed at length. Within the book you will find comprehensive discussion of the ongoing trade war between America and China, Brexit and the outlook for Britain and the EU post-Brexit, the renegotiation of NAFTA and the ratification of its successor, the USMCA, and the economic and business implications of the COVID-19 pandemic. In addition, the *Focus on Managerial Implications* section that has always appeared at the end of each chapter that deals with the macro environment (Chapters 1–12) has been renamed, *360° View: Managerial Implications.* In the more managerially focused chapters (Chapters 13–20) I have added a new section, *360° View: Impact of the Macro Environment,* which explicitly discusses how ongoing changes in the macro environment (such as the U.S.–China trade conflict and the COVID-19 pandemic) affect management practice. I believe this is a very valuable addition to this edition.

In addition to updating all statistics, figures, and maps to incorporate most recently published data, and including reference to important current events in appropriate chapters (e.g., discussion of U.S.–China trade conflict, Brexit, COVID-19), a chapter-by-chapter selection of changes for the 14th edition also includes the following:

Chapter 1: Globalization

- New opening case: Trucklabs
- Updated statistics and figures to incorporate the most recent data on global trade flows and foreign direct investment
- Discussion of the implications of recent political trends (Brexit, trade disputes, the rise of China) and what this might mean for cross border trade and investment
- New closing case: Detroit Bikes

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

- New opening case: Ireland's Economic Transformation
- Updated data on corruption
- New closing case: China's Mixed Economy

Chapter 3: National Differences in Economic Development

- New opening case: Economic Development in South Africa
- Updated maps, figures, and in-text statistics to reflect most recently available data
- Addition of demographic trends to the discussion of Political Economy and Economic Progress
- Updated discussion of the spread of democracy to reflect recent countertrends toward greater authoritarianism in several nations (e.g., Turkey)
- New closing case: What Ails Argentina?

Chapter 4: Differences in Culture

- New opening case: Doing Business in Brazil
- Inclusion of a discussion of patience across cultures
- Revised the foundation that most religions are now pro-business
- Revised discussion of the impact of Islam on national culture to note significant diversity in cultural practices between nations where Islam is the major religion
- New closing case: Russian Culture

Chapter 5: Ethics, Corporate Social Responsibility, and Sustainability

- New opening case: Gucci's Code of Ethics
- New closing case: Who Stitched Your Designer Jeans?

Chapter 6: International Trade Theory

- New opening case: Global Trade in Semiconductors
- Updated Country Focus on China and currency manipulation
- Added discussion of the impact of trade wars on business practice in 360° View: Managerial Implications
- New closing case: Trade in Services
- Updated balance of payments data in the Appendix to reflect 2020 data

Chapter 7: Government Policy and International Trade

- New opening case: The Jones Act
- Updated discussion of the world trading system to reflect recent developments, including Brexit and ongoing trade disputes between the United States, China, and others.
- New closing case: America and Kenya Negotiate a Trade Deal

Chapter 8: Foreign Direct Investment

- New opening case: Tesla's Direct Investment in China
- Updated statistics and figures on foreign direct investment in the world economy to incorporate the most recently available data
- New closing case: JCB in India

Chapter 9: Regional Economic Integration

- New opening case: Britain Post-Brexit
- Updated discussion of Brexit and its aftermath
- Added discussion of the renegotiation of NAFTA by the Trump administration and the ratification of NAFTA's replacement, the United States–Mexico–Canada Agreement (USMCA)

- Additional discussion of new free trade deals in Africa
- New closing case: RCEP: The World's Largest Trade Deal

Chapter 10: The Foreign Exchange Market

- New opening case: Hedging the Thai Baht
- Updated data throughout the chapter to reflect currency exchange rates in 2020
- New closing case: Exchange Rates and the Profitability of Korean Airlines

Chapter 11: The International Monetary System

- New opening case: The Future of the U.S. Dollar as the World's Reserve Currency
- Updated data and discussion of the floating exchange rate regime through till 2020
- New closing case: Did the IMF Help Egypt?

