Chapter 1: Overview of International Business Management

INTRODUCTION

The 2005 bestselling book by the New York Times staff reporter Thomas Friedman, entitled *The World is Flat: A Brief History of the Twenty-First Century* popularized the notion of “economic globalization.” Friedman’s main argument was that both businesses and workers in developed economies such as the United States are facing increasing competition from their counterparts in developing economies, particularly China and India. This increased competition is taking place across a range of industries and business activities, including service industries such as architecture, education and legal services. Relatively highly educated architects, teachers and lawyers, among others, are facing increased indirect competition from lower-paid, but competent, professionals located in emerging economies who are increasingly capable of supplying services to customers in developed economies using the Internet. An important implication is that profits and wages in countries such as the United States will come under increasing downward pressure from international competition, unless U.S. companies and educated workers “reinvent” themselves through innovation and the acquisition of new and specialized skills in order to differentiate themselves from their emerging market competitors.

Friedman’s perspective that political boundaries and geographic distance are becoming essentially irrelevant barriers to international business has been criticized by economists as a gross exaggeration.\(^1\) Nevertheless, the notion that businesses and workers everywhere are competing in an increasingly “globalized” business environment has become part of popular opinion, and a staple of the news media. To be sure, the notion that national economies are becoming increasingly integrated and interdependent is supported by a variety of data and observations. Some evidence is provided in Tables 1 and 2. Specifically, Table 1 reports merchandise trade as a percentage of Gross Domestic Product (GDP) for the United States for selected years from 1960 to 2011. Merchandise trade consists of exports and imports of goods and therefore excludes services. GDP measures the value of all goods and services produced in a country. The data reported in Table 1 shows that merchandise trade relative to the total value of all goods and services produced in the United States virtually quadrupled from 1960 to 2011. Table 2 reports exports of goods and services as a percentage of GDP for China for selected years from 1970 through 2011. The growth of the Chinese economy as a participant in the world economy is dramatically underscored by the data in Table 2. Exports increased from only 3 percent of GDP in 1970 to 37 percent in 2005. The decline to 31 percent in 2011 reflects a severe and prolonged slow-down in the economies of all developed countries from 2008-2011 which suppressed the growth in Chinese exports.

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\(^1\) See, for example, Edward Leamer (2007) and Rugman and Oh (2008).
Table 1

Merchandise Trade as a Percent of GDP – United States

<table>
<thead>
<tr>
<th>Year</th>
<th>Percent</th>
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</thead>
<tbody>
<tr>
<td>1960</td>
<td>7</td>
</tr>
<tr>
<td>1970</td>
<td>8</td>
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<tr>
<td>1980</td>
<td>17</td>
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<tr>
<td>1990</td>
<td>16</td>
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<tr>
<td>2000</td>
<td>21</td>
</tr>
<tr>
<td>2005</td>
<td>21</td>
</tr>
<tr>
<td>2011</td>
<td>25</td>
</tr>
</tbody>
</table>


Table 2

Exports of Goods and Services as a Percent of GDP – China

<table>
<thead>
<tr>
<th>Year</th>
<th>Percent</th>
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<tbody>
<tr>
<td>1970</td>
<td>3</td>
</tr>
<tr>
<td>1980</td>
<td>11</td>
</tr>
<tr>
<td>1990</td>
<td>16</td>
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<tr>
<td>2000</td>
<td>23</td>
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<tr>
<td>2005</td>
<td>37</td>
</tr>
<tr>
<td>2010</td>
<td>31</td>
</tr>
</tbody>
</table>

Source: [http://data.worldbank.org/indicator/TG.VAL.TO](http://data.worldbank.org/indicator/TG.VAL.TO)

The information reported in Tables 1 and 2 suggest that opportunities to sell goods and services abroad increased relative to opportunities in the home market for firms in the world’s largest developed economy (the U.S.), as well as for firms in the world’s largest emerging economy (China). Indeed, this
statement is true for the world as a whole, as evidenced by the fact that total world exports of goods
and services as a percentage of world GDP increased from 26 in 2000 to 30 in 2011.\footnote{2}

Some additional evidence illustrating the growing integration of national economies is provided
in Tables 3 and 4. Table 3 reports the ratio of inflows of foreign direct investment (FDI) to GDP for the
United States and China for select years.\footnote{3} FDI represents foreign investment undertaken by business, and
is distinguished from other forms of investment in that the foreign investor actively manages FDI assets,
as opposed to being a passive recipient of dividends or interest income. The distinction between active
and passive investing is generally made on the basis of the percentage of ownership of the relevant
assets. The minimum ownership threshold varies across countries, but a 10 percent ownership level is
generally considered a minimum threshold for identifying FDI as opposed to a portfolio (or passive)
investment. In fact, as we shall discuss in a later chapter, multinational companies (MNCs) that are
responsible for most FDI generally prefer to own and operate foreign assets through wholly owned
foreign affiliates. Hence, in practice, there is ordinarily a fairly clear dividing line between active and
passive foreign investing.\footnote{4}

Table 3

<table>
<thead>
<tr>
<th>Year</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>0.61</td>
</tr>
<tr>
<td>1985</td>
<td>0.50</td>
</tr>
<tr>
<td>1990</td>
<td>0.80</td>
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<tr>
<td>1995</td>
<td>0.80</td>
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<tr>
<td>2000</td>
<td>3.20</td>
</tr>
<tr>
<td>2005</td>
<td>1.10</td>
</tr>
<tr>
<td>2011</td>
<td>1.72</td>
</tr>
</tbody>
</table>

Source: The World Bank, Data, \url{http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD}

\footnote{2}{See The World Bank (2013), World Development Indicators, \url{http://wdi.worldbank.org/table/4.8}.}
\footnote{3}{The data reported for China reflects the earliest year for which the required information is available.}
\footnote{4}{For a broad overview of the FDI phenomenon, see Globerman (2013).}
Table 4

Foreign Direct Investment Net Inflows as a Percentage of GDP – China

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1983</td>
<td>0.55</td>
</tr>
<tr>
<td>1990</td>
<td>1.00</td>
</tr>
<tr>
<td>1995</td>
<td>4.90</td>
</tr>
<tr>
<td>2000</td>
<td>3.30</td>
</tr>
<tr>
<td>2005</td>
<td>4.60</td>
</tr>
<tr>
<td>2011</td>
<td>3.01</td>
</tr>
</tbody>
</table>


While there is a great deal of year-to-year variation in FDI flows, the long-run growth of inward FDI relative to the size of each economy is evident, particularly in the case of China. FDI is motivated by a variety of considerations, as will be discussed in the next chapter. One motive is to sell the firm’s products more effectively in foreign markets, particularly when physical proximity between the seller and the consumers is advantageous. A second motive is to gain access to lower cost inputs, particularly labor. A third is to gain access to new technologies and higher quality inputs, such as scientists and engineers. The first two motives are certainly prominent explanations of the growth in the ratio of inward FDI to GDP for China. The third motive is a prominent explanation of FDI inflows to the United States. The data reported in Tables 3 and 4 therefore further suggest the growing opportunities to sell product abroad relative to selling more in the home country. They also suggest an increasing advantage of carrying out alternative value chain activities abroad rather than at home.

