

Chapter 1

GLOBALIZING BUSINESS

Learning Objectives

After studying this chapter, you should be able to:

1. explain the concepts of international business and global business.
2. give three reasons why it is important to study global business.
3. articulate one fundamental question and two core perspectives in the study of global business.
4. identify three ways of understanding what globalization is.
5. state the size of the global economy and its broad trends and understand your likely bias in the globalization debate.

General Teaching Suggestions

Begin with motivation: help students see how the course relates to them regardless of whether they are convinced that they will never be involved in international business. (That should be challenged by pointing out that even if they work for a company that only does business in the local area that company could be acquired by an overseas based firm, that if they work for a local government that they might eventually need to work with overseas controlled contractors and firms that serve that government entity, etc.) Help them to see applications to the goods and services they buy and the nation's economy. Suggestion: break the class up into groups that are given the task of showing the relevance of the course in a variety of situations.

Opening Case Discussion Guide

Avon Fights Recession – One Lipstick at a Time provides a means of helping students to see how an older form of doing business (direct selling) can adapt to changing technologies and economic conditions in a global economy.

CHAPTER OUTLINE: KEY CONCEPTS AND TERMS

Sections I through VI of Chapter 1

I. WHAT IS GLOBAL BUSINESS?

1. *Key Concept*

IB is typically defined as (1) a business (firm) that engages in international (cross-border) economic activities and (2) the action of doing business abroad. Global business is defined in this book as business around the globe. This book goes beyond competition in developed economies. It devotes extensive space to competitive battles waged in emerging economies and the base of the global economic pyramid.

2. *Key Terms*

- **Base of the pyramid** is part of the view of the global economy as a pyramid. The vast majority of humanity, about four billion people, lives at the base of this pyramid making less than \$2,000 a year.

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- **BRIC** stands for Brazil, Russia, India, and China.
- **Emerging economies (emerging markets)** are countries that are starting to emerge as new players in the world economy.
- **Foreign direct investment (FDI)** is direct investment in, control, and management of value-added activities in other countries.
- **Global business** is defined in this book as business around the globe. The activities include both (1) international (cross-border) activities covered by traditional IB books and (2) domestic business activities.
- **Gross domestic product (GDP)** A nation's total output of goods and services.
- **Gross National Income** is GDP plus income from nonresident sources abroad.
- **International business (IB)** is defined as (1) a business firm that engages in international (cross border) economic activities and/or (2) the action of doing business abroad.
- **Multinational enterprise (MNE)** is defined as a firm that engages in **foreign direct investment** by directly investing in, controlling, and managing value-added activities in other countries.
- **Purchasing power parity (PPP)** is an adjustment to reflect the differences in cost of living in various countries.
- **Triad** refers to the developed economies in the three regions that consist of North America, Western Europe, and Japan.

II. WHY STUDY GLOBAL BUSINESS?

1. *Key Concept*

Reasons for reading this book and taking this course: to better compete in the corporate world that will require global expertise and to enhance your understanding of what is going on in the global economy.

2. *Key Terms*

- **Expatriate Manager (expat):** A manager who works abroad, or “expat” in short.
- **Group of 20 (G-20):** The group of 19 major countries plus the European Union (EU) whose leaders meet on a biannual basis to solve global economic problems.
- **International premium:** Managers who work abroad (expats) often command a significant pay raise when working overseas.

III. A UNIFIED FRAMEWORK

1. *Key Concept*

Our most fundamental question is: What determines the success and failure of firms around the globe? The two core perspectives are (1) the institution-based view and (2) the resource-based view. We develop a unified framework by organizing materials in *every* chapter according to the two perspectives guided by the fundamental question.

2. *Key Terms*

- **Institution based view** suggests that the success and failure are enabled and constrained by institutions
- **Institutions** are the structures that define the rules of the game

- **Institutional framework** is the formal and informal institutions that govern individual and firm behavior in a country.
- **Liability of foreignness** is the *inherent* disadvantage that foreign firms experience in host countries because of their nonnative status.

IV. WHAT IS GLOBALIZATION?

1. *Key Concept*

Some view globalization as a recent phenomenon, and others believe that it is a one-directional evolution since the dawn of human history. We suggest that globalization is best viewed as a process similar to the swing of a pendulum.

