**Part One**

**Background for International Business**

**CHAPTER ONE**

**Globalization and International Business**

**OBJECTIVES**

• Define *globalization* and *international business* and show how they affect each other

• Grasp why companies engage in international business and why international business growth has accelerated

• Discuss globalization’s future and the major criticisms of it

• Illustrate the different ways in which a company can accomplish its global objectives

• Recognize the need to apply social science disciplines to understanding the differences between international and domestic business

**CHAPTER OVERVIEW**

Globalizationhas become a major socioeconomic force and topic of debate in the twenty-first century. Chapter One examines the forces that are driving this phenomenon, as well as the often passionate criticisms of the process. It reviews the objectives that firms pursue when they engage in international business activities and describes the various modes of entry that may be used. It also notes the terminology that has come into existence as new types of organizations have evolved. The chapter concludes with a discussion of the ways in which international business differs from domestic business.

**CHAPTER OUTLINE**

#### OPENING CASE: THE GLOBALIZED BUSINESS OF SPORTS

 [See Map 1.1]

Although not everyone agrees that the unbridled globalization of professional sports is all for the good, the process and possibilities are definitely far reaching. Today’s satellite television broadcasts enable fans to watch top players and teams in nearly any sport from almost anywhere on earth. Professional teams scour the world to find and develop the most talented athletes, and players forsake home country allegiances in their pursuit of the world’s highest salaries. Further, the more people that tournaments can attract through attendance and television, the more money that sponsors and advertisers are willing to pay—and the greater the likelihood that those sponsors and advertisers will have business operations that span the globe. In addition, sports and nonsports companies alike pay famous athletes and teams generous sums to endorse their products. Successful teams have opened shops both domestically and internationally to sell souvenirs bearing their logos and may make more money on merchandise than from TV rights and sponsorships combined. Most recently, as teams and leagues have begun to seek income opportunities outside their home countries, foreign investors have acquired a U.S. baseball team; another group of foreign investors acquired controlling interest in a British soccer (football) team, and the National Football League (NFL) of the United States underwrites flag football games in Chinese schools, and is playing some regular season NFL games in Europe. Map 1.1 outlines national sports in a variety of countries and can be used to discuss how culture impacts globalization.

## Questions

* 1. *Professional athlete A is a star. And professional athlete B is an average player. How has the globalization of professional sports affected each of these both positively and negatively?*

All athletes playing abroad may generate interest in a player’s native country, due in part to the ability to watch games taking place anywhere in the world through live Web stream or satellite television. This gives not just the team owners, league representatives, but also the players a broadened audience exposure, expanded fan base and the opportunities for additional revenues. On the negative side, in undertaking any international sports effort, the athletes and teams must be sensitive to cultural differences. They need to appreciate differences in the world and understand how the same sport can be interpreted differently from country to country. It can also be noted that the average players can benefit by playing and presenting his skills to professional teams from foreign markets, which can in turn potentially offer them a contract. (LO: 2, Learning Outcome: To understand why companies engage in international business and why international business growth has accelerated, AACSB: Analytical Skills)

*1-2 As you read the chapter, identify and show an example of each international mode of operations that is illustrated in the globalization of professional sports.*

Using the NBA as an example in the opening case, it searches globally for talent and additional markets for its product. This is similar to any manager in almost any industry, who needs to identify where you can obtain the best inputs at the best price and where you can best sell the product that you have put together from those inputs. (LO: 2, Learning Outcome: To understand why companies engage in international business and why international business growth has accelerated, AACSB: Analytical Skills)

**Teaching Tips**: Carefully review the PowerPoint slides for Chapter One. A good Internet source of information on globalization can be found at www.globalization101.org. Finally, review the atlas provided in the text, where you will find maps of the world and its continents, as well as a country index.

1. **INTRODUCTION**

As people, firms, and other organizations have expanded their access to resources, goods, services, and markets across wider geographical areas, they have also become more deeply affected (positively and negatively) by conditions outside their home countries. **Globalization** refers to the broadening set of interdependent relationships among people from different parts of a world that happens to be divided into nations.

