International Management: Strategic Opportunities and Cultural Challenges

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chapter 1

on a global stage

the world of international management

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Learning Objectives

After reading this chapter, you should be able to:

- describe today's competitive environment in international business;
- identify major trends, both positive and negative, in international business;
- describe how managers can respond to international business challenges;
- identify key foundation concepts in international management.

International Challenge

New Balance: Still Running with Production in the United States

Athletic shoes are everywhere, as are brand names such as Nike. The industry's largest firms have all of their shoes made in low-wage locations such as China, Vietnam, and Indonesia, usually in factories owned and run by foreign subcontractors. Started in 1906 by an immigrant from England, New Balance Athletic Shoe, Inc., is a major player in the athletic shoe industry worldwide. New Balance also has foreign subcontractors. Stroll down the aisle of a subcontractor's plant in China and you will see young women performing repetitive sewing tasks to produce New Balance shoes and earning very little, at least by American and European standards.

Of course, the idea is that by reaping big labor savings companies can earn much higher profits. Plus, some argue that developed economies are better off when low-skill, low-wage jobs can migrate to countries where labor is cheap and plentiful. But New Balance really is different. Unlike its main competitors, New Balance has 1,300 employees making 7 million pairs of shoes annually in its five U.S. factories. A few years ago, New Balance opened a new state-of-the-art research facility at its Lawrence, Massachusetts, manufacturing site to develop innovations and new products. Overall, New Balance makes about 25 percent of its shoes sold in America at its U.S. factories.

But what is interesting is that, the enormous gap in labor costs notwithstanding, the difference in total costs between the Chinese and American plants is not that great. In China, the total cost of producing a pair of shoes is about $3 less than in the U.S., only around 4 percent of the price for the average shoe. And that 4 percent is manageable, especially since American production means New Balance can fill orders and change styles more quickly than its competitors in the U.S.

New Balance narrows the costs of producing in the United States enough to compete effectively by being extraordinarily efficient. Its American employees produce a shoe from scratch in less than 25 minutes compared to three hours in China. So, what accounts for the American plants' productivity and efficiency? And what role does management play in all of this? As you read through this introductory chapter, you will notice that change is a
International Business: A World of Constant Change

Even if you’re on the right track, you’ll get run over if you just sit there.
—Will Rogers, American social commentator and humorist

Will Rogers’ words are from the early twentieth century. Yet, his observation perfectly captures the challenge of international business in the twenty-first century. Indeed, Rogers’ words underscore that today’s international managers must be nimble, innovative, and adaptable. They must bridge cultural boundaries and cope with extraordinary global competition that changes and evolves at a pace that is faster than ever. Competitors can pop up quickly from anywhere, including emerging countries (such as China or India), while new technologies appear overnight.

Other factors that contribute to this “new normal” of international business include global trends toward increased outsourcing of components, flexible manufacturing, and greater reliance on logistics systems that can deliver parts as needed (i.e., on a “just-in-time” basis). These trends have helped China and other emerging nations with cost advantages, such as labor and materials, attract investment, develop home-grown technologies, and build competitiveness. Of course, astounding innovations in information technologies have made it possible for firms to manage inventories, interact with employees, collect customer data, and track shipments around the world 24 hours a day, seven days a week.

The ubiquitous availability of information technology also allows companies to scour the planet for the best talent at the best price. Wireless technologies, along with clever local partnerships, are allowing companies to reach hundreds of millions of new customers in poor economic areas of India and Africa with cell phone and other wireless services, despite the weak technological infrastructures within those locations. Overall, technology enables companies to stitch together far-flung outposts as well as reach new customers, both of which will help grow international business over the long haul.

Globalization and the World Trade Organization

In essence, technology facilitates the interconnections between national economies. This ongoing connecting process, known as globalization, has increased international growth, particularly in emerging economies. In the past 20 years, the value of international trade
has surged over 400 percent to more than $18 trillion annually. As tariffs and trade barriers slowly fade, the growth in international business should continue. Indeed, just a 1 percent reduction in the cost of international trade could boost income globally by $40 billion.\(^5\)

Of course, plenty of concerns remain in the meantime. For instance, consider the World Trade Organization (WTO). This governing body is made up of 159 member countries (as of 2014), and sets the global rules for trade. Determining those rules typically requires protracted negotiations, the latest series of which is known as the Doha Round (begun in 2001 and still used today). The WTO also has elaborate mechanisms to enforce its rulings on trade disputes between members. A key goal for the WTO is to reduce barriers and stimulate trade worldwide.\(^6\)

The WTO, however, is also a battleground for national interests and a lightning rod for criticism about globalization. For example, in responding to the charge that globalization destroys jobs and increases the gap between rich and poor, the WTO argues that freer trade promotes job creation and wealth building over the long haul. Naturally, the WTO’s critics are unlikely to be persuaded. Regardless, what is not in dispute is that the trade issues the WTO wrestles with are very complex. For instance, a single dispute between the United States and the European Union (EU) over banana tariffs (a government-imposed tax on imports) took several years to resolve. Of course, the WTO is not the only body that governs international trade. The growth of regional and bilateral free trade agreements in recent years has been enormous. While these agreements have many advantages and are generally positive, they also can make managing broader economic issues more difficult and complex, especially as new powerhouses such as Brazil, China, and India continue to flex their economic muscle.\(^7\)

**Our Plan for This Chapter**

Trade agreements and the WTO notwithstanding, international managers should expect downturns and setbacks to occur, sometimes in the blink of an eye. Overall, grappling with the speed of change and the increasing complexity of international business makes the role of management—and the stakes—more important than ever. If you are wondering how international business leaders view the threats and challenges facing them, look at Figure 1.1. It summarizes the threat perceptions of roughly 1,400 international CEOs. As you can see, international executives have plenty of things to worry about.\(^8\)

Yet, all companies face challenges and there are many good reasons to be fundamentally optimistic about the long-term prospects for international business. Consequently, the goal of this chapter is to give you a sense of the trends, opportunities, and challenges facing international managers today. It is also important to sketch out how firms approach international competition as well as provide a snapshot of the major players in the global economy. The chapter begins by describing how international business has grown in recent years, as well as profiling the countries and regions playing important roles in that growth.
Globalization and the Growth of International Business

Today, many companies look for ideas, workers, materials, and customers everywhere. Tough competitors can appear from anywhere. As one European manager put it, “The scope of every manager is the world.” Needless to say, managing that way is not easy. Among other things, it requires worldwide information networks, a supportive corporate culture, and the ability to tap into local needs and initiatives when they exist. For instance, Electrolux, the Sweden-based appliance maker, routinely rotates hundreds of appliance designers through the eight design centers it has scattered around the world. The idea is to expose people to different ways of thinking and the often divergent appliance needs people have in different parts of the world. By doing so, Electrolux hopes to speed up product development and be more innovative—something it must do to thrive in the face of tough competition from America’s Whirlpool and China’s Haier brands. But there is no single answer. For some companies, just letting local managers pursue their own ideas is a big step forward.9

The Hottest Areas for Growth and Investment

So, where is all the growth in international business occurring? One way to measure things is by the flow of foreign direct investment (FDI) into a particular country over several years. More than just capital, FDI also means that managerial knowledge and technical know-how is flowing into a country from outside its borders. As such, FDI is a good measure of a country’s prospects on the international business stage, either as

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<tr>
<th>Threat Issue</th>
<th>Overall Rank</th>
<th>% Mentioning</th>
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<tr>
<td>Over-regulation</td>
<td>1st</td>
<td>18%</td>
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<tr>
<td>Increased international competition</td>
<td>2nd</td>
<td>17%</td>
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<tr>
<td>Currency fluctuations</td>
<td>3rd</td>
<td>15%</td>
</tr>
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<td>Price deflation</td>
<td>4th</td>
<td>11%</td>
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<td>Loss of critical talent</td>
<td>5th</td>
<td>11%</td>
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<td>Global terrorism</td>
<td>6th</td>
<td>10%</td>
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<td>Risk to reputation (i.e., anything</td>
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<td>that might hurt the firm’s image or</td>
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<td>reputation)</td>
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<tr>
<td>Cost of capital</td>
<td>8th</td>
<td>8%</td>
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<tr>
<td>Emerging technologies</td>
<td>9th</td>
<td>6%</td>
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<td>Corporate governance issues</td>
<td>10th</td>
<td>5%</td>
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Figure 1.1 What Keeps Them Up at Night: International CEOs List Their Top Ten Threats.
Source: Adapted from Champion, M. (2004). CEOs’ worst nightmares. The Wall Street Journal, January 21, A13. Note that the total percentage exceeds 100 since CEOs could mention multiple threats.
Country | FDI Inflow (in $ billions)
---|---
U.S. | 198
China | 14
Hong Kong | 83
Brazil | 49
United Kingdom | 51
Australia | 36
Singapore | 54
Russia | 43
Canada | 29
Spain | 40
India | 21
France | 34
Sweden | 6
Mexico | 21
Turkey | 9
Developed Countries | 696
Developing Countries | 637
Total World FDI | 1400

Figure 1.2 Top Foreign Direct Investment Magnets in 2010 and 2012.


an established market or an emerging one. Figure 1.2 lists the top FDI magnets in 2010 and 2012.