Chapter 12: The Global Capital Market

- New opening case: Why do so many Israeli Companies List on American Stock Exchanges?
- Updated statistics and discussion to reflect most recently available data
- New closing case: Chinese IPOs in the United States

Chapter 13: The Strategy of International Business

- New opening case: Emirates Global Strategy
- New section: 360° View: Impact of the Macro Environment
- New closing case: Geely Holdings: China's First Global Car Company

Chapter 14: The Organization of International Business

- New opening case: Reorganizing Siemens to Compete Globally
- New Management Focus: IBM Moves Towards a Matrix Structure
- New section: 360° View: Impact of the Macro Environment
- New closing case: Philips: 120 years of Organization Change

Chapter 15: Entering Developed and Emerging Markets

- New opening case: Uber's Foreign Market Entry Strategy
- New section: 360° View: Impact of the Macro Environment
- New closing case: Vanguard in China

Chapter 16: Exporting, Importing, and Countertrade

- New opening case: Exporting to Egypt
- New section: 360° View: Impact of the Macro Environment
- New closing case: Maine Coast Company

Chapter 17: Global Production and Supply Chain Management

- New opening case: The Global Chip Shortage in the Auto Industry: Supply Chain Disruptions in the Age of COVID-19
- New section: 360° View: Impact of the Macro Environment
- New closing case: China: The World's Manufacturing Center in the Wake of Trade Wars and COVID-19

Chapter 18: Global Marketing and Business Analytics

- New opening case: Airbnb: Building a Global Brand by Emphasizing Local Experience
- New section: 360° View: Impact of the Macro Environment
- New closing case: Share a Coke

Chapter 19: Global Human Resource Management

- New opening case: Developing a Global Workforce at Colgate-Palmolive
- New section: 360° View: Impact of the Macro Environment
- New closing case: The Evolution of HR Strategy at IBM

Chapter 20: Accounting and Finance in the International Business

- New opening case: Google Ends its "Double Irish-Dutch Sandwich" Tax Minimization Scheme
- New section: 360° View: Impact of the Macro Environment
- New closing case: Microsoft's Acquisition of Skype

Integrated Cases

All of the 20 integrated cases are new for *International Business 14e.* Many of these cases build on previous opening and closing chapter cases that have been revised, updated, and oftentimes adopted a new angle or focus. A unique feature of the opening and closing cases for the chapters as well as the integrated cases at the back-end of the text is that we cover all continents of the world and we do so with regional or country issues and large, medium, and small company scenarios. This makes the 60 total cases that are included in *International Business 14e* remarkably wealthy as a learning program.

- How the iPhone is Made: Apple's Global Production System
- Kenya: An African Lion
- Poland: Eastern Europe's Economic Miracle
- Culture and Business in Saudi Arabia
- Microsoft Goes Carbon Neutral
- A Tale of Two Nations: Ghana and South Korea
- American Steel Tariffs
- Starbucks' Foreign Direct Investment
- The Cost of Brexit
- Managing Foreign Currency Exposure at 3M
- Pakistan Takes Another IMF Loan
- Saudi Aramco
- Red Bull
- Dow Chemical's Global Matrix Structure
- Walmart International
- IKEA Entering India, Finally!
- Higher Education Exporting and International Competitiveness
- Blockchain Technology and Global Supply Chains
- Marketing Sneakers
- Global Mobility at Shell

BEYOND UNCRITICAL PRESENTATION AND SHALLOW EXPLANATION

Many issues in international business are complex and thus necessitate considerations of pros and cons. To demonstrate this to students, I have always adopted a critical approach that presents the arguments for and against economic theories, government policies, business strategies, organizational structures, and so on.

Related to this, I have attempted to explain the complexities of the many theories and phenomena unique to international business so the student might fully comprehend the statements of a theory or the reasons a phenomenon is the way it is. These theories and phenomena are explained in more depth in this work than they are in competing texts. I have always believed that a shallow explanation is little better than no explanation at all. In international business, a little knowledge is indeed a dangerous thing.

PRACTICAL AND RICH APPLICATIONS

It is important to show students how the material covered in the text is relevant to the actual practice of international business. This is explicit in the later chapters of the book, which focus on the practice of international business, but it is not always obvious in the first half of the book, which considers macro topics. Accordingly, at the end of each of the first 12 chapters—where the primary focus is on the environment of international business, as opposed to particular firms—there is a section titled **360° View: Managerial Implications.** In this section, the managerial implications of the material discussed in the chapter are clearly explained. Additionally, most chapters have at least one **Management Focus box.** The purpose of these boxes is to illustrate the relevance of chapter material for the practice of international business. Finally, as noted already, in Chapters 13–20, where the focus in explicitly on management issues, a new section has been added, **360° View: Impact of the Macro Environment,** where we discuss how changes in the macro environment can affect the management of strategy and functional activities within an international business.

A **Did You Know?** feature challenges students to view the world around them through the lens of international business (e.g., Did you know that a Kit Kat bar is marketed very differently in different countries?). The author recorded short videos explaining the phenomena.

In addition, each chapter begins with an **opening case** that sets the stage for the chapter and ends with a **closing case** that illustrates the relevance of chapter material for the practice of international business.

