

11e

Global Business Today

Charles W. L. Hill | G. Tomas M. Hult



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GLOBAL BUSINESS TODAY

Charles W. L. Hill

University of Washington

G. Tomas M. Hult

Michigan State University



GLOBAL BUSINESS TODAY, ELEVENTH EDITION

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**For my mother June Hill, and the memory of my
father, Mike Hill**

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—Charles W. L. Hill

For Gert & Margareta Hult, my parents

—G. Tomas M. Hult

about the authors

CHARLES W. L. HILL

University of Washington

Charles W. L. Hill is the Hughes M. and Katherine Blake Professor of Strategy and International Business at the Foster School of Business, University of Washington. Professor Hill has taught in the MBA, Executive MBA, Technology Management MBA, Management, and PhD programs at the University of Washington. During his time at the University of Washington, he has received over 25 awards for teaching excellence, including the Charles E. Summer Outstanding Teaching Award. The Foster School is consistently ranked as a Top-25 business school. Learn more about Professor Hill at <http://foster.uw.edu/faculty-research/directory/charles-hill>.

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 among the most widely cited in international business and strategic management.

Beginning in 2014, Dr. Hill partnered with Dr. Tomas Hult in a formidable co-authorship of the International Business franchise of textbooks (*International Business* and *Global Business Today*). This brought together two of the most cited international business scholars in history.

Professor Hill works on a private basis with a number of organizations. His clients have included Microsoft, where he has been teaching 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, Microsoft, Philips Healthcare, Philips Medical Systems, Seattle City Light, Swedish Health Services, Tacoma City Light, Thompson Financial Services, WRQ, and Wizards of the Coast). Professor Hill has also served on the advisory board of several start-up companies.

For recreation, Professor Hill enjoys skiing and competitive sailing!

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G. TOMAS M. HULT

Michigan State University

Dr. Tomas Hult is Professor of Marketing, Byington Endowed Chair, and Director of the International Business Center in the Department of Marketing in the Eli Broad College of Business at Michigan State University. He also teaches for the Broad College's Department of Supply Chain Management and Department of Management. Learn more about Professor Hult at <http://broad.msu.edu/facultystaff/hult>.

A native of Sweden, Dr. Hult received a mechanical engineer degree in Sweden before obtaining Bachelor and MBA degrees in the United States, followed by a PhD at The University of Memphis. In addition to Michigan State University, he has served on the faculties of Florida State University and the University of Arkansas at Little Rock. Dr. Hult holds visiting professorships in the International Business Group of his native Uppsala University, Sweden, and the International Business Division of Leeds University, United Kingdom. Michigan State, Uppsala, and Leeds are all ranked in the top 10 in the world in international business research.

Dr. Hult serves as Executive Director and Board Member of the Academy of International Business (AIB), President and Board Member of the Sheth Foundation, and serves on the U.S. District Export Council. Tomas Hult hosts the radio show globalEDGE Business Beat on the Michigan Business Network.

Hult is one of the world's leading academic authorities (citations, publications) in marketing strategy, international business, international marketing, strategic management, global supply chains, and complex multinational corporations. He is one of only about 100 Elected Fellows of

the Academy of International Business, an accolade achieved by only the elite international business scholars. Dr. Hult was also selected in 2016 as the Academy of Marketing Science/CUTCO-Vector Distinguished Marketing Educator.

He regularly speaks at high profile events (e.g., European Commission, Swedish Entrepreneurship Forum, United Nation's Conference on Trade and Development, U.S. Department of Education, World Investment Forum) and publishes influential op-ed articles (e.g., *Time*, *Fortune*, *Fortune*, *World Economic Forum*, *The Conversation*). Tomas has developed a large clientele of the world's top corporations (e.g., ABB, Albertsons, Avon, BG, Bechtel, Bosch, BP, Defense Logistics Agency, Domino's, FedEx, Ford, FreshDirect, General Motors, GroceryGateway, HSBC, IBM, Michigan Economic Development Corporation, Masco, NASA, Raytheon, Shell, Siemens, State Farm, Steelcase, Tech Data, and Xerox).

In addition to co-authoring with Charles W. L. Hill the market-share leading textbooks in international business (*Global Business Today*, now in its 11th edition, and *International Business*, now in its 12th edition), Dr. Hult has written several popular business trade books (e.g., *Second Shift*; *Global Supply Chain Management*; *Extending the Supply Chain*; and *Total Global Strategy*).

Tennis, golf, and traveling are his favorite recreational activities.

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Current. Application Rich, Relevant. Accessible and Student Focused.

Global Business Today (GBT), the worldwide market leader among international business products, has set a new standard for international business teaching. We have focused on creating resources that

- Are comprehensive, state of the art, and timely.
- Are theoretically sound and practically relevant.
- Focus on applications of international business concepts.
- Tightly integrate the chapter topics throughout.
- Are fully integrated with results-driven technology.
- Take full and integrative advantage of globalEDGE.msu.edu—the Google-ranked #1 web resource for “international business resources.”

International Business (now in its 12th edition, 2019), also co-authored by Charles W. L. Hill and G. Tomas M. Hult, is a more comprehensive and case-oriented version that lends itself to the core course in international business for those that want a deeper focus on the global monetary system, structure of international business, international accounting, and international finance.

GBT has always endeavored to be current, relevant, application rich, accessible, and student-focused. Our goal has always been to cover macro and micro issues equally and in a relevant, practical, accessible, and

student-focused approach. We believe that anything short of such a breadth and depth of coverage is a serious deficiency. Many of the students in these international business courses will soon be working in global businesses, and they will be expected to understand the implications of international business for their organization's strategy, structure, and functions in the context of the global marketplace. We are proud and delighted to have put together this international business learning experience for the leaders of tomorrow.

Over the years, and now through 11 editions, Dr. Charles Hill has worked hard to adhere to these goals. Since the ninth edition, Charles' co-author, Dr. Tomas Hult, has followed the same approach. In deciding what changes to make, we have been guided not only by our own reading, teaching, and research but also by the invaluable feedback we received from professors and students around the world, from reviewers, and from the editorial staff at McGraw-Hill Education. Our 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:

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- 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.
- Conceptual and empirical work on global supply chain management—logistics, purchasing (sourcing), operations, and marketing channels.

In addition to including leading-edge theory, in light of the fast-changing nature of the international business environment, we 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 we began revisions of this book. By 2016, almost \$4 trillion per day were flowing across national borders. The size of such flows fueled concern about the ability of short-term speculative shifts in global capital markets to destabilize the world economy.

The world continued to become more global. As you can see in [Chapter 1](#) on Globalization, trade across country borders has almost exponentially escalated in the last few years. Several Asian economies, most notably China and India, continued to grow their economies at a rapid rate. New multinationals continued to emerge from developing nations in addition to the world’s established industrial powers.

Increasingly, the globalization of the world economy affected a wide range of firms of all sizes, from the very large to the very small. We take

great pride in covering international business for small- and medium-sized enterprises (SMEs), as well as larger multinational corporations. We also take great pride in covering firms from all around the world. Some sixty SMEs and multinational corporations from all six core continents are covered in the chapters' opening cases, closing cases, and/or Management Focus boxes.

And unfortunately, global terrorism and the attendant geopolitical risks keep emerging in various places globally, many new and inconceivable just a decade ago. These represent a threat to global economic integration and activity. Plus, with the United Kingdom opting to leave the European Union (Brexit), which has implications past 2019, the election of President Donald Trump in the United States (who espouses views on international trade that break with the long established consensus), and several elections around the world, the globe—in many ways—has paid more attention to nationalistic issues over trade. These topics and many more are integrated into this text for maximum learning opportunities.

WHAT'S NEW IN THE 11TH EDITION

The success of the first ten editions of *Global Business Today* (and its longer, more in-depth textbook option and companion, *International Business*, now in the 12th edition) 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 11th 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 globalEDGETM features in every chapter.
6. Connect every chapter to a focus on managerial implications.

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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. As before, we provide the only textbook in International Business that ensures that all material is up-to-date on virtually a daily basis. The copyright for the book is 2020, but you are likely using the text somewhere between the years 2019 to 2022. We keep the textbook updated to each semester you use the text in your course! We do this by integrating Connect and globalEDGE™ features in every chapter.