2. *Key Terms*

- **BRIC** is a newly coined acronym for Brazil, Russia, India, and China.
- **Globalization** can be viewed as a new force sweeping through the world in recent times, a long-run historical evolution since the dawn of human history, and a pendulum that swings from one extreme to another from time to time. The last (pendulum) view suggests that globalization is the “closer integration of the countries and peoples of the world which has been brought about by the enormous reduction of the costs of transportation and communication, and the breaking down of artificial barriers to the flows of goods, services, capital, knowledge, and (to a lesser extent) people across borders.”
- **Risk management:** The identification and assessment of risk and the preparation to minimize the impact of high-risk unfortunate events.
- **Scenario planning:** Planning for multiple high or low risk scenarios.
- **Semiglobalization** avoids total isolation and total globalization and calls for more than one-way for doing business around the globe.

V. GLOBAL BUSINESS AND GLOBALIZATION AT A CROSSROADS

1. *Key Concept*

MNEs, especially large ones from developed economies, are sizable economic entities. Current and future business leaders need to be aware of their own hidden proglobalization bias.

2. *Key Term*

- **Nongovernment organization (NGO)** is a term that includes environmentalists, human rights activists, and consumer groups.

VI. ORGANIZATION OF THE BOOK

1. *Key Concepts*

- Part I is *foundations*. This part contains an overview of international business and the two leading perspectives—institution- and resource-based views.
- Part II covers *tools*. This involves trade, foreign investment, foreign exchange, and global and regional integration.
- Part III covers *strategy*. This includes strategy for small firms, ways to enter foreign markets, management of competitive dynamics, alliances and acquisitions, and strategizing, structuring, and learning.

- Part IV builds *excellence in different functional areas*. The areas include marketing and supply chain, human resource management, corporate governance, and corporate social responsibility.

END-OF-CHAPTER GUIDE

- *Review Question Answers
- *Critical Discussion Question Answers
- *Global Action
- *Video Case
- *Closing Case

REVIEW QUESTION ANSWERS

1. What is the traditional definition of IB? How is global business defined in this book?
International business (IB) is defined as (1) a business firm that engages in international (cross border) economic activities and/or (2) the action of doing business abroad.
Global business is defined in this book as business around the globe. The activities include both (1) international (cross-border) activities covered by traditional IB books and (2) domestic business activities, particularly strategizing to compete with foreign businesses moving into a firm's own domestic territory.
2. Discuss the importance of emerging economies in the global economy? Use current news.
Emerging economies already command a significant part of global GDP. However, the improving economies of some countries are not keeping pace with their expanding populations. Current news examples will vary.
3. What is your interest in studying global business? How do you think it may apply to your future?
The important thing is not so much the answer as the extent to which the student demonstrates thought in providing the answer. Students should mention that it will help to prepare them to work in a global business, perhaps even as an expat.
4. If you were to work as an expatriate manager, where would you like to go and what would you like to do? Why?
Expatriate Manager (expat) is a manager who works abroad. The important thing is not so much the answer as the demonstration of thought.
5. How would you describe an institution-based view of global business?
Institutions are the "rules of the game." Doing business around the globe requires intimate knowledge about the formal and informal rules governing competition in various countries.
6. How would you describe a resource-based view of global business?

The resource-based view focuses on a firm's internal resources and capabilities.

7. After comparing the three views of globalization, which seems the most sensible to you and why?

The three views are as follows:

- *A new force sweeping through the world in recent times.*
- *A long-run historical evolution since the dawn of human history.*
- *A pendulum that swings from one extreme to another from time to time.*

The important thing is not so much the answer as the extent to which the student demonstrates thought in providing the answer to "why."

8. What is semiglobalization, and what factors contribute to it?

Semiglobalization avoids total isolation and total globalization and calls for more than one-way for doing business around the globe. Trade, FDI, and barriers to market integration are all factors.

9. Why do some people protest against globalization? Do they make any points that all people, whether for or against globalization, should consider?

They do raise a valid point on the necessity of firms, especially MNEs, to have a broader concern for various stakeholders affected by their actions around the world. This view is increasingly moving from the periphery to the mainstream.

10. You may view yourself as objective and neutral regarding globalization, but do you sense any bias that you may have one way or the other? What bias most likely exists on the part of other students taking this course?

The important thing is not so much the answer as the extent to which the student demonstrates thought in providing the answer. Anti-globals might mention anything from job loss in their home country to taking advantage of workers in developing economies. Pro-globals will probably frame their answers in terms of benefits, such as increased trade worldwide and opportunities to work for workers in developing economies.