The total worldwide inflow of FDI was roughly $1.3 trillion in 2012, with 52 percent of that total being invested in developing countries—the first time developed countries as a group saw less investment. As you can see from Figure 1.2, the U.S. was the single biggest recipient of FDI in 2012 among developed countries. Yet, China and Hong Kong (combined) raked in $191 billion in 2012 to lead the pack among developing countries. On a percentage basis, Africa was the region with the biggest recent increases in FDI inflows. Overall, experts predict FDI inflows worldwide will grow in the years ahead, perhaps reaching as high as $2.0 trillion by 2017. Interestingly, developing countries are also investors that, collectively, represent an increasing share of where FDI comes from. What are now commonly referred to as the BRICS countries (Brazil, Russia, India, China, and South Africa) collectively accounted for 10 percent of the total FDI outflow in 2012. Indeed, China alone was the third largest investor country in the world in 2012 after the U.S. and Japan. Clearly, China is an emerging economic power—one that both attracts significant FDI and has increasing clout as an investor nation.10

In essence, much of the growth in international business continues to occur outside the traditional economic powerhouses such as the U.S., Germany, and Japan. For instance,
China's economy has expanded by a factor of ten over the past 30 years. Granted, the U.S. may not be growing as fast, but it remains the biggest economy in the world. At $16.2 trillion worth of gross domestic product, the U.S. eclipses second-place China’s $9 trillion. Yet, statistics underscore that trade among the U.S., Japan, and the EU is becoming less important over time while trade with developing nations and trade within regions is growing. For instance, U.S. trade with Japan shrank after passage of the North American Free Trade Agreement (NAFTA), with regional partners Mexico and Canada making up the difference.11

Clearly, the total value of economic activity in a country, or gross domestic product (GDP), has generally been growing at a much faster rate in developing rather than developed nations. Consumer demand in developing markets is rising as citizens become more affluent and have more disposable income. Consequently, many American, European, and Japanese firms consider developing countries as markets where they can reach out to populations eager for new products and services as their income rises. Indeed, companies everywhere are increasingly creating products squarely aimed at developing markets, where incomes, albeit rising, are still lower than those in the developed world. This helps explain why Indian firms have designed $23 stoves and $70 battery-powered refrigerators for their local market. Foreign giants such as General Electric are taking notice, creating cheap, innovative products for developing markets.12

While we tend to think of large firms when international trade comes to mind, do not forget about small companies. Starting in 1995, firms with fewer than 500 employees accounted for a bigger share of total manufactured exports than large firms for the first time. Exports by small U.S. businesses have grown every year since that time, many facilitated by government agencies such as the Office of U.S. Trade Representative and the Small Business Administration. In 2010 small U.S. businesses exported nearly $270 billion, up nearly 70 percent since 1995. Overall, small businesses now account for 98 percent of known U.S. exporting companies (although they account for a smaller percent, 31 percent, of the overall value of U.S. goods exports). Even small start-up companies are in the mix, often thanks to the Internet—technology that puts customers and outsourced help (e.g., for marketing, customer support) in easy reach.13

A Snapshot of Regional Trends

This section offers brief snapshots of important trends in specific countries and regions. Special attention is paid to key developed nations as well as to their developing brethren.

The Americas

United States

Steady, if unspectacular, economic growth seems to be the watchword for the U.S. in the near term. In 2014, while low interest rates continued and energy production soared, corporate investment generally remained weak, as did job and income growth. Throw in government gridlock and China inching closer to seize the mantle of the world's
biggest economy and it is easy to see why many Americans are concerned about the future going forward. In particular, some feel angst about the increasing presence of Chinese companies buying American businesses (for example, Lenovo’s purchase of IBM’s personal computing unit) or investing in commercial property (such as a restaurant complex in Toledo, Ohio).14

Others point to the trade deficits that the U.S. has been running for many years. For instance, thanks to stronger exports, the U.S. trade deficit in 2013 was just over $470 billion—a sizeable drop from the $535 billion deficit in 2012. Of course, these are still large gaps regardless, with the U.S. continuing to import more goods from other nations than it exports. China is one of the U.S.’s top trading partners and accounts for a large chunk of annual U.S. trade deficits. That said, the United States does have trade surpluses with a variety of countries. Figure 1.3 lists countries producing the top five deficits and top five surpluses with the United States in recent years. 15

But the United States remains a huge target for foreign investment and, over the past 20 years, has accounted for roughly a third of global economic growth. While some of its advantages are eroding, the U.S. still leads in knowledge creation, innovation, entrepreneurship, higher education, and information technology. In essence, the United States has the most creative economic environment in the world.16

Today, prominent American multinational corporations enjoy considerable success worldwide. For instance, consumer products giant Colgate operates in over 200 countries, with foreign sales accounting for 75 percent of the firm’s revenues. In 2012, 132 of the 500 largest companies in the world were American. Yet, back in 2002, over 185 of the biggest firms were U.S.-based. Figure 1.4 presents the world’s ten largest companies in both 2002 and 2012. Even in this abbreviated list, it is clear that large energy companies are more dominant now than they were in 2002. Moreover, Sinopec, a Chinese energy firm, was not listed in 2002, but was among the top ten largest companies in 2012. This underscores the rapid growth of multinational corporations from developing countries over the past 15 to 20 years. In 1997, there was only one firm from a developing

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**Figure 1.3** A 15-Year Snapshot of America’s Trade Goods Deficits and Surpluses with Top Five Partners.

* Value of imports + exports; all values in $ billions.

**Source:** Adapted from www.census.gov/indicator/www/ustrade.html.
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<tbody>
<tr>
<td>1. Royal Dutch/Shell</td>
<td>485.5</td>
<td>Netherlands</td>
<td>Energy</td>
<td>1. Wal-Mart</td>
<td>240.53</td>
<td>U.S.</td>
<td>Retail</td>
</tr>
<tr>
<td>2. Exxon Mobil</td>
<td>452.9</td>
<td>U.S.</td>
<td>Energy</td>
<td>2. GM</td>
<td>186.76</td>
<td>U.S.</td>
<td>Auto</td>
</tr>
<tr>
<td>4. BP</td>
<td>386.5</td>
<td>Britain</td>
<td>Energy</td>
<td>4. Royal Dutch/Shell</td>
<td>179.43</td>
<td>Nether-lands</td>
<td>Energy</td>
</tr>
<tr>
<td>5. Sinopec</td>
<td>375.2</td>
<td>China</td>
<td>Energy</td>
<td>5. BP</td>
<td>178.72</td>
<td>Britain</td>
<td>Energy</td>
</tr>
<tr>
<td>7. State Grid</td>
<td>259.1</td>
<td>China</td>
<td>Energy</td>
<td>7. Daimler-Chrysler</td>
<td>141.42</td>
<td>Germany</td>
<td>Auto</td>
</tr>
<tr>
<td>8. Chevron</td>
<td>245.6</td>
<td>U.S.</td>
<td>Energy</td>
<td>8. Toyota</td>
<td>131.75</td>
<td>Japan</td>
<td>Auto</td>
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Figure 1.4 World's Largest Companies by Revenue: Comparing the Top Ten in 2012 and 2002.

nation large enough to be among the 500 largest companies in the world. In 2012, however, China alone had 73 companies on the top 500 list. NAFTA has dramatically increased trade and investment among the three signatory countries by gradually eliminating tariffs, import quotas, and barriers to foreign ownership.

