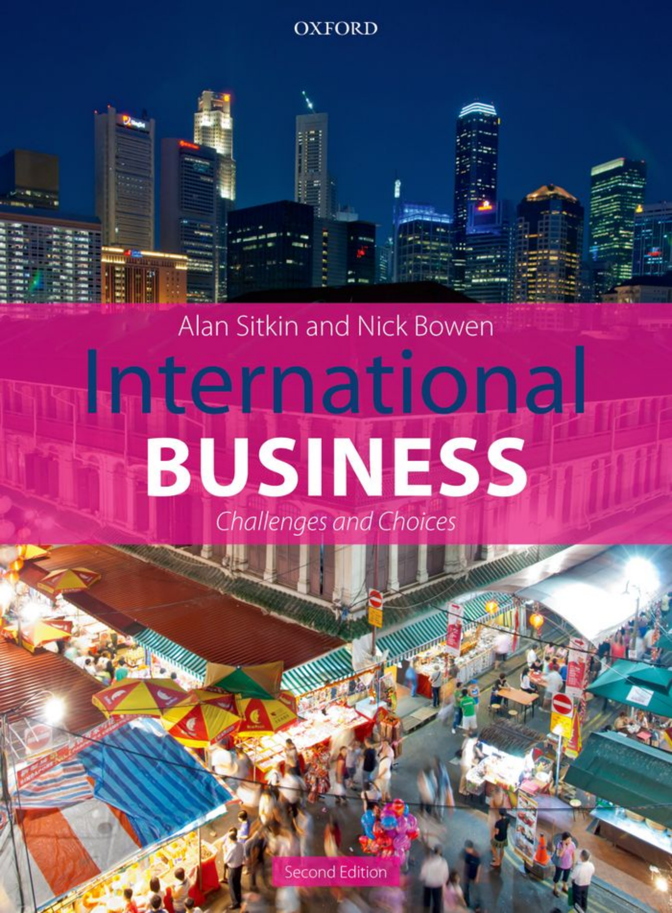

OXFORD

Alan Sitkin and Nick Bowen

International BUSINESS

Challenges and Choices

Second Edition

International Business

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International Business
Challenges and Choices

Second edition

Alan Sitkin and Nick Bowen

OXFORD
UNIVERSITY PRESS

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Preface

The world has experienced some major upheavals in the three years since the publication of this textbook's successful first edition, and this new edition reflects these changing circumstances.

Although the origins of many current trends could perhaps be sensed a few years ago, several have assumed a magnitude that few would have predicted. For instance, by the year 2010 some of the world's larger developing countries had already embarked upon a process of economic, political, and social emergence. The speed at which this has happened has been astonishing and is starting to upset many assumptions about the ongoing domination of the older industrialized countries. As a result, political discussions about the competition between these two categories of country have become less relevant: leading developing countries like China are no longer waiting to negotiate greater power on the world stage but are simply assuming a bigger role. This justifies the decision made in this second edition to devote an entire chapter to the changing geography of international business, which is no longer interesting merely for reasons relating to the location of global manufacturing, but increasingly due to the rising purchasing power of millions of new consumers emerging from a state of poverty. This too is changing the focus of international business in 2013 and beyond.

Similarly, the ecological crisis that some observers had started to recognize a few years (and even decades) ago has worsened, in part because economic growth in countries lacking modern energy-efficient equipment has worsened the twin problems of resource depletion and pollution. Whereas environmental management could still be presented in our 2010 edition as a sub-section of corporate responsibility, it now merits its own chapter to detail the new operational and strategic approaches being followed by the increasing number of multinational managers concerned about this trend that is both a potentially catastrophic problem and an exciting new opportunity.

Lastly, our first edition was written in the aftermath of the subprime crisis which spread out from the United States in 2008 to cause a global credit crunch. The main questions in international business at the time was whether this general setback would cause protectionist sentiments, and how long it would take trade and investment volumes to return to their pre-crisis levels. Given the state of the global economy in 2013, following a new financial upheaval caused by the European sovereign debt crisis, the whole tone of this discussion has become more ominous. The difficulties in which the world economy finds itself at the start of the second decade of the twenty-first century means that many countries would accept any solution to their problems, and no longer worry so much whether help is supposed to come from domestic or international business, or whether globalization is advantageous. To some extent, desperation has de-politicized the international business debate, with observers expressing anger at the banking sector but asking fewer ideological questions about the benefits of open borders. This too is reflected in our second edition.

New to this edition:

- revised structure to reflect students' knowledge as they progress through an International Business module;
- streamlined coverage of finance to enable greater focus on future trends in emerging markets and sustainability;
- addition of longer end-of-part cases to promote a holistic understanding of international business;

- more in-depth focus of the core international business theories carefully integrated with online coverage of more advanced theories; and
- increased number of in-text examples to help students envisage how companies and countries put theory into practice.

Acknowledgements

I would like to express my deepest gratitude to all friends and family members acknowledged in the book's first edition, not to forget a number of others from locations worldwide (ranging from Abergavenny/Clodock to l'Hexagone, CRESC, and the West Coast) whom there was no room to mention last time.

Also, since change is the only thing that never changes, I'd like to acknowledge colleagues new and old at the European Business School. More locally, there is the privilege I have had since 2010 of serving London Borough of Enfield as a member of the majority group. Thanks also to friends from Southgate CLP as well as Bowes constituents. Debate sharpens the mind.

Lastly, there are three acknowledgements that I would like to repeat. To my sf Lea and Dani—you make me incredibly happy (not to mention proud). And to my Verena, echt die beste Frau der Welt—may the next 30 years be as great as the past 30.

AS

For this edition, I would like to thank all those who contributed to the first, including many colleagues, students, and alumni at the European Business School London and Regent's College. I would also like to thank colleagues at the Chartered Institute of Linguists for adding to my understanding of international cultures.

My thanks also go to friends around the world and, of course, particularly to members of my family: again, my wife, Joan, as always for all her support and love; my three sons and daughters-in-law; my mother, Beryl, still as optimistic as ever at 92; my sister, Jane, with whom I have shared so much over the last six decades; and my two special grand-daughters, Eleanor and Amelia.

NB

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Outline contents

Detailed contents

List of case studies and practitioner insights

Walk-through of the textbook features

Chapter-opening features

Learning objectives

After reading this chapter, you will be able to:

- identify the principles guiding MNEs' historic efforts to shape the international environment
- identify SMEs' main international strengths and weaknesses
- discuss foreign direct investment (FDI) drivers
- describe how FDI affects host economies
- characterize international lobbying

Learning objectives

Each chapter contains a bulleted list of its main concepts and ideas. These serve as helpful indicators of what you can expect to learn in the chapter.

Case study 5.1

MNEs and international operations: IBM's Indian summer

Since 1991, market liberalization has been a core policy for all Indian governments. The result is that many MNEs have reappraised this huge continent-sized country, a land of contrasts where terrible poverty coexists with an education system turning out millions of world-class mathematicians and engineers. With many multinationals expanding their presence in India, the country has become a global hub for a variety of activities, ranging from bank administration to pharmaceutical research and information technology (IT). IBM (http://www.ibm.com/) is part of this wave.

Opening case study

A case study at the beginning of each chapter provides you with an introduction to the subject and helps to set the scene.

In-text features

Practitioner insight

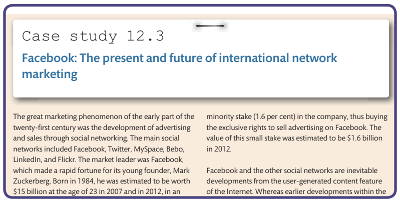
Robert Dennis, Advisory Board Member, Zafesoft.

'Zafesoft, a small hi-tech company operating in the field of digital information security, faces particular challenges in the international marketing of its security solutions. As a niche vertical player, it needs to make decisions on how it generates leads and how it delivers solutions to customers in different sectors with different needs and of different sizes. Zafesoft has to be smart in its approach in order to be competitive with its larger rivals.

Zafesoft is a software start-up company focused on the security and control of digital information. It targets government agencies, companies that deal with electronic health information, financial information, other proprietary and commercially valuable information, where the loss or compromise of this information can result in a breach of national security, loss of privacy and/or

Practitioner insights

Practitioners provide short summaries of their experiences in the world of business and explain how the theories and concepts discussed within the chapter are used in practice.



Case study 12.3

Facebook: The present and future of international network marketing

The great marketing phenomenon of the early part of the twenty-first century was the development of advertising and sales through social networking. The main social networks included Facebook, Twitter, MySpace, Bebo, LinkedIn, and Flickr. The market leader was Facebook, which made a rapid fortune for its young founder, Mark Zuckerberg. Born in 1984, he was estimated to be worth $15 billion at the age of 23 in 2007 and in 2012, in an minority stake (1.6 per cent) in the company, thus buying the exclusive rights to sell advertising on Facebook. The value of this small stake was estimated to be $1.6 billion in 2012.

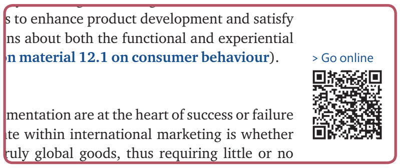
Facebook and the other social networks are inevitable developments from the user-generated content feature of the Internet. Whereas earlier developments within the

Case studies

The book is packed full of examples to help link business theory and concepts to the real business world.

Online Resource Centre references

Specific links to extension material hosted on the Online Resource Centre (ORC) allow you to expand your knowledge and understanding.



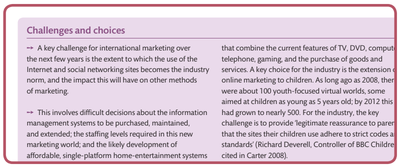
s to enhance product development and satisfy
ns about both the functional and experiential
n material 12.1 on consumer behaviour).