Other indicators of the closer integration of national economies might be mentioned including the controversial phenomenon of offshore outsourcing. The latter phenomenon refers to a practice whereby firms contract with other independently owned firms located abroad to carry out specific value chain activities. For example, many U.S. – based companies contract to have companies in India operate customer call centers in India. Indeed, the growth of offshore outsourcing of activities such as software programming underlies Thomas Friedman’s claim that the wages earned by workers in developed countries will increasingly be determined by wages earned in countries such as China and India, where much offshore outsourcing has taken place. To be sure, MNCs also operate global value chains, whereby their affiliates in foreign countries supply inputs to the home country affiliates and vice-versa. Such trade among MNC affiliates is called intra-firm trade. Intra-firm trade accounts for around one-third of all U.S. imports.

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5 For a discussion of FDI motives, see Dunning (1993).
THE VALUE CHAIN

Since this book focuses on issues related to managing an international business, it would be useful to have a convenient way to characterize business organizations and the broad job of managing those organizations. One such convenient framework is the value chain, a concept popularized by Michael Porter, a long-time professor at the Harvard Business School. The value chain describes the full range of activities that organizations engage in to bring each of its products from the initial conception stage to the ultimate customer. For international managers, value chain activities will be located in more than one country (global value chains). The value chain therefore identifies all the activities and the linkages that management must organize and coordinate efficiently and effectively, if their organizations are going to survive and prosper in an increasingly competitive market. It should be noted explicitly that organizations need not carry out each value chain activity themselves. For example, they can outsource specific activities to independent organizations. While both purely domestic and international businesses must decide which value chain activities they will carry out themselves (internalize) and which they will hire other companies to carry out, international companies are especially likely to look for outsourcing partners, or other types of shared management arrangements, for overseas value chain activities for reasons that will be discussed later in the book.

Figure 1 portrays a stylized representation of a value chain. It is stylized inasmuch as it is a generalization of the value chains of many different types of organizations.
Definitions of Value Chain Activities

Support Activities:

1. Corporate Planning and Strategy - encompasses developing and implementing organization and business unit plans, including the product and geographic markets in which the organization will compete, as well as how the organization will compete and coordinate the activities of subsidiaries and partners.
2. Research and Systems Development – encompasses designing and developing new products, and production processes, designing and implementing management information and other control systems, and monitoring the organization’s technological environment.
3. HR Management – encompasses recruiting, hiring, training, developing and compensating employees.
4. Legal and Regulatory – encompasses activities related to identifying all laws and regulations that apply to the organization, ensuring compliance with those laws and regulations, and lobbying politicians and regulators for changes in laws and regulations that harm the organization.
5. Accounting and Finance – encompasses preparing accounting and financial statements for internal use and for public documents such as annual reports, tax filings and so forth; preparing cash flow and capital budgets, raising capital and investing retained earnings.

Primary Activities:

1. Purchasing – acquiring inputs and receiving, storing and distributing the inputs where they are needed.
2. Operations – converting inputs into semi-finished and final products. Includes production, assembly, and factory maintenance.
3. Outbound Logistics – distributing products to buyers. Includes activities such as order processing, packing, shipping, warehousing and delivery.
4. Marketing and Sales – determining product features, promoting and advertising products, placing products in distribution channels and doing market research and planning.
5. Service – providing after-sales assistance to buyers, including installation, maintenance, repair, technical assistance, and buyer inquiries and complaints.
THE LOCALIZATION CHALLENGE OF INTERNATIONAL BUSINESS

The various indicators of the growth of international business cited earlier attest to the growing potential profits and other benefits that firms can realize by doing business outside their home countries; however, many international business initiatives have proven unprofitable, and most organizations, particularly small and medium-sized companies, do relatively little international business. While ignorance of business opportunities abroad may be part of the explanation of the home country bias exhibited by many firms, a more robust explanation is the added costs and complexities associated with doing business abroad. To paraphrase Jackson and Deeg (2008, P. 540): multinational companies are used to operating in their home countries with a set of routines, practices and capabilities appropriate for the home country, but they face very different sets of institutional constraints and opportunities in diverse host country environments and must adapt to the diversity. The costs and risks associated with adapting to foreign economic, cultural and legal environments are often referred to as “liabilities of foreignness.”

Carrying out value chain activities abroad imposes costs and risks on an organization that would either be substantially lower, or even non-existent, if those same activities were carried-out inside the home country. The added costs and risks arise from the fact that the business environments outside the home country typically differ substantially from the business environment in the home country. The differences oblige firms to “do things differently” in foreign markets in order to be profitable; however, the obligation to do things differently, or “localize” value chain activities imposes additional costs on international firms, as well as unique or magnified risks that must be managed. Unique organizational capabilities are required to manage localization initiatives and international business risks in an economical manner if international business is going to prove profitable.

An illustration of the pressure that international businesses face to localize value chain activities carried out abroad is provided by the example of Dulwich College’s expansion into Shanghai, China. Dulwich is a London-based private secondary school which also operates schools in Korea and Singapore and runs programs in several other locations in China. The schools in China operate as a franchise, and they are run by local management companies. Their primary customers are expatriate foreigners and local parents who plan to send their children to university in Europe or the United States. While Dulwich has a strong Christian tradition, it does not teach religion in its Chinese schools. Indeed, it is not allowed to under Chinese law. In contrast, a British competitor of Dulwich, King’s School headquartered in Canterbury, England, pulled out of a partnership in China after concluding that it would be inappropriate not to teach Christianity, given the cathedral in Canterbury’s historical role as the seat of the Church of England. The example illustrates the point that sometimes appropriate localization initiatives may be so costly or damaging to an organization’s business operations elsewhere that international expansion in specific locations is undesirable.