Canada

America’s northern neighbor emerged from the 2008–2009 financial crisis in reasonably good shape, though it will likely trail U.S. growth rates over the near term. Canada has low corporate tax rates at the federal level that promote business investment and it embraces cultural diversity. Yet, it remains joined at the hip to the U.S., with roughly 75 percent of Canadian goods exported to American customers. Indeed, Canada’s relationship with the U.S. is fraught with awkward comparisons. Canada and the United States are each other’s largest trading partner. But Canada’s smaller economy (less than 10 percent the size of the U.S.’s) is much more dependent on foreign trade. Canada frets about keeping up with its giant neighbor, at least in certain respects. Put simply, Canadians are taxed more and paid less than their American neighbors. Nevertheless, Canada’s situation is enviable, both as a place to live and a place to invest.
Mexico

Predating NAFTA was the maquiladora sector. Established by the government, maquiladoras are foreign factories that can import parts and materials into Mexico duty free, as long as they are used to make products for export. Most maquiladoras are in Mexico’s northern states, adjacent to the primary destination for their exports—the United States. NAFTA’s implementation was a huge boost to the maquiladora sector. In less than ten years, maquiladoras created some 800,000 new jobs as foreign companies, including American household names such as Ford and General Motors, came in to set up shop. Today, while Mexico still faces significant challenges, including crime and corruption, it also has a large and open economy where nearly 70 percent of the national GDP comes from international trade.  

Like Canada, Mexico is inextricably tied to its American neighbor. Indeed, Mexico sends 90 percent of its exports to the U.S. Because wages have been rising in China, labor cost differences between Mexico and Asia’s manufacturing powerhouse are now minimal. Combine that with cheaper and faster access to American customers and it is no wonder that having Mexico as an export platform is more compelling than ever for foreign companies such as Honda. Mexico also has some impressive multinationals in its own right, including Grupo Bimbo, a Mexican food company that recently bought part of U.S.-based Sara Lee and is planning to invest some $1 billion north of the border in the next few years.

South America

Experts now estimate that 30–50 percent of the population of this important region is now middle class with significant disposable income. Regardless of the precise definition of “middle class,” the current situation represents a dramatic improvement from 10 to 15 years ago and is largely the result of faster economic growth in the region. The causes of that growth are multifaceted to say the least, but include a variety of economic and educational reforms that most expect will continue. Granted, the pace of reforms is likely to be uneven. Generally speaking, countries enacting the most significant reforms, such as Chile, have done better than countries that made fewer changes, such as Ecuador. The region has also been prone to instability because of its dependence on foreign capital. In short, capital can move in or out of the region quickly, depending on the whims of foreign investors and external events. Plus, poverty, corruption, and business infrastructure issues remain regionwide concerns.

Argentina, Chile, and Brazil are the region’s three largest economies. Brazil and Chile have arguably been the most successful in recent years. For instance, American and Indian information technology firms poured into Chile to take advantage of outstanding computer engineers, low wages, and a modern business infrastructure. Of course, with over 200 million people and a $2.3 trillion GDP, Brazil is by far the biggest economy in South America, and the eighth largest in the world (as of 2012). Brazil has some positives going for it, including better fiscal policies, demand for commodities and other exports, and growing offshore oil revenues. Winning the summer 2016 Olympics was also a coup for Brazil, providing impetus to improve the infrastructure, tackle persistently high crime, and reduce poverty in Rio de Janeiro. Overall, there is reason to be cautiously optimistic about the
long-term future for South America. Many South American countries are looking beyond the region for trading partners. For instance, over 40 percent of Mercosur (a trading block including Argentina, Brazil, Paraguay, and Uruguay) exports go to the European Union and the U.S.\(^\text{23}\)

### The Asia-Pacific Region

Excluding Japan, the Asia-Pacific region is the world’s fastest growing with a rising share of global GDP. For instance, growth was expected to average 5.7 percent for 2014, with 15 of 17 countries in the region predicted to exceed the world average. Generally speaking, the developing economies in Asia have been the most dynamic and fastest growing in the world for some time—expanding over 7 percent annually in the past 10 to 15 years, a rate more than twice that of the rest of the globe. That said, while Asian countries have some similarities, they also have many differences. Countries that have structural problems such as high government debt, weak corporate governance, and poor legal protections, and are also highly dependent on key overseas markets tend to be most vulnerable to economic shocks.\(^\text{24}\)

### China

Over the past 30 years, China’s ascendance has been astounding, with billions of foreign direct investment pouring in annually. For much of this period, foreign firms coveted China’s cheap labor and low costs while salivating at the prospect of serving over a billion increasingly affluent consumers. Yet, the bloom may be off the proverbial rose for foreign multinationals. Chinese labor costs have risen dramatically, top talent is tough to find, and the government is trying to steer the nation toward developing more sophisticated products while it encourages more local innovation. These and other factors are making it harder for foreign firms to do business, much less make money, in China. For instance, home-grown Chinese firms are now formidable global competitors in their own right, increasing the pressure on foreign firms (e.g., Alibaba in e-commerce, Huawei in smartphones and Haier in appliances). Moreover, foreign companies that approach China as one big market are likely in for trouble. China is a huge and diverse nation with a variety of regional differences, tastes, and languages (some 400 million Chinese speak a language other than Mandarin). As General Electric’s CEO Jeffrey Immelt simply put it, “China is big, but it is hard.”\(^\text{25}\)

Indeed, there are the formidable obstacles that China puts in front of foreign businesses, including a weak legal system and opaque government policies. China also effectively limits foreign competition in strategic industries, a list that includes financial services and telecommunications. Business in China is also guided by *guanxi* (relationships or connections built on mutual dispensing of favors) as much as by rules and laws. This can mean a long courtship for foreigners who want to “get down to business” quickly—perhaps six to twelve months of relationship building, if not more, to build personal trust and friendships before business issues can be addressed in depth.\(^\text{26}\)

Overall, China’s competitive intensity is extremely high. Competitors are legion and the pace of business activity is frenetic. In 2000, there were over 360,000 foreign firms
ON A GLOBAL STAGE

in China. In less than ten years, the number had soared to more than 660,000. No other country has experienced this kind of corporate influx in such a short period. Plus, millions of small, privately owned firms offer plenty of formidable competition in China. When we visited China, a manager at a U.S. consumer products firm said besides competing against other world-class multinationals such as Unilever, the company faced thousands of local competitors (mostly small, family-run enterprises) just in Shanghai alone!27

India

Inevitably compared to China, India has a $4.7 trillion economy and a population of 1.2 billion. But within a few decades, India’s population is expected to eclipse China’s. While India is getting ready, it is getting a late start compared to China, with much less foreign direct investment, a lower literacy rate, and a larger percentage of its population in poverty. But the gap with China is closing, especially in India’s southern states. Indeed, more than 50 percent of the population in these states, where much of India’s booming technology industry is based, should achieve middle-class status by 2025. Experts urge the Indian government to keep moving forward and to focus on reforms in key areas:

- Accelerate the sell-off of state-owned enterprises and remove restrictive barriers to foreign ownership of companies.
- Reform India’s complex and restrictive labor laws.
- Deregulate various industries and continue reducing tariffs.
- Encourage private banking and relax currency restrictions.
- Keep improving the business infrastructure (e.g., roads, ports, sanitation, power).28

India’s most significant impact on the global economic scene is probably in information technology (IT) services. In 1999, India’s IT industry had roughly $4 billion in revenues—a figure that soared to nearly $60 billion over the next ten years. India is an excellent source of cheap, well-educated, English-speaking high-tech labor for U.S. firms. For instance, General Electric, IBM, Microsoft, and Intel are among the American companies with R&D facilities in India. Moreover, leading Indian IT firms such as Infosys, Tata Consultancy Services, and Wipro Technologies are now world-class competitors.29