To help students go a step further in expanding their application-level understanding of international business, each chapter incorporates two **globalEDGE™ research tasks.** The exercises dovetail with the content just covered.

INTEGRATED PROGRESSION OF TOPICS

A shortcoming of many texts is that they lack a tight, integrated flow of topics from chapter to chapter. This book explains to students in Chapter 1 how the book's topics are related to each other. Integration has been achieved by organizing the material so that each chapter builds on the material of the previous ones in a logical fashion.

Part One

Chapter 1 provides an overview of the key issues to be addressed and explains the plan of the book. Globalization of markets and globalization of production is the core focus.

Part Two

Chapters 2 through 4 focus on country differences in political economy and culture, and Chapter 5 on ethics, corporate social responsibility, and sustainability issues in international business. Most international business textbooks place this material at a later point, but we believe it is vital to discuss national differences first. After all, many of the central issues in international trade and investment, the global monetary system, international business strategy and structure, and international business functions arise out of national differences in political economy and culture.

Part Three

Chapters 6 through 9 investigate the political economy of global trade and investment. The purpose of this part is to describe and explain the trade and investment environment in which international business occurs.

Part Four

Chapters 10 through 12 describe and explain the global monetary system, laying out in detail the monetary framework in which international business transactions are conducted.

Part Five

In Chapters 13, 14 and 15 attention shifts from the environment to the firm. In other words, we move from a macro focus to a micro focus at this stage of the book. We examine strategies that firms adopt to compete effectively in the international business environment.

Part Six

In Chapters 16 through 20, the focus narrows further to investigate business functions and related operations. These chapters explain how firms can perform their key functions—exporting, importing, and countertrade; global production; global supply chain management; global marketing; global research and development (R&D); human resource management—to compete and succeed in the international business environment.

Throughout the book, the relationship of new material to topics discussed in earlier chapters is pointed out to the students to reinforce their understanding of how the material comprises an integrated whole. We deliberately bring a management focus to the macro chapters (Chapters 1 through 12). We also integrate macro themes in covering the micro chapters (Chapters 13 through 20).

ACCESSIBLE AND INTERESTING

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

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

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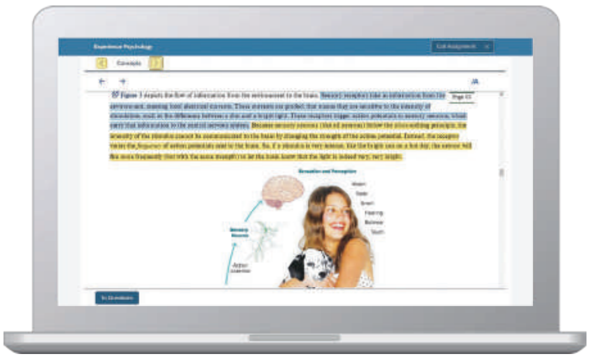

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International Business

Competing in the Global Marketplace

14e

part one **Introduction and Overview**

Globalization

1

LEARNING OBJECTIVES

After reading this chapter, you will be able to:

LO1-1 Understand what is meant by the term *globalization.*

LO1-2 Recognize the main drivers of globalization.

LO1-3 Describe the changing nature of the global economy.

LO1-4 Explain the main arguments in the debate over the impact of globalization.

LO1-5 Understand how the process of globalization is creating opportunities and challenges for management practice.

Wang Chun/VCG via Getty Images

TruckLabs

OPENING CASE

In 2015, Daniel Burrows started TruckLabs in a garage. He was still in graduate school, getting his MBA from Stanford University, and his funds were limited. Burrows' idea was to develop vertical panels that would automatically activate at highway speeds, sealing the gap between the truck cab and the trailer. This would significantly improve truck aerodynamics and save fuel costs. The product, named TruckWings, soon garnered interest from trucking companies. However, Burrows was faced with another problem: Where should he source the various component parts from?

Like many companies over the last four decades, TruckLabs decided to set up manufacturing operations in Asia hoping to minimize costs. Aluminum mounts were made in Taiwan. Pneumatic airflow systems, electronics, and wire harnesses were manufactured in China. Much of the decision on where to locate these various activities was driven by lower labor costs. In addition, TruckLabs and their U.S. suppliers struggled to find good manufacturing technicians in the United States. The U.S. unemployment rate was very low, and the necessary supply of skilled labor wasn't there. Thus, it made sense to outsource this manufacturing to other nations where skilled labor was in more abundant supply. Low tariffs on goods traded between the United States, China, and Taiwan, along with efficient shipping, also made the outsourcing decision logical.