> Go online

mentation are at the heart of success or failure
te within international marketing is whether
ruly global goods, thus requiring little or no

Challenges and choices

This feature highlights the challenges and choices that business practitioners face in each particular subject area.



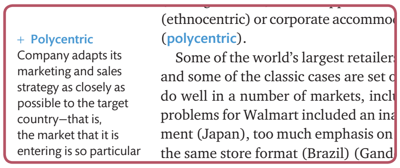
Challenges and choices

→ A key challenge for international marketing over the next few years is the extent to which the use of the Internet and social networking sites becomes the industry norm, and the impact this will have on other methods of marketing.

→ This involves difficult decisions about the information management systems to be purchased, maintained, and extended; the staffing levels required in this new marketing world; and the likely development of affordable, single-platform home-entertainment systems that combine the current features of TV, DVD, comput telephone, gaming, and the purchase of goods and services. A key choice for the industry is the extension o online marketing to children. As long ago as 2008, ther were about 100 youth-focused virtual worlds, some aimed at children as young as 5 years old; by 2012 this had grown to nearly 500. For the industry, the key challenge is to provide 'legitimate reassurance to paren that the sites their children use adhere to strict codes a standards' (Richard Deverell, Controller of BBC Childre cited in Carter 2008).

Key terms and glossary

Key terms are highlighted where they first appear. They are also defined in the glossary.



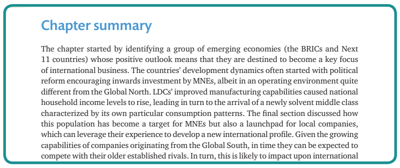
\+ Polycentric
Company adapts its marketing and sales strategy as closely as possible to the target country—that is, the market that it is entering is so particular

(ethnocentric) or corporate accommo
(polycentric).
Some of the world's largest retailer
and some of the classic cases are set o
do well in a number of markets, incl
problems for Walmart included an ina
ment (Japan), too much emphasis on
the same store format (Brazil) (Gand

End-of-chapter features

Chapter summary

Chapters conclude with a brief summary of the key concepts and points discussed.

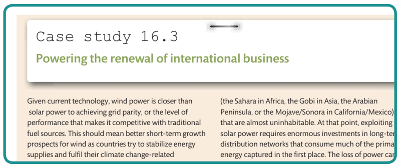


Chapter summary

The chapter started by identifying a group of emerging economies (the BRICs and Next 11 countries) whose positive outlook means that they are destined to become a key focus of international business. The countries' development dynamics often started with political reform encouraging inwards investment by MNEs, albeit in an operating environment quite different from the Global North. LDCs' improved manufacturing capabilities caused national household income levels to rise, leading in turn to the arrival of a newly solvent middle class characterized by its own particular consumption patterns. The final section discussed how this population has become a target for MNEs but also a launchpad for local companies, which can leverage their experience to develop a new international profile. Given the growing capabilities of companies originating from the Global South, in time they can be expected to compete with their older established rivals. In turn, this is likely to impact upon international

Closing case study and questions

At the end of each chapter is a case study accompanied by questions which enable you to test your knowledge.



Case study 16.3

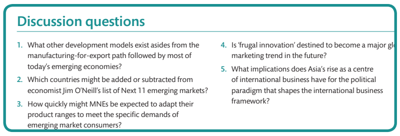
Powering the renewal of international business

Given current technology, wind power is closer than solar power to achieving grid parity, or the level of performance that makes it competitive with traditional fuel sources. This should mean better short-term growth prospects for wind as countries try to stabilize energy supplies and fulfil their climate change-related

(the Sahara in Africa, the Gobi in Asia, the Arabian Peninsula, or the Mojave/Sonora in California/Mexico) that are almost uninhabitable. At that point, exploiting solar power requires enormous investments in long-ter distribution networks that consume much of the prima energy captured in the first place. The loss of power car

Discussion questions

These stimulating questions are designed to help you to engage with and reflect upon the chapter.



Discussion questions

1. What other development models exist asides from the manufacturing-for-export path followed by most of today's emerging economies?
2. Which countries might be added or subtracted from economist Jim O'Neill's list of Next 11 emerging markets?
3. How quickly might MNEs be expected to adapt their product ranges to meet the specific demands of emerging market consumers?
4. Is 'frugal innovation' destined to become a major gl marketing trend in the future?
5. What implications does Asia's rise as a centre of international business have for the political paradigm that shapes the international business framework?

Further research

Suggestions for further reading are contained at the end of each chapter.

Further research

Gipouloux, F. (2011). *The Asian Mediterranean*. Cheltenham: Edward Elgar Publishing

Uses a cross-disciplinary approach to analyse the new 'East Asian economic corridor' intertwining all of the economies between Vladivostok and Singapore.

Radjou, N., Prabhu, J., and Ahuja, S. (2012). *Jugaard Innovation: Think Frugal, Be Flexible, Generate Breakthrough Growth*. San Francisco: Jossey-Bass

Makes the argument that the West would benefit by looking to the East and copying its frugal and flexible innovation processes.

Walk-through of the Online Resource Centre

www.oxfordtextbooks.co.uk/orc/sitkin_bowen2e/

The Online Resource Centre (ORC) comprises resources for both lecturers and students.

For students

Free and open-access material available to students:

Sectorial breakdown of international trade

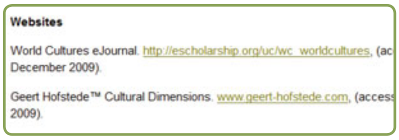
Product category	Value (billion USD)	Percentage merchandise exports
Total merchandise exports	15,717	100.0
Primary goods	4,872	31.0
Agricultural products	1,342	8.5
Fuels and mining products	3,530	22.5
Secondary goods, inc.	10,458	66.5
Iron and steel	587	3.7
Chemicals (inc. pharma)	1,705	10.8
Other semi-manufactures	1,004	6.4
Office and telecom equipment	1,561	9.9
Transport equipment	1,841	11.7
Other machinery	1,949	12.4

Extension material

A vast amount of material with specific references to the textbook enables you to expand your knowledge.

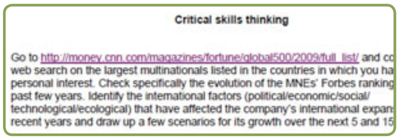
Self-test questions

These provide a quick and easy way to test your understanding, with instant feedback.



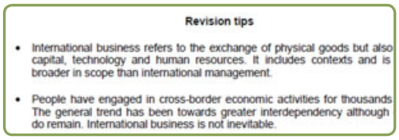
Key references

Includes a list of key texts and websites where you can learn more about a particular topic.



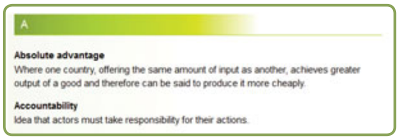
Critical skills activity

Scenarios or activities are provided to encourage you to think critically about an aspect of business, enabling you to understand alternative viewpoints and arguments.



Revision tips

Each chapter is accompanied by revision tips, which help sum up the key points.



Glossary

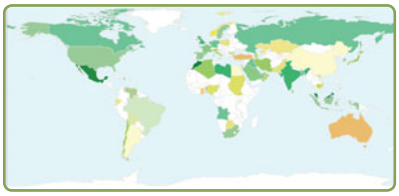
A fully searchable glossary helps you to quickly locate key terms.

Multimedia library

Access a wealth of carefully selected material including company video material, YouTube videos, and TED talks, all organized by chapter.

Interactive world map

Contains statistical country data, including imports and exports expenditure, population growth rate, CO_2 emissions, and inflation rates.

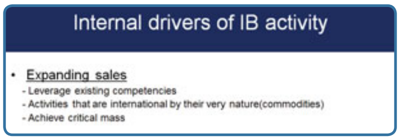


For lecturers

Free for all registered adopters of the textbook:

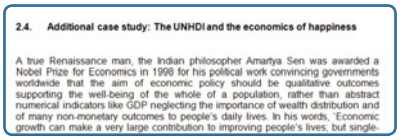
PowerPoint lecture slides

A suite of customizable PowerPoint slides has been provided to use in your lecture presentations.



Additional case studies

An additional case study accompanies every chapter and can be used to provide students with a further example of how theory is applied in practice.

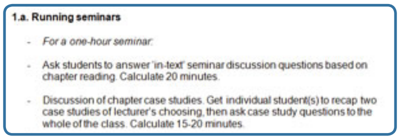


2.4. Additional case study: The UNHDI and the economics of happiness

A true Renaissance man, the Indian philosopher Amartya Sen was awarded a Nobel Prize for Economics in 1998 for his political work convincing governments worldwide that the aim of economic policy should be qualitative outcomes supporting the well-being of the whole of a population, rather than abstract numerical indicators like GDP neglecting the importance of wealth distribution and of many non-monetary outcomes to people's daily lives. In his words, 'Economic growth can make a very large contribution to improving people's lives; but single-

Running a seminar

The authors have provided suggestions for structuring a seminar and integrating the textbook and its resources in your teaching.

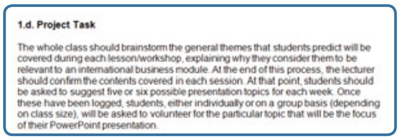


1.a. Running seminars

- *For a one-hour seminar:*
- Ask students to answer 'in-text' seminar discussion questions based on chapter reading. Calculate 20 minutes.
- Discussion of chapter case studies. Get individual student(s) to recap two case studies of lecturer's choosing, then ask case study questions to the whole of the class. Calculate 15-20 minutes.

Project tasks

Suggestions for various projects on which students can embark are provided for use in tutorial work.