Japan

With a 2012 GDP of nearly $4.7 trillion, Japan is among the top five economies in the world. Yet, Japan has endured years of weak growth. Recently, the government has taken more aggressive steps to enact structural reforms that would place the country on an upward track. That said, the failing value of the yen in recent years has boosted exports of the complex goods that many Japanese firms make efficiently at home (e.g., Japan’s Hitachi Construction saw Chinese demand for its power shovels soar while Toyota enjoyed big profits on cars exported to the U.S.). Nevertheless, some critics say that Japanese firms still have too much expensive factory capacity at home for things like domestic car production when much cheaper labor can be had in places such as Vietnam. Other challenges for Japan
include high government debt, weak support for entrepreneurship, and an inflexible labor force—especially compared with many developed countries. In part, problems with Japan's debt and its financial system reflect the government's efforts to simultaneously protect weak domestic industries (e.g., chemicals, financial services, retailing) and maintain a thriving export machine. Weak industries hurt the economy, driving up both the cost of living and the cost of doing business in Japan. 30

It would be a mistake, however, to underestimate Japan. Indeed, Japanese companies are surprisingly dominant in some unexpected global markets not visible to most consumers. For instance, a number of strong, mid-size electronics firms (called *chuken kigyo*) have carved out leadership positions in important areas such as semiconductor substrate and capacitors for electronic devices. These successes play to traditional Japanese strengths, including strong cultural values of continuous improvement (*kaizen*) and making things (*mono­zu­kuri*). But other Japanese values, including distrust of foreigners, inhibit *chuken kigyo* from partnering with, and learning from, foreign companies. Overcoming this may become particularly important in the years ahead if Japan's dominant specialists in electronics want to stay ahead of foreign competitors. Overall, Japan is a formidable international competitor, its problems notwithstanding. As a nation, Japan has impressive strengths, including a highly educated workforce, many world-class firms, and excellent capabilities in technology. 31

**South Korea**

A key player in the region with a $1.6 trillion economy, South Korea has a highly skilled workforce, an improved banking system, and a burgeoning information technology industry. It has incredible export strength in a variety of areas—and not just in cars (e.g., Hyundai) and electronics (e.g., LG, Samsung), but in heavy industries such as shipbuilding. South Korea faces plenty of challenges too, including an education system that is extremely rigid, foreign investment restrictions, government bureaucracy, a relatively inflexible labor market, and a need to continue reforming the chaebol (huge diversified conglomerates such as Samsung that still account for a big slice of the economy). Although transparency and accountability have improved, some problems remain in chaebol firms. On the positive side, the South Korean government has made it easier for foreigners to own pieces of the chaebol (e.g., roughly 50 percent of Samsung stock is owned by foreigners today), although critics charge that, too often, transgressions by the chaebol continue to be overlooked or treated lightly. 32

This may reflect official concern that South Korea must protect firms in strategic sectors such as electronics and automobiles, especially because they provide jobs and help support thousands of vendors and suppliers. Others counter that South Korea would be better off in the long run if the chaebol sold off or shut down losing businesses. In fact, many chaebol have disappeared over the past several years, crushed by their mountains of debt. A good example is Daewoo, which made everything from fertilizers to cars around the world, before collapsing. Interestingly, South Koreans are more interested in entrepreneurship these days and willing to embrace greater risk than ever before. Indeed, the percentage of South Korean adults working in firms less than four years old is far higher than in other industrialized countries. 33
Europe

Over the past 25 years, staggering political and economic changes have occurred in Europe, especially in Russia and its former satellites. Since the Berlin Wall fell in 1989, the people of the region have seen more change in a shorter period of time than just about anywhere else in the world.

The European Union

Today, the European Union (EU) has grown to a nearly $16 trillion economic colossus with 28 member countries (thanks, in part, to the EU’s currency, the Euro). Where future expansion will come from is hard to predict. For instance, while Turkey’s application for membership continues to be controversial, eastern EU members such as Poland advocate bringing in other eastern nations like Belarus, Moscow’s objections notwithstanding. Figure 1.5 provides a snapshot of all EU nations.

Yet, the EU is also facing stern tests about its future. With the exception of a few member countries (including Germany), unemployment, particularly among younger workers, is incredibly high. For instance, unemployment among younger workers is pushing 30 percent in Portugal and 50 percent in Spain. Indeed, a broader north–south divide has emerged, with deeply indebted members such as Greece and Italy clashing with creditor nations like Germany. Then there are conflicts between the 17 member countries that use the Euro, such as France, and those that do not, such as the United Kingdom. Indeed, economic growth has been uneven across the EU in recent years. Some members, such as Poland, have done well by embracing free markets and transforming their management talent to match. Others, such as Croatia, still have a long way to go.

Nevertheless, the EU has come far from its roots in the 1950s as a regional economic partnership among six nations. Indeed, the EU as we know it today was launched in the early 1990s with the signing of the Maastricht Treaty. The treaty expanded the boundaries of monetary and economic integration and laid the foundation for the current EU model. Therein lies both the opportunity and the challenge for international companies. On one hand, manufacturing in the EU allows firms to move their products to any member country without duties or currency hassles—an attractive prospect, to say the least, and something that has prompted billions in foreign investment in recent years. A unified market, however, does not mean that Europe’s diverse cultures have disappeared. So, companies doing business in Europe often need to be highly responsive to local preferences to do well, the EU notwithstanding.

As Figure 1.5 suggests, many of the newer Eastern European members of the EU are considerably poorer than their Western counterparts in terms of per capita GDP (the numbers are adjusted for price differences across nations) and are more vulnerable to economic shocks (Poland being an exception). On the other hand, the EU’s newer Eastern members generally have cheaper skilled labor and faster growing productivity than their Western EU counterparts. These factors suggest that the EU’s newer members will continue to be an attractive target for foreign direct investment and, as a consequence, put pressure on the more established economies of the EU (e.g., Germany, France) to reform their more costly tax, welfare, and labor systems. Indeed, cost-cutting pressures in
<table>
<thead>
<tr>
<th>Country</th>
<th>2012 GDP Per Capita (relative to EU average of 100; purchase power parity)</th>
<th>2012 GDP Per Capita in US $ (purchasing power parity)</th>
<th>2012 GDP Growth (% change over 2011)</th>
<th>Year Joined the EU</th>
<th>Using Euro, 2012?</th>
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Figure 1.5 The European Union: 28 Countries and Counting.

Western EU nations may lead companies there to another round of outsourcing to cheaper Eastern EU locations, or what one expert called “the China next door.”37

Overall, the EU markets are less efficient and less flexible than America's for reasons including onerous taxes, red tape, and rigid labor laws. Such factors could limit the EU's GDP growth over time, everything else being equal. In fact, high labor costs and rigid employment rules are among the reasons that German engineering giant Siemens has been shifting jobs and production capacity from Germany to lower-cost locations such as Hungary, Brazil, and China. This underscores the fact that EU firms, especially those in Western Europe, have been looking outward for places to invest for some time.38

Russia

Turning back to the east, Russia's GDP was $2.5 trillion in 2012. With a population of over 140 million, Russia seems to punch below its weight as a market. Despite joining the WTO in 2012, the country has been weighed down in recent years by low levels of foreign investment, weak growth, capital flight, and its dependence on oil and gas mining for revenues. Critics blame the government for not doing more to curb corruption, strengthen the legal system, streamline regulations, and reform banking rules—all things that would make doing business in Russia easier. Yet, Russia is too large and has too many attractive assets (such as huge oil deposits, well-educated professionals, and higher disposal income than many developing countries) to ignore. This explains why companies such as U.S. chip maker Intel have been there for years—Intel has sunk $800 million into its Russian operations since 1999. The firm employs over 1,000 highly skilled, but inexpensive, Russian engineers who tackle complex problems for the company.39

Nevertheless, Russia faces other challenges. Infrastructure improvements are sorely needed and Russian firms must become more innovative. The country is plagued by bad roads, toxic waste dumps, inadequate electric power, and leaking gas pipelines. Finding the money, much less actually repairing and modernizing Russian infrastructure, will take years. Finally, as already noted, corruption is a persistent thorn in the side of Russia and its foreign investors. The following International Insights feature provides a closer look at corruption in Russia.40

International Insights

Russia: Corruption in the Wild, Wild East

When your own president describes the country's economy as "primitive" and beset with "systemic corruption," you know that there is a problem. Vladimir Putin, president of Russia, made similar public statements about corruption, noting at one point that in Russia, "anywhere you go, you have to go with a bribe." A Russian think tank estimated that corruption cost Russia 20 percent of its GDP and that 80 percent of Russian firms paid bribes averaging $130,000 annually.
The roots of this are deep, driven by an old psychology in which government officials see their role as protecting the state (and enriching themselves in some cases) instead of helping people. As one Russian business owner put it, "You go to the local administration to get permission for something and they send you to a private firm that will sort out the paperwork for you, which happens to be owned by their relatives." Many businesspeople in Russia often pay bribes just to be left alone rather than to get something done (what Russians refer to as the "bribe of survival").

