



## THE NEED FOR INTERNATIONAL BUSINESS

### 1. To understand the history and impact of international business

You are about to begin an exciting, important, and necessary task: the exploration of international business. International business is exciting because it combines the science and the art of business with many other disciplines, such as economics, anthropology, geography, history, language, jurisprudence, statistics, and demography. International business is important and necessary because economic isolationism has become impossible. Failure to become a part of the global market assures a nation of declining economic influence and a deteriorating standard of living for its citizens. Successful participation in international business, however, holds the promise of improved quality of life and a better society, even leading, some believe, to a more peaceful world.

On an individual level, most students are likely to become involved with international business enterprises during their careers. Manufacturing firms, as well as service companies such as banks, insurance, or consulting firms have extensive global operations. Artwork, films, and music are already widely exposed to the international market. Many of the future professional colleagues and competitors of today's students will come from around the world. In an era of open borders, niche marketing, instant communications, and virtually free ways of reaching millions of people, there emerges an unprecedented opportunity for individuals to enter the international business arena. Start-up firms can challenge the existing, long-dominant large competition. Speed, creativity, and innovation have often become more important to international success than size. Understanding international business is therefore crucial in preparing for the opportunities, challenges, and requirements of a future career.

International business offers companies new markets. Since the 1950s, the growth of international trade and investment has been substantially larger than the growth of domestic economies. Technology continues to increase the reach and the ease of conducting international business, pointing to even larger growth potential in the future. A combination of domestic and international business, therefore, presents more opportunities for expansion, growth, and income than does domestic business alone. International business causes the flow of ideas, services, and capital across the world.

As a result, innovations can be developed and disseminated more rapidly, human capital can be used better, and financing can take place more quickly. International business also offers consumers

new choices. It can permit the acquisition of a wider variety of products, both in terms of quantity and quality, and do so at reduced prices through international competition. International business facilitates the mobility of factors of production—except land—and provides challenging employment opportunities to individuals with professional and entrepreneurial skills. At the same time, international business reallocates resources, makes preferential choices, and shifts activities on a global level. It also opens up markets to competition, which in many instances has been unexpected and is difficult to cope with. As a result, international business activities do



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Not everyone agrees with the benefits of globalization.

not benefit everyone to the same degree. Just like Janus, the two-faced god of the Romans, international business can bring benefits and opportunity to some, while delivering drawbacks and problems to others. The international firm and its managers, as well as the consumers of international products and services, need to understand how to make globalization work for them, as well as think about how to ensure that these benefits are afforded to a wide variety of people and countries. Therefore, both as an opportunity and a challenge, international business is of vital concern to countries, companies, and individuals.



## A DEFINITION OF INTERNATIONAL BUSINESS

International business consists of transactions that are devised and carried out across national borders to satisfy the objectives of individuals, companies, and organizations. These transactions take on various forms, which are often inter-related. Primary types of international business are export–import trade and direct foreign investment. The latter is carried out in varied forms, including wholly owned subsidiaries and joint ventures. Additional types of international business are licensing, franchising, and management contracts.

The definition of international business focuses on transactions. The use of this term recognizes that doing business internationally is an activity, not merely a passive observation. Closely linked to activity is the term “satisfaction.” It is crucial that the participants in international business are satisfied. Only if they feel they are better off after the transaction than they were before, will individual business transactions develop into a business relationship. The fact that the transactions are *across national borders* highlights a key difference between domestic and international business. The international executive is subject to a new set of macroenvironmental factors, to different constraints, and to quite frequent conflicts resulting from different laws, cultures, and societies. The basic principles of business are still relevant, but their application, complexity, and intensity vary substantially.

Subject to constant change, international business is as much an art as a science. Yet success in the art of business depends on a firm grounding in its scientific aspects. Individual consumers, policymakers, and business executives with an understanding of both aspects will be able to incorporate international business considerations into their thinking and planning. They will be able to consider international issues and repercussions and make decisions related to questions such as these:

- How will our idea, good, or service fit into the international market?
- Should we enter the market through trade or through investment?
- Should I obtain my supplies domestically or from abroad?
- What product adjustments are necessary to be responsive to local conditions?
- What threats from global competition should be expected and how can these threats be counteracted?

When management integrates these issues into each decision, international markets can provide growth, profit, and needs satisfaction not available to those that limit their activities to the domestic marketplace. To aid in this decision process is the purpose of this book.

2. To learn the definition of international business



## A BRIEF HISTORY

### 3. To recognize the growth of global linkages today

**Pax Romana** Two relatively peaceful centuries in the Roman Empire leading to a successful expansion of business.

Ever since the first national borders were formed, international business has been conducted by nations and individuals. In many instances, international business itself has been a major force in shaping borders and changing world history.

As an example, international business played a vital role in the formation and decline of the Roman Empire, whose impact on thought, knowledge, and development can still be felt today. Although we read about the marching of the Roman legions, it was not through military might that the empire came about. The Romans used the **Pax Romana**, or Roman peace, as a major stimulus. This ensured that merchants were able to travel safely and rapidly on roads built, maintained, and protected by the Roman legions and their affiliated troops. A second stimulus was the use of common coinage, which simplified business transactions and made them comparable throughout the empire. In addition, Rome developed a systematic law, central market locations through the founding of cities, and an effective communication system; all of these actions contributed to the functioning of the marketplace and a reduction of business uncertainty.