At the same time, TruckLabs kept some key operations in Silicon Valley in the United States. These included advanced research, software, firmware, and cybersecurity. These activities were core to TruckLabs' competitive advantage. The company did not want to give away any advantage it might have by outsourcing them. Moreover, the requisite skilled labor for these activities, such as software engineers, was available in Silicon Valley. Marketing and sales were also located in the United States.

By configuring its value creation activities in this manner, TruckLabs was following a well-worn path many companies had taken in recent decades as globalization accelerated. Encouraged by lower barriers to cross-border trade and investment, fast communications, and efficient transoceanic transportation systems, large numbers of enterprises have outsourced many of their value creation activities to locations around the world where they could be performed more efficiently and effectively. This lowers costs and helps companies compete in the highly competitive global marketplace.

However, in 2017, a significant shift occurred in the business environment. Donald Trump had been elected President of the United States, Following through on his campaign promises to bring manufacturing jobs back to the United States, Trump imposed a 25 percent tariff on many imports from China, raising their cost. However, things had begun to shift before Trump's election, and labor costs in China had been rising as the country continued its rapid economic development, meaning that the cost advantage of producing in China was already diminishing prior to 2017. Trump's tariff brought this into sharper focus. As Burrows noted, "Tariffs made it very hard to operate and did a lot of damage. We didn't have the margin to suddenly spend 25 percent more."

TruckLabs responded by starting to move production back to the United States. Burrows initially considered shifting production to other countries with low-cost labor, such as Bangladesh and Vietnam, but he came to the realization that deciding where to produce and assemble the panels was more important than reduced labor costs. Materials costs, shipping costs, operational complexities, the skills of local labor, and the risks of business disruption also factored into his decision. Moreover, because most of TruckLabs' customers were in North America, Burrows reasoned that bringing production back to the United States would save time and money in shipping and clearing parts through customs and would enable TruckLabs to respond more quickly to customer demands.

When the COVID-19 pandemic hit in early 2020, and supply chains faltered as nations entered lockdown, the value of moving production back home increased. By late 2020, TruckLabs had moved 60 percent of its overseas production back to the United States. The company now works with parts suppliers in Ohio, Pennsylvania, and Arizona and assembles many of its TruckWings units at a factory in North Carolina. According to Burrows, reshoring some activities lowered costs for component parts by 10 to 20 percent and reduced lead times from 8 weeks to 4 weeks, which enabled the company to fulfill customer orders more rapidly. The advantages come not just from avoiding tariffs on imports, but also from greater automation among the company's U.S. suppliers, which offsets the somewhat high labor costs of American workers. All this being said, whether these advantages will persist if the import tariffs imposed by Trump are lowered by a new White House administration remains to be seen.

Sources: D. Burrows, "Why We Are Reshoring Our Manufacturing: A CEO's View," *Industry Week,* November 3, 2020; M. Braga, "American Manufacturers Pine for Home as COVID Disruptions, Trump Tariffs Shake Up Supplies," *USA Today,* December 18, 2020; S. Tengler, "Beyond Tesla's Gigafactory: Why Some Auto Jobs Are Moving Back to North America," *Forbes,* August 25, 2020.

Introduction

Over the past five decades, a fundamental shift has been occurring in the world economy. We have been moving away from a world in which national economies were relatively self-contained entities, isolated from each other by barriers to cross-border trade and investment; by distance, time zones, and language; and by national differences in government regulation, culture, and business systems. We have moved toward a world in which barriers to cross-border trade and investment have declined; perceived distance is shrinking due to advances in transportation and telecommunications technology; material culture is starting to look similar the world over; and national economies are merging into an interdependent, integrated global economic system. The process by which this transformation is occurring is commonly referred to as *globalization.*

At the same time, recent political events have raised some questions about the inevitability of the globalization process. The exit of the United Kingdom from the European Union (Brexit), the renegotiation of the North American Free Trade Agreement (NAFTA), and trade disputes between the United States and many of its trading partners, including most notably China, have all contributed to uncertainty about the future of globalization. While the world seems unlikely to pull back significantly from globalization, there is no doubt that the benefits of globalization are more in dispute now than at any time in the last half century. This is a new reality, albeit perhaps a temporary one, but it is one the international business community will have to adjust to.

The Opening Case illustrates how this shifting landscape has affected one U.S. enterprise: TruckLabs.