What is the foreign business perspective on Russia, given the environment of corruption there? Clearly, many foreign multinationals are in Russia to stay—the corruption challenges notwithstanding. Moreover, multinationals tend to be less exposed to blackmail and extortion attempts from officials (other than occasional requirements to make "voluntary donations to the community," perhaps in the form of new police cars or fire trucks for the local government). Of course, that does not mean that multinationals do not get hassled. Motorola, for instance, once had a shipment of over 160,000 cell phones impounded when they arrived in Moscow. Government officials at different points alleged that the phones violated Russian patents, were counterfeit, and were "smuggled" into the country. In the end, Motorola got most of its phones back—except the 50,000 or so that may have ended up on the black market (government officials claimed the missing phones were "destroyed").

So, how should multinationals navigate Russia's murky and often corrupt waters? Here is some commonly offered advice:

- Avoid "strategic" industries (e.g., aerospace, oil, telecommunications) where foreign ownership is limited and partnerships with unsavory local firms may be required.
- Avoid "oligarchs"—rich, powerful businesspeople who amassed vast fortunes through dubious means and whose political fortunes can shift quickly.
- Focus on locations with the best local government reputations (e.g., St. Petersburg has attracted considerable foreign investment from U.S. multinationals such as Ford, thanks to local officials who cut red tape and offered tax incentives).
- Be prepared to pay bribes for small, routine tasks—such as getting parts through customs (one U.S. executive noted his company used customs brokers who "build bribes into the invoice").
- Be prepared for delays if your company refuses to pay bribes (one pharmaceutical firm noted building facilities in Russia took two to three additional years than it would elsewhere because of the company's refusal to pay bribes).

The good news in all of this is two-fold—many multinationals are sticking with Russia and senior Russian leaders seem to be talking about reining in corruption more than ever. But whether this translates into significant action that makes a difference remains to be seen. Experts argue that political competition, combined with independent media and courts, is what is needed to really make a major dent in Russian corruption. That may be a tall order indeed.41
The Middle East and Africa

The Middle East and Africa represent regions that come with plenty of risk, uncertainty, and unrealized potential.

The Shadows on the Middle East

Despite the region having many highly sought-after assets, including oil, political unrest casts a shadow on investment and economic growth in the Middle East. Civil war in Syria, ongoing Palestinian-Israeli discord, and political turmoil in Egypt are cause for great concern. Regional nervousness is a continuing boon for American (e.g., Raytheon) and British (e.g., BAE Systems PLC) defense contractors looking for business. Yet, when violence occurs in the region, nearby economies and their peoples often suffer. That includes Israel, a prosperous and stable nation in many ways—one with an open economy, impressive support for entrepreneurship, and technologically sophisticated companies. Economic hardship, however, is more pervasive in the Palestinian territories, which have many unemployed people, fewer assets, and must cope with Israeli restrictions. Economic hope, however, springs eternal. For example, a cell phone service operator, Wataniya Mobile, opened in the West Bank. Wataniya’s majority owner, Qatar Telecommunications, announced that it would invest some $700 million and create thousands of new jobs in its new venture over the next decade.42

Overall, long-term prospects for regional GDP growth are hard to predict. The Middle East faces major hurdles to becoming an integrated economic power. Israel is the only country in the region to resemble a dynamic, modern economy—with a true middle class and some globally competitive companies. There are also some successes, such as greater foreign direct investments and more government encouragement of entrepreneurship, in places as diverse as Dubai, the United Arab Emirates, and Jordan. Outsourcing is on the rise in the Middle East, led by Indian firms such as Satyam Computer Services and Wipro. These companies are putting tech support and service centers in the region because of multilingual populations, growing local markets, cheap labor, and time zones that fall between the big economies in Asia, Europe, and North America. Nevertheless, countries in the region generally need to do more to spur foreign investment and create jobs.43

Africa Ascending

Much of sub-Saharan Africa has emerged from years of slow growth, high inflation, and untapped potential onto stronger footing. Indeed, some of the fastest growing economies in the world in 2014 were in Africa. The region ranked second in the world overall, placing behind Asia.

China, India, and several Middle Eastern nations have become big investors in Africa in the past decade. For instance, Chinese companies have built power plants, roads, and mining operations across Africa in recent years and continue to invest. All that said, many African countries are still beset with heavy government intervention in their economies, official corruption, tribal conflicts, and weak business infrastructures. Indeed, there are still horror stories in Africa, such as in Zimbabwe, which has suffered under President Robert Mugabe and can no longer feed itself. But there seems to be optimism
across the continent, especially in sub-Saharan Africa. As one Nigerian investment manager put it, sub-Saharan Africa is “where China was 15 years ago.”

Speaking with one economic voice could help Africa obtain even more foreign direct investment and better access to overseas markets, especially for its quality textile and agricultural products. To improve regional cooperation and self-reliance, the presidents of several sub-Saharan countries have been working to create “sustainable economic development” across the continent by improving African infrastructure (roads, telecommunications, and air service), sharing resources, eliminating internal trade restrictions, and lobbying for easier access to developed markets.

Of course, the star of the continent is South Africa. Its peaceful transformation from a racist, white minority government to an elected majority-rule democracy, led by Nelson Mandela, inspired the world in 1994. Today, challenges for South Africa include high unemployment (officially around 25 percent), persistent poverty, and insufficient electric power. In essence, South Africa is both a rich and a poor country, one with extreme income gaps. But as an emerging market, South Africa has much to admire, including excellent legal and financial systems, plenty of natural resources, a growing high-tech industry, and modern roads, ports, and telecommunications. In fact, foreign investment has been rising in South Africa since 1994. The world’s car companies are a good example of that investment. BMW, Ford, GM, Toyota, and Volkswagen all operate in South Africa. They see South Africa as both an existing market and a jumping off point to the rest of Africa and beyond.

Key Challenges Facing International Business

This discussion of regional trends underscores the fact that growth and prosperity are not guaranteed. Optimism has to be tempered by an awareness that a variety of factors, including political uncertainty, corruption, disputes over trade issues, tough new competitors, and fiscal mismanagement, just to name a few, can derail the best-laid plans very quickly and at any time.

Technological Sophistication and International Volatility

Advances in communications, information technology, and manufacturing processes have created new foreign markets and helped firms internationalize. Indeed, innovations in information technology have made innovating itself quicker and cheaper. Firms can put new pricing models, products, and services on their websites, quickly giving them detailed information about how customers react. Being able to respond quickly to customers’ needs is a boon in highly competitive international markets. As a P&G executive put it, “we do the vast majority of our concept testing online, which has created truly substantial savings in money and time.” So, instead of long, complex R&D processes, companies use technology to quickly run many small experiments constantly with immediate impact. Fortunately, the cost of installing a digital infrastructure is falling, making it easier for companies in poorer countries to catch up and tap technology to innovate more quickly. Of course, realizing the benefits of technology requires an educated population as well as affordable access. As you might expect, that is a tall order in some cases.
Technological advances, however, do little to eliminate international business problems that are driven by cultural differences, political upheavals, corruption, and mismanagement. While technology can make life easier for international business in certain respects, it also can increase complexity in other areas and help accelerate how quickly new crises hit companies—challenges that management must grapple with. The key for international management is take advantage of technology while creating operational resilience and agility in the company to respond to rapid changes in the environment.48