International business flourished within the empire, and the improved standard of living within the empire became apparent to those outside. Soon city-nations and tribes that were not part of the empire decided to join as allies. They agreed to pay tribute and taxes because the benefits were greater than the drawbacks.

Thus, the immense growth of the Roman Empire occurred mainly through the linkages of business. Of course, preserving this favorable environment required substantial effort. When pirates threatened the seaways, for example, Pompeius sent out a large fleet to subdue them. Once this was accomplished, the cost of international distribution within the empire dropped substantially because fewer shipments were lost at sea. Goods could be made available at lower prices, which in turn translated into larger demand and greater, more widely available benefits.

The fact that international business was one of the primary factors that held the empire together can also be seen in the decline of Rome. When “barbaric” tribes overran the empire, again it was not mainly through war and prolonged battles that Rome had lost ground. Rather, outside tribes were attacking an empire that was already substantially weakened at its foundations because of infighting and increasing decadence. The Roman peace was no longer enforced, the use and acceptance of the common coinage had declined, and communications no longer worked as well. Therefore, affiliation with the empire no longer offered the benefits of the past. Former allies, who no longer saw any benefits in their association with Rome, willingly cooperated with invaders rather than face prolonged battles.

While Roman authority and prosperity were firmly established in the Mediterranean, trade flourished and even extended through the Red Sea and Indian Ocean and, indirectly, as far as China, where the Han Empire provided a similar stability for nearly four centuries. After its beginnings in BC 202, Han rulers solidified the unification of China and expanded its borders westward. Under their rule, trade expanded with the development of a system of trade routes to central Asia that became known as the Silk Road.

Trade between the Roman and Chinese empires was not direct and occurred through many intermediaries in India, Arabia, and central Asia. Suppliers and

recipients may not have even known of each other, even though they became highly dependent on the other. Today, many people may not know about the activities of the Deutsche Bundesbank and the European Central Bank—both located in Frankfurt, Germany—or the People’s Bank of China in Beijing, but those institutions play an important role in the availability and interest rates of their student loans.

Trading routes and conditions were far more difficult and dangerous in ancient times than today. Travel by sea or land exposed traders to enormous risk of weather, disease, and piracy, and the whims of various rulers. Thus, relatively stable political conditions helped foster trade for periods. “Stable countries are trading countries. . . . When Roman and Han authority finally collapsed around AD 200, trade with the East came to an almost complete standstill.”<sup>1</sup>

Similar patterns can be seen in later eras. “Just as the stability afforded by the Pax Romana and the Han Empire encouraged the long-range and highly indirect commerce between Rome and China in the first and second centuries after Christ, the power of the early Islamic and Tang empires stimulated a far more direct intercourse between the lands of the caliphate and China during the seventh through ninth centuries.”<sup>2</sup>

Much later, the British Empire grew mainly through its effective international business policy, which provided for efficient transportation, intensive trade, and an insistence on open markets.<sup>3</sup> More recently, the United States developed a world leadership position largely due to its championship of market-based business transactions in the Western world; the broad flow of ideas, goods, and services across national borders; and an encouragement of international communication and transportation. Some say that the period from 1945 to 1990 for Western countries, and since then, for the world, has been characterized by a **Pax Americana**, an American sponsored and enforced peace.

The importance of international business has not always persisted, however. For example, in 1896, the Empress Dowager Tz’u-hsi, in order to finance the renovation of the summer palace, impounded government funds that had been designated for Chinese shipping and its navy. As a result, China’s participation in world trade almost came to a halt. In the subsequent decades, China operated in almost total isolation, without any transfer of knowledge from the outside, without major inflow of goods, and without the innovation and productivity increases that result from exposure to international business.

Withholding the benefits of international business has also long been a tool of national policy. The use of economic coercion by nations or groups of nations, for example, can be traced back to the time of the Greek city-states and the Peloponnesian War. In the Napoleonic Wars, combatants used naval blockades to achieve their goal of “bringing about commercial ruin and shortage of food by dislocating trade.”<sup>4</sup> Similarly, during the Civil War period in the United States, the North consistently pursued a strategy of denying international business opportunities to the South in order to deprive it of needed export revenues.