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6 Home country bias refers to a widespread phenomenon whereby business and private investors exhibit a strong preference to invest in locations that are geographically very close to their home bases. See Nachum, Zaheer and Gross (2008).
The degree to which an organization chooses to localize will influence the organization’s mode of operation in a foreign location. Specifically, the more an organizations’ activities are localized, the more likely it is that ownership of businesses outside the home country will be shared with local companies, or even run as franchise operations. This is because local companies are likely more knowledgeable about how to do business profitably in the local environment, and because it is difficult for an international company to be efficient when it operates substantially differently across the various geographic locations in which it does business. However, a greater reliance on partnering with local companies or using franchises substantially increases an organization’s risk that its global brand will be devalued by product quality problems, or by product offerings that differ substantially from those found

Case Study

Americans Spit but Swedes Don’t

Swedish Match Company based in Stockholm, Sweden is the world’s largest maker of spitless tobacco. Its spitless product, known as snus (rhymes with “moose”) is more popular than cigarettes in Sweden. Mostly sold in pouches that look like miniature tea bags, snus is used by more than a quarter of adult men in Scandinavia. The U.S. smokeless tobacco market is dominated by moist snuff and chewing tobacco. Traditional American snuff goes inside the lower lip, triggering salivary glands that prompt users to spit to avoid swallowing tobacco juice. In contrast, snus is tucked in the upper lip and doesn’t require spitting. One would think that the convenience of not having to continually spit out tobacco juice would give snus a competitive advantage in the U.S. market. Indeed, a big part of Swedish Match’s advertising message in the U.S. is that snus is more convenient than stepping outside for a smoke or finding a cup to spit into; however, snus has held a small share of the U.S. smokeless tobacco products market since it was introduced by Swedish Match into the United States in 2006. It is apparently quite difficult to overcome established habits of consumers. One owner of a chain of retail tobacco stores in North Carolina and Virginia expressed skepticism about getting Americans to switch to the upper lip, given the long history of chewing and spitting going back to when the U.S. was largely an agrarian economy. Before the commercial production of cigarettes, American farmers twisted tobacco into knots and chewed on it for nicotine.

How can Swedish Match encourage American consumers to change their preference for “lower lip products”? The company is trying to increase its sales by selling snus in more U.S. stores and cutting the price of its largest brand (General) from the typical $3.79 to $.99 for a limited time in new markets. As well, to get snuff users to give its spit-free variety a try, Swedish Match passes out samples of General at hundreds of concerts, Nascar races and other events every year. Will such initiatives work? Shareholders of Swedish Match certainly hope so.

Note: The basic facts of this case are taken from “Spitting Americans Foil a Swedish Invasion”, *Bloomberg Business Week*, July 8 – July 14, 2013.
in other geographic markets served by the organization. Such problems and differences could adversely affect the organization’s image with customers in other geographic markets.

Given that localizing value chain activities imposes added costs and risks on an organization, international managers need to be selective in their decisions about where, what and how to localize. In particular, some differences between countries in the business environment may weaken or even disappear over time. Indeed, it might be possible for firms to mitigate existing differences through initiatives such as educating foreign consumers to behave more like consumers in the firm’s home country. An example in this regard is the Japanese company Kikkoman, the world’s largest maker of naturally brewed soy sauce. The company traces its origins to the early 17th century, and it first exported its soy sauce to the United States in very limited quantities in the 1800s. However, it was not until 1973 that it became the first Japanese food company to open a factory in the United States. The head of the company at the time (Yuzaburo Mogi) viewed the U.S. as the perfect place to establish its foreign-based operations given the country’s openness to new things. However, after travelling across America, Mr. Mogi realized how few Japanese eateries there were and, hence, how unfamiliar Americans were with how to use soy sauce as an ingredient. He concluded that Kikkoman had to adapt its sauce to the local cuisine if it was going to succeed. Kikkoman promoted soy sauce in the United States by hiring chefs to create recipes that incorporated the sauce into classic American dishes. It also sent the recipes to local newspapers. In effect, it positioned soy sauce as an “all-purpose seasoner” rather than as a Japanese product. It further expanded the market in the United States for its products by introducing teriyaki sauce in 1961. Teriyaki sauce is a mixture of soy sauce and other ingredients that was devised specifically for the U.S. market as a barbecue glaze.

Even when differences across national markets are likely to persist indefinitely, it might be possible to standardize specific business activities across geographic markets when standardization does not come into significant conflict with local business conditions. Indeed, standardization does not necessarily need to duplicate how things are done in the home country, if more efficient or effective ways of carrying out an activity have been identified in foreign markets. On the other hand, when standardizing a business activity is likely to be unprofitable, the international manager’s challenge is to ensure that localization does not harm the organization’s business activities in other geographic locations.

Differences across locations that impose pressures on managers to localize value chain activities obviously make it more difficult to extract synergies from the international linkages throughout the global organization. McDonald’s provides an example of how to leverage complementarities or synergies across its international affiliates with the development of its McWrap product offering. Synergies may be thought of as efficiency improvements an organization realizes through sharing resources and know-how that are distributed throughout the global organization. Capturing available synergies requires effective integration across different international business units of a company. Effective integration of an organization’s international activities requires that managers responsible for localizing business activities have the “right” incentives; that is, their goals and objectives should be aligned with those of the international organization as a whole. It also implies that headquarters’ management has good real time information about what is going on in the different foreign locations in
which it is carrying out business activities, and that it is capable of responding to the information in a timely manner.

Case Study

McDonald’s Premium McWrap

McDonald’s Premium McWrap was launched on April 1, 2013. It is a 10-inch white flour tortilla filled with chicken, lettuce, tomatoes, cheddar jack cheese and, used for the first time as a food ingredient by the company, sliced cucumbers. On top of the fillings is a ranch, sweet chili or creamy garlic sauce. The product took two years to develop, and it is seen as one of the most important additions to McDonald’s U.S. menu in years. In the past decade, McDonalds set up several “food studios” outside of the United States. The original version of the McWrap was actually developed and sold in Europe. Specifically, McDonalds in the Czech Republic began selling Chicken Roll Ups in 2004. McDonalds in Poland introduced a tortilla sandwich in 2005 inspired by a popular street food item, the kebab. The cardboard container used for the McWrap was developed by the Austrian unit of the company. The food studio along with the company’s menu innovation team, both located at McDonald’s corporate headquarters, in the U.S., commenced the task of “localizing” the European versions of the product to better suit the tastes of their typical American customers. For example, while the packaging design developed in Austria continues to be used, the larger size of the U.S. sandwich obliged McDonalds to make a bigger cardboard box for the McWrap. The experts at HQ also had to find a way to prevent the tortilla from tearing in the box. The solution was to place the ingredients on the warm side of the tortilla. The McWrap experience illustrates how synergies can be realized from operating international business units, even though some localization of the relevant product or production process is usually required in individual locations.

Note: The facts for this case study are taken from Susan Barfield “McFresh,” Bloomberg Business Week, July 8-14, 2013.
SOURCES OF DIFFERENCES ACROSS LOCATIONS

The imperative to do things differently arises from various factors that make the business environment different from location to location. While a major focus of this book is to analyze these factors in detail, it is useful to discuss them in broad terms in this introductory chapter. The major locational differences in the business environment can be grouped into three broad categories: 1. Economic; 2. Cultural; 3. Institutional. International business scholars sometimes refer to differences in economic, cultural and institutional features of different locations as “distances” between those locations, even though the magnitude of the differences between any two locations in these features does not necessarily correspond to the physical distances between the locations. While physical distance presents its own unique challenges to managing an international business, which will be discussed in later chapters, the emergence and diffusion of new communication technologies, particularly information computer technology (ITC) networks, has reduced the importance of physical distance, *per se*, as a factor conditioning the problems and challenges facing international business managers.

