

## CHAPTER ONE

# GLOBALIZING BUSINESS



### LEARNING OBJECTIVES

After studying this chapter, you should be able to

- 1 Explain the concept of international business (IB)
- 2 Articulate what you hope to learn by reading this book and taking this course
- 3 Identify one fundamental question and two core perspectives that provide a framework for studying this field
- 4 Participate in the debate on globalization with a reasonably balanced and realistic view
- 5 Summarize some basic trends in the global economy
- 6 Draw implications for action by integrating global and local knowledge



### OPENING CASE

#### **adidas: sales, suppliers and stakeholders around the world**

On Shanghai's fashionable Huaihai Road, not far from the outlets of *Apple*, *Nike* and *Gucci*, a multi-storey store invites shoppers to try a brand hailing from a small town in Germany. In Herzogenaurach, the intense rivalry between *adidas* and *Puma* has propelled both

sports shoe manufacturers onto the international stage. *adidas* pulled ahead with innovative approaches to sport sponsorship, placing its three stripes on the sports kit of international competitors in many sports. After taking over US sports brand *Reebok* in 2005, *adidas* became the world's second largest provider of sports shoes and clothing (after *Nike*), while expanding into the much broader market of leisure clothing.



When Kasper Rørstad, a Dane, took over as CEO of this iconic German brand in 2016, *adidas* had a truly global footprint, with an equally strong presence on all continents. Western Europe was still the most important region accounting for 27.4% of sales, followed by North America with 17.7%. Yet about half of *adidas*' sales already came from emerging economies, including Greater China (15.6%), other Asia and Middle East (13.9%) and Latin America (9.0%). The success in China builds on two decades of brand building and a major marketing push ahead of the 2008 Olympics, featuring adverts associating *adidas* with the Chinese national team and its successes. In a highly competitive premium segment in China, global brands *Nike* and *adidas* have been challenged by local brands such as *Li Ning*. Yet, by focusing on innovation and product quality they sustained their popularity among increasingly affluent young urban people.

However, not only sales have become global; the value chain of the company also extends across the globe. In particular, the labour-intensive parts of shoes and clothing manufacturing have, since the 1980s, been moved to locations with low labour costs, often to independent suppliers. In 2018, *adidas* reported 783 primary suppliers around the world, many of which are based in emerging countries, led by China (151), Vietnam (79), Korea (74) and Indonesia (75). They were complemented by suppliers in advanced economies like the USA (77), Japan (32) and Germany (15).

With global supply chains labour relations have also become global, and consumers in Europe and North America take an active interest in where and how their shoes are made. The shoe and textile industry historically has a poor record on working conditions in its factories, especially in Asia. Therefore, *adidas* is continuously engaging with a wide range of stakeholders and developing its standards of engagement. These codes and processes cover a wide range of issues including forced labour, child labour, discrimination, wage and benefits, hours of work, collective bargaining, disciplinary practices, environmental requirements and community involvement. They are supported by auditing tools and procedures, some of which by independent third parties. Audit teams visit factories not only to monitor compliance but also to train the management in the use of the standards of engagement and to explain the likely benefits of higher standards for the business itself. The teams rate each factory on several criteria, and these compliance ratings – together with quality criteria – influence decisions on which suppliers to use. At the same time, *adidas* engages in a constructive dialogue to provide solutions to problems that occur and also to discontinue relationships with suppliers repeatedly found in violation of its standards. In the interests of transparency, since 2007, *adidas* has been publishing a full list of all its suppliers on its website, which is updated twice yearly, still a rare practice in the industry.

*adidas* is the founding member of the *Fair Labor Association* (FLA), which provides external, independent monitoring, complaints procedures and public reporting, and partnerships with other NGOs. For example, in Indonesia *adidas* acted as lead in an initiative to engage with the trade union movement, which established a framework agreement for trade union rights in the workplace. Employees can report violations of employment codes to independent monitors not only to a telephone hot line but also by SMS.

Over the years, the standards of engagement have led to improvements in business practices in supplier firms, especially in those firms that chose a proactive approach. An independent study found rising product quality, fewer accidents, lower staff turnover and rising productivity in a proactive supplier firm, while reluctant adoption of the code in another supplier firm led to inferior economic performance. Moreover, a track record of responsible supply chain management enhances the reputation of the brand globally.

But *adidas* cannot stand still. Fashions and user habits are constantly changing, as are best practices in the manufacturing of textiles and footwear. Online sales are becoming increasingly important, and *adidas* is not only developing its own phone app and an online supply chain but is also assessing its global network of traditional outlets. Also the manufacturing of shoes is changing. By 2017, *adidas* was building a 3-D printing plant that would produce shoes fully automatically in Germany, while one of its US suppliers, Tianyuan Garments, was experimenting with textile machines that could stitch together T-shirts completely automatically.

Sources: (1) S. Frenkel & D. Scott, 2002, *Compliance, Collaboration, and Codes of Labor Practice: The adidas Connection*, *CMR*, 45: 29–49; (2) L. Hartman, R. Wokutch & J. French, 2003, *adidas-Salomon*, in: L. Hartman, D. Arnold & R. Wokutch, eds, *Rising Above Sweatshops*, Westport, CT: Praeger, 191–248; (3) *The Economist*, 2017. Stitches in time, August 26; (4), *Handelsblatt*, 2018, Diese App ist für Adidas wichtiger als jeder Turnschuh, March 26; (5) www.adidas-group.com.

Were you surprised to learn how many people in different countries are involved with *adidas* – not just wearing their shoes and sports clothing but as labourers, NGOs or brand managers? Did you expect *adidas* to be so concerned what people think about its labour practices around the world? Did you realize that its marketing practices are adapted locally, even when referring to the same global brand? International business (IB) has become an integral part of many businesses – and products. Yet, managing IB activities – for example, coordinating multiple suppliers of components – is challenging even for experienced managers. This book is about these sorts of challenges faced by managers of firms operating around the globe. In particular, we will be exploring what determines the success and failure of firms engaged in IB.

## EUROPEAN AND GLOBAL BUSINESS

**International business (IB)** is about (1) firms engaging in international (cross-border) economic activities and/or (2) the activity of doing business abroad. IB activities take many forms and involve many different actors. The most important actors in IB are known as **multinational enterprises (MNEs)**, defined as firms that engage in **foreign direct investment (FDI)** by directly investing in, controlling and managing value-added activities in other countries.<sup>1</sup> For example, *adidas*, an MNE, has undertaken many FDI projects, such as manufacturing plants in the UK or retail shops in China. In addition, it has a variety of relationships with other businesses (from suppliers to distributors), sports teams it sponsors and, last but not least, consumers. These others may not be MNEs themselves, but they engage in IB too. For example domestic firms actively compete and/or collaborate with foreign entrants. Understanding IB is thus also important for anyone facing foreign competitors.<sup>2</sup>

There are two key words in IB: international (I) and business (B). The I indicates that we will spend substantial time on analyzing the international environment of business, especially in Chapters 2, 3, 8 and 9. The B indicates why we study the

### international business (IB)

(1) A firm that engages in international (cross-border) economic activities and/or (2) the action of doing business abroad.

### LEARNING OBJECTIVE

- 1 Explain the concept of international business (IB)

### multinational enterprise (MNE)

A firm that engages in foreign direct investments and operates in multiple countries.

### foreign direct investment (FDI)

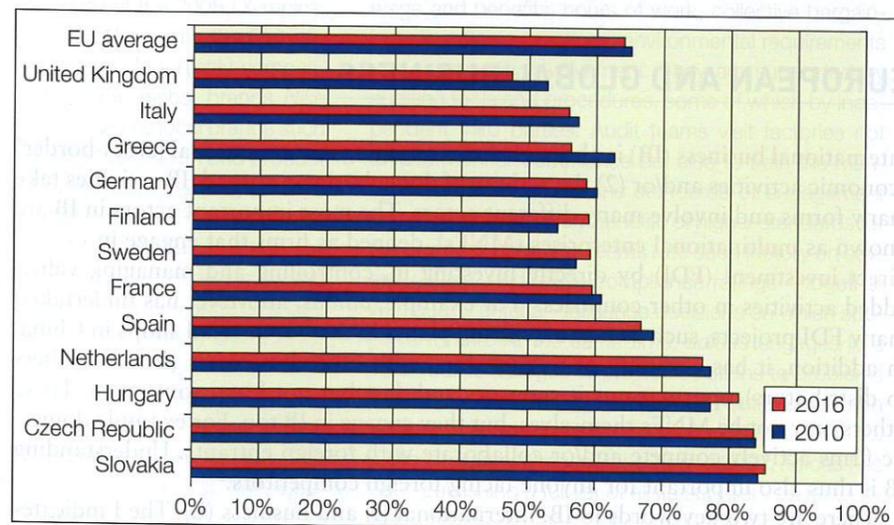
Investments in, controlling and managing value-added activities in other countries.

international environment: we want to know how and why it is important for business. It also indicates that we are not focused on one function, such as management, marketing or finance but on the overall picture of business.<sup>3</sup> The dual focus on both the international environment and the firm is the essence of IB. Like economics and political science, we study the business environment, but we look at it from the perspective of firms and individuals engaged in business activities. Thus, IB is an integrative course that has the potential to provide you with an overall business perspective grounded in a global environment.