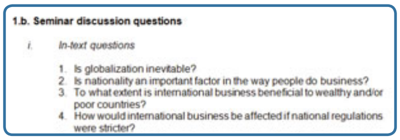


1.d. Project Task

The whole class should brainstorm the general themes that students predict will be covered during each lesson/workshop, explaining why they consider them to be relevant to an international business module. At the end of this process, the lecturer should confirm the contents covered in each session. At that point, students should be asked to suggest five or six possible presentation topics for each week. Once these have been logged, students, either individually or on a group basis (depending on class size), will be asked to volunteer for the particular topic that will be the focus of their PowerPoint presentation.

Seminar discussion questions

These can be used to help spark debate amongst students during seminars.



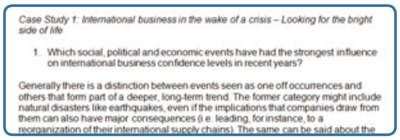
1.b. Seminar discussion questions

i. *In-text questions*

1. Is globalization inevitable?
2. Is nationality an important factor in the way people do business?
3. To what extent is international business beneficial to wealthy and/or poor countries?
4. How would international business be affected if national regulations were stricter?

Case study questions and indicative answers

Questions and answers are provided for each case study from the textbook for use in class or to set as homework.



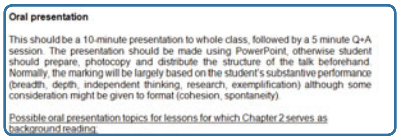
Case Study 1: International business in the wake of a crisis – Looking for the bright side of life

1. Which social, political and economic events have had the strongest influence on international business confidence levels in recent years?

Generally there is a distinction between events seen as one off occurrences and others that form part of a deeper, long-term trend. The former category might include natural disasters like earthquakes, even if the implications that companies draw from them can also have major consequences (i.e. leading, for instance, to a reorganization of their international supply chains). The same can be said about the

Oral presentation

Ideas for individual and group oral presentations are provided.



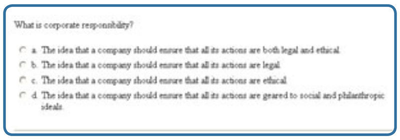
Oral presentation

This should be a 10-minute presentation to whole class, followed by a 5 minute Q+A session. The presentation should be made using PowerPoint, otherwise student should prepare, photocopy and distribute the structure of the talk beforehand. Normally, the marking will be largely based on the student's substantive performance (breadth, depth, independent thinking, research, exemplification) although some consideration might be given to format (cohesion, spontaneity).

Possible oral presentation topics for lessons for which Chapter 2 serves as background reading:

Test bank

A ready-made electronic testing resource which is fully customizable and contains feedback for students will help you to save time creating assessments.



What is corporate responsibility?

- a. The idea that a company should ensure that all its actions are both legal and ethical
- b. The idea that a company should ensure that all its actions are legal
- c. The idea that a company should ensure that all its actions are ethical
- d. The idea that a company should ensure that all its actions are geared to social and philanthropic ideals

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part

A

Introduction

1 Introduction to international business

Learning objectives

After reading this chapter, you will be able to:

- compare the concepts of international as opposed to global business
- determine the value for international managers of developing a flexible mindset
- understand the main terminology used in international business studies
- perceive the link between politics, economics, and international business
- analyse the internal and external drivers of international business

Case study 1.1

International business in the wake of a crisis—looking for the bright side of life

Like many management disciplines, international business is divided between company-internal topics, such as corporate philosophies or cultures, and things happening outside companies but shaping the general environment in which they operate. It may be impossible to survey every external factor affecting companies' cross-border dealings but the main ones can be identified and their effects analysed. This is what consultancy Grant Thornton does in its International Business Report, whose winter 2012 issue offered findings from interviews with more than 13,000 practitioners in 40 economies.

2011 was tumultuous, featuring among other events the European sovereign debt crisis, the Japanese tsunami and the Arab Spring. Add to this sustainability problems like the rising global population or political problems like the US Congress's budgetary problems and it is no surprise that global business confidence fell very low, particularly in the older industrialized countries. The Grant Thornton scale started 2011 at a mere 34 per cent level of confidence that profit growth prospects were improving. By the third quarter of 2011, confidence had shrunk to 3 per cent, reflecting a growing sense of hopelessness. General sentiments like this are extremely important in a social science like business, which is often driven by personal psychology. In the absence of confidence, many initiatives will never happen, particularly in foreign environments that are considered riskier because they are comparatively unknown.

International business benefits when managers have confidence in their ability to predict the situation abroad

The factors determining confidence in 2012 were expected to be a continuation of longstanding trends, led by a shift of economic activity to the newer industrialized countries. Significant variations in **gross domestic product (GDP)** growth rates in different parts of the world have been mirrored in the fact that businesses operating in emerging economies like Vietnam, India, and Mexico are expressing an optimistic view of the future, with 90, 79, and 68 per cent of all companies, respectively, forecasting profit growth in 2012. This should be compared with figures in troubled older industrialized countries like Spain, Japan, and Greece, where confidence figures were 15, –8, and, –11 per cent respectively.

The study also identified other constraints impeding countries' growth prospects. Companies in the more mature markets, especially the European Union, were concerned that high debt levels would prevent them from making the kinds of investment they need to consolidate their future, particularly involving research and development. Emerging economy players did not have the same worries but faced another constraint, namely poor transportation and ICT infrastructure. Of course, companies that are sufficiently 'agile and adaptable to change' might also view these problems as opportunities. In international business, many clouds have a silver lining.

Case study questions

1. Which social, political, and economic events have had the strongest influence on international business confidence levels in recent years?
2. Looking ahead, what scenarios are most likely to affect confidence in the future?

Introduction

+ **Gross domestic product (GDP)** National income, defined by national consumption plus/minus investment activity plus/minus government spending plus/minus balance of trade.

The simplest definition for international business is 'cross-border economic activity'. This has existed in various forms ever since human communities first began to interact with one another. When prehistoric tribes started trading beads or useful minerals like flint, they were engaging in early forms of international business (Watson 2005). Of course, trade has become somewhat more complicated since then. Nowadays, international business refers to the exchange not only of physical goods but also of services, capital, technology, and human resources. The first point to make about international business is that it covers a very broad spectrum of activities.

Just as important is to recognize what makes international business distinct from other areas of study, and where it overlaps with them. Many aspects of domestic business are also reproduced in international business, but they are treated differently because of the emphasis on cross-border aspects. Similarly, international business covers most if not all of the same topics as international management but goes much further. Where international management focuses mainly on decisions made by individuals operating within a corporate environment, international business also encompasses the broader political, economic, social, technological, philosophical, and environmental contexts within which firms operate. It is a very broad discipline with connections to many if not most of the issues that affect people's daily lives. Top international business students and practitioners are capable of carrying out analysis on many different levels and tend not to build artificial borders between business, economics, politics (White 2001), and society. Indeed, the ability and desire to embrace diversity is what gives this discipline its distinct philosophy and enduring attraction.

Section I: The international context

+ **Globalization** Process whereby the world becomes increasingly interconnected at an economic, political, and social level.

A useful starting point is the distinction between the concept of international business and the neighbouring notion of **globalization** with which it is often confused (Hirst and Thompson 1999). 'International' stresses differences; 'global' tries to highlight oneness. The emphasis on 'international' in this book is based on the expectation that strategies and behaviour that apply in one situation may not be appropriate in another, suggesting that there is no 'one best way' of doing business. This may seem obvious to people whose culture of origin emphasizes the need to seek multiple solutions to any one problem, but it can be a difficult adjustment for people from a culture where the emphasis is on discovering a single optimal solution to a problem.

A prime example of this focus on single solutions was in the early 1990s when certain academics claimed that the industrial methods that Toyota was implementing were so clearly superior to any other possibilities that they constituted a 'one-best-way' for the whole of the world (Womack et al. 1991). This caused a storm in university circles, with many academics opposing the idea that a universal solution to a business problem even exists. It is best to say from the outset that this book adheres to the second school of thought. Certainly, this is a more constructive approach from an educational perspective, since learners are better prepared for the diversity of the international business experience if they start with the expectation that things tend to be different in different places. Otherwise, it would be hard to spot the difference between international business and normal management studies.

Terminology and useful concepts

Every discipline has its own vocabulary, and it is useful to introduce certain key terms early on. This will be followed by a brief look at some of the many different approaches that companies take to international business. Lastly, a few statistics will be analysed to give readers a sense of some of the latest developments in this field.

International business features a number of specific challenges that business practitioners and academics ignore at their peril. It can be a very difficult adjustment for companies or individuals leaving a familiar **home country** to work in a **host country** where the environment and people are foreign to them. There is no doubt that the **psychic distance** between the world's different societies has shrunk over time, meaning that for many people, the 'foreignness' of operating in a country other than their own seems less challenging than it used to be (**go online to ORC Extension material 1.1**). It is also clear that globalization has been a key factor in this shift (MacGillivray 2006).

+ **Home/host countries**
People and companies originate from a 'home country'. When they operate abroad, they are working in a 'host country'.

+ **Psychic distance**
People's sense of the degree to which a foreign business culture differs from their own, adding to the sense of 'foreignness'.

> Go online

At the same time, it would be unrealistic and even dangerous to assume that societies worldwide have converged to the extent that there is no longer any need to study their economic, political, and cultural differences. The recognition that the world remains a complex and diverse place is best expressed by distinguishing between the basic terms of 'global' as opposed to 'international'. The word 'global' is associated with the idea of a single world and therefore stresses similarities between different communities. The word 'international', on the other hand, starts with an emphasis on the lack of similarity. This book will argue that this is a more useful approach, since it acknowledges the many obstacles that arise when people from different nations and cultures come together. Similarly, it is clear that most people have an identity that reflects, at least in part, the specificities of their culture of origin and/or the **paradigm** they use to make sense of the world. In our opinion, there is nothing inevitable about globalization or, indeed, any other socio-economic or cultural trend.

+ **Paradigm**
Worldview or vision of how things are and/or should be organized.