Specifically, combining McGraw Hill’s Connect platform with the Google number-one-ranked globaledge.msu.edu site (for “international business resources”), we can add up-to-date materials and exercises to each chapter to add value to the material and provide relevant data and information. This keeps chapter material constantly and dynamically updated for teachers who want to infuse Connect and globalEDGE™ material into the chapter topics, and it keeps students abreast of current developments in international business.

In addition to updating all statistics, figures, and maps to incorporate most recently published data, a chapter-by-chapter selection of changes for the 10th edition include the following:

CHAPTER 1: GLOBALIZATION

- New opening case: GM and Its Chevrolet Supercar, The Corvette ZR1
- New materials on international trade, trade agreements, world production, and world population
- Explanations of differences in cross-border trade and in-country production; the value of trade agreements; and population implications related to resource constraints
- Revised Management Focus: Boeing’s Global Production System
- Revised Management Focus: Wanda Group
- New closing case: Globalization of BMW, Rolls-Royce, and the MINI

CHAPTER 2: NATIONAL DIFFERENCES IN POLITICAL, ECONOMIC, AND LEGAL SYSTEMS

- New opening case: Transformation in Saudi Arabia
- New Country Focus: Putin’s Russia
- Updated data on corruption
- Updated Country Focus: Corruption in Brazil
- New closing case: The Decline of Zimbabwe

CHAPTER 3: NATIONAL DIFFERENCES IN ECONOMIC DEVELOPMENT

- New opening case: Brazil’s Struggling Economy
- Updated statistics and discussion in section Differences in Economic Development
- Updated Country Focus: Property Rights in China
- Updated statistics and discussion in section States in Transition
- New closing case: Economic Development in Bangladesh

CHAPTER 4: DIFFERENCES IN CULTURE

- New opening case: China, Hong Kong, Macau, and Taiwan
- Deeper treatment of culture, values, and norms
- Revised the foundation that most religions are now pro-business
- Updated the Hofstede culture framework with new research
- New Country Focus: Determining Your Social Class by Birth
- New Country Focus: Turkey, Its Religion, and Politics
- New Management Focus: China and Its *Guanxi*
- New closing case: The Swatch Group and Cultural Uniqueness

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CHAPTER 5: ETHICS, CORPORATE SOCIAL RESPONSIBILITY, AND SUSTAINABILITY

- New opening case: Sustainability Initiatives at Natura, the Bodyshop, and Aesop
- Deeper focus on corporate social responsibility and sustainability at the country, company, and customer levels
- New Management Focus: “Emissionsgate” at Volkswagen

- New closing case: Woolworths's Corporate Responsibility Strategy

CHAPTER 6: INTERNATIONAL TRADE THEORY

- New opening case: "Trade Wars Are Good and Easy to Win"
- Discussion of President Donald Trump's approach to international trade
- Updated Country Focus: Is China Manipulating Its Currency in Pursuit of a Neo-Mercantilist Policy?
- New closing case: The Trans Pacific Partnership (TPP) Is Dead; Long Live the CPTPP!
- Updated Appendix: International Trade and the Balance of Payments with new data and revised discussion

CHAPTER 7: GOVERNMENT POLICY AND INTERNATIONAL TRADE

- New opening case: U.S. and South Korea Strike a Revised Trade Deal
- New section: The World Trading System Under Threat, which discusses the potential ramifications of Brexit and the trade policies of the Trump administration
- New Closing Case: Boeing and Airbus Are in a Dogfight over Illegal Subsidies

CHAPTER 8: FOREIGN DIRECT INVESTMENT

- New opening case: Geely Goes Global
- Updated statistics and discussion in the section Foreign Direct Investment in the World Economy
- New Management Focus: Burberry Shifts Its Entry Strategy in Japan
- New closing case: FDI in the Indian Retail Sector

CHAPTER 9: REGIONAL ECONOMIC

INTEGRATIONS

- New opening case: NAFTA 2.0?
- Extended discussion of Brexit and its ramifications
- New section The Future of NAFTA, which discusses the renegotiation of NAFTA by the Trump administration
- New closing case: Free Trade in Africa: TFTA and CFTA

CHAPTER 10: THE FOREIGN EXCHANGE MARKET

- New opening case: The Fluctuating Value of the Yuan Gives Chinese Business a Lesson in Foreign Exchange Risk
- New closing case: The Mexican Peso, the Japanese Yen, and *Pokemon Go*

CHAPTER 11: THE INTERNATIONAL MONETARY SYSTEM

- New opening case: Can Dollarization Save Venezuela?
- Updated statistics discussion of floating exchange rates through to early 2018
- New Country Focus: China's Exchange Rate Regime
- New Closing Case: Egypt and the IMF

CHAPTER 12: THE STRATEGY OF INTERNATIONAL BUSINESS

- New opening case: Red Bull, a Leader in International Strategy
- Deeper discussion of the rise of regionalism
- Integration of global strategy thoughts
- New Management Focus: IKEA's Global Strategy
- New Management Focus: Unilever's Global Organization
- New closing case: Sony Corporation: An International Innovator?

CHAPTER 13: ENTERING

DEVELOPED AND EMERGING MARKETS

- New opening case: IKEA Entering India, Finally!
- New scope of the chapter to include entering developed and emerging markets, as well as aspects of less developed markets
- New closing case: Cutco Corporation—Sharpening Your Market Entry

CHAPTER 14: EXPORTING, IMPORTING, AND COUNTERTRADE

- New opening case: Spotify and SoundCloud
- New material on company readiness to export and import material
- New and revised material on globalEDGE™ Diagnostic Tools, with a focus on Company Readiness to Export (CORE)
- New Management Focus: Embraer and Brazilian Importing
- New Management Focus: Exporting Desserts by a Hispanic Entrepreneur
- New Management Focus: Two Men and a Truck
- New closing case: Tata Motors and Exporting

CHAPTER 15: GLOBAL PRODUCTION AND SUPPLY CHAIN MANAGEMENT

- New opening case: Procter & Gamble Remakes Its Global Supply Chains
- Revised and new material on global logistics, global purchasing, and global operations
- Revised sections Strategic Roles for Production Facilities, Make-or-Buy Decisions, and Global Supply Chain Functions
- New material in the sections Role of Information Technology, Coordination in Global Supply Chains, and Interorganizational Relationships
- New Management Focus: IKEA Production in China
- New Management Focus: Amazon's Global Supply Chains
- New closing case: Alibaba and Global Supply Chains

CHAPTER 16: GLOBAL MARKETING AND BUSINESS ANALYTICS

- New opening case: Fake News and Alternative Facts
- Revised section Globalization of Markets and Brands
- New section on Business Analytics; reordered with International Marketing Research to provide a better flow of the chapter material
- Revised section International Marketing Research
- Inclusion of more social media topics throughout
- Revised positioning of the Product Development and R&D section
- New Management Focus: Global Branding, Marvel Studios, and Walt Disney Company
- New Management Focus: Burberry's Social Media Marketing
- New closing case: ACSI and Satisfying Global Customers

CHAPTER 17: GLOBAL HUMAN RESOURCE MANAGEMENT

- New opening case: Global Mobility at Shell
- New section: Building a Diverse Global Workforce, which looks at the benefits, challenges, and policies for building a diverse global workforce in a multinational enterprise
- New Closing Case: Sodexo: Building a Diverse Global Workforce

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, we have 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, we 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. We believe that these theories and phenomena are explained in more depth in this work than they are in the competition, which seem to use the rationale that a shallow explanation is little better than no explanation. In international business, a little knowledge is indeed a dangerous thing.

Practical and Rich Applications

We have always believed that 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 chapter in Parts Two, Three, and Four—where the focus is on the environment of international business, as opposed to particular firms—there is a section titled **Focus on 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.

A **Did You Know?** feature in each chapter challenges students to view the world around them through the lens of international business (e.g., Did you know that sugar prices in the United States are much higher than sugar prices in the rest of the world?). The authors recorded short videos explaining the phenomenon.

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** designed and written by Tomas Hult. The exercises dovetail with the content just covered.

Integrated Progression of Topics

A weakness 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 and 11 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 12 and 13, 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 14 through 17, 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 11). We also integrate macro themes in covering the micro chapters (Chapters 12 through 17).