The international dimensions of business are increasingly important for all businesses, especially in Europe, because most national markets have opened to international competition. For example, suppliers of car parts need to be able and willing to cooperate with the car maker, for example VW, Toyota or Fiat, at multiple sites around the world if they want to sell to the brand. Moreover, with the creation of the common market in the European Union (EU), the definition of a home market is increasingly ambiguous. Especially in business-to-business markets, such as car parts, customers are often operating internationally, especially in Europe, such that competition in a single country would hardly be sustainable. Thus, it becomes difficult to tell what is international and what is domestic.

This book goes beyond traditional IB textbooks in two important ways. First, we focus on issues relevant to European businesses and managers. In Europe, domestic markets are smaller than, for example, in the USA and China. Hence, IB is an important aspect of business for almost all firms – large and small. Most of its business is conducted with neighbouring countries. For example, France and Germany are each other's main trading partners. For most European businesses, the EU member countries account for more than half of their international activities. Of the major nations, only British exporters sell less than half their overseas sales within the EU, while their Czech and Slovak counterparts sell over 83% within the EU in part because of their tight integration in pan-European supply chains in the car industry (see Figure 1.1). That is like working Monday to Friday on EU markets and Saturday on the rest of the world. Even the biggest MNEs do most of their business in their home region;<sup>4</sup> truly global companies like *adidas* remain the exception rather than the rule.

**Figure 1.1** Exports from EU member countries 2010 and 2016



**Note:** Share of intra-EU exports and imports in the countries' total exports in %.

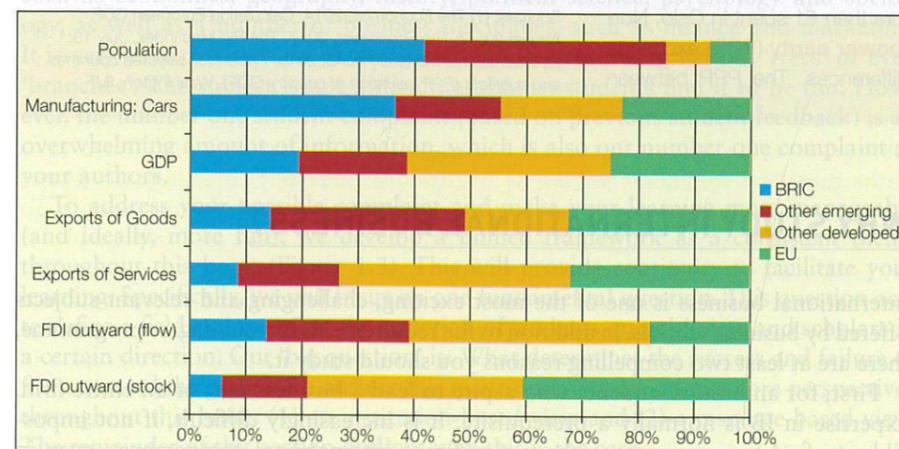
**Source:** Authors' creation using data from Eurostat database, accessed January 2018.

Within their own region, however, businesses face different kinds of challenges than when expanding beyond their home region. Notably, they operate under the auspices of the EU and the rules that the EU has established for business (see Chapter 8). Moreover, in neighbouring countries, differences in institutions are relatively small, yet big enough to derail unsuspecting business people (Chapters 2 and 3). On the other hand, the rest of the world presents some of the most attractive (profitable) business opportunities and recently much larger growth potential. For example, *adidas* has been able to tap into both traditional Western European markets and fast growing Asian markets. Hence, as an IB executive, you need competence for both Europe and beyond.

This book aims to give you *both*, which distinguishes it from most English-language textbooks which are often written by leading scholars based in the USA and thus focus on issues of interest to Americans going international. Typically, these are large companies dealing in distant markets because the home market in the USA is so big. Thus our European focus implies that we are paying more attention than other textbooks to (1) business in nearby countries, (2) institutions of the EU, (3) small- and medium-sized enterprises (SMEs) and (4) research by European scholars on these issues.

Second, this book is devoting extensive space to **emerging economies** (also known as **emerging markets**). These are economies that only recently established institutional frameworks that facilitate international trade and investment, typically with low- or middle-level incomes and above average economic growth.<sup>5</sup> How important are emerging economies? Figure 1.2 provides some indications. The largest four emerging economies are indicated in blue: Brazil, Russia, India and China (also known as **BRIC**). About 85% of the people of the world live in an emerging market, but they collectively contribute only about 30% of global **gross domestic product (GDP)**, the most common measure of the economic power of an economy (In Focus 1.1). However, their participation in the global economy is rapidly increasing. For example, 55% of all cars are built in an emerging economy (25% in China alone). Together, emerging economies account for almost half of all goods exports and a quarter of all service exports. Their position in FDI is still small but rapidly increasing; note the much larger share in new FDI (FDI flow) in the year 2013 compared to the existing FDI operations (FDI stock). The rapid growth of some emerging economies is evident. Today's students – and tomorrow's business leaders – will find rich opportunities in emerging economies. This book will help you to recognize them.

**Figure 1.2** The contributions of emerging economies



**Sources:** Authors' creation using data extracted from (1) United Nations, 2014, *World Investment Report 2014*, New York and Geneva: UN; (2) World Bank, 2014, *World Development Indicators* database; (3) World Trade Organization, 2014, *WTO Statistics* database; (4) *The Economist*, 2014, *Pocket World in Figures*, London. All data refer to 2013.

**emerging economies (emerging markets)**  
Economies that only recently established institutional frameworks that facilitate international trade and investment, typically with low- or middle-level income and above average economic growth.

**BRIC**  
Brazil, Russia, India and China.

**gross domestic product (GDP)**  
The sum of value added by resident firms, households and governments operating in an economy.



## IN FOCUS 1.1

### Setting the terms straight

GDP, GNP, GNI, PPP – there is a bewildering variety of acronyms that are used to measure economic development. It is useful to set these terms straight before proceeding. Gross domestic product (GDP) is measured as the sum of value added by *resident* firms, households and government operating in an economy. For example, the value added by foreign-owned firms operating in Mexico would be counted as part of Mexico's GDP. However, the earnings of *non-resident* sources that are sent back to Mexico (such as earnings of Mexicans who do not live and work in Mexico and dividends received by Mexicans who own non-Mexican stocks) are not included in Mexico's GDP. One measure that captures this is **gross national product (GNP)**. More recently, the World Bank and other international organizations have used a new term, **gross national income (GNI)**, to supersede GNP. Conceptually, there is no difference between GNI and GNP. What exactly is GNI/GNP? It comprises GDP plus income from non-resident sources abroad.

While GDP, GNP and now GNI are often used as yardsticks of economic development, differences in cost of living make such a direct comparison less meaningful. In particular, the costs of living in emerging economies, especially services such as housing and haircuts, tend to be much lower than in developed economies. For example, €1 spent in Nairobi, Kenya can buy a lot more than €1 spent in Oslo, Norway. The **purchasing power parity (PPP)** exchange rate considers such differences. The PPP between

two countries is the rate at which the currency of one country needs to be converted into that of a second country to ensure that a given amount of the first country's currency will purchase the same volume of goods and services in the second country.

For example, according to the International Monetary Fund (IMF, see Chapter 9), the Swiss per capita GDP is US\$80 603 based on official (nominal) exchange rates – a lot *higher* than the US per capita GDP of US\$56 084. However, everything is more expensive in Switzerland. For example, a Big Mac costs US\$6.74 in Switzerland versus US\$5.30 in the USA. Thus, Switzerland's per capita GDP based on PPP is only US\$59 561 – only slightly higher than the US per capita GDP based on PPP, US\$56 084 (the IMF uses the USA as the benchmark in PPP calculations).

Overall, when we read statistics about GDP, GNP and GNI, always pay attention to whether these numbers are based on official exchange rates or PPP, which can make a huge difference. However, PPP values have been created to compare standards of living; they only weakly proxy the 'real' size of an economy. Also, be aware of intra-country variations in PPP. If you live as an expatriate in Manila or Shanghai, you will find many actual expenses to be quite similar to Europe: the cheap food or local transport does not meet the same quality and safety standards that most Europeans expect.

Sources: (1) *The Economist*, 2014, Calculating European GDP, August 23; (2) *The Economist*, 2017, The Big Mac index, July 13; (3) International Monetary Fund, 2016, *Report for selected countries and subjects (PPP valuation of country GDP)*, Washington: IMF.

## WHY STUDY INTERNATIONAL BUSINESS?

### LEARNING OBJECTIVE

- 2 Articulate what you hope to learn by reading this book and taking this course

International business is one of the most exciting, challenging and relevant subjects offered by business schools. In addition to the requirements of your degree programme, there are at least two compelling reasons you should study it.

First, for ambitious students who aspire to lead a business unit or an entire firm, expertise in IB is normally a prerequisite. It is increasingly difficult, if not impossible, to find top managers without significant international competences, even in

small- and medium-sized enterprises. Of course, eventually, hands-on global experience, not merely knowledge acquired from this course, will be required. However, mastery of the knowledge and demonstration of interest in IB during your education will set you apart as a candidate for fast-track career development that involves **expatriate assignments** – job assignments located abroad (see Chapter 16).