The book also prepares practitioners to develop the **insiderization** strategies that they need to overcome the barriers that people so often face when operating abroad (Ohmae 1999). In an ideal world, no such barriers would exist. Unfortunately, humankind does not live in such a world, if only because of 'home bias' and the feelings of 'animosity' that some populations have towards others (Amine 2008). This is not to deny growing similarities between many societies at certain levels, or that some sectors of activity operate along global rather than national lines (see Chapter 10). Indeed, there is little doubt that greater global interconnectedness has had a very deep effect on business and individuals, and some sociologists have identified what should be greeted as a positive trend towards greater cosmopolitanism and tolerance among the world's many citizens (Giddens 2002). By the same token, others express doubt about how long this new religion of 'globalism' will last, preferring to highlight the enduring and even resurgent nature of national awareness (Saul 2006). As shown in the wake of the 2008 credit crunch and 2011 European sovereign debt crisis, when times are hard, many people's first concern is to protect their domestic interest.

+ **Insiderization**
Where a person or company has become so integrated into a particular host society that locals forget its foreign origins.

Companies doing international business

Now that we have outlined how the term 'international' will be used here, the next task is to define what kind of 'business' will be covered. It could be argued that 'international business' is already occurring whenever an individual engages in a cross-border transaction. Indeed, private individuals working by themselves have always had an important role to play in the world economy, whether investors purchasing currencies or shares in foreign companies (see Chapter 13), or local agents acting as representatives and providing firms with information on countries with which they are unfamiliar (see Chapter 9). Unsurprisingly, however, most international business is done by companies, ranging from huge firms to **small and medium-sized enterprises (SMEs)** to micro-firms that may or may not be 'born global' from the very outset. It is impossible to generalize why firms might want to seek their fortune abroad. In very general terms, many operators' motivation for going abroad used to be to acquire resources, whereas nowadays it tends to be to develop knowledge and markets (Aharoni and Ramamurti 2008). Paradigms vary strongly from one generation to the next, however. As Chapter 3 demonstrates, history is another discipline that has much to offer the international business student.

+ **Small and medium-sized enterprises (SMEs)**
– 'Enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding 50 million euros, and/or an annual balance sheet total not exceeding 43 million euros' (Extract of Article 2 of the Annex of Recommendation 2003/361/EC; European Commission 2003).

Despite its smaller size, German piano-maker Steinway dominates its sector globally

Source: Steinway & Sons

+ Multinational enterprises (MNEs) Companies whose regular activities cause them to engage with and/or operate in more than one country at a time.

+ Global firm Company designed to serve a single world market instead of different national markets.

+ Configuration How a company locates its different corporate functions like research, production, marketing, and finance.

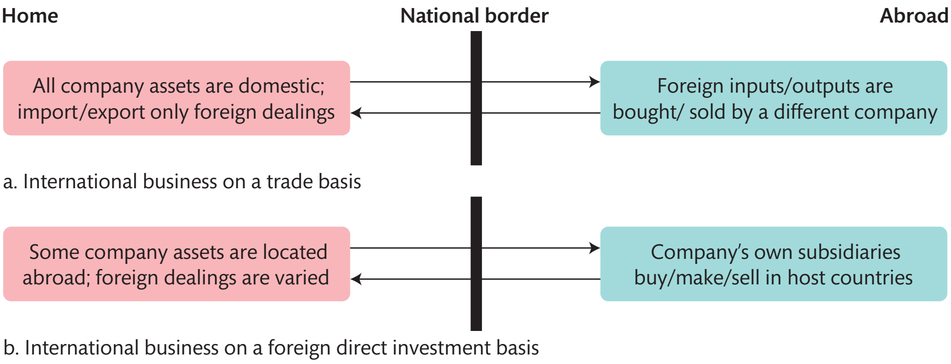
+ Subsidiaries (Foreign) Unit belonging to a company's head office.

+ Foreign direct investment (FDI) Where companies fund a permanent or semi-permanent unit overseas. The OECD defines FDI as a situation where a foreign owner has an equity stake of at least 10 per cent in a company's ordinary shares and aims to establish a 'lasting interest' in the host country.

The general terminology that this book uses to refer to companies that have regular dealings outside their home country is **multinational enterprises (MNEs)**. Other international business books will often use other terms, such as multinational corporation (MNC), transnational corporation (TNC), and **global firm**. The problem with these other expressions is that each refers to a specific kind of company and is therefore not general enough. For instance, talking about MNCs neglects the fact that not all actors playing a role in international business are corporations or even privately owned enterprises. Similarly, terms such as TNCs and global firms do not sufficiently communicate the connections that continue to tie most companies with international interests to their country of origin. MNE is a more neutral term to describe the broad category of firms that, according to some statistics, account for more than a quarter of global GDP (UNCTAD 2011) and an even higher percentage of global trade. Thus, for the rest of this book, MNEs (a term including those SMEs that do business overseas) will be the basic unit of analysis.

A firm that owns facilities in a single country but regularly does business outside its borders may qualify as an MNE, but a far more typical and informative example is one whose international **configuration** is comprised of a head office and foreign **subsidiaries**. It has been estimated that MNE subsidiaries are responsible for more than 10 per cent of global economic activity and up to a third of world exports (UNCTAD 2011). The scale of their activities can vary widely between countries like France or the UK, where foreign subsidiaries account for up to 30 per cent of national sales, and others like Japan, where they play almost no role at all in key economic functions like manufacturing. In general, however, there is a trend towards MNEs expanding their international presence through subsidiaries. Alongside trade, companies' **foreign direct investment (FDI)** is the second main pillar of international business and a key focus in this field (see Figure 1.1).

Figure 1. 1 Companies can choose different configurations when engaging in international business.



The tendency over recent decades has been for MNEs to try to integrate their different operational units' activities into a coherent unit. This is the concrete application of certain leading international business theories (see Chapter 2) postulating that particular locations should specialize in those specific activities in which they have a competitive advantage. There is also a connection here to the growing body of academic research measuring how a company's degree of internationalization affects its performance. One consequence is that an increasing proportion of international business involves MNE subsidiaries trading with one another or with subcontractors (Economist 2011). This is one reason why it is so important to understand the different ways in which MNE head offices organize their relational networks (see Chapter 10).

+ **Economies of scale** When a company increases output using the same equipment, its per-unit production costs fall.

+ **Value chain** Succession of acts that successfully add value to an item as it is transformed from a raw material or input stage to a finished product or service.

Case study 1.2

MNEs' many strategic options

Since 2005, *Fortune Magazine*, the US business magazine, has published an annual list of the world's largest multinational enterprises, ranked by the revenues they produce globally (http://money.cnn.com/magazines/fortune/global500/). This data is of some interest to international business students; particularly year-to-year comparisons revealing, for instance, which sectors dominate the top of the list (with energy companies having largely displaced banks in recent years). It is also worth noting the decreasing number of global top 500 MNEs with headquarters located in the older industrialized countries (133 in the USA in 2011 vs. 176 in 2005) matched by the rising number of top MNEs over this period of time with their head office in China (61 vs. 16). Above and beyond discussions of location, however, understanding MNEs means having a sense of the main strategic choices they face. To some extent, 'where' they do things simply reflects 'how' they do them.

Despite the inherent advantage for most companies of reaching a critical mass that will enable them to achieve **economies of scale** (thus lower unit production costs) different sectors of activity are usually guided by different business paradigms. For instance, culturally more sensitive sectors such as food often emphasize national differentiation, with leading MNEs operating in this field, including Nestlé, Unilever, or General Mills, tending to prefer localized operations. On the other hand, hi-tech pioneers like Microsoft or Intel generally emphasize global operations that are easier to streamline (see Chapter 10's discussion on MNEs' 'push' or 'pull' orientations). It is important to remember that international business is not a science but involves trying to understand managers' highly informed yet ultimately subjective appreciation of what constitutes the appropriate response to their circumstances.

In terms of MNE locations, contemporary analysts tend to be less interested in where a company runs its own operation and focus instead on the global **value chains** that they have developed through their dealings with suppliers and customers worldwide (Gereffi and Fernandez-Stark 2011). This new understanding of MNEs reflects the fact that many modern products are too complex to be manufactured by a single company working alone. Instead, as Chapter 5 will discuss, there is a growing trend towards a lead MNE working with an initial tier of counterparts, whose own suppliers or customers then become the lead MNE's second tier of counterparts. In the end, studying MNEs without identifying the relationships they build with other companies provides an incomplete picture of their strategic possibilities.

Case study questions

1. What factors explain why certain sectors are more or less represented at the top of the Fortune 500 rankings in certain years?
2. In which sectors of activity are MNEs particularly dependent on external counterparts, and why?

Like many if not most products, jeans are the result of a multitude of international supply chains coming together
Source: iStock

+ **Upstream**
Early value chain activities undertaken when processing or transforming a product or service.

+ **Downstream**
Late value chain activities undertaken when selling or distributing a product or service.