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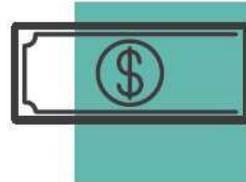
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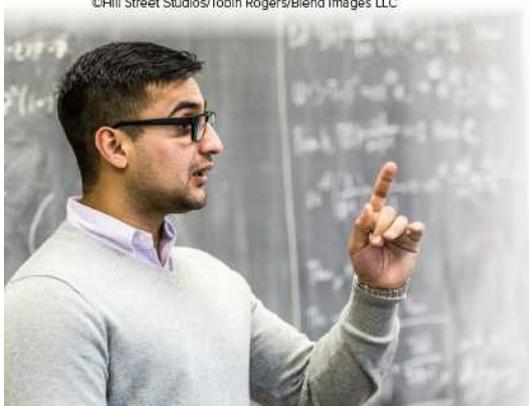
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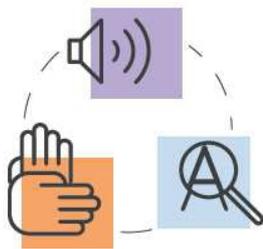
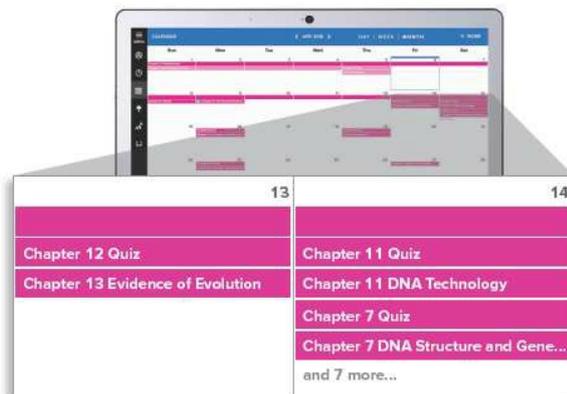
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1

Globalization



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.

opening case

The General Motors Company (gm.com), commonly abbreviated as GM (which is also the company's symbol on the New York Stock Exchange), is an American multinational corporation headquartered in Detroit, Michigan, that designs, manufactures, markets, and distributes vehicles and vehicle parts. GM was founded in Flint, Michigan, on September 16, 1908. In addition, to support its auto operations, GM Financial is a wholly owned captive finance subsidiary of General Motors, albeit headquartered in Fort Worth, Texas (and not at the main headquarters location in Detroit).

Interestingly, GM is a large conglomerate with a one-industry focus on automobiles that operates as a holding company for various vehicle brands. Consequently, there are no General Motors, or GM, branded cars. But the company has been around for more than 100 years making vehicles. Today, there are eight distinctive automotive brands under the General Motors umbrella: Chevrolet, Buick, GMC, Cadillac, Holden, Baojun, Wuling, and Jiefang. At one point the company owned more than 20 automobile brands (e.g., Hummer, McLaughlin, Oakland, Oldsmobile, Opel, Pontiac, Saab, Saturn, and Vauxhall).

Within its current brand umbrella, GM is served by about 180,000 employees who speak some 70 different languages, and operate on five continents across 23 time zones. GM delivers about 9 million vehicles via 12,450 dealers in 125 countries annually. China has become critical to GM's operations as one of the company's top markets in recent years, now accounting for about 5 million of the 9 million vehicles sold globally on an annual basis. To support this heavy Chinese focus, GM is building an additional five new manufacturing plants in the country (adding to its already strong Chinese presence of 10 joint ventures and two wholly owned enterprises and more than 58,000 employees).

Within GM, the Chevrolet brand, or vehicle line, occupies a distinctive position for its range of car makes. Amazingly, a Chevrolet is sold somewhere in the world every 8.33 seconds! Louis Chevrolet and then ousted GM founder William C. Durant started Chevrolet in 1911 as the Chevrolet Motor Car Company, and it became part of the General Motors Company in 1918. As of today, Chevrolet-branded vehicles are sold in all markets worldwide. Until 2017, Oceania had been an exception since GM had been represented in that part of the world since the 1980s by its Australian subsidiary, Holden. However, GM has also decided to focus its India manufacturing on producing vehicles for export only and will transition its South Africa manufacturing to Isuzu Motors.

Consequently, GM's Chevrolet brand was phased out of both country markets by the end of 2017.

What is not phased out is the Corvette! Chevrolet's sports car, Corvette, has been around since it was introduced at the GM Motorama at the New York Auto Show in 1953. Myron Scott is credited for naming the sports car after a relatively small, maneuverable warship called a corvette. As any automobile brand, the "Vette" or "Chevy Corvette," has several different brand Page 4 designations, and the car models are priced from a low of about \$60,000 to a high of \$160,000. Uniquely, the Corvette ZR1 was again introduced in 2019 (produced from mid-year 2018). This particular Corvette designation, ZR1, had been in production from 1969–1971, 1990–1995, and 2009–2013 before it again made a comeback in 2019.

"ZR1 has returned to the throne to push the Corvette legacy to its highest point ever. It's a supercar that's at once luxurious and overwhelmingly capable, delivering the icon's fastest, most powerful, most advanced performance in a production Corvette to date. Drivers, hail the new King." In much of the world, the Chevrolet Corvette is an instantly recognizable sports car. The pinnacle of its lineup is the ZR1, an extraordinary engine and performance pack that dates back to the 1969 model. But for the 2019 model and on, only 2,000 to 3,000 ZR1s are expected to be produced each year. The car has 755 horsepower, does zero to 60 miles per hour (about 97 kmh) in under 2.85 seconds, and has a top speed of 212 mph (about 341 kmh).

The 2019 ZR1's aerodynamics benefited in design from Corvette's racing teams that compete in races around the world (e.g., the annual 24 Hours of Le Mans endurance race in France). The new version has more carbon fiber parts than any Corvette before it. This includes an optional high wing rising from the rear deck that generates such a powerful downforce that it had to be mounted on the Vette's frame since the trunk would buckle under the pressure. The wing is needed to help keep the car planted solidly on the road at speeds where it might otherwise leave the ground.

Given its periodic dormant production within the Chevrolet Corvette product family, the Corvette ZR1 is a global phenomenon. It is the top of the line Corvette, produced in small numbers, and produced only periodically (and not every year as most other cars). The Corvette is a globally recognizable brand that inspires true passion, engagement, and commitment from its owners.

The global branding and a testament to its staying power are nicely exemplified by the first 2019 Corvette ZR1 having been sold for \$925,000 at a Barrett-Jackson auction in Scottsdale, Arizona. It was sold to Rick Hendrick, Chairman of Hendrick Automotive Group and owner of the Hendrick Motorsports NASCAR team. The price was a hefty markup paid to be first to get the new 2019 version of ZR1, since the Corvette ZR1 starts at about

\$120,000. However, the full sales price benefited the Stephen Siller Tunnel to Towers Foundation—a charitable foundation—and so the high sticker price went to a good cause. •

Sources: “Corvette ZR-1: Consider the Pace Set,” Chevrolet, www.chevrolet.com/performance/corvette-zr1-supercar (accessed April 16, 2018); Hannah Elliott, “GM Takes On Ferrari and Lamborghini with the 2019 Corvette ZR1,” *Bloomberg BusinessWeek*, November 29, 2017; Bradley Brownell, “The First Corvette ZR1 Just Sold For \$925,000,” *Jalopnik*, January 21, 2018; Mark Phelan, “First Look: 2019 Chevy Corvette ZR1 Convertible Is Faster and More Powerful than Ever,” *Detroit Free Press*, November 29, 2017; David Hollister, Ray Tadgerson, David Closs, and Tomas Hult, “Second Shift: The Inside Story of the Keep GM Movement,” McGraw-Hill Professional, 2016; and Chris Davies, “2019 Corvette ZR1: 5 Fast Facts About Chevy’s New Supercar,” *Slash Gear*, November 13, 2017.

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. As we will see later on in this chapter and throughout the text, international trade across country borders has become the norm, with an almost exponential increase in trade during the last decade.