One of the goals of this book is to give the reader a much greater understanding of the issues here and explain how business policy is affected by changes in the global environment within which firms compete. As suggested by the story of TruckLabs, geopolitics has an important influence on business strategy decisions for the international enterprise. Proponents of increased globalization argue that cross-cultural engagement, and cross-border trade and investment, have benefited us all and that returning to a more isolationist or nationalistic perspective will have a negative impact upon economic growth. On the other hand, those who argue for returning to a nationalistic perspective, such as Donald Trump did with his "America First" policy, want their countries to be more self-sufficient, to have greater control over economic activity within their borders, and to be able to set the rules by which they trade with other nations. In other words, they want to increase national sovereignty with regard to a number of issues, ranging from trade policy to immigration to environmental regulations. They are opposed to globalization as it has unfolded over the last 50 years. We will touch on many aspects of this debate throughout this text's 20 integrated chapters, always with the purpose of clarifying the implications for international business.

Irrespective of the current policy debate, the fact remains that globalization has and will probably continue to have an impact on almost everything we do. The impact of globalization is evident in our everyday lives. Consider this plausible scenario that describes today's reality: An American businesswoman wearing clothes that were designed in New York and manufactured in Bangladesh might drive to work in a sports utility vehicle (SUV) designed in Stuttgart, Germany, and assembled in Leipzig, Germany, and Bratislava, Slovakia, by Porsche from components sourced from parts suppliers worldwide, which in turn were created from Korean steel, Malaysian rubber, and Chinese plastics. She may have filled her car with gasoline at a Shell service station owned by a British-Dutch multinational company. The gasoline could have been made from oil pumped out of a well off the coast of Africa by a French oil company that transported it to the United States in a ship owned by a Greek shipping line. While driving to work, she might talk to her stockbroker (using a hands-free, in-car speaker) on an Apple iPhone that was designed in California and assembled in China using chip sets produced in Japan and Europe, glass made by Corning in

Kentucky, and memory chips from South Korea. Perhaps on her way, she might tell the stockbroker to purchase shares in Lenovo, a multinational Chinese PC manufacturer whose operational headquarters is in North Carolina and whose shares are listed on the New York Stock Exchange.

This is the world in which we live. In many cases, we simply do not know, or perhaps even care, where a product was designed and where it was made. Just a couple of decades ago, "Made in the USA," "Made in Germany," or "Made in Italy" had strong meaning and referred to something. The United States often stood for quality; Germany stood for sophisticated engineering; Italy stood for design flair. Now the country of origin for a product has given way to, for example, "Made by BMW" or "Made by Apple," and the company is the quality assurance platform, not the country. This is because the products are often global products, where the processes of design, component part manufacture, and final assembly are located in different places around the world.

The reality is that we live in a world where the volume of goods, services, and investments crossing national borders has expanded faster than world output for more than half a century. It is a world in which international institutions such as the World Trade Organization and gatherings of leaders from the world's most powerful economies continue to work for even lower barriers to cross-border trade and investment. The symbols of material culture and popular culture are increasingly global, from Coca-Cola and Starbucks, to Sony PlayStation, Facebook, Netflix video streaming service, IKEA stores, and Apple iPads and iPhones. Vigorous and vocal groups protest against globalization, which they blame for a list of ills from unemployment in developed nations to environmental degradation and the Westernization or Americanization of local cultures. Some of these protesters come from environmental groups, which have been around for some time, but more recently they have also come from nationalistic groups focused on their countries being more sovereign.

For businesses, the globalization process creates many opportunities. Firms can expand their revenues by selling around the world and/or reduce their costs by producing in nations where key inputs, including labor, are less expensive. Until very recently, the global expansion of enterprises has been facilitated by generally favorable political and economic trends. This has allowed businesses both large and small, from both advanced nations and developing nations, to expand internationally. As globalization has unfolded, it has transformed industries and created anxiety among those who believed their jobs were protected from foreign competition. Moreover, advances in technology, lower transportation costs, and the rise of skilled workers in developing countries imply that many services no longer need to be performed where they are delivered. An MRI scan undertaken in a hospital in Massachusetts might be diagnosed by a radiologist located in India, your inquiry to an American telephone company might be routed to a call center located in Costa Rico, the software that runs on your phone might be updated overnight with a patch that was written by software programmers in Taiwan, and your American tax returns might be completed by tax specialists located in the Philippines and then signed off on by your American accountant. As best-selling author Thomas Friedman has argued, the world is becoming "flat."[1] People living in developed nations no longer have the playing field tilted in their favor. Increasingly, enterprising individuals based in India, China, or Brazil have the same opportunities to better themselves as those living in western Europe, the United States, or Canada.