Accumulation of value in value chains

The most useful way of picturing MNEs' work organization is to imagine the production and sale of a good or service as a series of acts adding to the item's value as it is transformed from a raw material into a semi-processed stage, before ending up as a finished good or service (see Figure 1.2). This series of acts is called the value chain. It is split into production-related **upstream** activities (see Chapter 11) and marketing-related **downstream** activities (see Chapter 12). A key feature of international business today is that many firms do not perform by themselves all of the activities comprising the value chain in which they are involved. Instead, they might ask external partners to take responsibility for certain phases. As such, it is more accurate to represent international value chains as the sum of several intermediary value chains. A good example is provided by jeans, which should be analysed

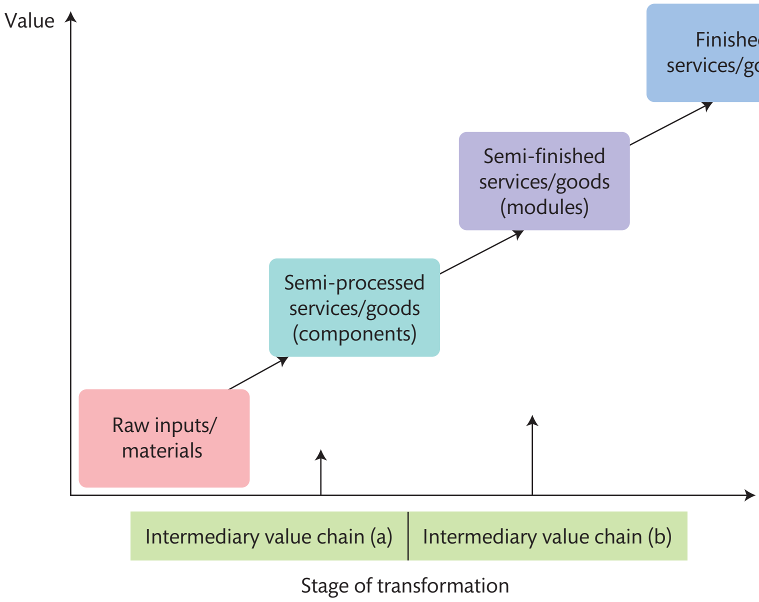


Figure 1.2 Visualizing the transformation of a good or service. Each level adds value and also has its own intermediary supply chains.

not just as a finished product but as the sum of many lower level **generic** products. One of these is the zip, which is the culmination of several intermediary businesses, starting with the extraction of minerals, the processing of basic metals, and their subsequent transformation into zips. It is important to understand that the end product of one company's international value chain (for example, zip-makers) is just an intermediate phase in the value chain of another company (the jeans-maker).

This portrayal of international business as a series of cross-border value chains raises questions about the rate at which value accumulates as a service or good is being transformed into its final form. For presentational purposes, Figure 1.2 shows value accumulating at a linear rate. This is generally unrealistic, since, depending on the sector in question, value tends to accumulate more or less quickly when the good or service passes through the upstream or downstream side of the value chain. For instance, in the coffee business, a tiny percentage of what consumers pay for a cup at many coffee shops goes to upstream bean-growers. To some extent, this reflects poor coffee bean growers' lack of bargaining power when dealing with powerful MNEs that dominate the value chain at the point where value accumulates more rapidly—in this case, further downstream, closer to consumers. Inversely, in a sellers' market (like oil) marked by less competition among producers, value tends to accumulate in the hands of upstream producers. Figure 1.3 offers a more realistic picture of (international) value chain curves.

Clearly it is more efficient to operate at that part of the value chain where value accumulates most rapidly (i.e. where the value-added curve is steepest). This is just as true for national economies as for companies. Those countries whose firms specialize in high value-added production clearly have an advantage over those that specialize in low value-added goods, or, as economists would put it, they enjoy better **terms of trade**. For example, if US firms are global champions in computers and Sri Lankan companies lead the world in the tea business, the USA is clearly at an advantage, since the market where it dominates creates greater value than the market where Sri Lanka dominates. National governments are very aware of this factor and will often take measures to improve their country's competitive position. Such efforts are part of the political environment within which MNEs operate, as are the measures enacted by global bodies (see Chapter 4) to control the actions that states might wish to take in the marketplace. Certain regions' tendency to concentrate on higher or (less advantageously) lower value-added activities is another major topic in international business, especially where this affects the international flow of wealth. Without underestimating the ongoing strength of the MNEs from the older industrialized world—often referred to as the **Triad** or the **OECD countries**—as discussed in Chapter 15, a growing number of companies from newly industrialized emerging economies (also known

+ **Generic**
Reference to goods that are not meant for a specific use but serve a variety of applications.

+ **Terms of trade**
Relationship between the value added inherent to the goods/services that a country imports or exports.

+ **Triad/OECD countries**
World's older industrialized nations. Triad refers to the three regions of Western Europe, North America and Japan/Oceania. The Organization for Economic Cooperation and Development (OECD) is a Paris-based association whose membership is comprised of the world's advanced economies.

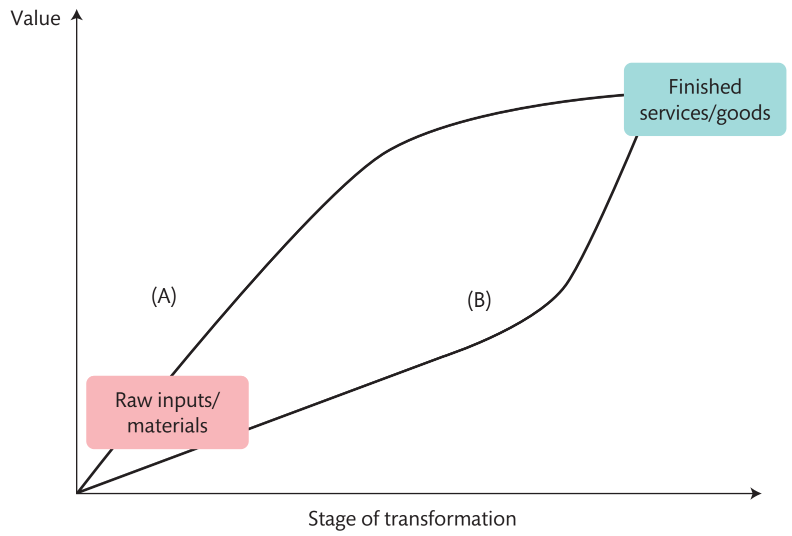


Figure 1.3
Value tends not to increase in a straight line. Curve (A) indicates a product or service where value accumulates more towards the upstream side of the value chain. Curve (B) indicates the opposite.

+ **Less developed countries (LDCs)** Countries whose industrial base and general level of human welfare does not enable most citizens to achieve a decent living standard. This is an umbrella term covering a vast range of economic, social, and demographic situations, ranging from 'emerging' or 'newly industrialized' countries that are on a clear industrialization path to 'heavily indebted poor countries' (HIPC) with very poor growth prospects.

as **less developed countries (LDCs)** have become leading players on today's international business scene. The challenge for them is whether the activities in which they specialize create greater or lesser value added.

Some observers point to the industrial emergence of many LDCs as showing that power is shared more widely nowadays. Others might emphasize the fact that most of the world's largest MNEs still come from OECD countries. Indeed, the Triad continues to host many if not most of the world's hi-tech production activities, meaning that the distribution of global economic power remains very uneven to this day (Mann 2004). MNEs' role in aggravating or reducing income inequalities, on a national but also a global scale, constitutes another major topic of debate in international business (**go online to ORC Extension material 1.2**).

When devising their value chain strategies, companies need to be aware of all relevant political and legislative frameworks, because they must obey the laws of the different countries where they will be operating. The problem today is that many operate on an **offshore** basis outside the control of any single government. Further confusion is caused by the fact that many of the policies shaping the international business framework (like the level of import taxes or export subsidies) vary greatly in time and place. In international business, political considerations are a key aspect of corporate strategizing (Scholte 2005). It is important for theory in this field to juggle the subjective nature of human attitudes with the hard facts on the ground.

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+ **Offshore** Transactions or actors over which national regulators have no authority.

Key statistics

International business is very much a living subject, rooted in the relationship between actions and outcomes. For this reason, it is crucial that practitioners and students develop the ability to analyse the basic concepts of this discipline in terms of what happens in the real world. Viewing international business in context necessitates linking theory to front-page news.

International trade data

Recent crises have been harmful to world trade and raised a number of issues that are key to the study of international business. The first question relates to the relative strength of cross-border as opposed to purely domestic activities during times of economic difficulty. As indicated in Figure 1.4, over the years there has been a definite trend towards international business expanding at a faster rate than business as a whole. Yet following the 2008 credit crunch, both trade and FDI fell much more quickly than global GDP did. This was exemplified most poignantly by the 46 per cent collapse between January 2008 and January 2009 in exports from Japan, one of the world's most competitive trading nations. For the global economy as a whole, total trade fell by about 12 per cent over this period. At one level, the disproportionate slump in international business was unsurprising, since national governments tend during a recession to provide 'stabilizing' financial resources (i.e. paying welfare benefits or running budget deficits) that are mainly spent on more domestic activities such as services. At the same time, it is very significant that many if not most economies react to crises by becoming more inwardly focused, at least temporarily. In a sense, the 'de-globalization' fears associated with the crisis of the late 2000s reveal the potential limitations of international business.

It remains that longer term statistics have shown a very strong trend towards cross-border activities increasing as a percentage of total business. In the decade preceding the 2008 credit crunch, for instance, world trade had expanded by an annual average of nearly 5.5 per cent, or about 2 per cent faster than the global economy as a whole. The result of this trend is that international business had already become a dominant aspect of many people's lives by the mid-2000s. Just one generation ago, trade accounted for a mere 10 per cent of the US GDP; around 25 to 30 per cent of GDP in medium-sized industrial exporting

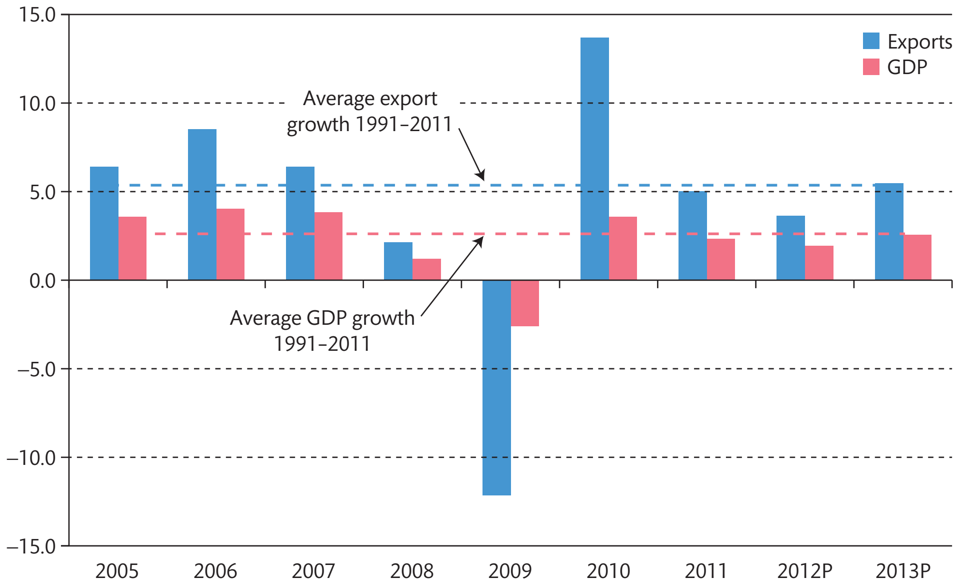

Figure 1.4
With the exception of 2009 (following the crisis in 2008), average export growth has been much faster than average economic growth for more than a decade.