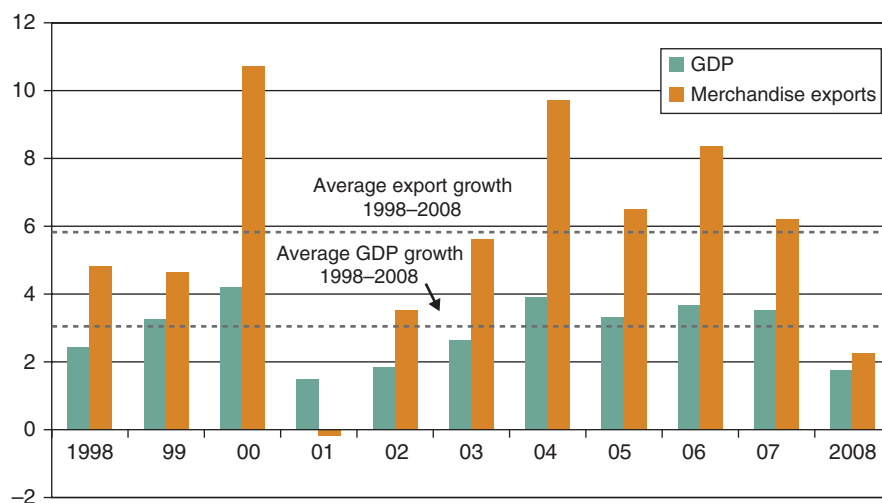
The importance of international business linkages was highlighted during the 1930s. At that time, the **Smoot-Hawley Act** raised import duties to reduce the volume of goods coming into the United States. The act was passed in the hope that it would restore domestic employment. The result, however, was retaliation by most trading partners. The ensuing worldwide depression and the collapse of the world financial system were instrumental in bringing about the events that led to World War II.

World trade and investment have assumed a heretofore unknown importance to the global community. In past centuries, trade was conducted internationally but not at the level or with the impact on nations, firms, and individuals that it has recently

**Pax Americana** An American peace since 1945 that led to increased international business transactions.

**Smoot-Hawley Act** A 1930 act that raised import duties to the highest rates ever imposed by the United States; designed to promote domestic production, it resulted in the downfall of the world trading system.

**Figure 1.1** Growth in the Volume of World Merchandise Trade and GDP, 1998–2008 (Annual percentage change)



Source: World Trade Organization, World Trade Report 2009, [www.wto.org/english/res\\_e/booksp.../world\\_trade\\_report09\\_e.pdf](http://www.wto.org/english/res_e/booksp.../world_trade_report09_e.pdf), accessed August 18, 2009, p. 5.

achieved. Within the past 35 years alone, the volume of international trade in goods and services expanded from \$200 billion to more than \$19.5 trillion in 2008.<sup>5</sup> As Figure 1.1 shows, during almost all of the past decade, as in the preceding decades, the growth in the value of trade has greatly exceeded the level of overall world economic growth.

Concurrently, on a global level, annual foreign direct investment (FDI) inflows reached \$1.8 trillion in 2007, finally exceeding the previous all-time high set in 2000, before the events of September 11, 2001, triggered a downturn.<sup>6</sup> FDI stock, or accumulated totals, exceeded \$15 trillion in 2007. The sales by an estimated 790,000 affiliates of **multinational corporations** exceeded \$31 trillion.<sup>7</sup> As Table 1.1 shows, these corporations have their headquarters in many of the leading economies around the world. Table 1.2 illustrates that many of these corporations have their origins in developing economies as well. Nonetheless, FDI is highly selective with a few major economies being the preferred choice of foreign investors. In 2007, developed economies received \$1,248 billion, or about 68 percent of these inflows, although investment increased in developing countries and least-developed countries as well. The United States led all nations as a recipient of these inflows, followed by the United Kingdom, France, Canada, and the Netherlands.<sup>8</sup>

Despite the longer-term growth trends in both trade and investment, the financial crisis and economic downturn that began in 2007 resulted in the sharp volume reductions at the end of 2008 and in 2009. WTO economists assessed 2009 world trade growth as “strongly negative.”<sup>9</sup> The major developed economies were bearing the brunt of the decline. On the other hand, developing economies such as China, India, and Brazil experienced continued growth. Individuals and firms have come to recognize that they are competing in a dynamic global marketplace, characterized by major change and where risk and opportunity must be examined not only domestically but around the world both in terms of market opportunities and global supply and sourcing chains.

### multinational corporations

Companies that invest in countries around the globe.

**Table 1.1 World's Top 25 Nonfinancial TNCs, Ranked by Foreign Assets, 2006<sup>a</sup> (Millions of dollars and number of employees)**