1. **What is International Business?**

**International business** involves all commercial transactions, including sales, investments, and transportation—private and governmental—between parties of two or more countries. Global events and competition affect almost all firms—large or small. However, the international environment is more complex and diverse than a firm’s domestic environment. [See Fig. 1.1]

1. **THE FORCES DRIVING GLOBALIZATION**

Globalization is a difficult concept to measure. Currently, over 20 percent of world production is sold outside of its country of origin, restrictions on imports continue to decline, the foreign ownership of assets as a percent of world production continues to increase, and world trade continues to grow more rapidly than world production. Recessionary contraction in recent years has at least temporarily reversed this trend. That said, on a value basis, only a few countries (mainly very small nations) either sell more than half of their production abroad or source more than half of their consumption from foreign countries. Further, the principal source of capital in almost all nations is still domestic. Studies have shown several interrelated factors that have contributed to the spiraling growth in globalization, including people to people contacts through travel and communication, technological interchanges, government to government relationships, and acceptance and adaptation and attributes from foreign cultures such as words from other languages.

1. **Factors in Increased Globalization**

 There are seven factors that are often cited as having contributed to the increased growth in globalization.

1. **Increase in and Application of Technology**

Vast improvements in transportation and communications technology—including the development of the Internet—have significantly increased the effectiveness and efficiency of international business operations. Today, a much larger portion of the population is involved in the *development* of new products, than just the production of products.

1. **Liberalization of Cross-Border Trade and Resource Movement**

Over time most governments have lowered restrictions on trade and foreign investment in response to the expressed desires of their citizens and producers. The primary motives for this change include giving citizens greater consumer choice and lower prices, international competition making domestic producers more efficient, and the hope that liberalization will cause other countries to also lower trade barriers.

1. **Development of Services That Support International Business**

Services provided by government, banks, transportation companies, and other businesses greatly facilitate the conduct and reduce the risks of doing business internationally.

1. **Growth of Consumer Pressures**

Because of innovations in transportation and communications technology, consumers are well informed about and often able to access foreign products. Thus competitors the world over have been forced to respond to consumers’ demand for increasingly higher quality and more cost-competitive offerings.

**5. Increased Global Competition**

The pressures of increased foreign competition often persuade firms to expand internationally in order to gain access to foreign opportunities and to improve their overall operational flexibility and competitiveness. How companies become global players can be discussed using the terms **born-global companies** and **clustering**.

1. **Changes in Political Situations and Government Policies**

The transformation of the political and economic policies of Eastern Europe, Vietnam, Myanmar, and China has led to vast increases in trade between those countries and the rest of the world. In addition, the improvements in national infrastructure and the provision of trade-related services by governments the world over have further led to substantial increases in foreign trade and investment levels.

1. **Expansion of Cross-National Cooperation**

Governments have increasingly entered into cross-national treaties and agreements in order to gain reciprocal advantages for their own firms, to jointly attack problems that one country cannot solve alone, and to deal with areas of concern that lie outside the territory of all countries. Often, such cooperation occurs within the framework of international organizations such as the International Bank for Reconstruction and Development (World Bank). [See Chapter 7]

**III. THE COSTS OF GLOBALIZATION**

*Antiglobalization forces* have protested both peacefully and violently as they press for legislation and other means to stop or slow the globalization process. Issues of threats to national sovereignty, increasing income inequality and personal stress, and growth and environmental stress are addressed in the Point—Counterpoint sections found throughout the text.

1. **Threats to National Sovereignty**

Many citizens fear that a country’s participation in multilateral agreements will diminish its sovereignty and freedom from external control and curtail its ability to act in its own best interests. In particular, people in small countries worry that dependence on larger countries for sales and/or supplies, as well as the presence of large international firms, will make them vulnerable to the demands of parties against which they are essentially powerless. In addition, people the world over are concerned that globalization will bring the homogenization of products and traditional ways of life—including language and social structure.

1. **Environmental Stress**

Clearly, economic growth can result in both positive and negative consequences, including damage to society and the environment. While globalization can, in fact, support the sustenance of natural resources and the maintenance of an environmentally sound planet, unless the positive consequences of globalization keep pace with the negative costs of economic growth, the sustainability of economic improvement on a worldwide basis will, at best, be problematic.