Economic Differences and Their Implications

Economic conditions obviously differ across geographic locations. One major difference is in overall size or total income levels. Simply put, some economies are much larger than other economies. While there is substantial debate about how to measure national income, the basic statistical approach taken by economists is to estimate the monetary value of all goods and services produced within a country. The monetary value of all goods and services produced in a country is that country’s gross domestic product (GDP). Since labor and capital inputs are paid from the value of the output they create, a higher value for real GDP is equivalent to a higher overall income level for the residents of the country in question.

Since different countries use different exchange rates, it would not be possible to compare real income levels unless they were all converted to a common currency. Conventionally, that common currency is the U.S. dollar. Hence, Figure 1 reports the GDP levels for a sample of different countries, where the local currency values of each country’s GDP is converted to U.S. dollars using the nominal or current value for the U.S. dollar for 2012. Quite clearly, the United States is the largest economy in the world as measured by GDP. Perhaps surprisingly, China is now the second largest economy. The main point of Figure 1 is that there is a tremendous disparity across countries in their overall size, as measured by total output produced and incomes received. The implications for international management will be discussed in later chapters.

All other things constant, larger and richer countries are more attractive potential markets for the products produced by international companies, since consumers can afford to buy a wider range of products and are generally less sensitive to the prices charged for those products.\(^8\) Indeed, identifying

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\(^8\) A number of international business experts have recently cautioned that international companies tend to overlook opportunities to sell to consumers who are at the “bottom” of the income pyramid. See, for example, C.K. Prahalad (2006). In a later chapter, we shall discuss how some companies have localized their product offerings to sell their products profitably in relatively low income countries.
locations where income levels are likely to grow at above-average rates can give an international company a first-mover advantage against its rivals in selling products to consumers who are experiencing rapid increases in their purchasing power. Certainly, the influx of business investment in China over the past two decades reflects the rapid economic growth experienced by that country in the recent past, as well as the expectation that relatively rapid growth will continue into the future such that opportunities to sell goods and services in China will outpace the growth of opportunities in most other parts of the world.

While GDP identifies the total income level of a country, it does not necessarily identify the economic condition of the average person or family. That is, it does not necessarily identify income per capita or per household, since the latter economic indicators will depend upon how many individuals or households live in a country. Figure 2 reports the level of GDP per capita for the same list of countries identified in Figure 1. What one can see from Figure 2 is that substantial differences can exist between GDP and GDP per capita for specific countries. For example, the GDP of China dwarfs that of Canada, although real GDP per capita for Canada is substantially higher than that for China. As another example, while the U.S. is easily the largest economy in the world, several countries have higher per-capita incomes than the U.S. As we shall see shortly, this latter result has much to do with the exchange rate used to convert foreign currencies into U.S. dollars.

Should international companies pay more attention to GDP or to GDP per capita? It depends upon the company. For example, companies that sell industrial products are likely more interested in the overall level of economic activity in a country, since they are selling products that directly support industrial production. Hence, they are more likely to find attractive markets in large economies. On the other hand, companies that sell durable consumer goods (such as electronic appliances) might be more concerned with the growth of middle-class individuals and households, and therefore especially interested in average personal and household incomes. Of course, rapid growth of total income, as well as per-capita or per-household income, makes an economy particularly attractive to all types of international businesses, other things constant.

Comparisons of income levels such as those shown in Figures 1 and 2 are tricky because the current values of different currencies do not necessarily reflect their purchasing power parities. Comparisons of GDP across countries are done by converting the GDP value denominated in each country’s own currency to U.S. dollars using what is called the current exchange rate. This is the exchange rate that existed on the date at which the comparison was made. Or if the comparisons are for annual values, the nominal exchange rate is the average daily rate for the year of the comparison. In Chapter 3, we shall discuss in some detail how exchange rates are measured and determined, as well as the implications of variable exchange rate values for international business management. At this point, it is noted that using the current exchange rate to convert GDP values outside the United States into a common measuring rod, i.e. the U.S. dollar, can result in misleading comparisons of the income levels of different countries. This is because the purchasing power of individual currencies can differ from their corresponding nominal values.
To illustrate the concept of purchasing power parity, imagine that, on average, for the month of January 2013, one could buy 1 Australian dollar (AUS $1) for 1.03 U.S. dollars (U.S. $1.03). While the sums are obviously unrealistically small, we can still run this thought experiment. Imagine that you could buy a basket of goods for U.S. $1.03 in the United States. You could also convert U.S. $1.03 into AUS $1.00 and try to duplicate buying that same basket in Australia. If you could buy the same basket in both countries, we would say that the two currencies have the same purchasing power.

However, imagine that the basket you could buy in Australia has fewer goods than the basket you could buy in the U.S. In this case, the two currencies do not have the same purchasing power. Specifically, you would need more than AUS $1.00 to buy the same basket of goods in Australia that you could buy in the U.S. for U.S. $1.03. For arguments sake, let’s say that you need AUS $1.03 to buy the same basket in both countries. If this were true, we would say that the Australian dollar is overvalued relative to the U.S. dollar at the exchange rate U.S. $1.00 = AUS $1.00. Equivalently, the U.S. dollar is undervalued. If the currencies traded at parity in this hypothetical example, the current exchange rate (U.S. $1.00 = AUS $1.00) would also be the purchasing power parity exchange rate. This is because the basket of goods you could buy in the U.S. for U.S. $1.03 is identical to the basket you could buy in Australia for AUS $1.03.

Figure 3 reports purchasing power parity-based estimates of GDP. By comparing the GDP estimates in Figures 1 and 3, it can be seen that GDP estimates using PPP exchange rates are generally higher than GDP estimates using current exchange rates in the case of developing (relatively low income) countries. The opposite is the case for developed (high income) countries. That is, GDP estimates are lower when current exchange rates are used rather than PPP exchange rates. One explanation is that developing countries frequently keep their currency values relatively low in order to stimulate exports as a source of economic growth.

Another important difference in the economic conditions between countries is captured by the concept known as comparative advantage. This concept identifies the relative cost advantages that individual countries enjoy in carrying out specific value chain activities. Comparative advantage is determined by the abundance or scarcity of inputs that are intensively used in specific activities. For example, scientists and engineers are especially prominent inputs in carrying out research and development activities. On the other hand, relatively unskilled labor is a prominent input in simple assembly operations such as making textile and apparel products. Hence, a country that has a large supply of unskilled labor relative to scientists and engineers will likely have a comparative advantage in making textile and apparel products, whereas a country with a large supply of scientists and engineers relative to unskilled labor will likely have a comparative advantage in doing research and development. Furthermore, the country with a comparative advantage in making textiles and apparels will likely export those products and import technology-intensive products. Conversely, the country with a comparative advantage in research and development will likely export technology-intensive products and import textiles and apparel. Hence, companies manufacturing textile and apparel products will likely find it profitable to concentrate that manufacturing in relatively low wage countries possessing a relatively large supply of unskilled labor. Companies designing and/or producing high technology products such as new cancer therapies will likely find it profitable to concentrate the design and/or
production activity in countries where substantial amounts of advanced research and development can be carried out, because they are home to relatively large numbers of scientists and engineers.