Currency Volatility

Another challenging area of volatility for international management is currency fluctuation. National currencies can move up or down in ways that dramatically impact businesses—and often very quickly. For instance, the Euro plunged in value against the U.S. dollar from its introduction in 1999 to mid-2001, only to reverse course, rising 50 percent against the dollar through early 2004. Currency volatility can also escalate dramatically during economic downturns—for example, from mid-2008 to mid-2009, the dollar moved up or down against the Euro by at least 1 percent in a single day over 70 times, compared with just 16 times in the preceding year. And in late 2009, countries such as South Korea began buying dollars to slow its fall, fearful that their own exports would become too expensive too quickly as their own currencies rose.49

Volatile currency fluctuations underscore the impact of rapidly shifting business conditions as well as the use of technology by sophisticated investors. Virtually anywhere, anytime, an investor can electronically move in or out of international currency markets. Billions of dollars can flow in and out of a country in minutes, whether sparked by a real crisis or not. Plus, the sheer size of the currency markets (over $5.3 trillion is traded daily) makes stabilizing currencies difficult.50

Sudden currency updrafts can make a firm’s exports more expensive overnight, increasing the pressure to reduce costs. For example, such was the case for Toyota in 2008 when the yen rose 19 percent against the dollar. When you consider that every 1 yen increase in value against the dollar meant a $450 million hit to operating profits, the point (and pain) is clear and so is the impact on the bottom line for currency anomalies like these. The reverse is true as well—falling currencies help exporters. For instance, by 2013 the situation had flipped for Toyota, with the yen down considerably against the dollar. As a result, Toyota was making an additional $1,500 on each car exported to the U.S. because of the currency swing. Likewise, the dollar’s slide in recent years against the Euro made American companies exporting to Europe gleeful. Farm equipment giant Deere & Company was a good example—its exports surged, at least in part, owing to the weaker dollar.51

Overall, currency volatility clearly increases the risks inherent in international business. So, what can international firms do to combat wild currency fluctuations? Currency hedging is an option. Companies can buy currency options that fix exchange rates for a period of time. For example, during periods when the U.S. dollar was falling, many large European firms bought hedges to protect dollar-based revenues earned in the United States. Indeed, both BMW and Volkswagen stepped up their currency hedging in 2012 because of worries about currency fluctuations, including in top markets such as the U.S. But hedging is basically pricey, complex guesswork. Imagine that a company wants to protect $500 million
in earnings against a drop in the dollar against the Euro. If the dollar’s value slipped 10 percent, then that $500 million would be worth only $450 million. But the cost of that protection could run a steep $26 million. Another way to minimize the risks associated with exchange rate swings is to use local suppliers and make more products in the places where you sell them. This is referred to as natural hedging. Honda, for instance, manufactures three out of every four cars that it sells in the United States in American factories, isolating U.S. sales against a rising yen. Some companies use both options. Dow Chemical, for example, uses financial hedges and scatters its production facilities around the world.52

Of course, currency volatility often hits small firms the hardest. While currency fluctuations may slice a sizeable chunk off a big multinational’s earnings, it is often just a nibble in the overall scheme of things. Such firms typically have more experience with currency problems and thus have more options available for dealing with them than their smaller brethren. Consequently, more small firms are copying bigger firms by shopping for materials at cheaper locations, opening overseas operations in major markets, looking for foreign partners, and dabbling in currency hedging. Nevertheless, many of these steps are beyond the reach of small firms that want to sell abroad.53

While technology helps stitch national economies together, it also makes international business a volatile proposition. One way that firms try to minimize that volatility is by scattering facilities and suppliers across many countries. Granted, this is hardly foolproof—creating supply chain complexities and raising transportation costs in many cases. Moreover, such moves lead to another set of challenges, including managing people from diverse cultures. These workforce challenges are examined next.

International Workforce Challenges

Also driving the increasing complexity of international management is the need to have innovative and productive employees in order to compete. In essence, a global talent race is underway, one that has profound implications for companies, employees, and countries alike. Today, companies scour the globe to find the most talented employees at the most reasonable overall cost, with the jobs involved following the talent overseas.54

Offshoring, Reshoring, and Global Job Dispersion

This process of sending jobs overseas, sometimes referred to as offshoring, is not limited to big multinationals. Indeed, according to some American venture capital firms, up to 75 percent of the small companies that they invest in disperse jobs abroad. For instance, a number of small American software companies have offshored jobs such as customer support and software testing to places as diverse as Greece, India, and the Ukraine.55

This example also begs to question what kind of work firms offshore and why. Clearly, the reasons vary. The stereotype is that firms are merely chasing cheaper labor for back-office tasks (for example, the prototypical service center overseas fielding calls from disgruntled credit card holders). While cheaper labor is a motivation, especially for smaller companies with limited resources, it may not be the only or even the primary reason. Instead, education quality and location factors (e.g., political stability) may also be important. When firms are looking to innovate and create new products, labor savings
may be a secondary motivation. Indeed, offshoring jobs for the purpose of innovation, product development, and other knowledge-generating activity has soared in recent years. When U.S. firms offshore such jobs, their main motivation is often that better employees, particularly in technical fields, can be found elsewhere. Because fewer Americans are earning degrees in technical fields and because the U.S. government restricts the number of foreigners who can be brought into the country, the local talent supply is limited. As a result, U.S. firms needing technical employees with science or engineering backgrounds may move those jobs overseas, especially if innovating in particular locations provides quicker access to foreign markets.

This is not to say that potential labor savings from offshoring are trivial, but labor savings in places such as China and India are evaporating thanks to rapidly rising wages. Indeed, firms' expectations regarding labor cost savings can be unrealistic. Take call centers, for example, which are often located in low-wage locations with well-educated English-speakers. The Philippines is a top two call center location meeting these criteria. First, the costs of running call centers tend to be underestimated. Turnover is high and annual pay increases are often automatic, meaning that costs can rise quickly. In recent years, companies such as Delta Airlines and insurer AXA SA either closed call centers or turned them over to outside firms to run to save money.

Likewise, some firms that offshored skilled manufacturing jobs or knowledge workers (such as software designers and programmers) have pulled back the jobs to their home countries, sometimes referred to as “reshoring.” Their reasons included underestimated costs (thanks to rising wages overseas and transportation expenses), cultural challenges, and better quality and intellectual property control. For instance, companies as diverse as Google, Ford, GE, Apple, and Caterpillar have pulled manufacturing back to the U.S. in recent years. In particular, NCR pulled production for complex ATMs back to the U.S. after it realized company engineers were spending too much time flying around the world to fix production problems and design glitches.

Successful offshoring starts with good management—including analyzing the costs and benefits, hiring the right people overseas, laying out expectations clearly, providing support to offshored employees, and effectively dealing with cultural differences. Without this, cost savings are unlikely regardless of the circumstances. For instance, one California-based security software firm found this out when it started offshoring software development to India. Its Indian software engineers did not understand how the firm’s software was used (because they were not told) and, as a consequence, they left out features that customers wanted in new products. When customers balked, attempting to solve the problem quickly across a dozen time zones turned into an expensive nightmare that hurt relationships on both sides until things were turned around. Offshoring requires careful thought about what jobs should be sent abroad and how to establish effective foreign operations.

Besides these management challenges, offshoring is controversial, particularly in the United States. Companies respond that offshoring is part of a worldwide competition for jobs and talent. Of course, the realities associated with offshoring are complex. For instance, some argue that thanks to foreign companies that come to the U.S., the number of imported jobs (which tend to be high paying, skilled jobs) far exceed the number of exported jobs (which are more likely to be lower paying). Others argue that offshoring allows American companies to save money, thereby allowing more high-skilled hiring at
home as well as cheaper goods and services for customers. Yet, these arguments are likely to be cold comfort to American employees whose jobs have been lost to offshoring. For instance, American software application developers and database engineers are, as one executive put it, “competing with everyone else in the world who has a PC.”

Nevertheless, controversy is not likely to slow, much less reverse, offshoring. In fact, in certain parts of the world, offshoring continues to grow. The call center business in the Philippines is one such example, thanks to Filipinos’ good English skills, an excellent communications infrastructure, cheap facilities, and low wage costs. Cincinnati’s Convergys Corporation has 12 centers in the Philippines—the company’s Filipino employees do sales-related work and perform debt collection calls. Convergys is hardly alone. India’s Wipro Ltd recently opened a call center in the Philippines.