WTO 2012

nations such as Germany, France, and Japan; and around 50 per cent of GDP in a few smaller, open economies like the Netherlands. By 2008, almost all of these countries' openness to trade, measured as the sum of their imports and exports divided by national GDP, had at least doubled (see Figure 3.2). Even more dramatically, by the late 2000s the sum total of imports and exports in countries like China, Russia, and India, which for political reasons had engaged in very little trade before the 1990s, had jumped to somewhere between 45 and 65 per cent of national GDP. Of course, it could be argued that simply adding imports and exports overstates an economy's degree of openness. Admittedly, this is an inadequate way of accounting for certain situations, like the temporary import of components assembled in final goods that will be resold in export markets. Moreover, in the wake of the 2008 credit crunch, some observers were predicting that, within a few short years, global trade would fall from a peak of around two-thirds of global GDP to a more sustainable figure of 40–50 per cent (Munchau 2009). This would remain very high, however. Even after the recent turbulences, there is little doubt that international business will continue for the foreseeable future to account for a large proportion of all economic activity.

Within this general trend, however, regional performances vary widely, as indicated in Figure 1.5. This reflects differences in economic performance or orientations and has clear implications for the politics of international business.

This data set is interesting for both historical and current reasons. Compared with global trade's breakdown in 1990, exports from North America and Western Europe have fallen as a percentage of the world total, matched by rising exports from Africa, the ex-Soviet Union, the Middle East, and above all Asia. For the first three regions, the change is largely explained by higher commodity prices. For Asia, it reflects the region's growing role as a global manufacturing centre. It is also worth exploring the topic of how world trade breaks down between the primary sector (raw materials and agricultural products), the secondary sector (manufactured goods), and the tertiary sector (services) (**go online to ORC Extension material 1.3**). Changes in the **relative pricing** of goods can be an important factor in determining the current and future prospects of one sector of activity as opposed to another. All of these trends are largely driven by MNEs' behaviour—before shaping, in turn, the contexts to which MNEs are forced to adapt.

Figure 1.6 reveals the enormous gap between merchandise imports and exports in some of the world's leading economies—starting with the largest, the USA. When analysing national economic performance, it is always worth examining whether a country is in surplus or deficit, if only to anticipate the likely impact upon economic indicators such as

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+ Relative pricing
Price of a given category of goods or services expressed in relation to the price of a different category.

Figure 1.5
World merchandise trade, by region and selected country, in US$ billion and percentages; exports accounted for FOB (free on board) imports on CIF (cost insurance freight) basis.
WTO 2012

	FOB value exports 2011	Percentage global exports 2011, in % (% in 1990)	CIF value imports 2011	Percentage global imports 2011, in %
World	17,779		18,000	
North America	2283	12.8 (16.6)	3090	17.2
USA	1481	8.3	2265	12.6
South and Central America	749	4.2	727	4.0
Mercosur*	354	2.0	334	2.0
Europe	6601	37.1 (49.6)	6854	38.1
EU 27	6029	33.9	6241	34.7
Germany	1474	8.3	1254	7.0
Netherlands	660	3.7	597	3.3
France	597	3.4	715	4.0
UK	473	2.7	636	3.5
Russia	522	2.9	323	1.8
Africa	597	3.4 (3.1)	555	3.1
Middle East	1228	6.9 (4.1)	665	3.7
Asia	5534	31.1 (21.8)	5568	3.1
China	1890	10.6	1743	9.7
Japan	823	4.6	854	4.7
India	297	1.7	451	2.5
Asian NICs†	1290	7.3	1302	7.2
ASEAN‡	1244	7.0	1151	6.4

(*) Argentina, Brazil, Paraguay, Uruguay
(†) Hong Kong, Republic of Korea, Singapore, Chinese Taipei
(‡) Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam

unemployment or inflation. For example, despite the size of its economy, the USA is only the world's second leading exporter, far behind China. Germany comes a close third—a remarkable performance by Europe's leading trading power, given its much smaller population. The USA did claw back some of its 2011 merchandise trade deficit with a $187 billion surplus on the trade in services—a sector that accounts for upwards of 30 per cent of total trade volumes in Europe and around 15 per cent elsewhere. However, with the country's already large trade deficit aggravated by large FDI outflows, all in all the USA ran a significant **current account** deficit in 2011, as it had in fact done for quite a few years previously. Questions must be raised about the viability of a system whose leading economy runs such large deficits. The global financial architecture (see Chapter 4) is another major debate in international business today.

+ **Current account** Country's 'balance of trade' (exports minus imports) plus or minus its financial flows from abroad (interest or dividend payments, cash transfers).

Lastly, it is also worth commenting upon the growing percentage of world trade accounted for by newly industrialized countries, led by China and other emerging Asian powers. Some observers analyse this as a sign that globalization offers poorer nations greater opportunities, especially considering that, as recently as 1990, LDCs accounted for only around 25 per cent of total volumes. This view is encapsulated in the body of theory

	Trade balance (FOB exports – CIF imports)
World	–221
North America	–807
USA	–784
South and Central America	+22
Mercosur*	+20
Europe	–253
EU 27	–212
Germany	+220
Netherlands	+63
France	–118
UK	–163
Russia	+199
Africa	+42
Middle East	+563
Asia	–34
China	+147
Japan	–31
India	–154
Asian NICs†	–12
ASEAN‡	–93

(*) Argentina, Brazil, Paraguay, Uruguay
(†) Hong Kong, Republic of Korea, Singapore, Chinese Taipei
(‡) Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam

Figure 1.6
Trade balances for selected countries and regions.
WTO 2012

supporting the idea that, one way or another, all countries stand to gain from international trade (see Chapter 2). Whether this is true or not, the shifting geography of international business (see Chapter 15) is another key feature of the modern era. With its enormous impact on MNEs' structures and the global distribution of capital, this is a trend that affects managers' decisions at many different levels.

Introduction to foreign direct investment

As indicated above, trade is just one of international business's two main pillars. The second, foreign direct investment, has gained in importance over recent decades, characterized by a growth rate that has often surpassed the increase in trade itself. Being able to analyse the rise of FDI is also key to understanding this discipline as a whole.

FDI can involve any part of a value chain, from the upstream extraction of raw materials to the downstream retailing of services or finished goods. Recent FDI data should be handled with care given statistical categorization problems but also because the long-term uptrend has been very inconsistent, featuring strong rises followed by interruptions such as the events of 2001 (the 9/11 attacks on New York's World Trade Center and bursting of the 'dot.com' stock market bubble) and the 2008 credit crunch. One of the main explanations

Figure 1.7
FDI inflows and outflows for selected nations, from Q4 2010 through Q3 2011, in US$ billion.

(FDI in figures http://www.oecd.org/dataoecd/60/43/48462282.pdf OECD 2012)

Total global inflows, Q4 2010 through Q3 2011	**1362.8**	
Breakdown	FDI inflows	FDI outflows
OECD countries	790.1	1276.3
USA	226.5	391.5
EU	385.9	565.5
France	28.9	89.7
Germany	29.6	57.6
UK	70.8	109.1
Brazil	76.4	–5.2
Russia	54.2	64
India	31.0	17.5
China	217.8	57.3

+ **Protectionist**
General attitude that a national government should adopt policies restricting foreign interests' ability to access its domestic market.

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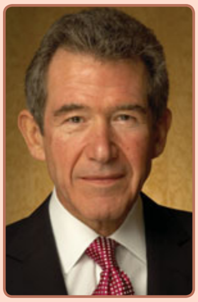
+ **Outsourcing**
Where a company delegates to another company certain tasks (like the production of components) that it might otherwise undertake itself.

for the collapse in FDI following this crisis was a 77 per cent fall in international mergers and acquisitions (see Chapter 9), one of the main drivers of FDI (UNCTAD 2009). At times of trouble, MNEs may be reluctant to invest abroad, especially if funding dries up. Managers might also become more pessimistic about foreign markets' growth prospects.

A similar reaction can also be witnessed in the kinds of attitudes that policy-makers often display during times of economic hardship. Thus, some observers have predicted that the 2008 and 2011–2012 crises could lead to the resurrection of old protectionist attitudes and trigger a process of 'de-globalization' (**go online to ORC Extension material 1.4**), reversing the major trend of the past half-century. In general, this pessimism was met with widespread declarations of support for open borders (e.g. statements made at the April 2009 G20 meeting in London), with many economists and politicians asserting that it is precisely during an economic slowdown that governments must avoid the kinds of discriminatory nationalistic measures that impede the cross-border flow of goods, services, and capital. Having said that, in times of crisis there is a natural tendency, especially in certain political cultures, to prioritize domestic investment and restrict capital outflows. One example of this was the decision by France's old Sarkozy administration in 2009 to require automaker Renault, in exchange for government aid, to close a plant in Slovenia and bring the work back home. MNEs will also have their own ways of reacting to weak economic conditions, often speeding up their ongoing cost-cutting drive. Under certain circumstances, however, this can have the effect of a further acceleration in international outsourcing, a trend that for several decades now has been a key factor in the explosion of cross-border trade volumes. These interrelationships explain why, at a certain level, it can be inaccurate to analyse FDI in isolation from companies' other international trade decisions.