Thanks to globalization, low-skilled jobs not only command lower salaries but are also more vulnerable to international competition. However, top management capabilities, especially those that create connections across the world, are in demand. For example, if a factory in Europe is shut down and the MNE sets up a similar factory in China, only a few dozen people may keep their jobs. Yes, you guessed it: these jobs are top-level positions such as the chief executive, chief financial officer, factory directors and development engineers. They may be sent by the MNE as expats to China to lead operations there. To motivate their best people to take such challenging assignments, MNEs typically offer them a higher salary and extra perks during their stay. Knowledge of IB and the ability to contribute to discussions on global business issues are a foundation for becoming a sought after, globetrotting manager.

Second, even if you do not have aspirations to move around the world in your professional life, you may find yourself dealing with foreign-owned suppliers and buyers, competing with foreign-invested firms in your home market and perhaps even managing investments abroad. Very few companies in Europe are able to pursue their business without regular interaction across international borders. Moreover, you may also find yourself working for a foreign-owned firm if your domestic employer is acquired by a foreign MNE. Understanding how global business decisions are made may facilitate your own career in such MNEs. If there is a strategic rationale to downsize your unit, you would want to be able to figure this out and be the first one to talk to alternative employers. In other words, it is your career that is at stake. In this age of global competition, a good place to start is to study hard and do well in your IB course.

## A UNIFIED FRAMEWORK

International business is a vast subject area. We draw on major social sciences, such as economics, geography, history, political science, psychology and sociology, as well as a number of business disciplines, such as finance and marketing. It is very easy to lose sight of the 'forest' while scrutinizing various 'trees' or even 'branches'. The subject is not difficult, and most students find it to be fun. However, the number one student complaint (based on previous student feedback) is an overwhelming amount of information, which is also our number one complaint as your authors.

To address your possible complaint and make your learning more manageable (and ideally, more fun), we develop a unified framework as a consistent theme throughout this book (Figure 1.3). This will provide continuity to facilitate your learning. Specifically, we will focus on one fundamental question. This question acts to define a field and to orient the attention of students, practitioners and scholars in a certain direction. Our 'big question' is: What determines the success and failure of firms around the globe?<sup>6</sup> To answer this question, we focus on two core perspectives throughout this book: (1) an institution-based view and (2) a resource-based view. The remainder of this section outlines why this is the case.

### gross national product (GNP)

Gross domestic product plus income from non-resident sources abroad.

### gross national income (GNI)

GDP plus income from non-resident sources abroad. GNI is the term used by the World Bank and other international organizations to supersede the term GNP.

### purchasing power parity (PPP)

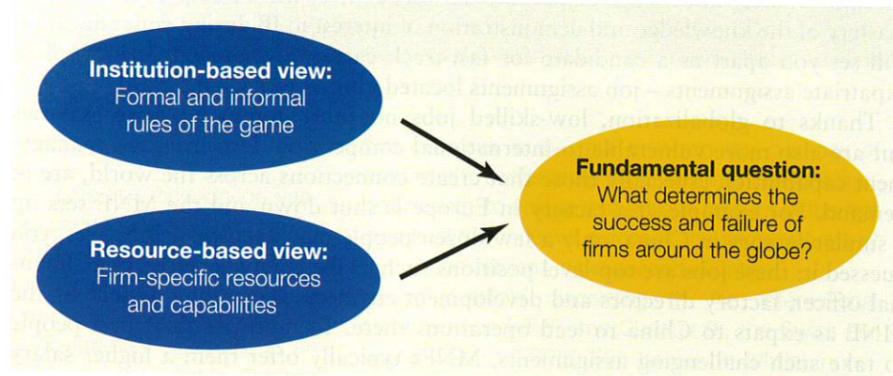
A conversion that determines the equivalent amount of goods and services different currencies can purchase. This conversion is usually used to capture the differences in cost of living in different countries.

### expatriate assignment

A temporary job abroad with a multinational company.

### LEARNING OBJECTIVE

- 3 Identify one fundamental question and two core perspectives that provide a framework for studying this field

**Figure 1.3** A unified framework for global business

### One fundamental question

What is it that we do in IB? Why is it so important that practically every student in a business school around the world is either required or recommended to take such a course? Although there are certainly a lot of questions, ‘what determines the success and failure of firms that cross national boundaries?’ serves to focus our studies. IB, fundamentally, is about not limiting yourself to your home country and about treating the entire global economy as your potential playground (or battlefield). Some firms may be successful domestically. However, when they venture abroad they fail miserably. Other firms successfully translate their strengths from their home market to other countries. If you were to lead your firm’s efforts to enter a particular foreign market, wouldn’t you want to find out what is behind the success and failure of other firms in that market?

Overall, firm performance in all their operations around the globe is, more than anything else, of concern to managers in internationally operating firms. Numerous other questions all relate in one way or another to this most fundamental question. For example, how do firms affect those they cooperate or compete with, their employees and suppliers, and society as a whole? This broader perspective is part of what constitutes the ‘success’ of firms looking beyond profits. In this spirit, the primary focus of the field of IB – and of this book – is: what determines the success and failure of firms around the globe?

### First core perspective: an institution-based view

Like sports or board games, businesses have to play by certain rules. These ‘rules of the game’ are commonly known as ‘institutions’, and they come in many forms. However, they also vary considerably across countries, or even within countries. To succeed in IB, you need intimate knowledge about the formal and informal rules of doing business in each country in which you are operating. In a nutshell, an institution-based view suggests that success and failure of firms are enabled and constrained by the different rules of the game.<sup>7</sup>

Some *formal* rules of the game, such as the requirements to treat domestic and foreign firms as equals, would enhance the potential odds for foreign firms’ success. Hong Kong is well known for treating all comers, ranging from neighbouring mainland China (whose firms are still technically regarded as ‘non-domestic’) to far-away

Chile, the same as it treats indigenous Hong Kong firms. It is thus not surprising that Hong Kong attracts a lot of outside firms. Other rules of the game, which may discriminate against foreign firms, would undermine the chances for foreign entrants. For example, trucking companies, banks and defence contractors in many countries operate under rules that favour home-based firms. Foreign entry is much more difficult under such circumstances.

In addition to formal rules, *informal* rules such as culture, norms and values play an important part in shaping the success and failure of firms around the globe. For example, because founding new firms tends to deviate from the social norm of working for other bosses, individualistic societies, such as Australia, the UK and the USA, tend to have a relatively higher level of entrepreneurship as reflected in the number of business start-ups. Conversely, collectivistic societies such as Japan often have a hard time fostering entrepreneurship; most people feel discouraged from sticking their neck out to found new businesses. Yet such collectivist societies may find it easier to mobilize teams to work towards common goals over long periods of time.

As we will discuss further in Chapters 2 and 3, the institution-based view suggests that the formal and informal rules of the game, known as institutions, shed a great deal of light on what is behind firm performance around the globe.

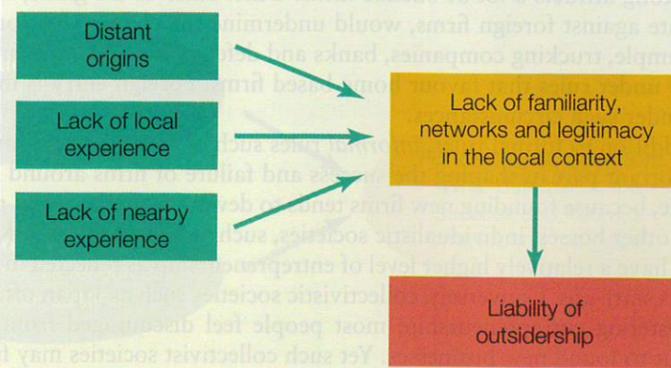
### Second core perspective: a resource-based view

The institution-based view suggests that firms’ success and failure around the globe are influenced by their environments. However insightful this perspective may be, there is a major drawback. If we push this view to its logical extreme, then firms’ performance around the globe would be entirely determined by their environments. The validity of this extreme version is certainly questionable.

This is where the resource-based view comes in.<sup>8</sup> While the institution-based view primarily deals with the external environment, the resource-based view focuses on a firm’s internal resources and capabilities. It starts with a simple observation: in harsh, unattractive environments, most firms either suffer or exit. However, against all odds, a few superstars thrive in these environments. For instance, the worldwide automotive industry has been under pressure from overcapacity. Yet, some European manufacturers like *Audi* and *BMW* have been increasing their market share, while US manufacturers *General Motors (GM)* and *Ford* needed a government bail-out in 2009. On the other hand, *Toyota* suffered a major drop in sales due to quality control problems and a US government investigation. Likewise, in the global airline industry, where most of the major airlines around the world have been losing money in recent years, a small number of players, such as *Southwest* in the USA and *Ryanair* in Ireland, have been profitable year after year. How can these firms succeed in very challenging environments? A short answer is that *BMW*, *Audi*, *Southwest* and *Ryanair* must have certain valuable and unique firm-specific resources and capabilities that are not shared by competitors in the same environments.