Granted, many of these offshored jobs provide basic customer and service support functions. As we have already suggested, however, professional jobs, such as scientific research and pharmaceutical development, are increasingly moving to “centers of excellence” worldwide. In the meantime, developed nations should embrace the idea that workforces will more than likely continue to disperse around the world in the years ahead. In terms of high-tech innovation, product development, and manufacturing, American skills need to be upgraded to keep up. For example, over 20 years of offshoring have undercut the U.S.’s technology base as work shifted overseas—and increasingly, the skilled jobs that went with it.

**Workforce Quality and Competitiveness**

The common bottom line for international firms everywhere is that they need employees who can handle increasingly complex work. The best workforce usually wins (and keeps) their jobs in the process. All of this raises a question: what makes for a highly qualified workforce? Education, on-the-job training, motivation, and computer literacy all matter. Having a sophisticated industrial base where new technologies can be developed, commercialized, and manufactured helps create and retain demand for technical workers and professionals.

Plus, there is little doubt that workforce quality is an important factor for determining how competitive a country is—or at least how competitive a country’s companies are in a particular industry. India’s increasingly competitive IT service companies (including Infosys and Wipro) are a case in point and are increasingly a force to be reckoned with. Part of their success is due to India’s well-educated, high-skilled, and experienced workforce of inexpensive IT professionals. Figure 1.6 ranks the world’s 25 most competitive countries in 2013, 2009, and 2005. You will notice that India is not on the list. While there is little doubt that India’s IT workforce is superb in many respects, the country as a whole still faces enormous challenges with respect to raising the incomes and educating a large swath of its population.

Indeed, although they have many differences, a common thread among the top countries in Figure 1.6 is the overall quality of their workforces. But harbor no illusions about what can be done anywhere given good worker training and the right infrastructure. After touring several award-winning Mexican plants, one American union official put it this way: “The workers at those plants make a fraction of what American workers
Country | 2013 Rank | 2009 Rank | 2005 Rank
--- | --- | --- | ---
U.S. | 1 | 1 | 1
Switzerland | 2 | 4 | 14
Hong Kong | 3 | 2 | 6
Sweden | 4 | 6 | 11
Singapore | 5 | 3 | 2
Norway | 6 | 11 | 17
Canada | 7 | 8 | 3
UAE | 8 | * | *
Germany | 9 | 13 | 21
Qatar | 10 | 14 | *
Taiwan | 11 | 23 | 12
Denmark | 12 | 5 | 7
Luxembourg | 13 | 12 | 9
Netherlands | 14 | 10 | 15
Malaysia | 15 | 18 | 16
Australia | 16 | 7 | 4
Ireland | 17 | 19 | 10
U.K. | 18 | 21 | 22
Israel | 19 | 24 | *
Finland | 20 | 9 | 8
China (mainland) | 21 | 20 | 24
Korea | 22 | 28 | 30
Austria | 23 | 16 | 13
Japan | 24 | 17 | 23
New Zealand | 25 | 15 | 18

Figure 1.6 Rankings of the World’s 25 Most Competitive Countries over Three Timeframes.

* Indicates not in top 25 rankings.

Source: Adapted from The International Institute for Management Development’s (IMD) 2013, 2009 and 2005 World Competitiveness Scoreboards, available from: www.imd.ch/research/publications/wcy/index.cfm

make, but there’s no drop in quality. Most Third World countries are turning out world-class products.”

While the U.S. is at the top of the competitiveness heap at this point, there is reason for concern, particularly in certain industries. Experts suggest that the U.S. industrial infrastructure is challenged to produce sophisticated new products in some areas because the knowledge, skills, and people required have largely been lost (owing to offshoring, for example). Consider the Kindle e-reader. This innovative electronic reader was designed by Amazon in California but its parts are largely made in Asia (Taiwan, South Korea, and China) and it is assembled in China. Asian firms have the necessary skills to produce these parts thanks to their experience making flat-panel displays and other electronic components, an outgrowth of the migration of semi-conductor and consumer electronics production to Asia—where a large supplier network is now concentrated."
Moreover, the U.S.'s ability to develop world-class products in some areas is eroding as sophisticated design work is increasingly done overseas. For instance, besides Apple, no American computer firm even designs laptops in the U.S. anymore. One response to this concern is that rising wealth, innovation, and workforce competitiveness in certain nations does not necessarily mean long-term declines in developed countries such as the U.S. Regardless, complacency is not likely to do the U.S., or other countries, much good when it comes to maintaining a top-notch workforce and a rising standard of living for citizens.67

Increasing Workforce Diversity

Workforce competitiveness aside, globalization is also bringing people from diverse cultures and backgrounds together. Many American and European companies aggressively recruit foreign immigrants, especially for jobs requiring specific technical skills. Demographic shifts within nations are having a similar impact. In the United States, for example, people of Hispanic descent will represent almost 25 percent of the population by 2050, up from 10 percent in 1995. At the same time, the share for non-Hispanic whites will drop to around 50 percent from over 70 percent in 1995.68

A diverse workforce can help firms better serve their increasingly diverse customer base. Targeting these and other groups in recruiting brings in employees who can help connect firms with important segments of their customer base. Indeed, P&G had greater success penetrating the Hispanic population in the United States after it set up a bilingual team of employees to do so. Today, according to one P&G executive, “Hispanics are a cornerstone of our growth in North America.” So, companies cannot afford to let antiquated attitudes permeate the workforce. For instance, key corporate decisions are increasingly made in cross-functional groups that bring together people from diverse backgrounds. In fact, experts recommend introducing cultural diversity into decision-making groups and teams, putting a premium on managers’ abilities to overcome the difficulties of making it all work. But few companies have created an atmosphere where diversity is taken seriously. In one survey, less than 10 percent of firms felt they did a very good job of supporting diversity.69

Managing in a Challenging International Environment

All of this raises a larger question about the impact of today's challenging international environment on management. Clearly, the goal of international management is to achieve the firm's international objectives by effectively procuring, distributing, and using company resources (e.g., people, capital, know-how, physical assets) across countries.70

So, what happens if management decides that China (for example) is a place to develop, manufacture, or sell a product? What then? How should managers manage in the environment they find themselves in? These questions defy easy answers. Just imagine all of the contextual challenges facing managers in firms that operate in dozens of countries. How do they find the best talent worldwide, much less deploy, train, and reward them properly? After all, business practices, laws, languages, cultural values, and market structures may all vary across countries, globalization notwithstanding. These factors
can effect every aspect of management, including communication, motivation, compensation, employee development, business strategy, and ethics.71

Executives are feeling the pressure, especially those charged with running complex global empires. For instance, some two decades ago, P&G was already big, with $7 billion in sales, 50,000 employees, and facilities in 23 countries. But as of 2014, the firm was downright gargantuan, with over $84 billion in annual revenues, over 120,000 employees, and facilities in several dozen nations. As one executive put it, P&G today is "a much more diverse, much more culturally different, much more global company." Senior leaders worry about how to manage their vast operations when information and capital fly around the world in a heartbeat, economies bounce around rapidly, and customer preferences are fickle. Many want to improve communications and somehow knit together company outposts to be more responsive to, if not anticipate, changes in international business.72

Overall, this book will provide some guidelines for responding to these challenges. Today, successful international firms will be led by managers who:

- value ethnic diversity and have multicultural experience;
- embrace teamwork and information sharing;
- act globally where possible while fine-tuning things for local markets where necessary;
- look to local managers abroad for ideas and give them control;
- embrace and encourage adaptation to help the firm thrive in a world where change is constant and sometimes unpredictable;
- offer employees around the world an implicit contract where good work is rewarded with decent wages, continuous learning, and recognition.73

Embracing these ideas, however, may require new assumptions about how to run a business. For example, many managers still see their roles in control terms, with corporate headquarters making decisions for foreign subsidiaries. Unfortunately, this does not take full advantage of local expertise, nor permit a quick response to rapidly changing local conditions. In fact, international corporations with a rigid control mentality are fading from the scene. Wholly owned subsidiaries are giving way to networks of alliances between organizations. Managing companies this way, however, requires flexible managers who are willing to accept the ambiguity inherent in relationships not based on control.74

Basic Conceptual Foundations

Some of the points in this chapter rest on several management concepts. These are introduced now to help you with the rest of the book.