The concept of comparative advantage helps explain why countries, especially small countries, tend to specialize in a relatively narrow range of international business activities. A related concept described as “agglomeration economies” helps explain why the advantages that individual countries and regions enjoy in specific business activities tend to persist for relatively long periods of time. The basic idea is that as a location grows as a result of new businesses entering that location and existing businesses expanding, it is cheaper and easier for the activities in question to be carried out in that location. One underlying reason is technological synergies. The concept can be illustrated using the following example. Imagine that there are initially two software engineers in a small city. They have specialized and complementary expertise, so that they can share ideas and critique each other’s work. Presumably, each will be more productive as a result than either would be if the two engineers were located in different cities and could not engage in the ongoing day-to-day in-person communication that they can engage in when they live in close physical proximity. Now imagine a third engineer moves into the city. There are now six possible channels of communication rather than two. Specifically, there is two-way communication possible between the original two engineers, as well as between each of the original engineers and the new engineer. In effect, a 50 percent increase in the number of engineers resulted in a threefold increase in the channels through which a productive idea possessed by one engineer can be communicated to another engineer.

**Culture**

For anyone who has traveled abroad, cultural differences between one’s home country and foreign countries visited are usually quite evident. Culture is a complex and multi-faceted phenomenon that exerts both short-run and long-run pressures on international managers to identify and implement efficient localization initiatives. While numerous definitions of culture can be identified in the international business literature, the broad concept is captured by the two definitions provided below.

**Two Definitions of Culture**

1. Culture encompasses the behaviors, beliefs, values and symbols that people accept and that are passed along by communication and imitation from one generation to the next;
2. Culture is a group’s shared set of distinct assumptions, values, practices and artifacts that are formed and retained over a long period of time.

One important shared feature of these two definitions, and, indeed, virtually all definitions of culture is that culture spans multiple generations. A second is that culture is learned, although there is a growing literature suggesting that at least some manifestations of culture may be biologically influenced. A third is that culture encompasses values, beliefs, attitudes and social practices. While the values, beliefs and attitudes of a society are often difficult for the foreigner to identify, or even for members of that society to articulate, they are usually manifested in distinctive practices and behaviors.

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9 See Spolaore and Wacziarg (2013) and the references therein.
that are referred to as cultural institutions. Insights into a society’s values, beliefs and attitudes can assist in understanding behaviors and practices that differ from those in the management’s home country.

A Suggested Definition of Values: A broad tendency to prefer certain states of affairs over others.

A Suggested Definition of Beliefs: A statement, principle, or doctrine that a person or group accepts as true.

A Suggested Definition of Attitudes: A relatively enduring organization of beliefs around an object or situation predisposing one to respond in some preferential manner.

Culturally rooted social practices and behaviors are manifested in numerous ways including language, religion, art, literature, educational curricula, child rearing practices, treatment of the elderly and so forth. From the more narrow perspective of international business management, culture influences consumer preferences towards products, the attitudes and behaviors of workers, reliance on trust and reputation versus legal contracts as a basis for transacting, and expectations regarding corporate social responsibility, among other dimensions of the business environment. Differences across countries in laws and regulations that formally govern business behavior will also reflect cultural differences, although for the purposes of discussion in this book, formal laws and regulations will be given separate treatment from social practices and behaviors that are not explicitly governed through legal or regulatory institutions.

Concepts such as values and beliefs can be difficult to assess, let alone quantify. Hence, it is a clear challenge for international managers to identify when specific aspects of a location’s business environment are durable reflections of culture and when they reflect economic incentives and influences that may or may not remain constant over time. For example, preferences on the part of employees toward working longer hours and earning more income versus working less and spending more time with one’s friends and family undoubtedly reflect social values and attitudes to some extent; however, they may also reflect the marginal tax rates those employees expect to pay on additional

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10 For an extended discussion of whether and how culture can affect economic behavior and outcomes, see Guiso, Sapienza and Zingales (2006).

11 Admittedly, a bright-line distinction between formal and informal institutions governing behavior is often difficult to draw. For example, in the Canadian Province of Quebec, French is the primary language spoken by residents. At the same time, there are formal laws that require the use of French in business communications and legal contracts, among other things.

12 Singh (2007), for example, argues that the relevance of cultural differences as they influence business strategy and performance has been exaggerated and that factors such as legal and regulatory institutions, and a country’s stage of economic development are much more important influences.
income earned. For companies seeking to encourage an increase in hours worked among its employees, the underlying motivation influencing the work versus leisure tradeoff is important, since companies may be able to find ways to pay their workers in non-taxable benefits, or in other ways that avoid the applicable marginal tax rate. On the other hand, it is much harder for companies to change the culture of a society. In the first instance, companies may be able to identify effective ways to localize the methods of paying employees in order to encourage increased hours of work. In the second instance, alternative localization initiatives to encourage longer hours of work are likely to be ineffective, and companies may need to reconsider whether they can do business profitably in the relevant locations given labor practices in those locations.

There are different aspects to the challenge of identifying and assessing cultural differences across locations. One is to identify a common set of measurements that can be applied across different locations. It does not do management much good when evaluating where to locate or expand any given business activity if specific indicators of cultural attributes fail to distinguish one location from another. The common set of measures should also be quantitative in nature, so that managers can evaluate the degree to which cultural attributes differ between locations. International business scholars often refer to the magnitude of these differences as “cultural distance.” Obviously, it is useful for international business managers to be able to make distinctions between relatively large or small cultural distances between locations in which they are currently doing business or plan to do business. A second challenge is to identify indicators of cultural distance that provide useful intelligence to management about whether and how any specific business activity can be carried out in a particular location. In particular, indicators of cultural distance should provide insight into whether and how localization of an organization’s business activities should proceed in a specific location.

Chapter 5 of this book discusses in detail methodologies that have been developed and used to measure cultural distance between countries (national distance) and cultural distance between organizations (organizational distance). The work of the Dutch sociologist Geert Hofstede has been extremely influential in the measurement of cultural distance.\textsuperscript{13} Chapter 5 also contains an extensive discussion of how measures of cultural and organizational distance have been used in international business management, as well as the effectiveness of those measures. It also presents and assesses evidence bearing upon the claim that the emergence and growth of the World Wide Web and social networks such as Facebook are “shrinking” the distance between national cultures.