Doing business outside one’s home country is challenging. Foreign firms have to overcome a **liability of outsidership**, which is the inherent disadvantage that outsiders experience in a new environment because of their lack of familiarity with local contexts and networks (see Figure 1.4).<sup>9</sup> Just think of all the differences in regulations, languages, cultures and norms. Your ability to operate depends on your familiarity with the local context. Thus the liability of outsidership increases the more a firm’s origins differ from the host environment,<sup>10</sup> the less the firm has experience in the host country<sup>11</sup> and the further away its nearest prior affiliate.<sup>12</sup>

**liability of outsidership**  
The inherent disadvantage that outsiders experience in a new environment because of their lack of familiarity.

**Figure 1.4** Liability of outsidership

Against such significant odds, the primary asset of foreign firms is overwhelming resources and capabilities that after offsetting the liability of outsidership, still result in significant competitive advantage. Many of us take it for granted that year in year out, *Coca-Cola* is the best-selling soft drink in many countries, and *Microsoft Word* is the market-leading text processing software around the world. We really shouldn't take it for granted because it is *not* natural for these foreign firms to dominate non-native markets. Behind such remarkable success stories, these firms must possess some powerful resources that enabled them to attain these leadership positions. Chapter 4 will explore how the resource-based view can be used to analyze businesses and business opportunities.

## UNDERSTANDING GLOBALIZATION

### LEARNING OBJECTIVE

- 4 Participate in the debate on globalization with a reasonably balanced and realistic view

The rather abstract word 'globalization' is hotly debated across the world. Those who approve of globalization praise its contributions to economic growth and standards of living, sharing of technologies and more extensive cultural exchange. Critics argue that globalization undermines wages in rich countries, exploits workers in poor countries and gives MNEs too much power. So, what exactly is globalization? This section (1) provides a first glance of what globalization is all about, (2) sets it in a historical perspective and (3) outlines the current wave of globalization. We will further explore the forces driving globalization in Chapter 9.

### Views on globalization

Many people talk about globalization, yet they do not necessarily mean the same thing (Table 1.1). For young people, globalization is often first and foremost the internet and the information and communication opportunities it creates. It is now as easy to chat with your friends at the other end of the world as if you were sitting in the same room. Imagine the days when letters took days or even weeks to be delivered. You may be studying anywhere in the world, but you can easily update yourself about activities of the authors of your textbook over the internet – what a difference to your fellow students only a decade ago. *Facebook*, *Twitter* and *YouTube* are certainly expressions of globalization affecting your daily life. Moreover, digital technologies not only enable instant communication but entirely new types of business models. For example, *Uber* and *Airbnb* (Closing Case) pioneer the sharing economy worldwide, *Amazon* and *Alibaba* revolutionize online shopping – including access to products

overseas – while *Spotify* and *Apple Music* provide (legal) music streaming services. At the same time, mature businesses have to reassess their manufacturing operations and supply chains in view of potential disruptions through digital technology, a trend often discussed as **Industry 4.0** (see Integrative Cases *SSI Schaefer* and *BMW*).

### Industry 4.0

Disruptions of operations and supply chains through advances in digital technologies.

**Table 1.1** What is globalization?

- New technologies accelerating communication and transportation and creating new business opportunities?
- Rising power of MNEs and increased inequality in the world?
- Increased competition for jobs, especially for low-skilled workers?
- A force eliminating differences between distinctive national cultures and identities?

A second view associates globalization primarily with the rising power of MNEs and growing inequality around the world.<sup>13</sup> Many people feel that they are losing control over their lives as a result of forces unleashed by globalization and beyond the control of even their elected representatives. MNEs have grown big (see next section) and have attained considerable bargaining power when negotiating with national governments. Nations appear to have less control over what happens within their borders, and politicians have lost some of their power to shape events.<sup>14</sup> Important rules are set or implemented by the European Union (Chapter 8), the World Trade Organization or international arbitration tribunals (Chapter 9) – organizations that even elected national politicians have little influence over. No wonder citizens sometimes feel disempowered! The legitimacy of globalization is an ongoing concern for businesses and thus for this book.

Third, unskilled workers appear to lose out, at least in relative terms. The relative income of the highest skilled people is rising,<sup>15</sup> while the share of income from capital is rising relative to income from labour. Globalization has dramatically reduced inequality among nations, but it appears to also have contributed to rising inequality within nations, especially large countries like the USA and China. According to French economist Thomas Piketty and American Nobel Prize winner Robert Solow, these trends are likely to continue.<sup>16</sup> Moreover, in Western Europe, international competition creates pressures on the welfare state,<sup>17</sup> while low-skilled workers fear that their job will be offshored to India, China, Poland or Romania.<sup>18</sup> These concerns have given rise to substantive 'populist' political movements opposed to free trade and investment. On the other hand, many economists point to the fundamentally positive effects. In particular, increased global trade allows greater specialization and greater synergies of pooling resources, which increase productivity and thus create potentially more wealth that should eventually benefit all (Chapter 5). Advocates of this view thus argue that fine-tuning of regulations – rather than wholesale rejection of globalization – would be the appropriate way to ensure benefits of globalizations are shared more broadly.<sup>19</sup>

Fourth, some interpret globalization as a force that makes us all more similar and that eliminates the distinctiveness of our national cultures and identities. Some scholars, especially in marketing, argue that the world is on a path of convergence where consumers become more alike and companies thus sell the same products everywhere on the globe.<sup>20</sup> This expectation has created substantial anxieties, especially in more traditional communities.<sup>21</sup> For some consumer electronics manufacturers of computers and smartphones. Yet such strategies have their limits, and in fact almost all products are in one way or another adapted to local contexts, even the infamous *Coca-Cola*.

People around the world may be watching Hollywood movies, yet they live their daily lives in distinctly different ways. Thus we may see some convergence – especially among the middle classes – but there is little evidence to suggest that globalization would create a homogenous ‘global culture’ any time soon.

The following definition by sociologist Mauro Guillén nicely sums up this discussion: **globalization** is ‘a process leading to greater interdependence and mutual awareness (reflexivity) among economic, political and social units in the world, and among actors in general’.<sup>22</sup> In other words, globalization has created unprecedented contacts between cultures, but it has only marginally reduced clashes between them. Hence, in business, you have to work more frequently with others who operate under quite different conditions than yourself. This book aims to help you deal with the challenges and opportunities that this creates.

### Trends of globalization

Globalization is not new; it has long been part and parcel of human history. People have been trading over long distances for more than five millennia, with early traces of internationally operating businesses going as far back as the Assyrian and Phoenician Empires.<sup>23</sup> From 50 BCE to 500 CE, the Roman Empire ruled the Mediterranean region and created road and shipping infrastructure as well as political and legal structure, notably a common currency that facilitated trade, while the Silk Road connected Europe to Asia. In the Middle Ages, the Hanseatic League created a trading network of cities in Northern Europe that stretched from Novgorod in Russia to London in England. The League established common rules (or ‘institutions’) that applied to merchants in member cities and thus overcame the fragmented political structures at the time. Technological progress, notably in shipping and navigation techniques, has been advancing the speed and scope of international trade throughout the Middle Ages and into modern times.

Globalization accelerated in the 19th century following major innovations in manufacturing, communication and transport, as well as legal changes.<sup>24</sup> Industrialization took off with the invention of the steam engine, which powered the new railway networks and steam ships as well as mechanized mass production. Communication accelerated first by faster transport and then by the invention of the telegraph in 1838. However, these technological changes alone would probably not have brought about the rapid economic growth of the 19th century; they were accompanied by major **liberalization**, the removal of regulatory restrictions on business, such as the abolition of guild systems for trades and crafts. The introduction of the limited liability company permitted new forms of ownership and thus larger companies, while new patent laws encouraged entrepreneurs to innovate and thereby reap the benefits of their innovations. Many countries adopted the gold standard, which provided stable exchange rates, and allowed unrestricted transfers of capital. Migration was uninhibited by passport controls, visas or work permits. MNEs played a major role in this global economy, and the level of world FDI relative to GDP reached an estimated 9% in 1913, a level that was reached again only in the 1990s.

The wave of globalization of the 19th century peaked with the outbreak of World War I (see In Focus 1.2). While technological advances continued, politics interfered with a lot of the benefits that our grandparents might have enjoyed. Tariffs started to be introduced from the 1850s; by 1914 only Britain, the Netherlands and Denmark were committed to free trade. During the 1920s, many countries raised tariffs to record levels, and new quotas and trade barriers were created as countries aimed to protect their domestic industries. During World War I, many MNE subsidiaries were expropriated, and all foreign investors lost their assets in Russia after the revolution of 1917.

#### globalization

A process leading to greater interdependence and mutual awareness among economic, political and social units in the world and among actors in general.

#### liberalization

The removal of regulatory restrictions on business.



## IN FOCUS 1.2

### Globalization in the year 1900

The world economy was highly globalized at the start of the 20th century. By some measures, the same levels of global integration were only reached again in the 1990s. For instance, the ratio of FDI-stock to GDP reached 9% in 1913, dropped to 4.4% by the 1960s, before rising to 8.8% in 1990 and 28.4% in 2007 (before falling back to 24.5% in 2008). However, the nature of global business was quite different. European powers ruled large colonial empires, and a lot of international trade was bringing raw materials to Europe, and manufactured goods from Europe were sold worldwide.