Ranking by:						Assets		Sales		Employment	
Foreign Assets	TNI	II	Corporation	Home Economy	Industry	Foreign	Total	Foreign	Total	Foreign	Total
1	71	54	General Electric	United States	Electrical & electronic equipment	442,278	697,239	74,285	163,391	164,000	319,000
2	14	63	British Petroleum Company Plc	United Kingdom	Petroleum expl./ref./distr.	170,326	217,601	215,879	270,602	80,300	97,100
3	87	93	Toyota Motor Corporation	Japan United Kingdom	Motor vehicles	164,627	273,853	78,529	205,918	113,967	299,394
4	34	79	Royal Dutch/Shell Group	Netherlands	Petroleum expl./ref./distr.	161,122	235,276	182,538	318,845	90,000	108,000
5	40	35	ExxonMobil Corporation	United States	Petroleum expl./ref./distr.	154,993	219,015	252,680	365,467	51,723	82,100
6	78	64	Ford Motor Company	United States	Motor vehicles	131,062	278,554	78,968	160,123	155,000	283,000
7	7	99	Vodafone Group Plc	United Kingdom	Tele communications	126,190	144,366	32,641	39,021	53,138	63,394
8	26	51	Total	France	Petroleum expl./ref./distr.	120,645	138,579	146,672	192,952	57,239	95,070
9	96	36	Electricite de France	France	Electricity, gas and water	111,916	235,857	33,879	73,933	17,185	155,968
10	92	18	Wal-Mart Stores	United States	Retail	110,199	151,193	77,116	344,992	540,000	1,910,000
11	37	34	Telefónica SA	Spain	Telecommunications	101,891	143,530	41,093	66,367	167,881	224,939
12	77	88	E.On	Germany	Electricity, gas and water	94,304	167,565	32,154	85,007	46,598	80,612
13	86	82	Deutsche Telekom AG	Germany	Telecommunications	93,488	171,421	36,240	76,963	88,808	248,800
14	58	65	Volkswagen Group	Germany	Motor vehicles	91,823	179,906	95,761	131,571	155,935	324,875
15	73	57	Franco Telecom	France	Telecommunications	90,871	135,876	30,448	64,863	82,148	191,036
16	90	63	ConocoPhillips	United States	Petroleum expl./ref./distr.	89,528	164,781	55,781	183,650	17,188	38,400
17	56	89	Chevron Corporation	United States	Petroleum expl./ref./distr.	85,735	132,628	111,603	204,892	33,700	62,500
18	11	75	Honda Motor Co Ltd	Japan	Motor vehicles	76,264	101,190	77,605	95,333	148,544	167,231
19	36	62	Suez	France	Electricity gas, and water	75,151	96,714	42,002	55,563	76,943	139,814
20	45	48	Siemens AG	Germany	Electrical and electronic equipment	74,585	119,812	74,858	109,553	314,000	475,000
21	10	11	Hutchison Whampoa Limited	Hong Kong, China	Diversified	70,679	87,146	28,619	34,428	182,149	220,000
22	84	85	RWE Group	Germany	Electricity, gas, and water	68,202	123,080	22,142	55,521	30,752	68,534
23	9	7	Nestle SA	Switzerland	Food and beverages	66,677	83,426	57,234	78,528	257,434	265,000
24	62	38	BMW AG	Germany	Motor vehicles	66,053	104,118	48,172	61,472	26,575	106,575
25	51	33	Procter & Gamble	United States	Diversified	64,487	138,014	44,530	76,476	101,220	138,000

<sup>a</sup>All data are based on the companies' annual reports unless otherwise stated. Data on affiliates are based on Dun and Bradstreet's *Who Owns Whom* database.

Source: UNCTAD, *World Investment Report 2008: Transnational Corporations and the Infrastructure Challenge*, annex table A.1.15.

**Table 1.2 Top 25 Nonfinancial TNCs from Developing Countries, Ranked by Foreign Assets, 2006<sup>a</sup>**  
(Millions of dollars and number of employees)

Ranking by:						Assets		Sales		Employment	
Foreign Assets	TNI	II	Corporation	Home Economy	Industry	Foreign	Total	Foreign	Total	Foreign	Total
1	18	9	Hutchison Whampoa Limited	Hong Kong, China	Diversified	70,679	87,146	28,619	34,428	182,149	220,000
2	88	94	Petronas - Petroliam Nasional Bhd	Malaysia	Petroleum expl./ref./distr.	30,668	85,201	14,937	50,984	3,965	33,439
3	53	11	Samsung Electronics Co., Ltd.	Republic of Korea	Electrical and electronic equipment	27,011	87,111	71,590	91,856	29,472	85,813
4	21	4	Cemex S.A.	Mexico	Nonmetallic mineral products	24,411	29,749	14,595	18,114	39,505	54,635
5	86	32	Hyundai Motor Company	Republic of Korea	Motor vehicles	19,581	76,064	30,596	68,468	5,093	54,711
6	33	3	Singtel Ltd.	Singapore	Telecommunications	18,678	21,288	5,977	8,575	8,606	19,000
7	92	86	CITIC Group	China	Diversified	17,623	117,355	2,482	10,113	18,305	107,340
8	65	10	Formosa Plastic Group	Taiwan Province of China	Chemicals	16,754	75,760	13,002	50,445	67,129	89,736
9	28	18	Jardine Matheson Holdings Ltd.	Hong Kong, China	Diversified	16,704	20,378	12,527	16,281	58,203	110,125
10	57	74	LG Corp.	Republic of Korea	Electrical and electronic equipment	15,016	53,315	43,902	70,613	36,053	70,000
11	73	66	Companhia Vale do Rio Doce	Brazil	Mining and quarrying	14,974	60,954	37,063	46,746	3,982	52,646
12	94	88	Petroleo Brasileiro S.A. - Petrobras	Brazil	Petroleum expl./ref./distr.	10,454	98,680	17,845	72,347	7,414	62,266
13	69	73	China Ocean Shipping (Group) Company	China	Transport and storage	10,397	18,711	8,777	15,737	4,432	69,549
14	54	64	América Móvil	Mexico	Telecommunications	8,701	29,473	9,617	21,526	27,506	39,876
15	89	56	Petróleos De Venezuela	Venezuela, Rep. of Bol.	Petroleum expl./ref./distr.	8,534	60,305	32,773	63,736	5,373	49,180
16	50	8	Mobile Telecommunications Company	Kuwait	Telecommunications	7,968	12,027	3,373	4,185	975	12,700
17	41	85	Capitaland Limited	Singapore	Real estate	7,781	13,463	1,461	2,053	16,261	32,876
18	45	15	Hon Hal Precision Industries	Taiwan Province of China	Electrical and electronic equipment	7,606	19,223	16,801	40,507	322,372	382,000
19	80	65	China State Construction Engineering Corporation	China	Construction	6,998	15,986	4,483	18,544	25,000	119,000
20	67	5	Kia Motors	Republic of Korea	Motor vehicles	6,767	18,655	11,525	21,316	10,377	33,005
21	100	90	China National Petroleum Corporation	China	Petroleum expl./ref./distr.	6,374	178,843	3,036	114,443	22,000	1,167 129
22	72	82	New World Development Co., Ltd.	Hong Kong, China	Diversified	6,147	18,535	1,430	2,995	16,949	54,000
23	77	68	CLP Holdings	Hong Kong, China	Electricity, gas and water	6,096	15,965	1,283	4,951	1,827	6,087
24	90	40	Teléfonos De Mexico S.A. De C.V.	Mexico	Telecommunications	5,790	24,265	4,295	16,084	16,704	76,394
25	87	47	Sasol Limited	South Africa	Industrial chemicals	5,709	14,749	2,920	8,875	2,205	27,933