In this text, we will take a close look at these issues and many more. We will explore how changes in regulations governing international trade and investment, when coupled with changes in political systems and technology, have dramatically altered the competitive playing field confronting many businesses. We will discuss the resulting opportunities and threats and review the strategies that managers can pursue to exploit the opportunities and counter the threats. We will consider whether globalization benefits or harms national economies. We will look at what economic theory has to say about the outsourcing of manufacturing and service jobs to places such as India and China and look at the benefits and costs of outsourcing, not just to business firms and their employees but to entire economies. First, though, we need to get a better overview of the nature and process of globalization, and that is the function of this first chapter.

LO1-1
Understand what is meant by the term *globalization*.

What Is Globalization?

As used in this text, **globalization** refers to the shift toward a more integrated and interdependent world economy. Globalization has several facets, including the globalization of markets and the globalization of production.

THE GLOBALIZATION OF MARKETS

The **globalization of markets** refers to the merging of historically distinct and separate national markets into one huge global marketplace. Falling barriers to cross-border trade and investment have made it easier to sell internationally. It has been argued for some time that the tastes and preferences of consumers in different nations are beginning to converge on some global norm, thereby helping create a global market.[2] Consumer products such as Citigroup credit cards, Coca-Cola soft drinks, Sony video games, McDonald's hamburgers, Starbucks coffee, IKEA furniture, and Apple iPhones are frequently held up as prototypical examples of this trend. The firms that produce these products are more than just benefactors of this trend; they are also facilitators of it. By offering the same basic product worldwide, they help create a global market.

A company does not have to be the size of these multinational giants to facilitate, and benefit from, the globalization of markets. In the United States, for example, according to the International Trade Administration, more than 300,000 small- and medium-sized firms with fewer than 500 employees, accounts for 98 percent of the companies that export. More generally, exports from small and medium-sized companies account for 33 percent of the value of U.S. exports of manufactured goods.[3] Typical of these is B&S Aircraft Alloys, a New York company whose exports account for 40 percent of its $8 million annual revenues.[4] The situation is similar in several other nations. For example, in Germany, a staggering 98 percent of small and midsize companies have exposure to international markets, via either exports or international production. Since 2009, China has been the world's largest exporter. In 2019, China sold $2.5 trillion worth of products and services to the rest of the world.

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Despite the global prevalence of Apple phones, McDonald's hamburgers, Starbucks coffee, and IKEA stores, for example, it is important not to push too far the view that national markets are giving way to the global market. As we shall see in later chapters, significant differences still exist among national markets along many relevant dimensions, including consumer tastes and preferences, distribution channels, culturally embedded value systems, business systems, and legal regulations. Uber, for example, the fast-growing ride-for-hire service, is finding it needs to refine its entry strategy in many foreign cities in order to take differences in the regulatory regime into account. Such differences frequently require companies to customize marketing strategies, product features, and operating practices to best match conditions in a particular country.

The most global of markets are not typically markets for consumer products—where national differences in tastes and preferences can still be important enough to act as a brake on globalization. They are markets for industrial goods and materials that serve universal needs the world over. These include markets for commodities such as aluminum, oil, and wheat; for industrial products such as microprocessors, DRAMs (computer memory chips), and commercial jet aircraft; for computer software; and for financial assets, from U.S. Treasury bills to Eurobonds, and futures on the Nikkei index or the euro. That being said, it is increasingly evident that many newer high-technology consumer products, such as Apple's iPhone, are being successfully sold the same way the world over.

In many global markets, the same firms frequently confront each other as competitors in nation after nation. Coca-Cola's rivalry with PepsiCo is a global one, as are the rivalries between Ford and Toyota; Boeing and Airbus; Caterpillar and Komatsu in earthmoving equipment; General Electric and Rolls-Royce in aero engines; Sony, Nintendo, and Microsoft in video-game consoles; and Samsung and Apple in smartphones. If a firm moves into a nation not currently served by its rivals, many of those rivals are sure to follow to prevent their competitor from gaining an advantage.[5] As firms follow each other around the world, they bring with them many of the assets that served them well in other national markets—their products, operating strategies, marketing strategies, and brand names—creating some homogeneity across markets. Thus, greater uniformity replaces diversity. In an increasing number of industries, it is no longer meaningful to talk about "the German market," "the American market," "the Brazilian market," or "the Japanese market"; for many firms, there is only the global market.

Did You Know?