The mining industry led international investment. Many natural resources required by the rapidly industrializing nations of Europe and North America were found in colonies: petroleum, copper, tin and other metals. MNEs led the exploitation of these resources employing imported technologies and capital. Concessions, once obtained, were relatively generous, giving these early MNEs a free hand to manage their affairs, and few taxes or charges were levied by the host countries. The notion that natural resources underground belong to the nation was only developed early in the 20th century. A leading player in the global exploitation of natural resources was *Standard Oil*, one of the largest companies of the world until it was broken up by US anti-trust legislation in 1911.

Many renewable resources in demand by the early industrial societies were also found in the colonies. In some industries, MNEs controlled the entire value chain from the plantation to the retailer: for instance, *United Fruit* controlled the banana trade between Central America and North America, while British trading houses not only imported tea but invested in tea plantations in South Asia. Elsewhere, British entrepreneurs took seeds from Brazil to build rubber plantations in Malaya (modern day Malaysia) that came to dominate world markets. In other industries, such as cotton, tobacco and coffee, multinational trading houses sourced from local farmers and sold on the big exchanges in Europe and North America.

Resource exploiting companies were often organized as free-standing MNEs. They would be headquartered in the leading financial markets of London or New York

but operate solely in distant locations or colonies. Often these firms started out designing and implementing major projects, such as railways and mines. Entrepreneurs would bring together engineering skills and capital from the home country with knowledge of local geology, geography, economics and politics. This business model enabled risk capital to be raised from European or US investors, who used it where high returns could be earned. After the initial construction phase, the operation of the railway or mine was often transferred to a local management company – similar to modern build-own-operate contracts.

The earliest manufacturing MNEs were established in the 1850s, including *Singer Sewing Machines* (USA) and *Siemens* (Germany). Yet integrated global operations as we know them in the 21st century were rare in the year 1900 because distance – in particular the time it took to communicate over long geographic distances – inhibited the establishment of effective control mechanisms. Many businesses thus entrusted subsidiaries to a family member or clan member and gave him (rarely her) a free hand to manage it locally. Hierarchical organizational forms to manage MNEs only evolved later with advances in technology and marketing practices.

In many industries, businesses organized international cartels to reduce the uncertainty created by free competition and to protect their profits. Especially in small countries, many industries were thus highly concentrated, with tacit or even formal agreements between international competitors not to enter each other's home markets. Liberal policies at the time also meant an absence of effective merger control or constraints on private monopolies. Moreover, protection of industrial workers was still in its infancy. Unprecedented wealth was created in the late 19th century, but it took several decades longer for this wealth to spread to all strata of society.

Sources: (1) J.F. Hennart, 1994, International financial capital transfers, *BH*, 36, 51–70; (2) M.C. Casson, 1994, Institutional diversity in overseas enterprise, *BH*, 36, 95–108; (3) G. Jones, 2005, *Multinationals and Global Capitalism*, Oxford: Oxford University Press; (4) S. Fellman, M.J. Iversen, H. Sjögren & L. Thue, eds., 2008, *Creating Nordic Capitalism*, Basingstoke: Palgrave-Macmillan; (5) M. Buchell, 2008, Multinational corporations, totalitarian regimes and economic nationalism: United Fruit Company in Central America 1899–1975, *BH*, 50, 433–454.

Many developing countries nationalized natural resource investments between the 1930s and 1960s. New FDI was made less attractive by restrictions on foreign ownership and by exchange controls that inhibited the repatriation of profits. Migration has become more restricted since World War I. The USA started requiring passports and visas and soon added work restrictions: its annual immigration rate fell from 1.16% of the population in 1913 to 0.04% after the war. The stable exchange rate system broke down when Britain abandoned the gold standard in 1931, and others followed with competitive devaluations, thus raising the costs and uncertainty of trading across currency areas. As a consequence, international trade declined during World War I, recovered moderately during the 1920s, and then collapsed in the depression of the 1930s. In a nutshell, globalization is nothing new and it is marching on, but there have been quite substantial and costly setbacks. Hence, following business historian Geoff Jones, we suggest that **waves of globalization** may appropriately describe the world economy.<sup>25</sup>

#### waves of globalization

The pattern of globalization arising from a combination of long-term trends and pendulum swings.

### What is globalization?

The current wave of globalization gradually evolved after World War II. A new fixed exchange rate system was created and provided stability until the late 1960s (see Chapter 7). However, in the 1950s and 1960s, barriers to trade and capital movements were pervasive, even among the countries that had embraced the principles of a market economy. Many developing countries, such as Argentina, Brazil, India and Mexico, focused on fostering and protecting domestic industries, while socialist countries, such as China and the (then) Soviet Union, sought to develop self-sufficiency. Even in Western Europe, trade barriers were substantial – not only shielding European businesses from outside competition but also inhibiting companies operating across borders within Europe.<sup>26</sup> However, barriers to global trade and investment ended up breeding uncompetitive industries focused on domestic markets only.

Gradually, international integration gathered pace. At a regional level, initiatives such as the European Community, predecessor of the EU, created an institutional framework for intra-regional trade (see Chapter 8), while global agreements, such as the GATT, aimed to liberalize trade globally (see Chapter 9). However, in the 1970s and 1980s, globalization remained largely a matter for the developed economies in the **Triad**, three regions that consist of North America, Western Europe and Japan.

Globalization accelerated dramatically in the 1990s. While world output grew by 23% over the decade, global trade expanded by 80% and the total flow of FDI increased fivefold.<sup>27</sup> A major contributor to the acceleration were emerging economies that joined the global stage, bringing billions of people with much lower incomes into the fold. More and more countries, such as China and Latin America in the 1980s, and Central and Eastern Europe and India in the 1990s, realized that joining the world economy was a must. As these countries started to emerge as new players in the world economy, they become collectively known as ‘emerging markets’<sup>28</sup> or ‘emerging economies’. Since the late 1980s, many of them have risen from ‘cheap workbenches’ to major markets for consumer goods, and some have even become sources of innovation (In Focus 1.3).

The active participation of emerging economies in the global economy has created a new awareness of the pyramid structure of the global economy (Figure 1.5). The top consists of about one billion people with per capita annual income of €15 000 or higher. However, the vast majority of humanity – about four billion people – live at the base of this pyramid, making less than €1500 a year. These people at the **base of the pyramid** provide new resources, and new demands (see Closing Case, and Integrated Case Fan Milk).<sup>29</sup>

#### base of the pyramid

The vast majority of humanity, about four billion people, who make less than €1500 a year.

#### Triad

Three regions of developed economies (North America, Western Europe and Japan).



## IN FOCUS 1.3

### GE innovates from the base of the pyramid

MNEs such as *General Electric (GE)* historically innovated new products in developed economies and then localized these products by tweaking them for customers in emerging economies. However, such expensive products developed with customers in developed economies in mind often flop in emerging economies not only because of their price tag but also because of their lack of consideration for the specific needs and wants of local customers. In recent years, some firms have turned this pattern around.

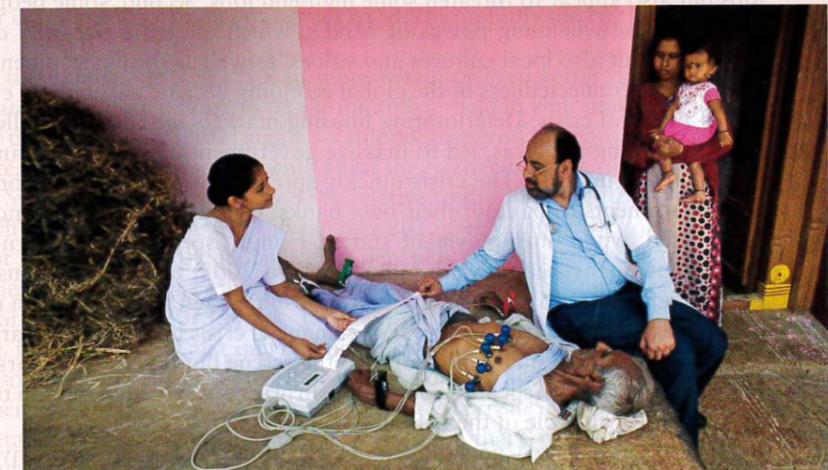
For example, *GE Healthcare*, a unit of *GE*, traditionally build ultrasound machines that sell in the US and Japanese markets for €100 000 and up. In emerging economies, these devices sold poorly because most rural hospitals or clinics are poorly funded. Conventional ultrasound machines were simply out of reach for them. Since patients could not come to the ultrasound machines, the machines, thus, had to go to the patients. Scaling down its existing complex ultrasound machines was not going to serve that demand. *GE Healthcare* realized that it needed a revolutionary product – a compact, portable ultrasound machine. It thus developed a

compact ultrasound machine that was operated with a regular laptop computer, and sold for €12 000. These portable ultrasound machines combine a new dimension previously unavailable to ultrasound machines – portability – with a low price, in developed economies where containing health care cost is increasingly paramount.