<sup>a</sup>All data are based on the companies' annual reports unless otherwise stated. Data of affiliates are from Dun and Bradstreet's *Who Owns Whom* database.

Source: UNCTAD, *World Investment Report 2008: Transnational Corporations and the Infrastructure Challenge*, annex table A.1.16.



## GLOBAL LINKS TODAY

International business has forged a network of global links around the world that binds us all—countries, institutions, and individuals—much closer than ever before. These links tie together trade, financial markets, technology, and living standards in an unprecedented way. A freeze in Brazil and its effect on coffee and orange juice production are felt around the world. Just as the effects of previous financial crises in Mexico and Asia influenced stock markets, investments, and trade flows in all corners of the earth, the financial crisis that started in 2007 reverberated around the world. “Although the crisis began in the United States, it soon spread [to] financial institutions and economies throughout the developed and developing world [which] have been severely affected.”<sup>10</sup>

These linkages have also become more intense on an individual level. Communication has built new international bridges, be it through music or the watching of international programs transmitted by CNN (<http://www.cnn.com>). New products have attained international appeal and encouraged similar activities around the world. For example, consumers purchase similar jeans; dance the same dances; watch the same movies; eat hamburgers, pizzas, and sushi. Transportation links let individuals from different countries see and meet each other with unprecedented ease. Common cultural pressures result in similar social phenomena and behavior—for example, more dual-income families are emerging around the world, which leads to more frequent, but due to new time constraints, also more stressful, shopping.<sup>11</sup>

4. To understand the U.S. position in world trade and the impact international business has on the United States

### FOCUS ON CULTURE

#### Make That a Caffé Latte Please

If you're hungry in Hong Kong, or in São Paulo or Milan for that matter, you have many dining options beyond the local fare. Over the past three decades, perhaps one of the greatest transformations in daily life has been the global proliferation of chain restaurants and the food choices available to consumers.

You don't have to be in London to get a Slim Sandwich or a preservative-free wrap at a Pret a Manger, which has multiple locations in Hong Kong. If you prefer a burger, you might try a Tsukune Rice Burger in Kowloon at MOS Burger, the big Tokyo-based burger chain that uses Japanese ingredients and sauces. Of course, McDonald's is ubiquitous, or you can get a flame-grilled Whopper at Burger King, which opened in Hong Kong in 2007.

International business has brought diversity of choice, quality food, clean environments, and fast, efficient service to locations around the world. You can find a California Pizza Kitchen in the Dubai Mall or in Plaza Indonesia in Jakarta. Tim Hortons, the Canadian fast food chain, has brought its famous coffee and Timbits, the bite-sized donut holes, to more than 400 locations in the United States.

Some criticize restaurant franchise operations for spreading industrialized food processes and junk food to cultures that have rich cuisine and dining tradition. In 1999, José Bové, a French activist, drove a bulldozer into a McDonald's in Millau, France, to protest American cultural imperialism and “malbouffe” (bad food). While many in France were vocally

supportive of Bové's sentiments, the French public proved their appreciation for Le Big Mac with their wallets. By 2007, France had become the second-most profitable market in the world for McDonald's, ranking only behind the United States.

The international restaurant business is not only about fast-food franchises, coffee, and burgers. For example, Wolfgang Puck and other celebrity chefs have opened fine dining and more casual restaurants in cities around the world. And Fogo de Chão, an upscale Brazilian churrascaria and meat lover's dream, has opened locations throughout the United States. It was an idea meant for internationalization: waiters dressed as gauchos bring a seemingly endless array of multiple cuts of beef and other meats to your table. They give you cards with green and red sides; turn the green side up and the meats keep coming. When you have had enough, flip the card to red.