11. Look at Maps 2.1 and 2.2. Compare the global position of the United States in merchandise trade versus service trade. Imagine that you were asked to give reasons why you think it is good from the U.S. perspective that it is the world's largest importer in both merchandise and services. What reasons would you mention?

Some countries may have an advantage in the production of certain goods and services and thus those countries export them to other countries that do not have the same advantage. Since the U.S. is the world's largest economy, it is thus the world's largest importer.

12. Some readers may be studying this book in one or more of the emerging economies shown on Map 1.2. Others may be descended from immigrants from these countries. If this is the case with you, pick one of the countries and do some research into current changes in that country. Indicate the reasons why you think

that over the long run there may be a shift from an emerging status to a developed status.

The important thing is not so much the answer as the extent to which the student demonstrates thought in providing the answer. Answers should include information about economic growth, political stability and freedom, etc.

CRITICAL DISCUSSION QUESTION ANSWERS

1. A classmate says: “Global business is relevant for top executives such as CEOs in large companies. I am just a lowly student who will struggle to gain an entry-level job, probably in a small domestic company. Why should I care about it?” How do you convince your classmate that global business is something to care about?
Refer to what was covered in the discussion and assignments related to the Opening Case Discussion Guide.
2. Thomas Friedman in his book *The World Is Flat* (2005) suggests that the world is flattening—meaning it is increasingly interconnected by new technology such as the Internet. This can raise the poor from poverty, nurture a worldwide middle class, and even spread democracy. On the other hand, this presents significant challenges for developed economies, whose employees may feel threatened by competition from low-cost countries. How does this flattening world affect you?
This would be a good assignment for a group to discuss and report their answer unless they have in essence already done so in how you handled the Opening Case Discussion Guide.
3. **ON ETHICS:** What are some of the darker sides (in other words, costs) associated with globalization? How can business leaders make sure that the benefits of their various actions (such as outsourcing) outweigh their drawbacks (such as job losses in developed economies)?
There should be a variety of answers, including some that are not practical. This is a question in which the answer is not as important as the thought process and the ability to clearly articulate.
4. **ON ETHICS:** Some argue that aggressively investing in emerging economies is not only economically beneficial but also highly ethical because it may potentially lift many people out of poverty (see Closing Case). However, others caution that in the absence of reasonable hopes of decent profits, rushing to emerging economies is reckless. How would you participate in this debate?
The response to this question may depend on how the student perceives the purpose and capabilities of business. Is lifting people out of poverty the purpose of firms and to what extent do firms have the capability of doing so? Challenge people to explain their answers.

GLOBAL ACTION

1. Chemical companies are among the largest firms worldwide. Two approaches to evaluating operations of chemical companies are by capital spending and research and development (R&D) spending. Access a resource that provides this information about top global chemical producers. Then compare the top five capital-spending and R&D-spending chemical companies. Are any companies found on both lists? What insights does this information provide?

Exercise 1 Answers

One resource that can be used is “*Chemical and Engineering News: Global Top 50 Chemical Producers*”. This website can be found by entering the search term “chemical and engineering” or “chemical producers” at the globalEDGE™ Resource Desk search box located at <http://globaledge.msu.edu/resourceDesk/>. Once at the Chemical and Engineering News website, click on the Global Top 50 Spending link (located on the right side). After accessing the data available, the top 5 capital-spending companies are: Sinopec, BASF, ExxonMobil, Air Liquide, and Dow Chemical. Meanwhile, the top 5 R&D-spending companies are: BASF, DuPont, Dow Chemical, Bayer, and DSM. Answers will vary, but students may indicate that capital spending may be a proxy for global presence while R&D-spending could be a proxy for innovative development. Regardless, some discussion may revolve around the two companies that are on both lists (BASF and Dow Chemical) to indicate that they may be particularly well positioned globally for the foreseeable future.

Search Term: “chemical and engineering” or “chemical producers”

Resource Name: *Chemical and Engineering News: Global Top 50 Chemical Producers*

Website: <http://pubs.acs.org/subscribe/journals/cen/87/i31/html/8731cover.html>
globalEDGE™ Tags: Chemicals, Industries, Industry Specific

2. An important aspect of globalization is the fundamental stability of the global economic order currently in place. Thus, FDI intentions can be influenced by its perceived sustainability to some degree. Identify the three most important issues related to global economic stability over the next 20 years. Be sure to discuss the sample surveyed to provide the appropriate frame of reference for discussion.