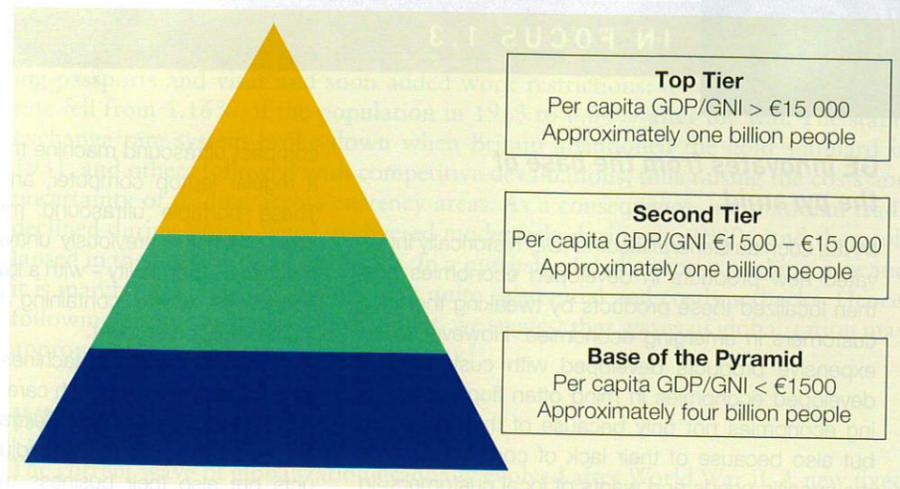
Portable ultrasound machines are not the only such innovation. In Africa, health care service providers like *GE*, *Philips*, *Siemens* and *Elektra* offer slimmed down and adapted products. They adjust not only their products but also their business models. Governments are concerned that hospital equipment is often used by poorly trained doctors and maintained under challenging climatic conditions. In Kenya, *GE Healthcare* thus developed with innovative service contracts rather than traditional product sales.

These experiences in emerging economies change the mental map of first world health care equipment providers. They started transferring innovative ideas between emerging economies – and eventually back to their home regions.

Sources: (1) *The Economist*, 2009, GE: Losing its magic touch, March 21; (2) GE Report, 2009, www.gereports.com; (3) J. Immelt, V. Govindarajan, & C. Trimble, 2009, How GE is disrupting itself, *HBR*, October: 56–65; (4) K. Manson, 2015, GE and Philips scan African market as disease burden grows, *Financial Times*, March 6.



GE Healthcare's Mac 400 electrocardiogram (ECG) machines, developed for India and China.

**Figure 1.5** The global economic pyramid

Sources: (1) C. K. Prahalad & S. Hart, 2002, The fortune at the bottom of the pyramid, *Strategy + Business*, 26: 54–67; (2) S. Hart, 2005, *Captialism at the Crossroads* (p. 111), Philadelphia: Wharton School Publishing.

Thus for the past century, the base of the pyramid has been rising. The number of people living in poverty has dramatically declined, not only in relative terms but in absolute numbers. Although the world population has been growing, from 5.3 billion in 1990 to 7.3 billion in 2013, the number of people living in absolute poverty (defined by the World Bank as \$1.90 per day at constant prices) has declined from 1.85 billion in 1990 to 767 million in 2013. Arguably, it is globalization that has made this dramatic progress possible.

However, despite these achievements, globalization has become more controversial in recent years. Opposing pressures arise from at least two sources. First, globalization is creating fear among many people in Europe and North America because emerging economies not only seem to compete away many low-end manufacturing jobs but also appear to threaten some high-end jobs. Second, some people complain about the overwhelming power of MNEs, which allegedly not only destroy local companies but also local cultures and values, as well as the environment.

The inter-connectedness of the global economy became particularly evident in the global financial crisis. Deteriorating housing markets in the USA, fuelled by unsustainable lending practices, led to massive government bail-outs of financial services firms starting in 2008. The crisis quickly spread around the world, forcing numerous governments to bail out their own banks. Global output, trade and investment plummeted, while unemployment started rising. Especially in Eastern and Southern Europe, many people were bitter. Prior to 2008, they were enthusiastic about their integration with the EU, and many consumers felt they could join rich Western Europe's living standards. However, the financial crisis hit the region hard. The International Monetary Fund (IMF) came to the rescue but not without harsh medicines of belt tightening and spending cuts. Not surprisingly, this intervention triggered lots of debate over the role of the IMF (see Chapter 9).<sup>30</sup>

After unprecedented government intervention, the global economy turned the corner. However, economic recovery was slow in some developed economies, especially Southern Europe, whereas some emerging economies rebounded faster, especially China. The recession reminded all firms and managers of the importance of

**risk management** – the identification and assessment of risks and the actions taken to minimize the impact of rare, unfortunate events.<sup>31</sup> Considerations of risk are thus central for how firms develop their strategies on the global stage (Chapter 14) and specifically for the management of global supply chains (Chapter 17).

Overall, globalization is seen by everyone and rarely comprehended. Some aspects of globalization are continuously advancing – notably transport and communication technology.<sup>32</sup> Other aspects – notably politics – are more like a pendulum swinging back and forth. Thus the world economy may best be described as a combination of continuous technological advance and pendulum swings in government policies, resulting in waves of globalization. This view suggests possible temporary reversals of some aspects of globalization, though communication technologies, and thus the intensity of cross-border interactions, is unlikely to roll back.

## A GLANCE AT THE GLOBAL ECONOMY

The global economy is driven by the competitive interplay between nations and firms. To add some substance to the trends explored in the previous section, we now offer some specific data. Who are the biggest players in the global economy?

Let's have a look at countries first (Table 1.2). The USA accounts for €13.5 trillion or about 22% of world GDP. China has risen to the second largest economy, achieving a GDP of €7.2 trillion, and with regularly higher growth rates its weight in the global economy is continuously growing. The EU as a whole is, however, bigger than either of these countries; its combined GDP totals €13 trillion. Looking at other indicators of economic power, however, quite different rankings emerge. Four of the five most populous countries are emerging economies: China (1.37 billion people), India (1.27 billion), Indonesia (258 million) and Brazil (206 million). The biggest exporters of goods in 2016 were China (€1.8 trillion), the USA (€1.3 trillion) and Germany (€1.2 trillion). The countries of the EU together export over €5.0 trillion, most of which is traded within the EU. Yet exports to the rest of the world still account for €1.7 trillion, second only to China. The country with the largest investments by its MNEs abroad is the USA, with €5.8 trillion of assets overseas, followed by the UK, Germany and Japan.<sup>33</sup> However, look further in the table and you will note that some smaller countries also are major homes to MNEs, notably the Netherlands and Switzerland.

Do study the numbers in Table 1.2 in more detail, or even better download and analyze the latest data from databases on the internet or held in your university library. You will note that these numbers are highly volatile because growth trends and exchange rates fluctuate. Exchange rate realignments affect the relative position of countries, for instance, the Swiss franc appreciated by 35% relative to the euro from 2005 to 2015, 15% of which was over just one week in January 2015 (see Chapter 7).

A frequent observation in the globalization debate is the enormous size of MNEs. The size of these leading MNEs is indeed striking: the largest MNE – retailer *Walmart* – generated more turnover in 2013 (Table 1.3) than the GDP of Sweden (€450 billion), ranked 22nd. Of course, you can't quite compare sales revenues and GDP figures, but this comparison indicates the economic power that some of these MNEs may attain, especially when operating in smaller countries. The largest private employer of the world is also US retailer *Walmart*, with 2.3 million employees; that's more people than the populations of Slovenia or Latvia, or the inhabitants of Paris. Second comes *Hon Hai* of Taiwan (better known under its trade name *Foxconn*), which employs 1.1 million people, which is about as many as living in Estonia or in the cities of Milan or Munich.

### risk management

The identification and assessment of risks and the actions taken to minimize their impact.

### LEARNING OBJECTIVE

- 5 Summarize some basic trends in the global economy

**Table 1.2** Top 25 economies in 2013

	Country	GDP (€ billion)	Population (million)	Exports (€ billion)	Stock of Outward FDI (€ billion)
1	USA	13 479	319.3	1264	5 166
2	China (PR)	7413	1367.2	1773	492
3	Japan	3932	127.1	559	797
4	Germany	2916	80.8	1198	1 372
5	France	2198	66.1	464	1 313
6	UK	2023	64.1	652	1 512
7	Brazil	1802	203.6	196	235
8	Russia	1682	146.3	413	402
9	Italy	1662	60.8	380	480
10	India	1506	1264.1	251	96
11	Canada	1466	35.5	368	588
12	Australia	1259	23.7	202	191
13	Spain	1090	46.5	367	516
14	South Korea	1047	50.4	447	176
15	Mexico	1012	119.7	298	115
16	Indonesia	697	252.2	144	13
17	Turkey	658	76.7	134	26
18	Netherlands	642	16.9	463	860
19	Saudi Arabia	598	30.8	302	32
20	Switzerland	522	8.2	184	1 010
21	Argentina	491	42.7	68	27
22	Sweden	448	9.7	146	350
23	Nigeria	419	178.5	75	7
24	Poland	415	38.5	162	44
25	Norway	411	5.2	124	185

Sources: (1) IMF, 2014, *International Financial Statistics*, Washington: IMF; (2) UNCTAD, 2014, *World Investment Report*, Geneva: United Nations.