All in all, the global stock of foreign direct investment has risen substantially since the turn of the twenty-first century. Unlike the international trade of goods and services, however, with FDI there has been relatively little variation in recent years in terms of the breakdown between the developed and the developing worlds' share of total volumes, with the OECD countries still accounting for nearly two-thirds of global totals. This may even out in the future given sharp rises in FDI flow to (and increasingly from) the developing world. Moreover, it is also worth exploring the relative variation in LDCs' share of global trade as opposed to FDI because of what this reveals about managers' varying levels of comfort in different business environments and the impact on MNEs' internationalization decisions (see Chapter 9). In international business, there are many different levels where political 'macro' analyses of national interest link to more 'micro' discussions of corporate (and even personal) strategy.

Practitioner insight



John Browne has had a very successful career in the international energy sector, including as Chief Executive of British Petroleum (later BP) between 1995 and 2007, and more recently as Managing Director of Riverstone Holdings LLC. As Baron Browne of Madingley, he has been a member of the House of Lords since 2001. He is also President of the Royal Academy of Engineering.

'The three main drivers of economic globalization have been: communications technology and infrastructure; the reduction in global tariffs and establishment of free trade areas (lowering the cost of international business); and the emergence of new trading partners for the developed world, like the BRICs. Some drivers are both a cause and an effect of globalization.

International and domestic business have an interesting relationship. When the whole world is in crisis, globalized international industries often suffer the most. This is because most global industries are, for various industry-specific reasons, very vulnerable to downturns. Examples include: oil, where turnover falls sharply in global recessions; luxury consumer goods, where customers cut back heavily during a downturn; and finance, because of lending constraints during recessions. Domestic industries, on the other hand, tend to be more resilient because they provide essential goods for which demand is less sensitive to income. Examples include agriculture, healthcare, transport, and the public sector, which often increases spending at times of crisis to stimulate the economy.

In general, however, I predict that international business will continue to expand faster than its domestic counterpart. Every firm above a certain size wants to spread overheads across a larger market to reduce costs per unit sold. I also think the growth of foreign direct investment will remain strong. Even when national or regional shocks occur, the diversity of international business should protect it.

Regarding corporate decisions to internationalize, I see three main drivers. The first is comparative growth rates. If you face a shrinking market at home and booming markets abroad, the signal to internationalize is strong. Second is the wider environment abroad: infrastructure, education, stability, and taxation. There is no point accelerating international expansion if you can't hire appropriately skilled staff or are likely to lose everything in a war. The third factor is confidence in your company's internal capability to succeed in a foreign market. You need to have the right skills, relationships, and structures to cope with the many challenges that each move presents. You must become an apparently domestic player in each market.

Lastly, there is the management of MNEs, typically vast organizations with tens of thousands of employees operating in very different environments. You need a structure that leverages local information close to the ground, ensuring that people from every background, including local people, are equally valued. In general, you need to balance power between the centre and subsidiaries, which should be given the maximum possible freedom to operate within defined boundaries. As a rule-of-thumb, decisions should be taken at the lowest level possible. Country-specific decisions should be taken within the country.'

Section II: The international business framework

Chapter 9 discusses a range of motivations explaining why and where companies operate abroad. Some MNEs internationalize systematically, taking advantage of the relationships they have built up to exploit any and all opportunities (Ellis 2011). Others might only

Figure 1.8
Summary of the main strategic drivers of international business today.

Internal drivers
– Expand sales
– Leverage existing competencies
– Use extra capacities
– Spread risks
– Avoid saturation
– Internalize competencies
– Acquire resources
– Access more efficient inputs
External drivers
– Technology
– Liberalized regulatory framework
– Free trade friendly institutions
– Global competitive paradigm
– Deregulated finance

venture abroad on specific, ad hoc occasions. The following section (see Figure 1.8) offers an overview of some of the main factors driving companies' international business projects.

Strategic drivers

+ **Internalization** When a company decides to run a particular function itself (using its own employees) instead of delegating it to an external party.

Some of the motives driving international business are 'micro' in nature and primarily related to firms' profit-seeking initiatives and strategic intent. Others involve companies' reactions to external 'macro' trends such as political, governmental, macro-economic, and socio-cultural factors over which they have little control (Yip 1989). Of course, 'micro' and 'macro' motivations are often interrelated. One example of this linkage can be found in the corporate philosophy of **internalization**. This is the idea that when markets function poorly (for example, where market participants do not receive a fair reward for their efforts) companies may wish to run their international value chain operations themselves, because they need to maintain in-house any knowledge that they may possess (Buckley and Casson 1976). In this view, firms will not need external partners to lead their internationalization drive as long as they have high-quality managers capable of assuming responsibilities abroad, and as long as the host countries are not too different from the ones to which the company and its managers are accustomed. This is a case where international business springs from the interface between a company's internal attributes (managers' qualities) and the characteristics (foreignness and/or market mechanisms) of the host country where it is hoping to move. Another example of the interconnection between micro vs. macro-drivers of international business is when an MNE calculates that the costs of going abroad are lower than its potential gains from operating in a regulatory, labour, or tax system where it is well placed to pressure the host country government into offering it certain facilities (Ietto-Gillies 2003). This is because a company's cross-border success depends not only on how suitable its behaviour is to the market(s) where it is operating (Porter 1986) but also on how effectively it deals with non-business actors such as politicians or regulators. In short, separating micro and macro-drivers of international business may be a useful categorization (see Figure 1.8) but it is necessarily an artificial one.

Internal drivers of international business

Companies often operate outside their borders because they are in a sector shaped by international rather than domestic factors. At the same time, it is rare to find companies launched as multinationals from the very outset. The vast majority of MNEs throughout history, with the exception of 'born-globals' (see Chapter 9), have started in their home market and moved abroad later: expanding downstream to increase sales; upstream to acquire resources; or in both directions to diversify risk. Each of these actions is based on a different logic that the company will have developed for its own internal reasons.

Expand sales

Once a firm has built a system allowing it to produce and market a product or service efficiently, it will usually want to leverage this competency by selling the finished good, with or without modification, into a new market. Thus, on the downstream side, the expansion of sales is the main driver of international business. There are countless examples of this rationale being put to use. For instance, Dutch vegetable farmers have developed the greenhouse technology to grow tomatoes and peppers even during cold North European winters. Because consumer demand for these products from neighbouring countries such as Germany and the UK remains strong all year long, doing business across borders is a natural step for Dutch agribusiness companies like The Greenery, which sources fresh produce and sells it to foreign retailers.

A related example is the trade between Japan, a dynamic but mineral-poor industrial giant whose factories require enormous amounts of raw materials, and Australia, which has an abundance of minerals as well as an industrial sector capable of refining ore (like bauxite) into usable production inputs (like aluminium). For Australian mining or refining companies, exporting to Japan is a logical extension of what started out as a domestic activity. A third example from the service sector is the way that huge pension funds like Jupiter or Allianz RCM leverage their expensive management infrastructure (often located in London) to sell their products to customers worldwide. Expanding sales worldwide is a quick way of paying for the enormous costs that they incurred building their trading rooms in the first place. Lastly, cross-border sales can also be a natural move for companies that are small or medium-sized but operating in sectors that are by their very nature international in

Dutch food manufacturers use their facilities to serve domestic and foreign markets alike

Source: The Greenery

scope. One example here would be the engineering consulting business, which in Europe and neighbouring regions like the Middle East is 96 per cent dominated by companies with fewer than 20 employees (http://www.ecceengineers.eu). In all these instances, international business is as relevant to a company's mission as the work that it does in its home market. This is especially true when the company is looking to move into a foreign country that is similar in political, economic, and/or cultural terms, not to mention close geographically. Without minimizing the real differences that exist between the USA and Canada, when McDonald's first began expanding across America, setting up outlets across its northern border must have seemed a relatively easy step. The skills developed selling in one country can sometimes be transplanted seamlessly to another.

There are also strategic reasons why companies organize their commercial functions to embrace international sales as a matter of course. As mentioned above, a basic principle of modern production is that selling large volumes is beneficial because it creates economies of scale. In a similar vein, the greater the experience that a company has acquired in producing something, the better it becomes at this activity. This is because it appropriates skills that will allow it to achieve productivity gains. As a result, many companies size their production operations to obtain **critical mass**. To justify these investments and avoid surplus capacities, they often need to sell more than they would if they were simply serving domestic customers. This is especially true if the firm comes from a small country. For example, discount airliner Ryanair would have been at a disadvantage using its Dublin home as its only hub. With so many more passengers travelling through the UK, it made sense for this Irish company to run its main operations out of London Stansted Airport, which is, after all, a foreign location. Another way of looking at the issue of the size of a company's international operations is in financial terms. In the mid-2000s, the cost of building a new automotive plant was roughly \$1 billion. To have any hope of recovering such a large upfront investment, a car company would have to make sure that its new plant produced enough cars to justify the expense. This is not possible if the plant is located either in a small country (Luxembourg does not have a car plant serving its domestic market alone, for instance) or in one where demand is already saturated due to competition. In both cases, the production scale must be international or else the investment becomes impracticable.

+ **Critical mass** Minimum threshold beyond which positive, size-related benefits arise.