But sometimes you just want a convenient espresso or cup of coffee. In 2008, Starbucks had locations in 44 countries. If you're in Milan, however, you won't find a Starbucks—but you can find a La bottega del Caffè, an Italian franchise that began in 2000 and is now spreading in Europe. Italians take their coffee seriously. If you want a caffè latte in Italy, be precise when you order. If you just ask for a latte, you'll get a cup of steamed milk.

Sources: Daniel Gross, “McSushi, Why Is American Food So Popular in Japan?” *Newsweek*, June 22, 2009; Mike Steinberger, “How McDonald's Conquered France. The fast-food chain's most surprising success,” *Slate*, June 25, 2009; <http://www.labottegadelcaffe.net/english>, accessed August 3, 2009; <http://www.mos.co.jp/english/>, accessed August 3, 2009; [http://www.starbucks.com/aboutus/Company\\_Factsheet.pdf](http://www.starbucks.com/aboutus/Company_Factsheet.pdf), accessed August 3, 2009.

International business has brought a global reorientation in production strategies. Only a few decades ago, for example, it would have been thought impossible to produce parts for a car in more than one country, assemble it in another, and sell it in yet other countries around the world. Today, such global strategies, coupled with production and distribution sharing, are common. Consumers, union leaders, policymakers, and sometimes even the firms themselves are finding it increasingly difficult to define where a particular product was made, because subcomponents may come from many different nations. Firms are also linked to each other through global supply agreements and joint undertakings in research and development. Figure 1.2 gives an example of how such links result in a final consumer product.

In addition to the production of goods, service firms are increasingly part of the international scene. Consulting firms, insurance companies, software firms, and universities are participating to a growing degree in the international marketplace. As Focus on Culture explains, international franchising has changed the eating habits of global audiences with the proliferation of choices available to them.

Firms and governments are recognizing the effects that globalization of business can have on the environment common to all. For example, high sulfur emissions in one area may cause acid rain in another. Pollution in one country may result in water contamination in another. Service activities can have cross-national impacts as well. For example, weaknesses in some currencies, due to problems in a country's banking sector, can quickly spill over and affect the currency values of other nations. The deregulation of some service industries, such as air transport or telephony can, thoroughly affect the structure of these industries around the world.

All these changes have affected the international financial position of countries and the ownership of economic activities. For example, the United States, after having been a net creditor to the world for many decades, has become a world debtor since 1985. This means that overall the United States owes more to foreign institutions and individuals than is owed to the United States. China has emerged as the number one U.S. creditor. In addition, **sovereign wealth funds**, or funds owned by governments and managed specifically for investment purposes, have emerged as key international investors.

The shifts in financial flows have had major effects on **foreign direct investment** into plants as well. U.S. direct investment abroad at the end of 2008 had a market value of nearly \$3.7 trillion, while foreign direct investment in the United States exceeded \$2.6 trillion.<sup>12</sup> Plants abroad increasingly take the place of trade. All of these developments make us more and more dependent on one another.