1. **Growing Income Inequality and Personal Stress**

**Offshoring***,* the process of shifting domestic production to a foreign country for the purpose of serving the home market at a reduced cost, speeds up the process of altering the relative economic discrepancies between the two countries involved. Thus, even if the overall global gains from globalization are positive, there remains a continuing challenge to bring about the positive gains in ways that minimize costs to the losers. It is easy to think about the impacts of globalization at a macro level, but individuals are impacted very specifically, causing stress and insecurity.

**POINT—COUNTERPOINT: Is Offshoring Good Strategy?**

POINT: Offshoring is good because it reduces costs. Although a firm may temporarily need fewer workers in its home country, eventually domestic employment (particularly high-value jobs) will increase because of the firm’s growth. In addition, offshoring not only contributes to the economic growth of less-developed countries, but it increases their need and ability to import products from developed countries and thus indirectly contributes to the growth of all nations. There is also a natural extension from outsourcing to offshoring. Some industries and companies have actually seen some reversal of the outsourcing trend.

COUNTERPOINT: Only a few people benefit from offshoring. Cheaper labor inputs have not resulted in cheaper prices for consumers. Further, firms that grow as a result of offshoring do so at the expense of their competitors; thus, there is no real economic growth. Displaced workers are forced to take jobs with fewer, if any, benefits and lower pay, while multinationals take advantage of their foreign workers, who are powerless. While a few countries are growing economically, world poverty levels have increased significantly in recent decades.

**IV. WHY COMPANIES ENGAGE IN INTERNATIONAL BUSINESS**

When engaging in international business, a firm should consider its mission, its objectives, and its possible strategies. Primary objectives would include the following:

1. **Expanding Sales**

Companies may increase the potential market for their sales by pursuing international consumer and industrial markets.

**B. Acquiring Resources**

Foreign-sourced products, services, resources, and components can make a firm more competitive both at home and abroad.

1. **Reducing Risk**

Firms seek foreign markets in order to minimize cyclical effects on sales and profits. Defensively, they may also wish to counter the potential advantages that competitors might gain from participating in foreign market opportunities.

### V. MODES OF OPERATION IN INTERNATIONAL BUSINESS

A firm can engage in international business through various operating modes, [See Fig. 1.1] including *exporting* and *importing* merchandise and services (see Chapters 6 and 7 regarding international trade) and *licensing* and *foreign direct investment* (see Chapter 14 regarding direct investment and collaborative strategies), joint ventures, and management contracts. The firm or individual exporting merchandise or a service will receive international earnings while the firm or individual importing merchandise or a service will make an international payment.

1. **Merchandise Exports and Imports**

**Merchandise exports** consist of tangible (visible) products, i.e., goods that are sent to a foreign country for use or resale. **Merchandise imports** consist of tangible products, i.e., goods brought into a country for use or resale.

# B. Service Exports and Imports

**Service exports and imports** represent intangible (invisible), i.e., non-merchandise products.

**1. Tourism and Transportation.** When an American flies to Paris on Air France and stays in a French-owned hotel, payments made to the airline and the hotel represent service export earnings (income) for France and service import payments (expenses) for the United States.

1. **Service Performance.** Some services, such as banking, insurance, rental, engineering, **turnkey operations** (construction, performed under contract, of facilities that are transferred to the owner when they are ready for operation), and **management contracts** (arrangements in which one firm provides personnel to perform management functions for another), net companies export earnings in the form of fees paid by a foreign client.
2. **Asset Use.** Firms may receive export earnings, i.e., **royalties**, by allowing foreign clients to use their assets (trademarks, patents, copyrights, and other expertise). **Licensing** **agreements** are contracts that represent a transaction in which a licensor sells the rights to the use of its intellectual property to a licensee in exchange for a fee or royalty. **Franchising** is a special form of licensing in which the *franchisee* is granted additional control over the operation in exchange for the provision of additional support and services by the *franchisor*.
3. **Investments**

Foreign investment consists of the ownership of foreign property for the purpose of realizing a financial gain via profits, growth, dividends, and/or interest.