\textsuperscript{13} For an overview of Hofstede’s methodological contributions to the measurement of cultural distances, see Geert Hofstede (2001).
Laws and Regulations

The laws and regulations that govern human behavior in a location, including business behavior, may be seen as formal manifestations of cultural and economic forces at work in that location. Conceptually, differences across countries in laws and regulations should be fairly easy to identify and assess, so that management decisions about what must be done to conform to the relevant laws and regulations should be fairly straightforward. In fact, the task is likely to be anything but straightforward. For one thing, there are typically an extremely large number of formal laws and regulations that apply to business activities in any location. The precise wording of the relevant laws and regulations may well depend upon the specific business activity being pursued by an organization. This is true even for international trade and investment agreements which are meant to harmonize the treatment of business activities across countries, insofar as tariffs and non-tariff barriers to trade and investment are

Case Study

Hollywood Adapts to Foreign Audiences

A 2010 article in The Wall Street Journal discusses the challenges that American producers of feature films are facing in their efforts to sell their products outside the United States. In decades past, foreign ticket sales were a small share of the total revenues earned by those producers. Now they represent nearly 70% of the total global market for U.S. feature films. Entertainment products are likely to be particularly sensitive to tastes and preferences of consumers that, in turn, are shaped by cultural forces. Hence, feature film producers confront strong and complex imperatives to localize their products for different national audiences.

As the article puts it, most American feature films are “retooled” to suit foreign tastes. One approach to localizing American films is to cast foreign actors in the retooled versions. An example cited of this approach to localization is the decision of one movie studio to substitute soccer stars David Beckham of England and Cristiano Ronaldo of Portugal for the American baseball star Derek Jeter in a film scene. The producer of the film in question felt that jokes that involved Jeter would seem “too American” to foreign markets. In other cases, scripts are being rewritten for foreign audiences, particularly in the case of comedies, since foreign movie-goers often don’t find American jokes very funny. Several studios have implemented even more dramatic localization initiatives in the form of financing, producing and marketing original movies for foreign markets with substantial audiences such as Brazil and South Korea. Indeed, they have set up international divisions to develop, produce and distribute local language movies for foreign audiences drawing on local producers and their expertise. The head of one international division explained that the initiative was not about bringing Hollywood tactics to foreign markets but about participating sufficiently in a local culture to create products that the audience will want to watch.

Note: The details for this case were taken from Lauren Schuker, “Plot Change: Foreign Forces Transform Hollywood Films,” The Wall Street Journal, July 31 – August 1, 2010, P.8A.
concerned. For example, Canada is a member of the World Trade Organization (WTO) about which more will be said in Chapter 3. Upon joining the WTO, countries were allowed to designate specific business activities to be exempted from a set of rules that would oblige national governments to treat foreign investors no differently from domestic investors. Canada chose to exempt the culture sector, among others, so that it could legally maintain a domestic law that prohibits foreign ownership of culture businesses. However, there is no explicit and well-accepted definition of what constitutes a culture business, and any definition is relatively quickly blurred by technological change and other phenomena. As a result, some efforts by U.S.-based businesses such as the book chain Barnes and Noble to expand in Canada have been blocked by the Canadian government, whereas Netflix was recently granted permission to distribute films and videos online to Canadian customers.

In other cases, while laws and regulations may be clearly written with seemingly little room for different interpretations by authorities, their actual enforcement might be capricious or influenced by extra-legal phenomena such as personal relationships between business owners and government or regulatory authorities, or by bribery, political cronyism, and even by public opinion. An example of changing enforcement of anti-bribery laws is provided by the experience of the Chinese affiliate of Glaxo-SmithKline PLC, a large pharmaceutical company headquartered in Great Britain. In the summer of 2013, Chinese government officials alleged that the Company’s Chinese affiliate used travel agencies as vehicles to bribe hospitals, officials and medical personnel to sell more of Glaxo’s drugs at inflated prices. Glaxo China’s vice-president acknowledged that his company would organize conferences through travel agencies that never took place. They allegedly would bill the parent company for reimbursement for the phony conferences and use the money received to pay travel agents for their collusion, as well as to pay bribes to promote the sale of Glaxo’s products. 14 In fact, China enacted new anticorruption laws in 2010, but experts say that the laws have primarily been used to prosecute local government officials in Chinese cities and provinces. The Glaxo example is the first instance of a major foreign company being charged under the new anticorruption laws. Experts believe that China’s leadership is feeling itself under increasing public pressure to address bribery and other forms of corruption that are endemic in China, and that making an example of Glaxo could deflect attention from government corruption, as well as show that China’s government is taking the problem more seriously.

The fact that laws and regulations can change fairly abruptly imposes so-called political risks on international companies. To the extent that the changes in relevant laws and regulations are imperfectly anticipated by international managers, serious adverse financial consequences could befall their companies. A fairly recent example is the experience of big Western beer companies like Carlsberg, SAB Miller and Anheuser-Busch In Bev in Russia. Those companies invested heavily in building breweries and distribution outlets in Russia in the mid-2000s when domestic beer sales were shooting up by almost 15 percent per year. However, new regulations and tax increases were imposed by the Russian government in 2009, when the government “declared war” on alcoholism, which The World Health Organization claims accounts for one in five deaths among Russian males. In 2010, their prime minister Vladimir Putin signed off on a 10-year plan to cut alcohol consumption in half by 2020. In 2011, a law was implemented classifying beer as an alcoholic beverage and thereby putting it under higher controls, such as

prohibitions on late-night sales and bans on advertising. Steep tax increases were also applied to alcoholic beverages which resulted in sharp price increases. The result has been a sharp decline in beer sales and profits experienced by Western companies with several of those companies closing or selling breweries.\footnote{See Lukas Alpert, “Russian Beer Fest Goes Flat,” \textit{The Wall Street Journal}, August 17-18, 2013, B1.}

International business scholars frequently refer to the complex of laws and regulations in a location, as well as how those laws and regulations are enforced, as the political and regulatory infrastructure of the location.\footnote{See, for example, Globerman and Shapiro (2003).} Differences across countries in their political and regulatory infrastructures are often referred to as “Institutional Distances.” As in the case of cultural distance, the concept of institutional distance must be capable of being operationalized empirically and provide insight into whether and how business activities in a given location need to be localized in order to be carried out effectively.

In fact, just as there are quantitative measures that focus on cultural distance between countries, there are quantitative measures of institutional distance that shall be discussed in some detail in Chapter 7.\footnote{For an empirical study using quantitative measures of institutional distance to understand the joint venture behavior of Danish multinational companies, see Globerman and Nielsen (2007).} Suffice to say at this point that localizing an organization’s business activities in a particular country in order to more closely match the organization’s behavior to the location’s political and regulatory infrastructure can lead to difficulties in other political jurisdictions characterized by different infrastructures.