Many of these big companies do most of their business overseas, as indicated by the transnationality index (TNI), which measures the share of activities outside the home country. Most of the largest firms do more than half of their business abroad, especially those originating from a small country. An unusual case is *Arcelor Mittal* (TNI = 89.0%), which is registered in Luxembourg, although it is controlled by the Indian Mittal family and has operations spread across Europe and Asia. Why activities in different countries are organized within a single firm – an MNE – is the focal question of Chapter 6.

**Table 1.3** Top 25 companies by revenues in the global economy

	Company	Headquarters	Industry	Sales (€ billion)	Assets (€ billion)	Employment	TNI*
1	<i>Walmart</i>	USA	Retailing	486	199	2 300 000	29.3
2	<i>Toyota</i>	Japan	Cars	255	436	348 877	60.2
3	<i>Volkswagen</i>	Germany	Cars	240	432	626 715	60.3
4	<i>Royal Dutch Shell</i>	UK	Petroleum	234	411	92 000	74.3
5	<i>Exxon Mobil</i>	USA	Petroleum	219	330	71 100	52.1
6	<i>Apple</i>	USA	Info technology	216	322	166 000	47.9
7	<i>BP</i>	UK	Petroleum	183	263	74 500	74.9
8	<i>Samsung</i>	Korea	Info technology	174	218	325 677	55.1
9	<i>Daimler</i>	Germany	Cars	170	256	282 488	59.6
10	<i>General Motors</i>	USA	Cars	166	222	225 000	32.7
11	<i>Glencore Xstrata</i>	Switzerland	Mining	153	125	154 832	74.9
12	<i>Ford</i>	USA	Cars	152	238	201 000	38.1
13	<i>Total</i>	France	Petroleum	142	243	102 168	80.9
14	<i>Amazon</i>	USA	e-commerce	136	83	341 400	62.7
15	<i>Hon Hai (Foxconn)</i>	Taiwan	Manufacturing	135	80	1 061 465	83.5
16	<i>Honda</i>	Japan	Cars	129	170	208 399	77.6
17	<i>General Electric</i>	USA	Machinery	124	365	295 000	56.8
18	<i>Fiat Chrysler</i>	UK	Cars	123	110	234 499	77.7
19	<i>Chevron</i>	USA	Petroleum	111	260	55 200	57.9
20	<i>Nissan</i>	Japan	Cars	108	165	152 421	70.1
21	<i>Nippon Telegraph</i>	Japan	Telecom	105	190	241 448	26.0
22	<i>BMW</i>	Germany	Cars	104	199	124 729	56.1
23	<i>Nestlé</i>	Switzerland	Food	91	129	328 000	92.5
24	<i>Alphabet</i>	USA	e-commerce	90	167	72 053	33.3
25	<i>Siemens</i>	Germany	Machinery	88	140	351 000	65.9

\*TNI (transnationality index) = average of three ratios: foreign/total assets, foreign/total employment and foreign/total sales.

Note: Data refer to the world's top 100 non-financial TNCs, ranked by foreign assets, 2016.

Source: UNCTAD, 2017, *World Investment Report 2017 (Table 24)*, Geneva: United Nations.

Table 1.4 documents the change in the makeup of the 500 largest firms listed by *Fortune* magazine. In general, over 80% of the 500 largest firms used to come from the Triad (North America, Europe and Japan). Since 1990, the USA has contributed about one-third of these firms, the EU has maintained a reasonably steady increase, and Japan has experienced a dramatic variation corresponding to its economic boom and bust, with several years of delay. Among MNEs from emerging economies, those from China have come on strong – from zero in 1990 to 102 in 2017. Beijing is now the headquarters of 52 Fortune Global 500 firms, followed by Tokyo (41) and New York (20). The rise of emerging economy MNEs will be a theme running throughout this book (e.g. Integrative Cases *Xiaomi* and *SG Group*).

**Table 1.4** Changes in the *Fortune Global 500*, 1990–2014

Country	1990	1995	2000	2005	2010	2014	2017
USA	164	153	185	170	133	128	133
EU	129	148	136	165	149	121	118
Japan	111	141	95	70	68	57	51
Korea (South)	11	12	8	12	10	17	15
Switzerland	11	16	10	12	15	13	13
Canada	12	6	13	14	11	10	11
China	0	2	10	20	61	95	102
Brazil	3	4	3	4	7	7	7
Russia	0	0	2	3	7	8	4
India	0	1	1	5	8	8	7
Others	59	17	37	25	31	36	39
Total	500	500	500	500	500	500	500

**Sources:** Based on data from various issues of *Fortune Global 500*. Finland and Sweden are included as 'others' prior to 1996 and as European Union after 1996; China includes Hong Kong since 1997.

## IMPLICATIONS FOR PRACTICE

### LEARNING OBJECTIVE

- 6 Draw implications for action by integrating global and local knowledge

The field of IB is full of debates. First, policy debates concern how societies should influence the path of globalization (see Chapters 8 and 9). Second, debates concern the responsibility of business towards the consequences of globalization, often discussed under the topic of corporate social responsibility (Chapter 10). Third, businesses debate how they can develop their strategies to take advantage of the opportunities of globalization (Chapters 11 to 14). Fourth, managers debate how to manage people and organizations exposed to the trends of globalization (Chapters 15 to 17). Be prepared for a lot of debates as you go through the course of IB!

It is important to approach these debates with an open mindset to recognize international connections and analyze their implications. There are two traps when engaging

in IB. The first is to believe that the 'best practices' that your organization has developed in one place should consistently be rolled out worldwide. Such a view is often taken by people who have an **ethnocentric perspective**, i.e. they view the world through the lens of their own culture and believe in the superiority of that culture. Their confidence in their 'superior practices' may be grounded in success in their own country, prior to growing their business internationally. On the other hand, some people reject advice from outside because of the advisors' presumed lack of local knowledge. Let's call them 'exceptionalists'. Their **not-invented-here syndrome**,<sup>34</sup> which is a tendency to distrust new ideas coming from outside of one's own organization or community, is particularly prevalent in countries with distinct social histories and limited international exchange; China and Russia at the onset of economic transition were prime examples.

Neither of the two is likely to enjoy long-term success in IB. Those approaching IB with an ethnocentric perspective will hit a wall when their 'best practices' fail to deliver; complaints about the incompetence of local employees or customers are symptoms of that phenomenon. The exceptionalist is likely to fail even in their home country because international competition is a reality virtually everywhere (at least in Europe). Complaining about foreigners enjoying unfair advantages makes for good media coverage but not for a viable business. There is a lot you can learn from other countries – no matter how good you already are – if you observe others with an open mind.

Successful managers operate within the spectrum between universalists and exceptionalists. Some practices may be effective in a wide range of different countries but may need fine-tuning to accommodate local idiosyncrasies. At the same time, each country has unique institutions, but adapted practices informed by experiences elsewhere may outperform traditional local practices. In other words, successful managers not only *know* about global best practices and local idiosyncrasies but they are able to *integrate* such knowledge to develop practices that outperform competitors in a given context.<sup>35</sup>

Hence, as an international manager, you have to iterate across levels: think global, think local and integrate those two lines of thinking (Table 1.5)! Global economic linkages affect virtually every business. For example, supply chains crossing countries and continents face risks of disruptions through local events that impact businesses at the other end of the world. Such disruptions may be caused by natural disasters such as epidemics (like Ebola or avian flu), earthquakes, typhoons, tsunamis or volcanic eruptions. For example, when volcano Eyjafjallajökull erupted unexpectedly in 2010, aircraft across Europe were grounded and many firms had to stop production because components could not be delivered on time. Other disruptions are man-made. For example, the financial crisis of 2008/9 spread rapidly from the USA through the financial sector to banks in numerous countries and caused an unprecedented credit squeeze as inter-bank lending came to a virtual halt. This in turn hit the real economy as businesses faced liquidity squeezes and consumers cut back their expenses.<sup>36</sup> Businesses operating around the globe thus have to continuously ask questions about their business environment and be able to respond flexibly.

**Table 1.5** Implications for practice

- Think global.
- Think local.
- Integrate your global and local knowledge.
- Communicate effectively with those who are not in the global jet set.

**ethnocentric perspective**  
A view of the world through the lens of one's own culture.

**not-invented-here syndrome**  
The tendency to distrust new ideas coming from outside of one's own organization or community.

At the same time, you have to think local. Every country has its own peculiarities. In this book we are emphasizing the institutional view as a conceptual lens to identify and analyze such idiosyncrasies. Consider two examples of local knowledge. First, Europe shares common rules that are created by the EU and which are implemented by national governments (Chapter 8). Yet not all is harmonized in the EU. For example, the rules by which we elect political leaders are very different. Similarly, what is or is not acceptable business practice still varies across countries.

As another example, consider China. In only four years, *Xiaomi* became the largest mobile phone manufacturer in China and number four in the world (see Integrative Case). *Xiaomi* certainly learned from the best in the world, yet fundamentally its business model was grounded in deep understanding of Chinese consumers, the evolution of online business models in China and access to the best manufacturing sites in China. Deeply grounded in China, they need to develop a deep understanding of, say, India in their drive to expand overseas.