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THE GLOBALIZATION OF PRODUCTION

The **globalization of production** refers to the sourcing of goods and services from locations around the globe to take advantage of national differences in the cost and quality of **factors of production** (such as labor, energy, land, and capital). By doing this, companies hope to lower their overall cost structure or improve the quality or functionality of their product offering, thereby allowing them to compete more effectively. For example, Boeing has made extensive use of outsourcing to foreign suppliers. Consider Boeing's 777 first introduced in 1995: Eight Japanese suppliers make parts for the fuselage, doors, and wings; a supplier in Singapore makes the doors for the nose landing gear; three suppliers in Italy manufacture wing flaps; and so on.[6] In total, some 30 percent of the 777, by value, is built by foreign companies. And for its most recent jet airliner, the 787, Boeing has pushed this trend even further; some 65 percent of the total value of the aircraft is outsourced to foreign companies, 35 percent of which goes to three major Japanese companies.

Part of Boeing's rationale for outsourcing so much production to foreign suppliers is that these suppliers are the best in the world at their particular activity. A global web of suppliers yields a better final product, which enhances the chances of Boeing winning a greater share of total orders for aircraft than its global rival, Airbus. Boeing also outsources some production to foreign countries to increase the chance it will win significant orders from airlines based in that country. For a more detailed look at the globalization of production at Boeing, see the accompanying Management Focus.

MANAGEMENT FOCUS

Boeing's Global Production System

Executives at the Boeing Corporation, America's largest exporter, say that building a large commercial jet aircraft such as the 787 Dreamliner involves bringing together more than a million parts in flying formation. Half a century ago, when the early models of Boeing's venerable 737 and 747 jets were rolling off the company's Seattle-area production lines, foreign suppliers accounted for only 5 percent of those parts, on average. Boeing was vertically integrated and manufactured many of the major components that went into the planes. The largest parts produced by outside suppliers were the jet engines, where two of the three suppliers were American companies. The lone foreign engine manufacturer was the British company Rolls-Royce.

Fast-forward to the modern era, and things look very different. In the case of Boeing's super-efficient 787 Dreamliner, 50 outside suppliers spread around the world account for 65 percent of the value of the aircraft. Italian firm Alenia Aeronautica makes the center fuselage and horizontal stabilizer. Kawasaki of Japan makes part of the forward fuselage and the fixed trailing edge of the wing. French firm Messier-Dowty makes the aircraft's landing gear. German firm Diehl Luftahrt Elektronik supplies the main cabin lighting. Sweden's Saab Aerostructures makes the access doors. Japanese company Jamco makes parts for the lavatories, flight deck interiors, and galleys. Mitsubishi Heavy Industries of Japan makes the wings. KAA of Korea makes the wing tips; and so on.

Why the change? One reason is that 80 percent of Boeing's customers are foreign airlines, and to sell into those nations, it often helps to be giving business to those nations. The trend started in 1974 when Mitsubishi of Japan was given contracts to produce inboard wing flaps for the 747. The Japanese reciprocated by placing big orders for Boeing jets. A second rationale was to disperse component part production to those suppliers who are the best in the world at their particular activity. Over the years, for example, Mitsubishi has acquired considerable expertise in the manufacture of wings, so it was logical for Boeing to use Mitsubishi to make the wings for the 787. Similarly, the 787 is the first commercial jet aircraft to be made almost entirely out of carbon fiber, so Boeing tapped Japan's Toray Industries, a world-class expert in sturdy but light carbon-fiber composites, to supply materials for the fuselage. A third reason for the extensive outsourcing on the 787 was that Boeing wanted to unburden itself of some of the risks and costs associated with developing production facilities for the 787. By outsourcing, it pushed some of those risks and costs onto suppliers, who had to undertake major investments in capacity to ramp up to produce for the 787.

So what did Boeing retain for itself? Engineering design, marketing and sales, and final assembly are done at its Everett plant north of Seattle, all activities where Boeing maintains it is the best in the world. Of major component parts, Boeing made only the tail fin and wing to body fairing (which attaches the wings to the fuselage of the plane). Everything else was outsourced.

As the 787 moved through development, it became clear that Boeing had pushed the outsourcing paradigm too far. Coordinating a globally dispersed production system this extensive turned out to be very challenging. Parts turned up late, some parts didn't "snap together" the way Boeing had envisioned, and several suppliers ran into engineering problems that slowed down the entire production process. As a consequence, the date for delivery of the first jet was pushed back more than four years, and Boeing had to take millions of dollars in penalties for late deliveries. The problems at one supplier, Vought Aircraft in North Carolina, were so severe that Boeing ultimately agreed to acquire the company and bring its production in-house. Vought was co-owned by Alenia of Italy and made parts of the main fuselage.