We are moving toward a world in which barriers to cross-border trade and investment are declining; 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 world events (e.g., increase of terrorism in many parts of the world, the United Kingdom leaving the European Union, and elections globally of nationalistic politicians) create tension and uncertainty regarding the future of global trade activities. These political swings usually temper, or even out, over time in democratic societies, and long-term indications generally are for stability in the marketplace. We are unlikely to backtrack on globalization and global companies’ willingness to satisfy the needs and wants of global customers.

For example, as described in the opening case, General Motors and its Chevrolet brand are an illustration of the trend toward the unique opportunities that globalization can present to a company. It is pretty amazing to think that a Chevrolet is sold somewhere in the world every 8.33 seconds! However, it is clear that within GM's global product portfolio (Chevrolet, Buick, GMC, Cadillac, Holden, Baojun, Wuling, and Jiefang), the Chevrolet brand occupies a distinctive position. People in the U.S. know Chevrolet along with GM's other core brands (Buick, GMC, and Cadillac) well but have not been exposed so much to Holden, Baojun, Wuling, and Jiefang. GM uses Holden to focus on Oceania and also manufactures and sells numerous Baojun, Wuling, and Jiefang vehicles in the important Chinese market. As we've mentioned, five million of GM's nine million annual vehicle sales are in the Chinese market.

Proponents of increased global trade argue that cross-cultural engagement and trade across country borders is the future and that returning back to a nationalistic perspective is the past. On the other hand, the nationalistic argument rests in citizens wanting their country to be sovereign, self-sufficient as much as possible, and basically in charge of their own economy and country environment. As with any debate, both sides of the argument have merit. We will explore many aspects of today's global marketplace in this text's 17 integrated and topical chapters.

Globalization now has an impact on almost everything we do. For example, an American medical doctor—let's call her Laurie—might drive to work at her pediatric office in a sports utility vehicle (SUV) that was designed in Stuttgart, Germany, and assembled in Leipzig, Germany, and Bratislava, Slovakia, by Porsche from components from parts suppliers worldwide, which in turn were fabricated from Korean steel and Malaysian rubber. Laurie 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, Laurie 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 Laurie 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” or “Made in Germany” (or “Made in the United Kingdom” for Charles W. L. Hill, the first author of this textbook, or “Made in Sweden” for G. Tomas M. Hult, the second author of this textbook) had strong meaning and referred to something. The U.S. often stood for quality and Germany often stood for sophisticated engineering. Now the country of origin for a product has given way to, for example, “Made by BMW,” and the company is the quality assurance platform, not the country. In many cases, it goes even beyond the company to the personal relationship a customer has developed with a representative of the company, and so we focus on what has become known as CRM (Customer Relationship Management).

Whether it is still the quality associated with the country of origin of a product, or the assurance given by a specific company regardless of where they manufacture their product, 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. These protesters come from environmental groups, which have been around for some time, but more recently also from nationalistic groups focused on their countries being more sovereign.

Page 6



Will the United States Produce Just Services?

The United States has the largest and most technologically powerful economy in the world, with a per capita GDP (gross domestic product) of \$57,466. The

country's overall GDP is valued at \$18.57 trillion. Most of the labor force (80 percent) is employed in the services sector, with 19 percent employed in manufacturing industries, and only 1 percent in the agricultural area. China, India, and the European Union have labor forces larger than that of the United States. Data show that the United States has become much more of a service economy over the years. Will the United States continue to increase its service sector at the cost of manufacturing and agriculture?

Source: U.S. Central Intelligence Agency, *World Factbook*, 2019. www.cia.gov.

For businesses, the globalization process has 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 cheap. 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 unfolds, it is transforming industries and creating anxiety among those who believed their jobs were protected from foreign competition. 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. 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.

What Is Globalization?

- LO 1-1 Understand what is meant by the term *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-size firms with fewer than 500 employees export, accounting for 98 percent of the companies that export. More generally, exports from small- and medium-size companies Page 7 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, sending more than \$2 trillion worth of products and services last year to the rest of the world.



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Despite the global prevalence of Citigroup credit cards, 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 that 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—but markets for industrial goods and materials that serve universal needs the world over. These include the 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.

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: 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 that 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.

Did You Know?

Did you know why your iPhone was assembled in China? It's not what you might think.

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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 economist 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.

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Nevertheless, the globalization of markets and production will probably continue. Modern firms are important actors in this trend, their very 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.

Boeing's Global Production System

Executives at the Boeing Corporation, America's largest exporter, say that building a large commercial jet aircraft like 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 Luftfahrt 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 next jet, a new version of its popular wide-bodied 777 jet, the 777X, which will use the same carbon-fiber technology as the 787, Boeing will bring 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; and 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.

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 half-century, 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 2017, 164 nations that collectively accounted for 98 percent of world trade were WTO members, thereby giving the organization enormous scope and influence. The WTO is also responsible for facilitating the establishment of additional multinational agreements among WTO member states. Over its entire history, and that of the GATT before it, the WTO has promoted the lowering of barriers to cross-border trade and investment. In doing so, the WTO has been the instrument of its member states, which have sought to create a more open global business system unencumbered by barriers to trade and investment between countries. Without an institution such as the WTO, the globalization of markets and production is unlikely to have proceeded as far as it has. However, as we shall see in this chapter and in [Chapter 7](#) when we look closely at the WTO, critics charge that the organization is usurping the national sovereignty of individual nation-states.

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Can the International Court of Justice Be Effective?

The International Court of Justice (www.icj-cij.org) is the principal judicial organ of the United Nations (UN). Of the six principal organs of the UN, it is the only one not located in New York (United States); instead, the seat of the Court is at the Peace Palace in The Hague (Netherlands). The court's role is to settle, in accordance with international law, legal disputes submitted to it by countries and to give advisory opinions on legal questions referred to it by authorized United Nations organs and specialized agencies. But how effective can the UN International Court of Justice really be in the global marketplace with its many legal systems?

Source: www.icj-cij.org/en/court.

The **International Monetary Fund (IMF)** and the **World Bank** were both created in 1944 by 44 nations that met at Bretton Woods, New Hampshire. The IMF was established to maintain order in the international monetary system; the World Bank was set up to promote economic development. In the more than seven decades since their creation, both institutions have emerged as significant players in the global economy. The World Bank is the less controversial of the two sister institutions. It has focused on making low-interest loans to cash-strapped governments in poor nations that wish to undertake significant infrastructure investments (such as building dams or roads).

The IMF is often seen as the lender of last resort to nation-states whose economies are in turmoil and whose currencies are losing value against those of other nations. During the past two decades, for example, the IMF has lent money to the governments of troubled states including Argentina, Indonesia, Mexico, Russia, South Korea, Thailand, and Turkey. More recently, the IMF took a proactive role in helping countries cope with some of the effects of the 2008–2009 global financial crisis. IMF loans come with strings attached, however; in return for loans, the IMF requires nation-states to adopt specific economic policies aimed at returning their troubled economies to stability and growth. These requirements have sparked controversy. Some critics charge that the IMF's policy recommendations are often inappropriate; others maintain that by telling national governments what economic policies they must adopt, the IMF, like the WTO, is usurping the sovereignty of nation-states. We will look at the debate over the role of the IMF in [Chapter 11](#).

The **United Nations (UN)** was established October 24, 1945, by 51 countries committed to preserving peace through international cooperation

and collective security. Today, nearly every nation in the world belongs to the United Nations; membership now totals 193 countries. When states become members of the United Nations, they agree to accept the obligations of the UN Charter, an international treaty that establishes basic principles of international relations. According to the charter, the UN has four purposes: to maintain international peace and security, to develop friendly relations among nations, to cooperate in solving international problems and in promoting respect for human rights, and to be a center for harmonizing the actions of nations. Although the UN is perhaps best known for its peacekeeping role, one of the organization's central mandates is the promotion of higher standards of living, full employment, and conditions of economic and social progress and development—all issues that are central to the creation of a vibrant global economy. As much as 70 percent of the work of the UN system is devoted to accomplishing this mandate. To do so, the UN works closely with other international institutions such as the World Bank. Guiding the work is the belief that eradicating poverty and improving the well-being of people everywhere are necessary steps in creating conditions for lasting world peace.⁸

Another institution in the news is the [**Group of Twenty \(G20\)**](#). Established in 1999, the G20 comprises the finance ministers and central bank governors of the 19 largest economies in the world, plus representatives from the European Union and the European Central Bank. Collectively, the G20 represents 90 percent of global GDP and 80 percent of international global trade. Originally established to formulate a coordinated policy response to financial crises in developing nations, in 2008 and 2009 it became the forum through which major nations attempted to launch a coordinated policy response to the global financial crisis that started in America and then rapidly spread around the world, ushering in the first serious global economic recession since 1981.