1. **Direct Investment.** **Foreign direct investment (FDI)** occurs when an investor gains a controlling interest in a foreign operation. A **joint venture** represents a direct investment in which two or more parties share ownership of an FDI.
2. **Portfolio Investment.** **Portfolio investment** is a noncontrolling interest in a venture made in the form of either debt or equity. Often, firms use portfolio investment as part of their short-term financial strategy.
3. **Types of International Organizations**

There are numerous forms of **collaborative arrangements** through which companies work together internationally, such as *minority ownership*, *joint ventures, licensing agreements*, *management contracts*, or other long-term contractual arrangements. A **strategic alliance** is more narrowly defined to indicate that the agreement is of critical importance to the competitive viability of one or more of the partners. The **multinational enterprise (MNE)** is a firm that takes a global approach to foreign markets and production, i.e., it is willing to consider markets and production sites anywhere in the world. The terms **multinational corporation (MNC)** and **transnational company (TNC)** may also be used in this context.

**VI. WHY INTERNATIONAL BUSINESS DIFFERS FROM DOMESTIC BUSINESS**

*External environments* that affect the ways in which firms operate internationally include physical, societal, and competitive factors. In fact, the amount of adjustment required in foreign operations is largely influenced by the extent to which the home and host country environments resemble one another. [See Fig. 1.1]

1. **Physical and Social Factors**

 **1. Geographic Influences.** The uneven distribution of resources results in different opportunities being located in different parts of the world. In addition, geographic barriers affect transportation, communications, and distribution channels within a country. Finally, the probability of natural disasters and adverse climatic conditions make it riskier to invest and operate in some countries than others.

 **2. Political Policies.** Politics often determine where and how international business takes place because of the influence of government leaders over the process.

**3. Legal Policies.** While every nation has its own body of business law, agreements between/amongst nations determine international law. *Domestic business law* may include regulations on home-country firms in both home and host countries regarding such matters as taxation, employment, and foreign-exchange transactions. *International law* may also determine how and whether firms can operate in certain locales. [Note: while most countries have laws that recognize and protect intellectual property rights, many do little to enforce them.]

**4. Behavioral Factors.** By studying the disciplines of anthropology, psychology, and sociology, managers can better understand the interpersonal norms of people in foreign countries and the reasons why operating procedures may need to be adjusted in foreign locales.

**5. Economic Forces.** Among other things, economics explains why countries exchange goods and services, why capital and people travel among countries in the course of business, and why one country’s currency has a certain value compared to another. It also provides the analytical tools to determine the impact of foreign operations on home and host countries, as well as the effect of a country’s economic policies and conditions upon domestic and foreign firms.

1. **The Competitive Environment**

The global competitive environment varies both by industry and by country. Likewise, a company’s competitive situation may differ in terms of its relative strength and in terms of which competitors it faces from one country to another. Thus, a firm’s competitive strategy directly influences how and where it can operate most effectively. A firm’s competitive strategy for products will usually involve competing on the basis of price or differentiation. Differentiation strategies can be based on a brand image or a unique characteristic. Company resources and experience influence choice of strategy, and competitors faced in each market may alter overall global strategy. [See Fig. 1.1]

**LOOKING TO THE FUTURE: Three Ways of Looking at Globalization**

By envisioning different ways in which the future may evolve, a company can be better prepared to develop the facilities and people needed to succeed in an uncertain environment. At this time, there is much discussion about the following three viewpoints.

The first view, that further *globalization is inevitable,* is based largely upon the premise that technical advances in transportation and communications are pervasive, that consumers demand the best products for the best prices regardless of their country of origin, and that MNEs are so powerful they can pressure governments to further reduce restrictions on trade and investment. If this is true, then the challenge is to determine what to make of globalization with respect to the distribution of its costs and benefits.

The second view, that *international business will grow primarily along regional rather than global lines,* is premised on studies that show that almost all firms that consider themselves global conduct a dominant portion of the business in their home and neighboring countries. It may be possible however, that regionalization is a transitional step on the route to globalization.