Risk diversification

Another strategic driver of international business is the desire to spread risk by working in more than one country at a time. Evidence shows that this kind of 'multinationality' not only increases flexibility, thereby increasing profit-making opportunities, but also reduces risk by preventing over-dependence on a single location or market (Andersen 2011). One way of looking at this is from an upstream, production perspective. If a firm had all its industrial assets in northern Turkey and another earthquake were to hit the region, its chances of continuing manufacturing operations would be worse than if it also had plants in zones not affected by the earthquake. That is why so many firms have disaster plans allowing them to continue functioning in case a catastrophe affects one of their main locations. The same logic can be applied on the downstream, sales side. A company that sells into one market alone runs the risk that its outlet might collapse for whatever reason (natural disaster, bad policy, war) without any other customers to compensate for lost sales. Any firm whose entire business revolved around exports to Syria at the time of the 2012 civil war, for instance, would have experienced major problems. The adversity that a company experiences in one location has less of an impact when it has interests in many others.

Spreading risk through international operations can be done in different ways. The 'product life cycle' (PLC) is the idea that, from an international marketing perspective, a product or service that is on an upward trend in some countries may be in decline elsewhere (see Chapter 12). Clearly, it is advantageous for firms to sell goods in markets where demand is on the rise, since they will be able to command higher prices. One example from the 1970s and 1980s is the way that jeans were so much more expensive in Western Europe, where they were new and fashionable, than in California, where they had long been a commodity product. The PLC variation enabled San Francisco firm Levi Strauss to supplement revenues in its home market with exports to Europe. International business can be used to diversify other risks as well. For instance, foreign sales can be used to offset the risk of accumulating liabilities in the currency concerned (see Chapter 13). Despite the challenges of operating in a foreign environment, diversification means that international business can actually be a way for a company to reduce risk.

Acquire inputs

The final internal driver of international business is the acquisition of resources (materials and labour but also capital and technology) used during a firm's production process. Sometimes this involves inputs that are unavailable at home. For example, non-oil-producing countries such as Japan, Germany, and France must look abroad to source this commodity. At other times, the cost of an input might be so much lower overseas that a company would be at a competitive disadvantage if, unlike its rivals, it did not source the factor where it can be acquired most cheaply. As discussed in Chapter 9, this can be done via FDI or trade. UK vacuum cleaner manufacturer Dyson provides one example of a firm engaging in FDI to reduce input costs. Portrayed as a symbol of the rebirth of British manufacturing in the 1990s, Dyson had decided by 2002 that it needed to lower its cost base. Accordingly, it moved almost all its production activities to Malaysia, where workers' wages were less than those paid to British production staff. However, the company continued to run higher end tasks out of the UK, with its founder and CEO sponsoring annual awards from 2009 onwards to encourage young British design engineers.

Trade can also be used to reduce return costs. The budding solar energy business is a good case in point. Builders worldwide seeking to enter this fast-growing sector must source solar panels at a competitive price. However, few countries can make these components as cheaply as Germany, where companies like Solarworld or Q-Cells that were relatively small SMEs until recently have now achieved critical mass, allowing them to compete successfully in the global markets. Thus, it is in the interest of energy system installers worldwide to import from Germany if they want to acquire resources cheaply. In short, international business is often driven by firms focusing more on the advantages inherent to a given production location and less on whether this site is in their country of origin or not.

External factors

Business decisions are always shaped by trends and events that escape a company's direct control. This can be particularly significant in an international situation, as most multinationals are less able to influence multiple global events affecting their fortunes, as opposed to trends unfolding within a single country where they might have greater influence.

Dyson famously moved its manufacturing facilities to Malaysia, while maintaining most of its engineering activities in the UK

Source: Dyson

Technology

It is not always easy to determine which drivers a company can control, and which it cannot. One case in point is technology, a key factor in today's global economy. This is an umbrella term that refers to companies' internal innovation efforts (see Chapter 11's section on knowledge management) but also to the technological advances that a particular society achieves. Thus, technology affects the international business environment at many different levels. On the upstream side, for instance, improved telecommunications enable companies to stretch their value chains to distant locations offering competitive advantages. One example is when hospitals in the West use remote diagnostics facilities to get advice from doctors located, for instance, in India. Out of a service that was once as localized as medical treatment is, modern technology has created an opportunity for an international work organization. The same applies to downstream activities, for instance, where company–customer relationships extend worldwide due to technological advances like the Internet. When consumers worldwide purchase their books through Amazon instead of at their local bookstore, they are cementing technology's role as a key organizing principle in international business. Indeed, given the positive impact that technology-related transportation improvements have traditionally had on trade, it can be argued that technology is one of the main causes of today's shrinking world. It is rare that a community chooses to remain completely isolated once the means exist for it to interact with other communities. Google's rapid rise in China, despite the obstacles raised by the Beijing government, is a good example of this. Before China had any exposure to Western consumption goods (or ideas), its population was less focused on them. People's outlooks and desires often change when they see how foreigners live. Cross-border comparison has always been a significant driver of international business.

Regulatory framework

However, just because a technology exists that enables something to happen does not mean that it will necessarily occur. For international business to take place, it must be enabled by a general regulatory framework. National governments' main responsibility is to ensure the well-being of their population in the face of danger from abroad. The main threat is clearly war, but foreign competition can also be damaging to local interests, for instance, by crowding home country companies out of their domestic marketplace. The state must therefore determine to what extent it wants to use regulation as protection against this international business threat. Chapter 3 looks at the issue of state intervention in greater depth. For the moment, it is worth stating that the general paradigm in many countries since the early 1980s has been to accept and indeed promote cross-border flows by allowing foreign actors to enter domestic marketplaces. The effect of this deregulation (also known as 'liberalization') trend has been to reduce **barriers to entry**, making it easier for companies to operate on an international scale.

+ **Barriers to entry** Regulatory, competitive, financial, and other obstacles that make it difficult for a firm to enter a particular market.

A liberalization philosophy has affected the trade and FDI regulations of most if not all of the world's nation-states, but, as Chapter 4 details, it has also led to the creation of a global framework that is conducive to international business. One aspect is the rise of regional trading arrangements like the EU. These are groups of neighbouring countries that have signed agreements enabling easier access to one another's markets. Their degree of integration can vary, but in general such arrangements promote free trade among members. The same philosophy has also led to the creation of trade-friendly international institutions like the WTO, whose laws create a framework in which countries are positively discouraged from adopting isolationist policies. The idea is to create a world where cross-border transactions are no longer considered unusual.

Global competition

In terms of corporate strategy, a whole new vision has arisen regarding what it means to compete. Before the arrival of a world of free trade, companies would position themselves in terms of local and national rivals, competing for a share of their domestic markets. Today, with increasingly penetrable national borders, economic competitors can come from anywhere, taking advantage of any experiences that they have accumulated at home or abroad. This means that some companies that have worked very hard over the years to improve productivity or quality, and that would be very competitive in a purely domestic framework, might suddenly lose market share because of the arrival of hyper-competitive foreign companies. For example, where Bordeaux wineries used to compete successfully with domestic rivals from France's Burgundy region, they must now face challenges from New World winemakers from Australia, Chile, and South Africa. With rivals achieving economies of scale because they already operate globally, Bordeaux winemakers can no longer afford to think in domestic terms alone. Furthermore, the profits that global groups make in one market can be used to fund their activities in another, which is why it is sometimes just as important to go abroad specifically to limit rivals' profitability as it is to turn a profit oneself. This explains the outcry when companies like US aircraft-maker Boeing and its European rival Airbus suspect one another of receiving different kinds of preferential treatment at home, enabling them to subsidize lower prices to foreign customers and thereby gaining global market share to their rivals' detriment. The new competition involves fighting not just in rivals' home markets but also in markets all across the world, which is why business has become so much tougher in many sectors today.

The main consequence of the new competitive paradigm is that producers are no longer able to rely on the comfortable positions they used to hold in their domestic markets. Consumers' greater awareness of possible foreign alternatives to domestic products, and their ability to access rival products at competitive prices, has given buyers greater power. For example, in the mid to late twentieth century, when German consumers could buy their television sets only from local companies AEG Telefunken and Grundig (or Dutch rival Philips), these proud old firms were in a position to sell their high-quality products at a good profit. Once the market began to be flooded with equally good but cheaper Japanese alternatives, the two German companies were forced to compete at a level to which they were unaccustomed. Today both survive only as brand names listed in other firms' product portfolios. Given the partial convergence of consumer behaviour and demand patterns worldwide (see Chapter 12), companies have come to realize that, regardless of how directly or indirectly they operate outside their national borders, international business will affect them at one level or the other. As Chapter 10 discusses, MNEs running worldwide operations increasingly look to integrate their units' management, in a bid for greater coherency (Held et al. 1999). Everyone's playing field has expanded.

International finance

Corporate finance has also been affected by the trend towards a more globalized world. To source the capital needed to run vast multinational empires, MNEs often have to rely on different funding sources, many of which operate offshore and thus free from domestic controls. The deregulation of the finance industry since the 1980s, part of an overall 'liberalization' paradigm, has led to an explosion in cross-border capital flows. Much of this money is free floating, that is, not directly associated with the production of goods and services. This partial separation of finance from real business activity—one of the causes of the 2008 global credit crunch—has added to pressures weighing on MNE managers today. On the one hand, financial asset prices are becoming increasingly volatile and difficult to predict, adding to the uncertainty of international business. On the other, whereas many MNEs used to be owned by 'passive shareholders' mainly interested in the safety of their investments, in the new **'shareholder value'** paradigm international managers are under pressure to maximize short-term financial returns by running tighter operations and taking greater risks. In a similar vein, the deregulation of the world's financial markets means that problems first affecting just one country have become more contagious and are therefore more likely to affect other economies (see Chapter 4). A more globalized world has advantages but also creates particular challenges.

+ **Shareholder value**
Idea that the purpose of a company is to maximize returns to shareholders.