GLOBALIZATION
INTERNATIONAL BUSINESS

OBJECTIVES

• To define globalization and international business and how they affect each other
• To understand why companies engage in international business and why international business growth has accelerated
• To comprehend criticisms of globalization
• To become familiar with different modes a company can use to accomplish its global objectives
• To grasp the role social science disciplines play in understanding why international business is different from domestic business

I. WHY ARE GLOBALIZATION AND INTERNATIONAL BUSINESS IMPORTANT?

As people, firms, and other organizations have expanded their access to resources, goods, services, and markets across wider geographical areas, they have also become more deeply affected (positively and negatively) by conditions outside their home countries. Globalization refers to the ongoing social, economic, and political process that deepens the relationships and broadens the interdependencies amongst nations—their people, their firms, their organizations, and their governments.

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

II. THE FORCES BEHIND GLOBALIZATION

Globalization is a difficult concept to measure. Currently, about 25 percent of world production is sold outside of its country of origin, restrictions on imports continue to decline, the foreign ownership of assets as a percent of world production continues to increase, and world trade continues to grow more rapidly than world production. That said, on a value basis, only a few countries (mainly very small nations) either sell more than half of their production abroad or source more than half of their consumption from foreign countries. Further, the principal source of capital in almost all nations is still domestic. Following are seven interrelated factors that have contributed to the spiraling growth in globalization.

A. Increase in and Expansion of Technology
Vast improvements in transportation and communications technology—including the development of the Internet—have significantly increased the effectiveness and efficiency of international business operations.

B. **Liberalization of Cross-Border Trade and Resource Movements**
Over time most governments have lowered restrictions on trade and foreign investment in response to the expressed desires of their citizens and producers. In addition, the General Agreement on Tariffs and Trade, the development of economic blocs such as the European Union, and other such facilitating mechanisms have provided increased access to many foreign markets.

C. **Development of Services That Support International Business**
Services provided by government, banks, transportation companies, and other businesses greatly facilitate the conduct and reduce the risks of doing business internationally.

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

E. **Increased Global Competition**
The pressures of increased foreign competition often persuade firms to expand internationally in order to gain access to foreign opportunities and to improve their overall operational flexibility and competitiveness.

F. **Changing Political Situations**
The transformation of the political and economic policies of the former Soviet Union and the People’s Republic of China has led to vast increases in trade between those countries and the rest of the world. In addition, the improvements in national infrastructure and the provision of trade-related services by governments the world over have further led to substantial increases in foreign trade and investment levels.

G. **Expanded Cross-National Cooperation**
Governments have increasingly entered into cross-national treaties and agreements in order to gain reciprocal advantages for their own firms, to attack problems jointly that one country cannot solve alone, and to deal with areas of concern that lie outside the territory of all countries. Often, such cooperation occurs within the framework of international organizations such as the United Nations, the International Monetary Fund, the World Trade Organization, and the International Bank for Reconstruction and Development (World Bank).

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

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

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

C. Growing Income Inequality
Offshoring, the process of shifting domestic production to a foreign country for the purpose of serving the home market at a reduced cost, speeds up the process of altering the relative economic discrepancies between the two countries involved. Thus, even if the overall global gains from globalization are positive, there remains a continuing challenge to bring about the positive gains in ways that minimize costs to the losers.

IV. WHY COMPANIES ENGAGE IN INTERNATIONAL BUSINESS
When engaging in international business, a firm should consider its mission, its objectives, and its possible strategies. Primary objectives would include the following:

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

B. Acquire Resources
Foreign-sourced goods, services, components, capital, technology, and information can make a firm more competitive both at home and abroad.

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

IV. MODES OF INTERNATIONAL BUSINESS
A firm can engage in international business through various operating modes, including exporting and importing merchandise and services (see Chapters 6 and 7 regarding international trade) and licensing and foreign direct investment (see Chapter 14 regarding direct investment and collaborative strategies). The firm or individual exporting merchandise or a service will receive international earnings while the firm or individual importing merchandise or a service will make an international payment. [See Fig. 1.3.]
A. Merchandise Exports and Imports

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

B. Service Exports and Imports

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

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

2. Performance of Services. Some services, such as banking, insurance, rentals, engineering, turnkey operations (construction, performed under contract, of facilities that are transferred to the owner when they are ready for operation), and management contracts (arrangements in which one firm provides personnel to perform management functions for another), net companies export earnings in the form of fees paid by a foreign client.

3. Use of Assets. Firms may receive export earnings, i.e., royalties, by allowing foreign clients to use their assets (trademarks, patents, copyrights, and other expertise). Licensing agreements are contracts that represent a transaction in which a licensor sells the rights to the use of its intellectual property to a licensee in exchange for a fee or royalty. Franchising is a special form of licensing in which the franchisee is granted additional control over the operation in exchange for the provision of additional support and services by the franchisor.

C. Investments

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

1. Direct Investment. Foreign direct investment (FDI) occurs when an investor gains a controlling interest in a foreign operation. Sole ownership represents 100% ownership of an operation; however, effective control can be realized with just a minority stake if the remaining ownership is widely dispersed. A joint venture represents a direct investment in which two or more parties share ownership.

2. Portfolio Investment. Portfolio investment is a noncontrolling interest in a venture made in the form of either debt or equity. Often, firms use portfolio investment as part of their short-term financial strategy.

D. International Companies and Terms to Describe Them

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

V. WHY INTERNATIONAL BUSINESS DIFFERS FROM DOMESTIC BUSINESS

External environments that affect the ways in which firms operate internationally include physical, societal, and competitive factors. In fact, the amount of adjustment required in foreign operations is largely influenced by the extent to which the home and host country environments resemble one another. [See Fig. 1.4.]

A. Physical and Societal Factors

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

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

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

4. Economic Forces. Economics explains country differences in costs, currency values, and market size. It also provides the analytical tools to determine the impact of foreign operations on home and host countries, as well as the effect of a country’s economic policies and conditions upon domestic and foreign firms.

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

B. The Competitive Environment

The global competitive environment varies both by industry and by country. Likewise, a company’s competitive situation may differ in terms of its relative strength and in terms of which competitors it faces from one country to another. Thus, a firm’s competitive strategy directly influences how and where it can operate most effectively. [See Fig. 1.5.]