Exercise 2 Answers

One resource which can be used is “*A.T. Kearney: FDI Confidence Index*”. This website can be found by entering the search term “foreign direct investment intentions” at the globalEDGE™ Resource Desk search box located at <http://globaledge.msu.edu/resourceDesk/>. Once at the website, click on the Download the PDF link (found in the middle). Then, scroll to page 11 of the report where Figure 9 provides an overview of the most important challenges to the sustainability of the global economic order over the next 20 years. The three most important challenges are: 1) global competition for scarce energy reserves; 2) climate change; and 3) global competition for scarce nature resources (excluding energy). The respondents surveyed included senior executives of the

world's leading corporations. Responses from C-level executives as well as regional and business heads were included in the report.

Search Term: “foreign direct investment intentions”

Resource Name: A.T. Kearney: FDI Confidence Index

Website: <http://www.atkearney.com/index.php/Publications/foreign-direct-investment-confidence-index.html>

globalEDGE™ Tag: Rankings

VIDEO CASE

Watch “Integrating Global Business at a Local Level” by E. Neville Isdell of the Coca-Cola Company.

1. What is meant by the title of the video “Integrating Global Business at a Local Level”? What is being “integrated”?

A firm must be integrated into the local environment both in perception and reality. It must understand the culture and institutions of the local environment in order to fit in, otherwise it will be viewed as an outsider.

2. In referring to past practices of global firms, he referred to simply “parachuting in.” What did he mean by that and how does it relate to his concern about economic nationalism?

Often companies have simply moved into a country to achieve their specific objectives without regard to the impact of the firm on the local country. He advocates that firms consider how they can provide a positive benefit to local needs and not simply to the firm's needs.

3. How must global firms in the future be different regarding identifying with society as a whole?

They need to identify the needs of the society that can be addressed with the expertise of the firm in a mutually beneficial manner.

4. How does a franchise system with its use of local entrepreneurs contribute to the integration desired by Isdell?

Franchisees are already part of the local environment and are affected by their own actions. Local citizens are more likely to view the company in terms of their neighbors who are franchisees instead of as an organization headquartered in a different country.

5. Isdell warns against simply extracting and not putting something back. What challenge did Coca-Cola have in that regard? Think of an example of another firm or industry that may heed Isdell's warning and explain the reason for your selection.

Water is a vital part of the firm's products and it is also vital to each nation in which it operates. Its challenge was to not be viewed as a threat to a country's water supply but rather as a positive force in its proper management and in its availability to all citizens. Most students' examples will probably involve firms or industries that have harmed either the people and/or the environment.

CLOSING CASE

- **Closing Case Discussion Guide**

Most business people would agree that being an innovator can be very valuable but this case suggests that it may be useful to “innovate in the way one innovates” – i.e. use “reverse innovation.”

- **Closing Case Discussion Question Answers**

1. What are the similarities and differences between GE’s traditional innovation and reverse innovation?

In both cases GE seeks to grow through new development but the difference is that traditional innovation begins in developed countries and applications are developed for emerging nations whereas reverse innovation begins in emerging nations and expands to developed nations. The benefit of the reverse approach is that it is more likely to involve a focus on low cost and simplicity in order to be profitable in the emerging nation but such attributes can also pay off in developed nations.

2. Why is GE so interested in reverse innovation?

GE recognizes that it is more likely to be a source of competitive threats and if it does not use that approach it may be ultimately destroyed by those who do.

3. What are the main concerns that prevent Western MNEs from aggressively investing in emerging economies? What are the costs if they choose not to focus on emerging economies?

Students may have varying opinions regarding this question. Many may point out that the developed economies may appear to be the most profitable in the short run thus firms might be inclined to overlook the long run potential benefits and the corresponding cost of being overtaken by emerging economy MNE’s.

4. Why is a leading U.S. MNE such as GE afraid of emerging multinationals from emerging economies?

Innovation can come from anywhere in the world and innovators who focus on low cost and simplicity may eventually come to dominate the market. One historic example in the U.S. is Henry Ford. Ford did not invent the automobile but he did simplify the production process and cut costs thus he became a billionaire not by raising price but by lowering price.