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<th>Case Study</th>
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<td>Is it Bribery or is it a Business Decision?</td>
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U.S. MNCs often face competitive difficulties in foreign markets where gifts and other gratuities are accepted instruments to “grease the wheels” of commerce. U.S. companies are subject to a very restrictive piece of domestic legislation called the Foreign Corrupt Practices Act which makes it illegal for a U.S. person to provide gifts or payments to foreign officials in order to obtain or retain business. In August 2013, it was announced that the large U.S. bank, JP Morgan, was being investigated by the U.S. Securities Exchange Commission for hiring the children of influential Chinese officials in order to win investment banking business. The practice is being investigated as a violation of the Foreign Corrupt Practices Act. Hiring politically connected bankers in China is not unique to JP Morgan. It was a fairly widespread practice amongst foreign investment banks in the early to mid-2000s. One complication is that the children hired are often well-educated and professionally qualified for their positions, in part because their parents are well-off and were able to provide the children with a superior education, often at top U.S. schools.
Indeed, in the legal and regulatory arena, perhaps more than in other dimensions of the international business environment, the imperatives to harmonize the organization’s international behavior around a “socially responsible” minimal standard are strong, and the standard is often calibrated to meet the expectations of countries considered to be politically well-governed through institutions such as rule-of-law, independent judiciaries, the protection of property rights and civil liberties and so forth. For example, many U.S. and Canadian oil and gas companies have corporate responsibility officers whose job it is to ensure that the environmental and other social practices of their affiliates in developing countries meet the companies’ home country standards.

**Codes of Conduct**

Besides formal laws and regulations, international business behavior is increasingly influenced by corporate codes of conduct. These represent standards of behavior that are voluntary in the sense that they do not necessarily have the force of law behind them. Nevertheless, they are important sources of extra-legal regulation of international business behavior given the social prominence of many of the issues addressed through codes of conduct, as well as the potential damage companies may suffer to their reputations if they are seen as behaving socially irresponsibly by not embracing highly publicized codes of conduct.

Non-governmental organizations (NGOs) are prominently involved in establishing and maintaining corporate standards or codes of behavior in the context of international business.

### Prominent NGOs

Several well-known examples of prominent environmental NGOs include Greenpeace which focuses on worldwide threats to the earth’s biodiversity and its environment; the National Wildlife Federation which organizes individuals and groups to protect wildlife, natural habitat and the environment; and the Sierra Club, which educates and enlists people to protect the “wild places” of the earth, its ecosystems and its resources.

There are innumerable NGOs dedicated to improving social and human rights conditions as they are affected by governments and large, international companies. Some are international, such as Save the Children, Oxfam and Amnesty International. Many others exist at the level of the individual country such as the Indian Social Action and Research Association which is focused on poverty eradication.

Standard setting bodies are frequently organized by companies themselves, usually along industry lines. They are often created to address specific issues that are of particular concern to industry participants in specific stages of the industry’s value chain. An illustrative example discussed below concerns the efforts of European and North American clothing retailers to implement safety performance standards for factories in Bangladesh that supply the retailers with clothing products. In a later chapter, several examples will be provided of producers that have established industry-wide product quality and health and safety standards.
Frequently NGOs, companies and governments will form coalitions to set standards. One well known example is the International Organization for Standardization (ISO). This is a private organization whose members represent national standards bodies from over 160 countries around the world. The ISO has been creating technical standards for a wide range of industrial activities since 1947. Indeed it has published almost 20,000 International Standards since its inception covering almost all aspects of business and technology. ISO standards aim to ensure that products and services are safe, reliable and of good quality. ISO certification can therefore assist companies marketing products internationally by signaling that those products meet widely accepted quality and safety standards.

Environmental Codes of Conduct

The environmental practices of international companies are the focus of attention of a number of well-known NGOs as mentioned earlier. While the goals of environmental NGOs are to encourage reductions in carbon emissions and limit the use of non-renewable natural resources by international businesses wherever they are operating, NGOs generally acknowledge that poor countries cannot afford to maintain the same environmental standards as wealthy countries. At the same time, companies are aware that environmental transgressions in one location can create ill-will, and even legal or regulatory sanctions, in other countries. Hence, international businesses tend to adopt environmental standards that exceed legally mandated standards in the countries in which they do business. For example, many Western oil and gas producers are members of the Association of Oil and Gas Producers (OGP) which applies lessons from offshore well incidents to prevent and reduce the consequences of future incidents. An important focus of the association is to develop better capabilities and practices in emerging economies with respect to designing and implementing safe oil well engineering design and operations management.

Codes of Conduct for Labor Practices

There is probably no more controversial or fraught issue facing international managers than the working conditions and pay they provide their workers in emerging economies. As with environmental practices, international companies interact directly and indirectly with NGOs that are concerned with improving working conditions and human rights in developing countries. Perhaps the most prominent NGO focused on protecting and promoting workers’ rights is the International Labor Organization (ILO). It was founded in 1919 and became a specialized agency of the United Nations in 1946. The ILO brings together government employers and workers to set labor standards, policies and programs.

Just as international businesses can suffer financial damage in many locations from an environmental mishap in one geographic location, the same is true for actions perceived as exploiting workers or failing to provide “proper” health and safety protections to workers, even when the actual employers are arms-length contractors. Companies such as Nike and Wal-Mart have been under pressure from labor rights groups for many years to improve wages paid by sub-contractors in developing countries that supply them with products. The dilemma for the Nikes and the Wal-Marts of the world is that they do not directly control the wages paid by their sub-contractors. Furthermore, the sub-contractors compete for supply contracts with large retailers such as Nike, and any sub-contractors
who choose to pay their workers above-market wages will likely find themselves with higher costs of production than their rivals and will lose sales as a result. Likewise, if a company such as Nike chooses to buy its supplies from sub-contractors that pay above-market wages while its rivals, such as Adidas, continue to buy supplies from sub-contractors with lower costs- and presumably lower prices for the shoes they supply - Nike runs a risk of losing sales to its rivals to the extent that it tries to pass on its higher cost of supplies to its customers.

In short, companies that directly or indirectly carry out business activities in developing countries face potentially serious risks to their global reputations if they tolerate labor market standards in those countries that are seen by NGOs as being exploitative. On the other hand, to the extent that individual companies try to raise wages and implement labor market practices in developing countries closer to wages and practices extant in the developed countries in which they operate, they incur competitive risks that might otherwise be avoided. An approach to this dilemma that an increasing number of companies are taking is to coordinate their labor market practices in emerging economies with those of their rivals; however, coordination across a large number of companies is difficult given different circumstances and constraints that individual companies face.