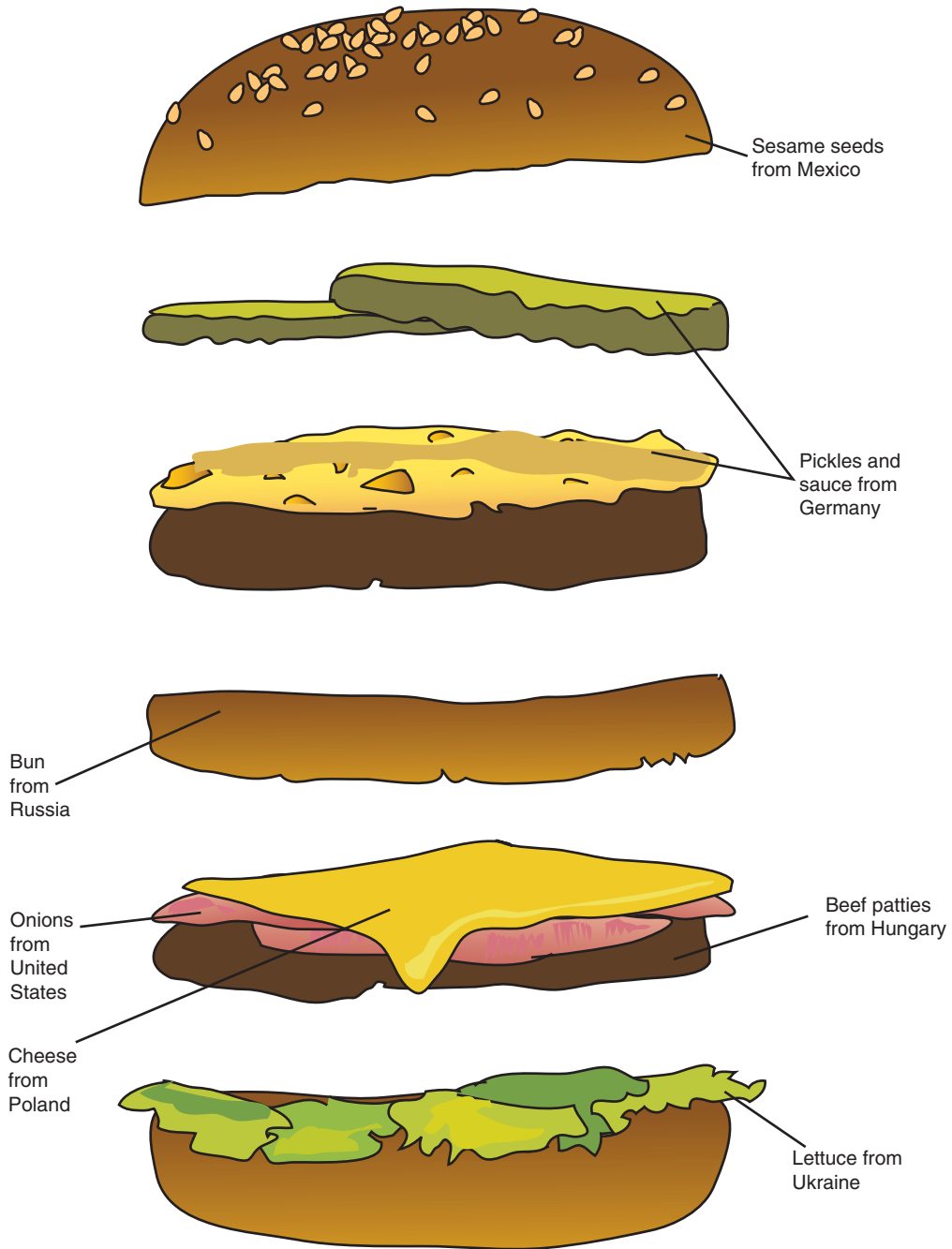
This interdependence, however, is not stable. On an ongoing basis, realignments take place on both micro and macro levels that make past orientations at least partially obsolete. For example, for its first 200 years, the United States looked to Europe for markets and sources of supply. Despite the maintenance of this orientation by many individuals, firms, and policymakers, the reality of trade relationships has changed. U.S. two-way merchandise trade with China, Japan, Korea, Taiwan, Australia, Hong Kong, and the Association of Southeast Asian Nations totaled \$993 billion in 2008, \$354 billion more than trade with the 27 member-countries of the European Union (EU).<sup>13</sup>

At the same time, entirely new areas for international business activities have opened up as eastern Europe, Russia, and many of the countries of the former Soviet Union have eagerly pursued new trade opportunities. In 2008, Ukraine acceded to the World Trade Organization (WTO), joining Georgia, Moldova, the Kyrgyz Republic, and Mongolia, which had already become members.

**sovereign wealth fund** Investment vehicle containing only government financial assets, which are invested globally.

**foreign direct investment** The establishment or expansion of operations of a firm in a foreign country. Like all investments, it assumes a transfer of capital.

Figure 1.2 The International Burger



Concurrently, a growing regionalization is taking place around the world along with the development of trading blocs and a proliferation of bilateral trade agreements. Firms must manage and navigate an increasingly complex array of trading arrangements between nations. They may find that the free flow of goods, services, and capital encounters new impediments as regions become more inward-looking and governments become more active.

Not only is the business environment changing, but the pace of technological change is accelerating. Atari's Pong was first introduced in the early 1980s; today action games and movies are made with computerized humans. The first office computers emerged in the mid 1980s; today home computers have become commonplace, and notebooks and ultraportables are favorites in the classroom.<sup>14</sup> E-mail was introduced to the mass market only in the 1990s; today many college students reserve "old fashioned" e-mail for their parents and professors while using blogs or social networks like Facebook and Twitter among themselves.<sup>15</sup> All these shifts, allow for a faster and user intense information exchange in business, leading to new approaches in advertising, production and consumption.

These changes, and the speed with which they come about, significantly affect countries, corporations, and individuals. For example, the relative participation of countries in world trade is shifting. Over the past decades, in a world of rapidly growing trade, the market share of western Europe in trade has been declining. For the United States, the export share has declined while the import share has increased. Some countries, like China, Germany, and Japan, have become dependent upon exports to drive economic growth. As their economies have grown, the global market shares of China, Southeast Asian countries, and Brazil have increased.