In the complex interaction of global and local forces, many business leaders are well at ease with globalization and its opportunities. As **cosmopolitans**, they embrace the cultural diversity and the personal and professional opportunities that globalization brings. Most elites in both developed and emerging economies – executives, policymakers and scholars – tend to adopt cosmopolitan views.<sup>37</sup> In fact, many business school students already share the beliefs and biases in favour of globalization.<sup>38</sup>

Yet the fact that these elites share certain perspectives on globalization does *not* mean that other members of society share the same views. Those other people are important to you, even if you one day find yourself as a leader of a major MNE and join the global jet set. Those people work for your company, they buy your products – and they vote in the elections for the governments that eventually set the rules under which your business operates. It is not enough to mix with the global jet set, you also need to empathize with people who spend most of their lives in their home town and rarely engage with people outside their country. They may be very concerned about how globalization affects them. They want to be taken seriously too. Thus, as a business leader you have to be aware of the fundamental debates around globalization and find constructive ways to engage with them.

#### cosmopolitans

The people embracing cultural diversity and the opportunities of globalization.

## CHAPTER SUMMARY

- 1 Explain the concepts of international business (IB)
  - IB is defined as (1) a business (firm) that engages in international (cross-border) economic activities and (2) the action of doing business abroad.
  - This book places special emphasis on the challenges faced by European businesses and the challenges of emerging economies.
- 2 Articulate what you hope to learn by reading this book and taking this course
  - To better compete in the corporate world that will require global expertise.
  - To enhance your understanding of what is going on in the global economy.
- 3 Identify one fundamental question and two core perspectives that provide a framework for studying this field
  - Our most fundamental question is: What determines the success and failure of firms that cross national boundaries?
  - The two core perspectives are (1) the institution-based view and (2) the resource-based view.
- 4 Participate in the debate on globalization with a reasonably balanced and realistic view
  - Globalization has created unprecedented contacts between nations and cultures, with both positive and negative consequences for individuals.

- Globalization has been evolving in waves, with a major peak in the late 19th/early 20th century.
  - The recent wave of globalization has accelerated with the rising powers of emerging economies, yet it remains highly volatile.
- 5 Summarize some basic trends in the global economy
    - MNEs, especially large ones from developed economies, are sizeable economic entities.

- 6 Draw implications for action by integrating global and local knowledge
  - International managers need to think global, think local and integrate the two perspectives.
  - People with cosmopolitan worldviews and experience need to remember that not everyone shares their broad perspectives and experiences.

## KEY TERMS

Base of the pyramid	Foreign direct investment (FDI)	Liberalization
BRIC	Globalization	Multinational enterprise (MNE)
Cosmopolitans	Gross domestic product (GDP)	Not-invented-here syndrome
Emerging economies (emerging markets)	Gross national income (GNI)	Purchasing power parity (PPP)
Ethnocentric perspective	Gross national product (GNP)	Risk management
Expatriate assignments	International business (IB)	Triad
	Liability of outsidership	Waves of globalization

## CRITICAL DISCUSSION QUESTIONS

- 1 A classmate says: 'Global business is relevant for top executives such as CEOs in large companies. I am just a lowly student who will struggle to gain an entry-level job, probably in a small domestic company. Why should I care about it?' How do you convince her that she should care about it?
- 2 A classmate says: 'The world economy has changed so much; all those textbooks and historical cases don't really help me in the 21st century.' How do you convince him that he should care about lessons from the past?
- 3 What are some of the negative impacts of globalization on people and societies? How can business leaders make sure that the benefits of their various actions outweigh their drawbacks?
- 4 Some argue that aggressively investing in emerging economies is not only economically beneficial but also highly ethical because it may potentially lift many people out of poverty (see Closing Case). However, others caution that in the absence of reasonable hopes of decent profits, rushing to emerging economies is reckless. How would you participate in this debate?

## RECOMMENDED READINGS

- R. Baldwin, 2016, *The Great Convergence: Harvard University Press*** – an esteemed economist analyzes the challenges of globalization.
- P. Dicken, 2015, *Global Shift: Mapping the Changing Contours of the World Economy, 7th ed., London: Sage*** – a thorough analysis of the economic trends of globalization in a variety of industries.
- R. Grosse & K.E. Meyer, eds, 2018, *Oxford Handbook of Managing in Emerging Markets, Oxford: Oxford University Press*** – provides in-depth overview of the state of the art of management research related to emerging markets.
- K.E. Meyer, 2011, *What is and to what purpose do we study international business? AIB Insights 13(1): 10–13*** – an essay reflecting on why IB is an important field for study and research.
- M.W. Peng, 2004, *Identifying the big question in international business research, JIBS, 35: 99–108*** – outlines an agenda for IB scholars focused on the performance of firms in the global economy.
- T. Piketty, 2014, *Capital in the Twenty-First Century, Cambridge, MA: Harvard University Press*** – a much-discussed book offering a lot of data to support the argument that globalization causes increased inequality within countries.



## CLOSING CASE

### Global business in the digital age: Airbnb

Global digital networks such as *Facebook* and *Twitter* enable instant communication around the world. Companies such as *Apple*, *Uber* and *Spotify* use digital platforms to interact with customers around the world. So, how swiftly can such digital businesses sweep around the globe? One company that has succeeded in spreading around the globe in less than ten years is *Airbnb*, which has been described as 'Silicon Valley's most global unicorn' (a unicorn is a start-up that attracts an investor valuation in excess of US\$1 billion).

*Airbnb* was started in San Francisco, California, in 2008 by two students. Their idea was to let private individuals share their home with travellers, thus offering hosts a small income while travellers could stay in a more personal place at a lower cost than in a hotel. *Airbnb* thus acts as the middleman or broker between hosts and guests and collects a service fee for each booking. A key challenge for their business model is to create trust between hosts and guests. Thus, *Airbnb* has created various processes for hosts and guests to get to know one other and to verify their identity, along with safety features that either can call upon when something goes wrong. By 2018, *Airbnb's* database contained 4.5 million listings in 81 000 cities in 191 countries. Two-thirds of its booking were across national borders, with Europe as the largest market.

*Airbnb* established its first overseas subsidiary in Hamburg in 2011 by taking over local start-up *Accoleo*. Soon offices in London, Paris, Milan, Barcelona, Copenhagen, Moscow and Sao Paulo followed. Worldwide, *Airbnb* employed 3100 people in 19 offices in 2018.



Since 2013, European operations have been coordinated from a regional headquarters in Dublin, Ireland.

Why does a digital economy business need local offices? Can't they just do business over the internet? No. Some things may be global, such as the cleanliness standards expected of hosts, or the software used to bring hosts and guests together. However, even in the digital age, local touch is important. As *Airbnb* operates a two-sided platform, it needs both hosts and guests to sign up to build a critical mass in any particular market. Developing the supply side of hosts is often the more challenging part. For hosts to sign up to *Airbnb* and thus to let strangers stay in their home, trust in *Airbnb's* processes is essential.

In new markets, thus, the recruitment of hosts is driven by local or regional initiatives. For example, *Airbnb* may send a team of two or three people to the area to arrange info sessions, set up info booths and throw parties – and thereby sign up hosts and develop a better understanding of the local tourism market. *Airbnb* found that in-person recruitment was, for initial entries, more effective than *Facebook* ads and other digital marketing approaches in generating new users.

Moreover, translation is a big issue: hosts in Italy are likely to describe their offerings in Italian, but how will potential hosts from, say, Sweden be able to read that information? Using machine translation to translate everything into English would lead to inefficient communications and misunderstandings. Thus, *Airbnb* developed a customized translation management system which prioritizes translations based on the views a page receives. When the system recognizes a new phrase, it will take a screenshot and send it to human translators, including both in-house professionals and

crowd-sourced freelancers. The translation covers an increasing number of languages and even captures the subtle differences between US, English and Canadian variants of English, or converting 'B' to 'ss' when displaying German input to a Swiss reader. Moreover, automatically translating everything into English may put off some potential guests from within Italy. Thus information is usually displayed in the local language by default, with English translation just one click away.

Effective service in different countries also requires adaptation of, for example, payment options and currencies, sign-up methods and identity verification procedures. For example, in the USA, email and a *Facebook* accounts attract customers, while in China *Weibo* or *WeChat* are more functional in attracting travellers. Supplementary web content such as recommendations for tourist sights and activities is generally sourced locally.

Also regulatory and taxation issues vary across countries and even across cities. Most places have rules for hotels and even for bed & breakfasts, and thus it is often a contentious issue whether such rules apply to *Airbnb* hosts. Do they have to, for example, provide the same health and safety standards? Do they have to pay local hospitality taxes where hotels

are liable to such taxes? Do *Airbnb* revenues count for income tax? Some cities are even concerned that apartments rented out to *Airbnb* drive up rents, or lead to a shortage of apartments to rent by, for example, students staying for an entire year. To deal with such local issues, *Airbnb* needs to have its own people nearby who understand the issues and can support their hosts and guests.

### CASE DISCUSSION QUESTIONS

- 1 In the digital age, what barriers do entrepreneurs face wishing to expand their business globally?
- 2 For local businesses, such as *Airbnb* hosts, what are the key challenges of partnering with a digital economy firm based in another country?
- 3 As a traveller, what do you see as the main pros and cons of using *Airbnb* for your next trip to an unfamiliar country?

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## NOTES

For journal abbreviations, please see pages xviii–xix.

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