How Important is the European Union Among the Group of Twenty (G20)?

There have been twelve G20 Leaders' Summits since they started in 2008. The Group of Twenty includes 19 prominent countries and the European Union

(Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, United Kingdom, United States, and the European Union). G20 members represent about 85 percent of global GDP, 80 percent of global trade, and about two-thirds of the world's population. Now, is it really right for the G20 to include 19 countries and one union entity (the European Union), or should the European Union countries be selected individually (as some already are)?

Source: www.g20.org/en.

Drivers of Globalization

- **LO 1-2** Recognize the main drivers of globalization.

Two macro factors underlie the trend toward greater globalization.⁹ The first is the decline in barriers to the free flow of goods, services, and capital that has occurred in recent decades. The second factor is technological change, particularly the dramatic developments in communication, information processing, and transportation technologies.

DECLINING TRADE AND INVESTMENT BARRIERS

During the 1920s and 1930s, many of the world's nation-states erected formidable barriers to international trade and foreign direct investment. **International trade** occurs when a firm exports goods or services to consumers in another country. **Foreign direct investment (FDI)** occurs when a firm invests resources in business activities outside its home country. Many of the barriers to international trade took the form of high tariffs on imports of manufactured goods. The typical aim of such tariffs was to protect domestic industries from foreign competition. One consequence, however, was “beggar thy neighbor” retaliatory trade policies, with countries progressively raising trade barriers against each other. Ultimately, this depressed world demand and contributed to the Great Depression of the 1930s.

Having learned from this experience, the advanced industrial nations of the West committed themselves after World War II to progressively reducing barriers to the free flow of goods, services, and capital among nations.¹⁰ This goal was enshrined in the General Agreement on Tariffs and Trade. Under the umbrella of GATT, eight rounds of negotiations among member states worked to lower barriers to the free flow of goods and services. The first round of negotiations went into effect in 1948. The most recent negotiations to be completed, known as the Uruguay Round, were finalized in December 1993. The Uruguay Round further reduced trade barriers; extended GATT to cover services as well as manufactured goods; provided enhanced protection for patents, trademarks, and copyrights; and established the World Trade Organization to police the international trading system.¹¹ [Table 1.1](#) summarizes the impact of GATT agreements on average tariff rates for *manufactured* goods among several developed nations. As can be seen, average tariff rates have fallen significantly since 1950 and now stand at about 2.0–3.0 percent. Comparable tariff rates in 2017 for China and India were about 8 percent. However, it should be noted that while the long term trend has been towards lower tariff rates, it is possible that recent increases in tariff rates imposed by the Trump Administration in the U.S. could signify a reversal of this trend.

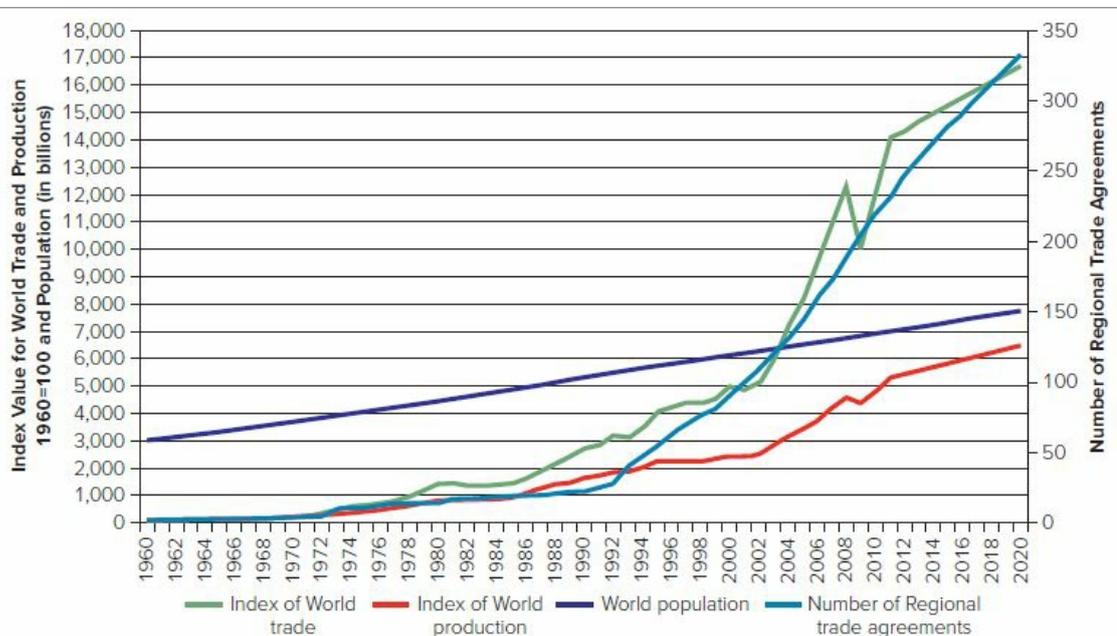
	1913	1950	1990	2017
France	21%	18%	5.9%	1.9%
Germany	20	26	5.9	1.9
Italy	18	25	5.9	1.9
Japan	30	—	5.3	2.1
Netherlands	5	11	5.9	1.9
Sweden	20	9	4.4	1.9
United Kingdom	—	23	5.9	1.9
United States	44	14	4.8	3.0

1.1 TABLE

Average Tariff Rates on Manufactured Products as Percentage of Value

Sources: The 1913–1990 data are from “Who Wants to Be a Giant?” *The Economist: A Survey of the Multinationals*, June 24, 1995, pp. 3–4. The 2017 data are from the *World Development Indicators*, World Bank.

Knowledge Society and Trade Agreements [Figure 1.1](#) reports on the value of world trade, world production, and active regional trade agreements in the world along with the world population from 1960 to 2020 (the last three years being forecast data). Trade and production are indexed to 100 in 1960 (the index calculation is based on current prices and not adjusted for inflation). The figure illustrates some interesting changing globalization trends. For example, according to the World Trade Organization, the value of world trade in merchandised goods has grown consistently faster than the world economy since 1960, and the chart shows that this growth has been markedly higher since the turn of the century (note that the index values in the chart are based on current prices, and are not adjusted for inflation).



1.1 FIGURE

Index value of world trade and world production (1960=100), world population (billions), and number of regional trade agreements.

Sources: World Bank, 2018; World Trade Organization, 2018; United Nations, 2018.

As a consequence, when adjusted for inflation, by 2020 the value of world trade is expected to be around 21 times larger than it was in 1960, whereas the world economy will be around 9.3 times larger. This trend has continued into the modern era. Between 2000 and 2017, the value of world trade increased 98 percent whereas the world economy has increased by 74 percent in real terms (adjusted for inflation). The forecast is that world

trade will continue to increase more rapidly than world production for the foreseeable future.

The difference in the growth rates of world production and world trade is why studying international business is so important. While we produce more goods and services today compared with before, a far greater proportion of that production is being traded across national borders than at any time in modern history. Moreover, the knowledge society that we live in has resulted in consumers knowing more than ever about goods and services being produced worldwide. From a customer perspective, this is driving demand for internationally traded goods. Thus, the larger the difference between the growth rates of world trade and world production, the greater the extent of globalization and the more important it becomes to understand international business.