There are now signs that Boeing is rethinking some of its global outsourcing policy. For its most recent wide-bodied jet, a new version of its popular wide-bodied 777 aircraft, the 777X, which uses the same carbon-fiber technology as the 787, Boeing has brought wing production back in-house. Mitsubishi and Kawasaki of Japan produce much of the wing structure for the 787 and for the original version of the 777. However, recently Japan's airlines have been placing large orders with Airbus, breaking with their traditional allegiance to Boeing. This seems to have given Boeing an opening to bring wing production back in-house. Boeing executives also note that Boeing has lost much of its expertise in wing production over the last 20 years due to outsourcing, and bringing it back in-house for new carbon-fiber wings might enable Boeing to regain these important core skills and strengthen the company's competitive position.

Sources: M. Ehrenfreund, "The Economic Reality Behind the Boeing Plane Trump Showed Off," *The Washington Post,* February 17, 2017; K. Epstein and J. Crown, "Globalization Bites Boeing," *Bloomberg Businessweek,* March 12, 2008; H. Mallick, "Out of Control Outsourcing Ruined Boeing's Beautiful Dreamliner," *The Star,* February 25, 2013; P. Kavilanz, "Dreamliner: Where in the World Its Parts Come From," *CNN Money,* January 18, 2013; S. Dubois, "Boeing's Dreamliner Mess: Simply Inevitable?" *CNN Money,* January 22, 2013; A. Scott and T. Kelly, "Boeing's Loss of a $9.5 Billion Deal Could Bring Jobs Back to the U.S.," *Business Insider,* October 14, 2013.

Early outsourcing efforts were primarily confined to manufacturing activities, such as those undertaken by Boeing and Apple. Increasingly, however, companies are taking advantage of modern communications technology, particularly the internet, to outsource service activities to low-cost producers in other nations. The internet has allowed hospitals to outsource some radiology work to India, where images from MRI scans and the like are read at night while U.S. physicians sleep; the results are ready for them in the morning. Many software companies, including Microsoft, now use Indian engineers to perform test functions on software designed in the United States. The time difference allows Indian engineers to run debugging tests on software written in the United States when U.S. engineers sleep, transmitting the corrected code back to the United States over secure internet connections so it is ready for U.S. engineers to work on the following day. Dispersing value creation activities in this way can compress the time and lower the costs required to develop new software programs. Other companies, from computer makers to banks, are outsourcing customer service functions, such as customer call centers, to developing nations where labor is cheaper. In another example from health care, workers in the Philippines transcribe American medical files (such as audio files from doctors seeking approval from insurance companies for performing a procedure). Some estimates suggest the outsourcing of many administrative procedures in health care, such as customer service and claims processing, could reduce health care costs in America by more than $100 billion.

The political scientist Robert Reich has argued that as a consequence of the trend exemplified by companies such as Boeing, Apple, and Microsoft, in many cases it is becoming irrelevant to talk about American products, Japanese products, German products, or Korean products. Increasingly, according to Reich, the outsourcing of productive activities to different suppliers results in the creation of products that are global in nature—that is, "global products."[7] But as with the globalization of markets, companies must be careful not to push the globalization of production too far. As we will see in later chapters, substantial impediments still make it difficult for firms to achieve the optimal dispersion of their productive activities to locations around the globe. These impediments include formal and informal barriers to trade between countries, barriers to foreign direct investment, transportation costs, issues associated with economic and political risk, and the sheer managerial challenge of coordinating a globally dispersed supply chain (an issue for Boeing with the 787 Dreamliner, as discussed in the Management Focus). For example, government regulations ultimately limit the ability of hospitals to outsource the process of interpreting MRI scans to developing nations where radiologists are cheaper.

Nevertheless, the globalization of markets and production will probably continue. Modern firms are important actors in this trend, their actions fostering increased globalization. These firms, however, are merely responding in an efficient manner to changing conditions in their operating environment—as well they should.

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The Emergence of Global Institutions

As markets globalize and an increasing proportion of business activity transcends national borders, institutions are needed to help manage, regulate, and police the global marketplace and to promote the establishment of multinational treaties to govern the global business system. Over the past 75 years, a number of important global institutions have been created to help perform these functions, including the **General Agreement on Tariffs and Trade (GATT)** and its successor, the World Trade Organization; the International Monetary Fund and its sister institution, the World Bank; and the United Nations. All these institutions were created by voluntary agreement between individual nation-states, and their functions are enshrined in international treaties.

The **World Trade Organization (WTO)** (like the GATT before it) is primarily responsible for policing the world trading system and making sure nation-states adhere to the rules laid down in trade treaties signed by WTO member states. As of 2021, 164 nations