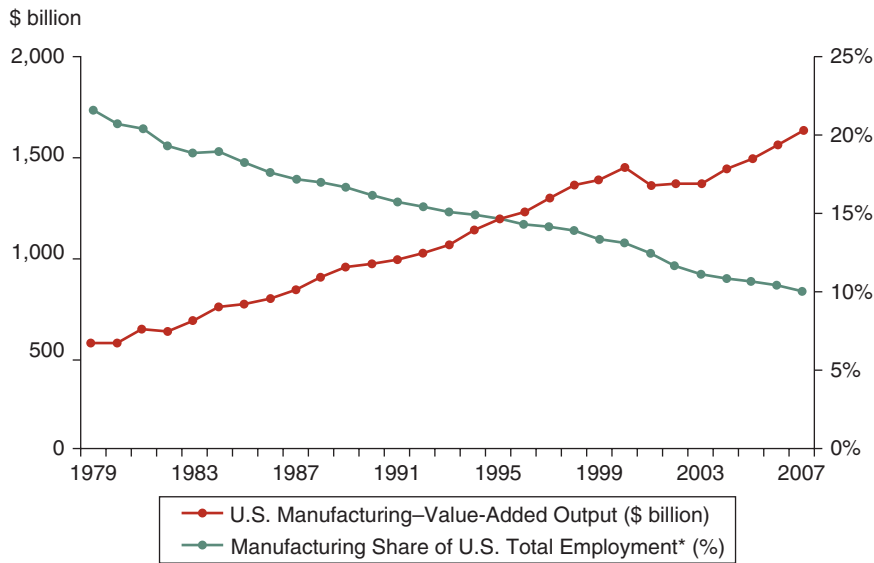
The **composition of trade** has also been changing. For example, from the 1960s to the 1990s, the trade role of primary commodities has declined precipitously while the importance of manufactured goods has increased. This has meant that those countries and workers who had specialized in commodities such as *caoutchouc* (rubber) or mining were likely to fall behind those who had embarked on strengthening their manufacturing sector. With sharply declining world market prices for commodities and rising prices for manufactured goods, their producers were increasingly unable to catch up. Some commodity-dependent countries realized temporary windfalls as prices on oil, wheat, and corn rose dramatically in 2008, only to watch them evaporate as prices dropped again in 2009.

More recently, there has been a shift in manufacturing to new nations. In the mid-1800s, manufacturing accounted for about 17 percent of employment in the United States. This proportion grew to almost 30 percent in the 1960s, only to decline at a rising rate. In mid-2009, manufacturing employment fell to about 9 percent, with the loss of some 2 million manufacturing jobs in the recession.<sup>16</sup> Despite this loss in employment, the U.S. manufacturing industry is in the process of significant transformation as productivity gains and skills upgrading have created a leaner and more skilled manufacturing workforce.<sup>17</sup> As Figures 1.3 and 1.4 show, U.S. value-added manufacturing output has been increasing as the U.S. share of global manufacturing output has remained reasonably stable at about 25 percent over the past two decades.

In the past 30 years, German manufacturing employment has dropped by 13 percentage points, while in Japan the decrease was 6.5 percentage points. All these shifts in employment reflect a transfer of manufacturing away from traditional manufacturers toward the emerging economies. During the times of large decline in the United States, Germany, and Japan, the proportion of manufacturing of gross domestic product (GDP) has more than doubled in Malaysia, Thailand, and Indonesia.<sup>18</sup>

**composition of trade** The ratio of primary commodities to manufactured goods in a country's trade.

**Figure 1.3 U.S. Manufacturing Output and Employment, 1979–2007**



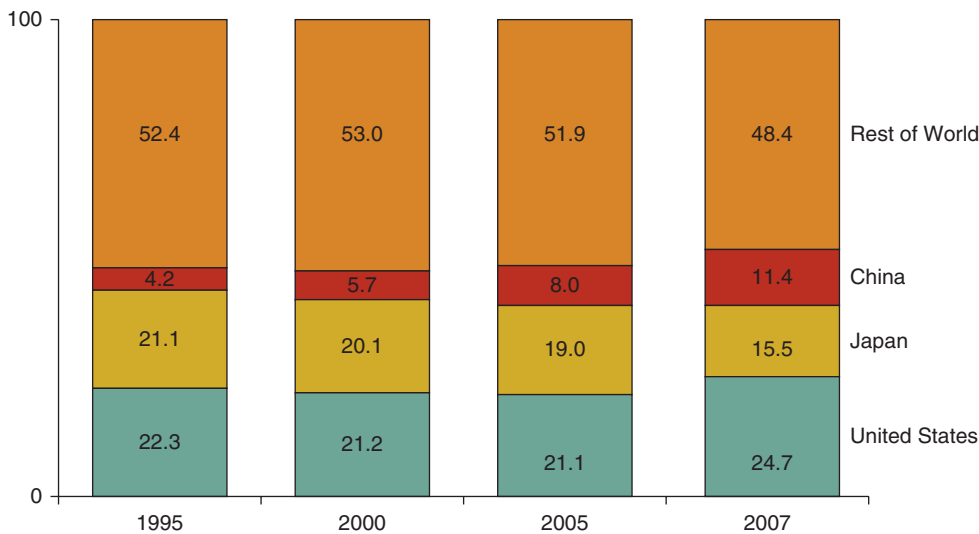
*Productivity gains have led to greater output but with fewer workers. Employment continues its long-term shift from manufacturing to services.*

\*Total nonfarm annual average

Sources: U.S. Bureau of Economic Analysis; U.S. Bureau of Labor Statistics; Oxford Economic Forecasting.

Increasingly, substantial shifts are also occurring in the area of services trade. Activities that were confined to specific locales have become mobile. The global transmission of radiology charts to physicians in India is a portent of shifts in trade composition in the future.

**Figure 1.4 Share of Global Manufacturing Output**



*The United States is maintaining its share of global manufacturing; China is taking share from Japan.*

Source: United Nations Industrial Development Organization (UNIDO; 2007 is a UNIDO estimate).