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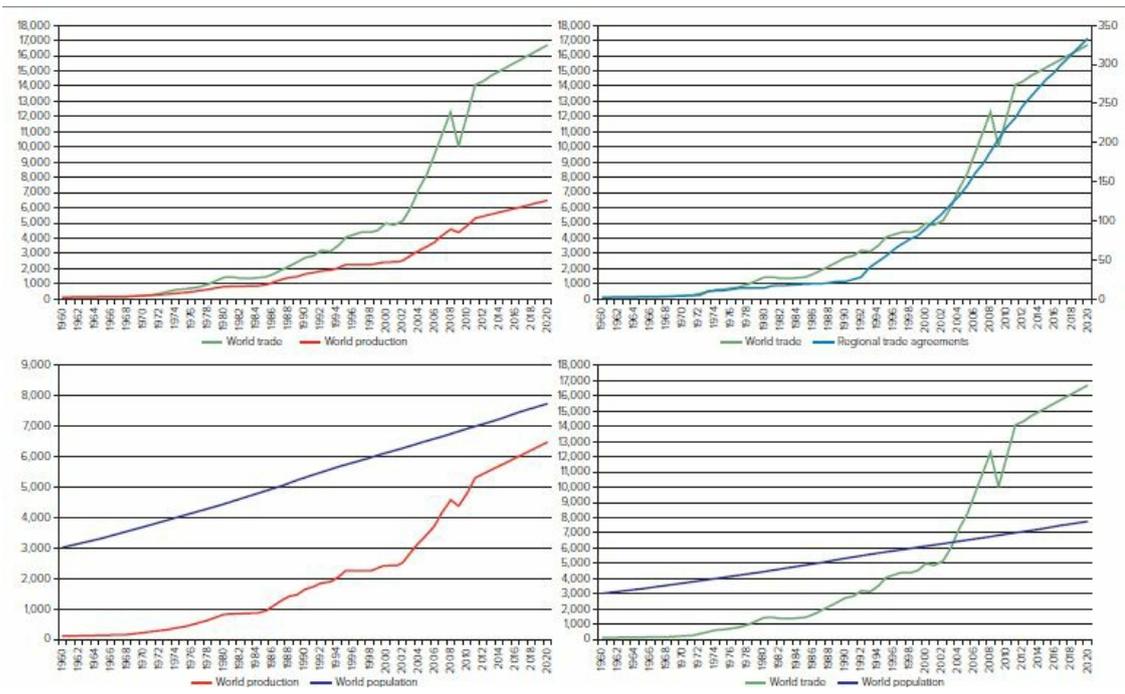
Additionally, despite the recent wave of nationalism around the world (e.g., Brexit, the 2016 U.S. presidential election), many countries have been progressively removing restrictions to foreign direct investment over the past 20 years. According to the United Nations, some 80 percent of the 1,440 changes made worldwide since 2000 in the laws governing foreign direct investment created a more favorable environment for FDI. Basically, the pressure from customers to make available any goods and services anywhere for their needs and wants has been facilitated by country governments removing restrictions on imports to their countries.

Such customer pressures and restrictions removal by countries have been driving both the globalization of markets and the globalization of production. The lowering of barriers to international trade enables firms to view the world, rather than a single country, as their market. The lowering of trade and investment barriers also allows firms to base production at the optimal location for that activity. Thus, a firm might design a product in one country, produce component parts in two other countries, assemble the product in yet another country, and then export the finished product around the world.

Another important facilitator of trade across country borders is the increased number of trade agreements that have been implemented in the world. [Figure 1.1](#) reports on regional trade agreements in force today (more than two countries involved), with another roughly 300 bilateral trade agreements between two countries also active worldwide. There is no doubt that trade at least between the countries in a trade agreement has been a strong reason for the increase overall in world trade. [Figure 1.1](#)

illustrates the almost 1:1 match of the trade agreement and world trade curves on the chart. That is, as regional trade agreements in force increase year-by-year, so does world trade across country borders at the same pace.

Two additional implications can be gleaned from the data in [Figure 1.1](#) that could become important for the global marketplace. These are illustrated in separate charts in [Figure 1.2](#). The first implication relates to sustainability—a topic we will cover much more in [Chapter 5](#). In 2000, the United Nations established the Millennium Development Goals to reduce the number of people who live in extreme poverty by 2015. Subsequently, in September 2015, the United Nations and its 193 member countries ratified the Sustainable Development Goals that set targets to end poverty, protect the planet, and ensure prosperity for all countries by 2030 as part of a new sustainability agenda.¹² The urgency of delivering on the UN’s Sustainable Development Goals can be traced to the difference between the world production and population data. As world production approaches the total population curve, we can infer that resource availability for all of our needs and wants in the world’s 260 countries and territories will potentially be drastically constrained.



1.2 FIGURE

Comparisons of index of world trade and world population; index of world trade and number of regional trade agreements; world population and index of world

production; and world population and index of world trade (index 1960 = 100).

Sources: World Bank, 2019; World Trade Organization, 2018; United Nations, 2018.



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The chart in [Figure 1.1](#) also indicates that our needs worldwide are still rather “spiky” and not as flat as Tom Friedman projected in 2004. Trading across country borders is significantly more pronounced today than ever before, growing at a rate above the population growth of the world. These two curves are likely to not intersect any time soon, and coupled with the large difference between world trade and world production, especially in the last 20 years, we will see a world consumer market where localized needs and wants are still very much unique in a large set of industries and product categories. Overall, though, the fact that the volume of world trade has been growing faster than world GDP implies several things.

The fact that the volume of world trade has been growing faster than world GDP implies several things. First, more firms are doing what Boeing does with the 777 and 787: dispersing parts of their production process to different locations around the globe to drive down production costs and increase product quality. Second, the economies of the world’s nation-states are becoming ever more intertwined. As trade expands, nations are becoming increasingly dependent on each other for important goods and services. Third, the world has become significantly wealthier in the last two decades. The implication is that rising trade is the engine that

has helped pull the global economy along.

Evidence also suggests that foreign direct investment is playing an increasing role in the global economy as firms increase their cross-border investments. The average yearly outflow of FDI increased from \$14 billion in 1970 to about \$1.5 trillion today, audited by the United Nations Conference on Trade and Development (UNCTAD).¹³ As a result of the strong FDI flow, the global stock of FDI is about \$28 trillion. More than 80,000 parent companies had more than 800,000 affiliates in foreign markets that collectively employed more than 75 million people abroad and generated value accounting for about 11 percent of global GDP. The foreign affiliates of multinationals had \$36 trillion in global sales, higher than the value of global exports of goods and services, which stood at close to \$23.4 trillion.¹⁴

The globalization of markets and production and the resulting growth of world trade, foreign direct investment, and imports all imply that firms are finding their home markets under attack from foreign competitors. This is true in China, where U.S. companies such as Apple, General Motors, and Starbucks are expanding their presence. It is true in the United States, where Japanese automobile firms have taken market share away from General Motors and Ford over the past three decades, and it is true in Europe, where the once-dominant Dutch company Philips has seen its market share in the consumer electronics industry taken by Japan's Panasonic and Sony and Korea's Samsung and LG. The growing integration of the world economy into a single, huge marketplace is increasing the intensity of competition in a range of manufacturing and service industries.

However, declining barriers to cross-border trade and investment cannot be taken for granted. As we shall see in subsequent chapters, demands for "protection" from foreign competitors are still often heard in countries around the world, including the United States. Although a return to the restrictive trade policies of the 1920s and 1930s is unlikely, it is not clear whether the political majority in the industrialized world favors further reductions in trade barriers. Indeed, the global financial crisis of 2008–2009 and the associated drop in global output that occurred led to more calls for trade barriers to protect jobs at home. If trade barriers decline no further, this may slow the rate of globalization of both markets and production.

ROLE OF TECHNOLOGICAL CHANGE

The lowering of trade barriers made globalization of markets and production a theoretical possibility. Technological change has made it a tangible reality. Every year that goes by comes with unique and oftentimes major advances in communication, information processing, and transportation technology, including the explosive emergence of the “Internet of Things.”

Communications Perhaps the single most important innovation since World War II has been the development of the microprocessor, which enabled the explosive growth of high-power, low-cost computing, vastly increasing the amount of information that can be processed by individuals and firms. The microprocessor also underlies many recent advances in telecommunications technology. Over the past 30 years, global communications have been revolutionized by developments in satellite, optical fiber, wireless technologies, and of course the Internet. These technologies rely on the microprocessor to encode, transmit, and decode the vast amount of information that flows along these electronic highways. The cost of microprocessors continues to fall, while their power increases (a phenomenon known as [Moore’s law](#), which predicts that the power of microprocessor technology doubles and its cost of production falls in half every 18 months).¹⁵

The Internet The explosive growth of the Internet since 1994, when the first web browser was introduced, has revolutionized communications and commerce. In 1990, fewer than 1 million users were connected to the Internet. By 1995, the figure had risen to 50 million. By 2017, the Internet had 3.8 billion users, or 51 percent of the global population.¹⁶ Thus, 2017 marked the first year that more than half of the world’s population were Internet users. It is no surprise that the Internet has developed into the information backbone of the global economy.