The third view, that *forces opposing globalization will greatly slow its growth*, is not to be dismissed. Historically, pressure groups have often been successful in obstructing policies and activities that threatened their own well-being. In addition, recent *anti-globalization* interests have successfully promoted a variety of causes in numerous countries that span the globe. The impact of other uncertainties also impacts the future of globalization. Some examples of these uncertainties include the impact of oil prices on global transportation, the general economic recession, and concerns about product safety. Whether institutions and people can work together to effectively manage the complexities of today’s interconnected world remains to be seen.

**CLOSING CASE: Carnival Cruise Lines**

Although sea voyages have held an aura of mystique for centuries, only in recent decades have the general masses been able to experience open seas and exotic ports of call as a purely recreational activity. Cruises, i.e., sea voyages for pleasure, offer passengers the convenience of an assigned cabin as they sail along a fixed itinerary that concludes at their original point of sea embarkation. Almost everything about the entire cruise industry is international, from the routes traveled to the use of flags of convenience to the locations of shipyards to the staffing of vessels. By far the largest cruise competitor is Carnival Corp., which owns a number of different lines that it calls *brands*. Because Carnival operates globally, it can treat the entire world as a source of both customers and supplies. At the same time, its widespread operations also leave Carnival vulnerable to political upheavals, health crises, economic recessions, and natural disasters. Still, in all, the future outlook both for the industry and for Carnival is bright as more people the world over choose a holiday cruise.

## Questions

*1-3 What global forces have contributed to the growth of the cruise-line industry?*

Two major factors that have contributed to the growth of the cruise industry are the change in the competitive environment brought about by the advent of transoceanic airline service and increasing discretionary incomes. As demand for liner travel declined in response to the development of less expensive and much faster air service, shipping lines were forced to respond to the new market conditions by developing sea travel for the middle class, i.e., cruises. In addition, all-inclusive prices, a wide range of on-board and on-shore offerings, and the additional safety and security measures provided by the cruise industry have proven very attractive in light of recent political and socio-economic events. (LO: 1, Learning Outcome: Define globalization and international business and show how they affect each other, AACSB: Analytical Skills)

* 1. *What specific steps has Carnival Cruise Lines taken to benefit from global social changes?*

Carnival has responded to global environmental changes in a variety of ways. Because a ship is highly vulnerable to terrorist acts, Carnival has instituted very strict security measures. It has also implemented strict health and safety measures. Carnival has dealt with economic recessions by offering shorter cruises that embark closer to home and with times of economic prosperity by offering longer cruises that incorporate more exotic destinations. It minimizes staffing costs by sourcing employees on a global basis. In addition, across its various lines, Carnival offers a wide variety of themes, classes of service, and destinations. (LO: 2, Learning Outcome: To understand why companies engage in international business and why international business growth has accelerated, AACSB: Analytical Skills)

* 1. *What economic factors influence success of the international cruise industry? Explain how each affects such success.*

Economic factors affect the operations of cruise lines, which are truly international in nature. For example, most shipping lines choose to flag their vessels in countries such as Liberia, Mongolia, or Panama because of the lower taxes and less stringent employment practices required by the laws of those countries. Relatively few countries (Finland, France, Germany, Italy, Japan, and South Korea, for example) have shipyards capable of building cruise ships. Consequently, governments (e.g., Italy) may choose to subsidize the ship-building industry in order to secure contracts for their domestic firms. (LO: 5, Learning Outcome: To apply social science disciplines to understanding the differences between international and domestic business, AACSB: Multicultural and Diversity Understanding)

* 1. *Although most cruise line passengers are from the United States, the average number of annual vacation days taken by U.S. residents is lower than that of workers in most other high-income countries (13 days, compared with 42 days in Italy, 37 in France, 35 in Germany, and 25 in Japan). How might the cruise lines increase sales to people outside the United States?*