Case Study: Tragedy in Bangladesh

On April 24, 2013, a factory on the outskirts of Dhaka, the capital city of Bangladesh, collapsed killing 1,129 people. The massive loss of life was shocking, as were subsequent reports of other factories in Bangladesh being in similarly dangerous conditions. Most of the factories in Bangladesh make clothing products for retailers in North America and Europe. Coordinated action by the large retailers on both continents was seen as appropriate in light of the risk of other factory accidents and loss of life. However, North American and European retailers could not agree to sign on to the same standards. The large European retailers joined the Accord on Fire and Building Safety in Bangladesh that was largely created by an NGO called the Workers’ Rights Consortium. The North American retailers established their own action plan which is quite similar to the European Accord in many respects. They call for all Bangladeshi factories used by the retailers to be inspected within a year, with the results published and a boycott imposed on factories that fail their inspections. The factories’ workers will get safety training and a hotline to report any concerns about safety. The North American retailers also agreed to provide low-interest loans to factory owners to upgrade their factories. Where the North American and European retailer actions differ is that the European Accord is legally binding, whereas the North American alliance deal is not. The North American retailers expressed their concern about the risks of costly and frivolous litigation if they signed a legally binding agreement. This position was criticized by several NGOs who argued that the commitments made by North American retailers were not credible since they are not legally enforceable. One possible reason why the European Accord goes further than the North American alliance in terms of the former’s status of being legally binding is that European Union governments were in favor of legally binding their retailers’ commitments. Notwithstanding the differences, most observers agree that safety standards in Bangladeshi factories will remain lax unless the Bangladeshi government also takes action to bring about change.

The discussion of the initiatives taken by European and North American companies to coordinate their actions to improve safety standards in Bangladeshi factories underscores the imperatives to localize business activities that international businesses typically face. In other developing countries, individual multinational companies have put in place their own systems for auditing the activities of local subcontractors. The tragedy in Bangladesh was apparently sufficiently severe, and the low level of safety standards apparently so widespread, that individual company actions would likely prove ineffective.

SUMMARY AND OUTLINE OF BOOK

The primary difficulty facing international business managers and what distinguishes managing an international business from one that carries out all of its activities in a single country is the much more heterogeneous environment that managers face when carrying on business activities outside their home countries. While countries and regions differ in many ways that have important implications for managing companies’ value chains, international business scholars tend to group the differences into three broad sets of factors encompassing economic, cultural and legal/regulatory attributes of countries and regions. These differences generally oblige managers of international businesses to do things differently from location to location in which value chain activities are carried out. The challenge for international managers is to identify and implement profitable initiatives to localize value chain activities, and to coordinate the initiatives so that the international organization operates efficiently. The purpose of this book is to elaborate on this challenge.

Chapter 2 discusses motives for companies to expand internationally, as different ways in which companies carry out international business. There are a number of modes, several of which were mentioned earlier. For example, organizations can carry-out international business through exports and imports licensing and other contractual modes, joint ventures or other alliances and foreign direct investment. The goal of management is to choose the model(s) that is efficient in the context of the relevant value chain activities and where they are located.

Chapter 3 identifies some of main economic differences that exist across countries and regions. It also considers the factors that influence important economic features of countries such as the growth rates of real income and productivity, exchange rate behavior and comparative advantage. Chapter 4 explores the implications of economic differences across countries for international business management. In particular, it describes the localization strategies that managers can implement to address the economic differences that exist across potential geographic markets for a company’s products, as well as potential locations for production and administrative activities.

Chapter 5 focuses on major cultural differences that exist across countries and regions drawing upon some well-known measures of national and organizational culture. Criticisms and limitations of the measures are also discussed, as is the fundamental issue of whether or not the process of globalization is contributing to a gradual homogenization of national cultures. Chapter 6 assesses the implications of cultural differences for strategic issues such as how to enter and expand in new geographic markets.

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18 These are also referred to as modes of international business.
Chapter 7 parallels Chapters 3 and 5 by discussing how legal and regulatory differences across countries are identified and measured, as well as theory and evidence surrounding whether and how globalization affects these differences. Chapter 8, in turn, parallels Chapters 4 and 6 in considering some strategic implications of legal and regulatory differences across countries including implications for timing the organization’s entry and expansion into foreign markets, and assessing and managing political risk.

Chapter 9 deals with the increasingly important topic of corporate social responsibility and international business. As noted earlier, companies are constantly being exhorted to act in a socially responsible manner in matters related to sustainable, ethical and humane business practices; however, the practical incentives and constraints to behave in a socially responsible manner differ across countries and regions. Indeed, in some circumstances acting in what would be considered a socially responsible manner in an organization’s home country might be considered socially irresponsible – or just bad business management - in other countries. Examples of the challenges that international business managers face in meeting the social responsibility imperative while also operating a profitable global business enterprise are presented and evaluated, as are strategies that have been implemented to address those challenges.
Figure 1
GDP for Selected Countries (current U.S. $)

Figure 2
GDP per Capita for Selected Countries (current U.S. $)

Source: The World Bank, Data Bank
http://data.worldbank.org/indicator/NY.GDP.PCAP.CD
Figure 3
GDP for Selected Countries (PPP)

Calculating GDP using Purchasing Power Parity
(2012 Estimated U.S. $ Values)

Source: Central Intelligence Agency, The World Factbook
References

Books


Articles


**Videos**

Niall Ferguson, “Globalization”
[http://www.youtube.com/watch?v=FHpoYDCJVgc](http://www.youtube.com/watch?v=FHpoYDCJVgc)

Thomas Friedman, “The World is Flat”
[http://www.youtube.com/watch?v=53vLQnuV9FY](http://www.youtube.com/watch?v=53vLQnuV9FY)

Anil Gupta, “On Managing Globally Dispersed Value Chain”
[http://www.youtube.com/watch?v=OH4NR5oTKF1](http://www.youtube.com/watch?v=OH4NR5oTKF1)
DISCUSSION QUESTIONS

1. The adoption of a common currency (the Euro) by a growing number of European countries was seen by European governments as an important initiative to encourage a closer integration of their economies, as well as to promote the growth of large, European-based multinational companies. Why might the adoption of a common currency encourage increased trade, investment and other manifestations of closer economic integration among countries adopting that currency?

2. Companies often justify the expansion of their international business activities as reducing their business risks. Specifically, managers frequently argue that geographic diversification smooths-out fluctuations in their companies’ cash flows and profits because national and regional economies don’t usually expand or contract in synchrony; i.e. some are growing, while others are contracting. Do you think that business risk diversification is a good managerial motive for initiating or expanding international business activities?

3. Comparing a world-wide coffee retailer such as Starbucks to an aircraft manufacturer such as Boeing, which company do you think finds itself under stronger economic, cultural and/or political pressures to localize its value chain activities? Do you think they both feel the strongest pressures to localize the same value chain activities or different ones?

4. If you were an international manager of a clothing manufacturer such as Nike, would you prefer that there be clear and explicit laws and regulations governing business practices such as labor standards and factory conditions, or would you prefer to follow practices that are set out in codes of conduct established by international organizations such as the ILO?

5. What future economic, political and/or social developments are likely to make the global economy more or less “flat” over the next 10-20 years?