In North America alone, e-commerce retail sales will surpass \$520 billion in 2020 (up from almost nothing in 1998), while global e-commerce sales surpassed \$2 trillion for the first time in 2017.¹⁷ Viewed globally, the Internet has emerged as an equalizer. It rolls back some of the constraints of location, scale, and time zones.¹⁸ The Internet makes it much easier for buyers and sellers to find each other, wherever they may

be located and whatever their size. It allows businesses, both small and large, to expand their global presence at a lower cost than ever before. Just as important, it enables enterprises to coordinate and control a globally dispersed production system in a way that was not possible 25 years ago.

Transportation Technology In addition to developments in communications technology, several major innovations in transportation technology have occurred since the 1950s. In economic terms, the most important are probably the development of commercial jet aircraft and superfreighters and the introduction of *containerization*, which simplifies transshipment from one mode of transport to another. The advent of commercial jet travel, by reducing the time needed to get from one location to another, has effectively shrunk the globe. In terms of travel time, New York is now “closer” to Tokyo than it was to Philadelphia in the colonial days.

Containerization has revolutionized the transportation business, significantly lowering the costs of shipping goods over long distances. Because the international shipping industry is responsible for carrying about 90 percent of the *volume* of world trade in goods, this has been an extremely important development.¹⁹ Before the advent of containerization, moving goods from one mode of transport to another was very labor intensive, lengthy, and costly. It could take days and several hundred longshore workers to unload a ship and reload goods onto trucks and trains. With the advent of widespread containerization in the 1970s and 1980s, the whole process can now be executed by a handful of longshore workers in a couple of days. As a result of the efficiency gains associated with containerization, transportation costs have plummeted, making it much more economical to ship goods around the globe, thereby helping drive the globalization of markets and production. Between 1920 and 1990, the average ocean freight and port charges per ton of U.S. export and import cargo fell from \$95 to \$29 (in 1990 dollars).²⁰ Today, the typical cost of transporting a 20-foot container from Asia to Europe carrying more than 20 tons of cargo is about the same as the economy airfare for a single passenger on the same journey.

Implications for the Globalization of Production As transportation costs associated with the globalization of production have declined, dispersal of production to geographically separate locations has become more economical. As a result of the technological innovations

discussed earlier, the real costs of information processing and communication have fallen dramatically in the past two decades. These developments make it possible for a firm to create and then manage a globally dispersed production system, further facilitating the globalization of production. A worldwide communications network has become essential for many international businesses. For example, Dell uses the Internet to coordinate and control a globally dispersed production system to such an extent that it holds only three days' worth of inventory at its assembly locations. Dell's Internet-based system records orders for computer equipment as they are submitted by customers via the company's website and then immediately transmits the resulting orders for components to various suppliers around the world, which have a real-time look at Dell's order flow and can adjust their production schedules accordingly. Given the low cost of airfreight, Dell can use air transportation to speed up the delivery of critical components to meet unanticipated demand shifts without delaying the shipment of final product to consumers. Dell has also used modern communications technology to outsource its customer service operations to India. When U.S. customers call Dell with a service inquiry, they are routed to Bangalore in India, where English-speaking service personnel handle the call.

Implications for the Globalization of Markets In addition to the globalization of production, technological innovations have facilitated the globalization of markets. Low-cost global communications networks, including those built on top of the Internet, are helping create electronic global marketplaces. As noted earlier, low-cost transportation has made it more economical to ship products around the world, thereby helping create global markets. In addition, low-cost jet travel has resulted in the mass movement of people between countries. This has reduced the cultural distance between countries and is bringing about some convergence of consumer tastes and preferences. At the same time, global communications networks and global media are creating a worldwide culture. U.S. television networks such as CNN and HBO are now received in many countries, Hollywood films are shown the world over, while non-U.S. news networks such as the BBC and Al Jazeera also have a global footprint. In any society, the media are primary conveyors of culture; as global media develop, we must expect the evolution of something akin to a global culture. A logical result of this evolution is the emergence of global markets for consumer products. Clear signs of this are apparent. It is now as easy to find a McDonald's restaurant in Tokyo as it is in New York, to

buy an iPad in Rio as it is in Berlin, and to buy Gap jeans in Paris as it is in San Francisco.

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Despite these trends, we must be careful not to overemphasize their importance. While modern communications and transportation technologies are ushering in the “global village,” significant national differences remain in culture, consumer preferences, and business practices. A firm that ignores differences among countries does so at its peril. We shall stress this point repeatedly throughout this text and elaborate on it in later chapters.

The Changing Demographics of the Global Economy

● **LO 1-3** Describe the changing nature of the global economy.

Hand in hand with the trend toward globalization has been a fairly dramatic change in the demographics of the global economy over the past decades. Half a century ago, four facts described the demographics of the global economy. The first was U.S. dominance in the world economy and world trade picture. The second was U.S. dominance in world foreign direct investment. Related to this, the third fact was the dominance of large, multinational U.S. firms on the international business scene. The fourth was that roughly half the globe—the centrally planned economies of the communist world—was off-limits to Western international businesses. All four of these facts have changed rapidly.

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THE CHANGING WORLD OUTPUT AND WORLD TRADE PICTURE

In the early 1960s, the United States was still by far the world's dominant

industrial power. In 1960, the United States accounted for 38.3 percent of world output, measured by gross domestic product (GDP). By 2018, the United States accounted for 24 percent of world output, with China now at 15.2 percent of world output and the global leader in this category (see [Table 1.2](#)). The United States was not the only developed nation to see its relative standing slip. The same occurred to Germany, France, Italy, the United Kingdom, and Canada—as just a few examples. These were all nations that were among the first to industrialize globally.

Country	Share of World Output in 1960 (%)	Share of World Output Today (%)	Share of World Exports Today (%)
United States	38.3%	24.0%	8.2%
Germany	8.7	4.6	7.1
France	4.6	3.2	2.8
Italy	3.0	2.4	2.4
United Kingdom	5.3	3.3	2.3
Canada	3.0	2.0	2.2
Japan	3.3	6.0	3.6
China	NA	15.2	11.1

1.2 TABLE

Changing Demographics of World Output and World Exports

Sources: Output data from World Bank database, 2019. Trade data from WTO Statistical Database, 2019.

Of course, the change in the U.S. position was not an absolute decline because the U.S. economy grew significantly between 1960 and 2018 (the economies of Germany, France, Italy, the United Kingdom, and Canada also grew during this time). Rather, it was a relative decline, reflecting the faster economic growth of several other economies, particularly China as well as several other nations in Asia. For example, as can be seen from [Table 1.2](#), from 1960 to today, China’s share of world output increased from a trivial amount to 15.2 percent, making it the world’s second largest economy in terms of its share in world output (the U.S. is still the largest economy overall). Other countries that markedly increased their share of world output included Japan, Thailand, Malaysia, Taiwan, Brazil, and South Korea.

By the end of the 1980s, the U.S. position as the world’s leading trading

nation was being challenged. Over the past 30 years, U.S. dominance in export markets has waned as Japan, Germany, and a number of newly industrialized countries such as South Korea and China have taken a larger share of world exports. During the 1960s, the United States routinely accounted for 20 percent of world exports of manufactured goods. But as [Table 1.2](#) shows, the U.S. share of world exports of goods and services has slipped to 8.2 percent, significantly behind that of China.

As emerging economies such as Brazil, Russia, India, and China—coined the BRIC countries—continue to grow, a further relative decline in the share of world output and world exports accounted for by the United States and other long-established developed nations seems likely. By itself, this is not bad. The relative decline of the United States reflects the growing economic development and industrialization of the world economy, as opposed to any absolute decline in the health of the U.S. economy.