Given that the majority of people in the targeted income segment have yet to take a cruise, the major task confronting the cruise line industry is one of marketing. In addition to promoting the many appealing features of its various cruises and lines throughout the developed world and selected developing countries, Carnival could partner with foreign airlines and travel agents in order to get foreign vacationers to its many ports of embarkation. (LO: 4, Learning Outcome: To become familiar with different ways in which a company can accomplish its global objectives, AACSB: Dynamics of a Global Economy)

* 1. *What threats exist for the future performance of the cruise-line industry and, specifically, of Carnival Cruise Lines? If you were in charge of Carnival, how would you (a) try to prevent these threats from becoming reality, and (b) deal with them if they were realized?*

While the potential market for Carnival seems very attractive, port capacity could well become an issue. The deep water and the massive facilities required to dock a liner in any port are limited. In addition, there are passionate cries from environmentalists regarding the damage (pollution of the seas, disorientation of sea mammals caused by the noise of the propellers, etc.) being caused by liners both in port and at sea. Should there be a major global economic disaster or a global health pandemic, the cruise line industry will surely suffer.

To proactively deal with the possibility of a downturn, Carnival should invest heavily in research and development in order to continually minimize the environmental impact of its ships and their operation. It must also carefully develop its global cruise structure in a way that complements existing capacity—or else work with ports to provide additional capacity.

If Carnival finds that it must react to a downturn, it should always think in terms of all of its stakeholders, not just its stockholders. Of course, it will want to minimize any damage to its operations and profits. However, given the immense size of the firm, it may also be possible for Carnival to reach out to others (such as providing liners to be used as housing for workers, as in the case of Hurricane Katrina). Carnival will be better served by a long-term rather than a short-term orientation. (LO: 3, Learning Outcome: To discuss globalization’s future and the major criticisms of globalization, AACSB: Reflective Thinking Skills)

* 1. *Discuss the ethics of cruise lines regarding the avoidance of taxes while buying ships built with governmental subsidies.*

This is definitely a complex issue. While cruise lines avoid most taxes by flying flags of convenience, they argue that they *must* do so for competitive (cost-savings) reasons—and that other governments could choose to offer the same benefits. Their supporters also argue that the lost taxes are at least to some extent indirectly offset by port fees and passenger spending, and that the taxes realized by less developed countries are important contributions to their economies. However, others argue that the less restrictive staffing, safety, and operating requirements associated with flags of convenience are intolerable. They argue that lesser standards pose both safety and environmental hazards and that in the long run, the costs to society are high. They feel strongly that if shipping lines receive government subsidies on the one hand, it is immoral and should be illegal for them to avoid paying taxes on the other. (LO: 4, Learning Outcome: To become familiar with different ways in which a company can accomplish its global objectives, AACSB: Ethical Understanding and Reasoning Ability)

**Additional Exercises: The Globalization Process**

**Exercise 1.1.** Ask students to identify firms, both domestic and foreign, that operate internationally. Take time to explore the extent and nature of their operations. Also, discuss a logical geographical pattern of expansion for each type of operation. Conclude the discussion by examining the list to determine if there are any particular types of firms that seem to lend themselves (or not) to global operations and strategies. Have the students explain why this might be so. (LO: 2, Learning Outcome: To understand why companies engage in international business and why international business growth has accelerated, AACSB: Dynamics of the Global Economy)

 **Exercise 1.2.** Ask students why they think the world’s largest theme park operator, the Walt Disney Co., was motivated to establish parks in Tokyo, Paris, and Hong Kong. What particular market characteristics of each of those sites were especially attractive? Conclude the discussion by asking students if they believe that Disney should establish additional foreign parks, and if so, when, where, why, and how? (LO: 4, Learning Outcome: To become familiar with different ways in which a company can accomplish its global objectives, AACSB: Analytical Skills)

 **Exercise 1.3.** Divide students into small groups and ask them to explore the costs of the globalization process. What are the major issues? What companies seem to promote corporate responsibility in all aspects of their businesses? What can and/or should be done to encourage seemingly less-than-responsible businesses and governments to change their ways? (LO: 4, Learning Outcome: To become familiar with different ways in which a company can accomplish its global objectives, AACSB: Analytical Skills)