Most forecasts now predict a continued rise in the share of world output accounted for by developing nations such as China, India, Russia, Indonesia, Thailand, South Korea, Mexico, and Brazil and a commensurate decline in the share enjoyed by rich industrialized countries such as the United Kingdom, Germany, Japan, and the United States. The United Kingdom, in particular, presents an interesting case study with Britain's exit from the European Union (Brexit) looming. Perhaps more important, if current trends continue, the Chinese economy could ultimately be larger than that of the United States on a purchasing power parity basis as well, while the economy of India will become the third largest by 2030.²¹

Overall, the World Bank has estimated that today's developing nations may account for more than 60 percent of world economic activity by 2025, while today's rich nations, which currently account for more than Page 18 55 percent of world economic activity, may account for only about 38 percent. Forecasts are not always correct, but these suggest that a shift in the economic geography of the world is now under way, although the magnitude of that shift is not totally evident. For international businesses, the implications of this changing economic geography are clear: Many of tomorrow's economic opportunities may be found in the developing nations of the world, and many of tomorrow's most capable competitors will probably also emerge from these regions. A case in point has been the dramatic expansion of India's software sector, which is

profiled in the accompanying Country Focus.

country FOCUS

India's Software Sector

Some 30 years ago, a number of small software enterprises were established in Bangalore, India. Typical of these enterprises was Infosys Technologies, which was started by seven Indian entrepreneurs with about \$1,000 among them. Infosys now has annual revenues of \$10.2 billion and some 200,000 employees, but it is just one of more than 100 software companies clustered around Bangalore, which has become the epicenter of India's fast-growing information technology sector. From a standing start in the mid-1980s, this sector is now generating export sales of more than \$100 billion.

The growth of the Indian software sector has been based on four factors. First, the country has an abundant supply of engineering talent. Every year, Indian universities graduate some 400,000 engineers. Second, labor costs in the Indian software sector have historically been low. As recently as 2008, the cost to hire an Indian graduate was roughly 12 percent of the cost of hiring an American graduate (however, this gap is narrowing fast with pay in the sector now only 30–40 percent less than in the United States). Third, many Indians are fluent in English, which makes coordination between Western firms and India easier. Fourth, due to time differences, Indians can work while Americans sleep, creating unique time efficiencies and an around-the-clock work environment.

Initially, Indian software enterprises focused on the low end of the software industry, supplying basic software development and testing services to Western firms. But as the industry has grown in size and sophistication, Indian firms have moved up the market. Today, the leading Indian companies compete directly with the likes of IBM and EDS for large software development projects, business process outsourcing contracts, and information technology consulting services. Over the past 15 years, these markets have boomed, with Indian enterprises capturing a large slice of the pie. One response of Western firms to this emerging competitive threat has been to invest in India to garner the same kind of economic advantages that Indian firms enjoy. IBM, for example, has invested \$2 billion in its Indian operations and now has 150,000 employees located there, more than in any other country. Microsoft, too, has made major investments in India, including a research and development (R&D) center in Hyderabad that employs 4,000 people and was located there specifically to tap into talented Indian engineers who did not want to move to the United States.

Sources: “Ameerpet, India’s Unofficial IT Training Hub,” *The Economist*, March 30, 2017; “America’s Pain, India’s Gain: Outsourcing,” *The Economist*, January 11, 2003, p. 59; “The World Is Our Oyster,” *The Economist*, October 7, 2006, pp. 9–10; “IBM and Globalization: Hungry Tiger, Dancing Elephant,” *The Economist*, April 7, 2007, pp. 67–69; P. Mishra, “New Billing Model May Hit India’s Software Exports,” *Live Mint*, February 14, 2013; and “India’s Outsourcing Business: On the Turn,” *The Economist*, January 19, 2013.

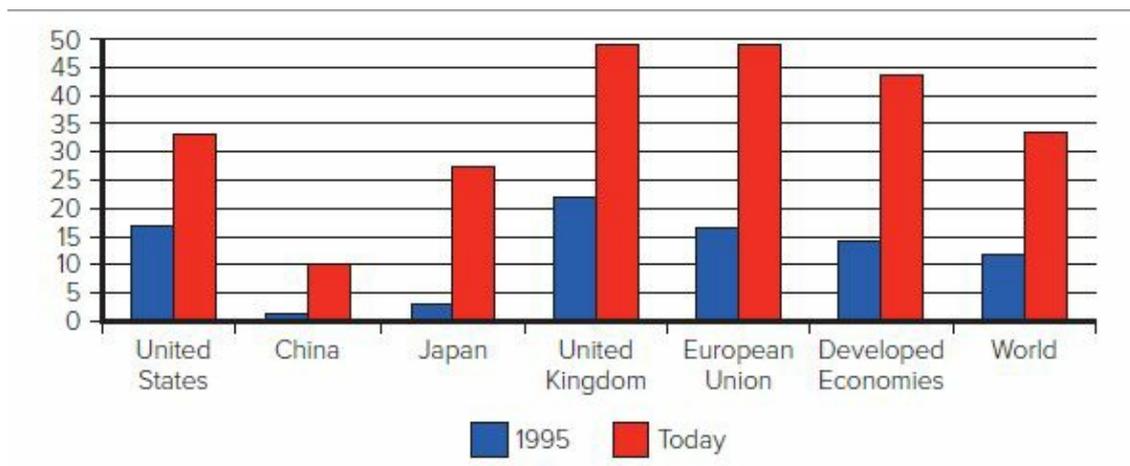
THE CHANGING FOREIGN DIRECT INVESTMENT PICTURE

Reflecting the dominance of the United States in the global economy, U.S. firms accounted for 66.3 percent of worldwide foreign direct investment flows in the 1960s. British firms were second, accounting for 10.5 percent, while Japanese firms were a distant eighth, with only 2 percent. The dominance of U.S. firms was so great that books were written about the economic threat posed to Europe by U.S. corporations.²² Several European governments, most notably France, talked of limiting inward investment by U.S. firms.

However, as the barriers to the free flow of goods, services, and capital fell, and as other countries increased their shares of world output, non-U.S. firms increasingly began to invest across national borders. The motivation for much of this foreign direct investment by non-U.S. firms was the desire to disperse production activities to optimal locations and to build a direct presence in major foreign markets. Thus, beginning in the 1970s, European and Japanese firms began to shift labor-intensive manufacturing operations from their home markets to developing nations where labor costs were lower. In addition, many Japanese firms invested in North America and Europe—often as a hedge against unfavorable currency movements and the possible imposition of trade barriers. For example, Toyota, the Japanese automobile company, rapidly increased its investment in automobile production facilities in the United States and Europe during the late 1980s and 1990s. Toyota executives believed that an increasingly strong Japanese yen would price Japanese automobile exports out of foreign markets; therefore, production in the most important foreign markets, as opposed to exports from Japan, made sense. Toyota also undertook these investments to head off growing

political pressures in the United States and Europe to restrict Japanese automobile exports into those markets.

One consequence of these developments is illustrated in [Figure 1.3](#), which shows how the stock of foreign direct investment by the United States, China, Japan, United Kingdom, European Union countries, Developed Economies, and the World changed between 1995 and today. (The [stock of foreign direct investment \(FDI\)](#) refers to the total cumulative value of foreign investments as a percentage of the country's GDP.) As expected, in all cases in [Figure 1.3](#), we invest more today outside of our own country than we did in 1995. For example, in 1995 the stock of FDI held by U.S. firms was equivalent to 17.8 percent of U.S. GDP; today the figure is 34.4 percent. Collectively, the global stock of FDI is now equal to 34.6% of global GDP, an increase from 12.8% in 1995. Bottom line, the world is becoming more globalized in investment mentality and opportunities are no longer as restricted to the home country of a firm as they used to be even as recently as 1995.



1.3 FIGURE

Share of FDI outward stock as a percentage of GDP.

Sources: OECD data 2017, FDI stocks.

[Figure 1.4](#) illustrates two other important trends—the sustained growth in cross-border flows of foreign direct investment that has occurred since 1990 and the increasing importance of developing nations as the destination of foreign direct investment. Throughout the 1990s, the amount of investment directed at both developed and developing nations increased dramatically, a trend that reflects the increasing internationalization of business corporations. A surge in foreign direct investment from 1998 to 2000 was followed by a slump from 2001 to 2004, associated with a