Defining Culture

Culture plays a big role in determining success or failure in international management, impacting how managers lead, hire, and compete in various countries. But what exactly is culture? We agree with international management expert Geert Hofstede, who defined culture as "the collective programming of the mind which distinguishes one group or category of people from another." This "programming" cannot be observed directly. Rather,
it can only be inferred from behavior. Likewise, people are often unaware of the pervasive impact of culture on their own attitudes, beliefs, and behaviors.\textsuperscript{75}

Culture is a concept that is only useful if it can accurately predict behavior. While cultural values can change dramatically when borders are crossed, this is not always the case. Furthermore, many distinct cultural groups can coexist within individual countries. On the other hand, knowing someone's national or group culture may reveal very little about them as individuals. Consequently, international managers must resist automatically seeing people as fitting into some kind of cultural stereotype. Despite these complexities, it is nevertheless important to understand country- or group-specific differences in cultural values that exist and to consider their potential implications for managerial behavior.\textsuperscript{76}

\textit{International Corporations and Their Evolution}

Firms tackle international business in many different ways. Some export products from a home base while others have sales facilities in foreign countries to handle their exported products. Other firms build or buy facilities abroad to manufacture products or deliver services. The various approaches to international business are discussed in later chapters, but for now, a basic understanding of how firms approach the international business arena might be very helpful.

In particular, you have already been reading about multinational enterprises—companies that operate in many overseas locations (referred to as \textit{multinationals} throughout the rest of the book). Multinationals are large, well-developed international firms that operate facilities to produce products or deliver services in a variety of overseas locations and have considerable resources invested abroad. The number of multinationals in 1970 was around 7,000—since then, that number has soared by more than ten times. As of 2013, there were 1,000 multinationals with sales of $1 billion or more just in emerging market nations alone (e.g., from Mexico to South Africa to Indonesia). Many of the biggest “economies” in the world are actually gigantic multinationals such as Wal-Mart that have annual sales that surpass the total GDP of about 90 percent of the countries in the world. Moreover, the world’s 1,000 biggest multinationals are responsible for about 80 percent of industrial production worldwide. Interestingly, multinationals, regardless of their nationality, tend to use management techniques more effectively than local firms. Indeed, an important role that multinationals play is the dissemination of best practices when it comes to management—something that their international experiences have helped shape.\textsuperscript{77}

This does not mean, however, that multinationals all compete in some identical “global” fashion. As discussed later in this book, some multinationals (such as those in the semiconductor industry) compete in global industries where few, if any, location-specific preferences exist. Other multinationals, however, operate in industries where a high degree of local tailoring has to be done. Even within industries, multinationals may operate quite differently. This variation results from many factors, including culture, firm values, and the moves of competitors. For some multinationals, the home country is where the headquarters resides and where decisions about firm culture, policies, and practices are made. In others, local operations have more freedom to make their own decisions. Such multinationals tend to be more diverse internally in terms of both culture and structure. Business practices, technologies, and cultural values may all vary depending on the needs of
particular locations where the firm operates. In short, headquarters may offer suggestions and guidance, but it is up to local managers to make operational choices. This emphasis is often reflected in multinationals that rely on local managers to run foreign operations, as opposed to sending an expatriate from the home country to run operations abroad. 

Some multinationals, usually referred to as transnational firms, take diversity one step further. Their firm cultures have evolved to the point where organizational diversity is a core value. This value is part of the glue that both holds the firm together and allows enormous flexibility. Such multinationals tend to be run by teams of managers from several countries. In fact, other than a few practices that are not subject to negotiation, such as indoctrinating employees in the firm’s core values, these multinationals operate on a diverse basis. 

Multinationals have changed greatly in the last 100-odd years. As shown in Figure 1.7, multinationals have gradually changed both their geographic scope and their orientation toward foreign subsidiaries. But while not all multinationals develop in the same way or at the same rate, they are generally expected to continue moving toward the more liberal model in the years ahead.

<table>
<thead>
<tr>
<th>Era</th>
<th>Time Frame</th>
<th>Description of Multinational Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Paternalism</td>
<td>1900–1960s</td>
<td>• Firms innovate in the home country, moving products out to the rest of the world from there.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• As foreign subsidiaries evolved, however, it became clear that the home office did not have a monopoly on good ideas.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• IBM and Procter &amp; Gamble are prominent examples during this period.</td>
</tr>
<tr>
<td>Expansionism</td>
<td>1970s–1980s</td>
<td>• Some firms set up R&amp;D or other units abroad in an effort to capture ideas in key markets.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• But these outposts had difficulty integrating ideas across the company and holding headquarters’ attention.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Plus, establishing outposts signaled to other foreign facilities that their ideas weren't needed (e.g., because they weren't in a big enough market or important enough to warrant an R&amp;D operation).</td>
</tr>
<tr>
<td>Liberalism</td>
<td>1990s–today</td>
<td>• The emerging approach takes a more democratic twist to the pursuit of new ideas.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• It assumes that great ideas can come from anywhere, especially in parts of the firm directly connected to customers/other constituencies. It also assumes that the farther a foreign outpost is from the home office, the less constrained it is by corporate traditions and beliefs.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Foreign subsidiaries are better viewed as peninsulas than as islands. With that in mind, firms can expect some of their most innovative ideas to come from the edges rather than center of the organization. Leveraging those ideas is a key challenge for management.</td>
</tr>
</tbody>
</table>

Figure 1.7 The Evolution of Multinationals and Their Approach to Innovation: Three Eras. 
Chapter Summary

The purpose of this chapter is to describe the basic landscape of international business and the competitive environment that it represents. The strongest growth in globalization will most likely be in emerging markets. An important way to assess such prospects is by examining the flows of foreign direct investment. To do so, examine trends in specific regions of the world, including the Americas, Asia-Pacific, Europe, the Middle East and Africa.

Challenges in international business include sweeping technological changes and the volatility of international business. Rapid currency fluctuations can impact business and what management can do in response. Small firms are particularly vulnerable to such fluctuations, especially because their resources are often more limited than those of larger firms. Another set of challenges involves offshoring, reshoring, and the increasing internationalization of workforces around the world. Companies are willing to look anywhere in the world to find employees with the right set of skills, at the right price, for just about any job—including innovative work and new product development. So, jobs are dispersing throughout the world as never before and countries are more formidable competitors when they can offer firms a hardworking and skilled pool of employees.

For international executives, maintaining workforce quality and managing diversity are important challenges. To meet these challenges, international managers must, among other things, value ethnic diversity, have multicultural experience, embrace teamwork, and be open to ideas from anywhere. The chapter concludes with a discussion of the role of culture in international management and how multinational enterprises have evolved over the last 100 years.

Discussion Questions

1. What are the most important trends in international business?
2. Which are the biggest management challenges for international firms? Why? What can firms do in response?
3. Which markets represent the biggest opportunities for international firms? Which markets represent the biggest risks? Why?
4. What is culture? Why is it important for international management?
5. In your view, what are the pros and cons about the influence of multinationals on the global economic scene?
6. How have multinationals evolved over the years? What are the implications of this for management?
New Balance Makes “Made in the U.S.A.” Lean and High-Tech

At the beginning of this chapter it was stated that New Balance was unique among athletic shoe companies in that it manufactures 25 percent of its shoes in the United States. New Balance has minimized the cost gap with Asian subcontractors to the point where it can remain competitive while producing in high-wage locations such as the U.S., where it feels obligated to keep a foothold in manufacturing. Plus, being close to customers in a major market offers speed and quality control advantages in terms of fulfilling orders and changing styles.

But making this philosophy work essentially meant shifting from low-tech to high-tech, both in terms of equipment and employee skills. Borrowing a page from manufacturing methods in higher-tech industries, New Balance had employees take classes on computerized manufacturing and sophisticated teamwork so that they could operate in small, flexible teams. Employees master many skills, switch jobs continuously, help each other out, and take responsibility for production activities, while employee training is constant and ever-evolving.

New Balance also took a creative approach in adapting high-tech equipment from other industries to its needs. For instance, the company bought computerized sewing machines that came with templates designed for other products, then ripped out the templates and set up facilities to make their own. With the right templates in place, the result was a technology-intensive manufacturing operation. With a highly skilled workforce to run the equipment, New Balance factories in the United States need only one employee for every six that overseas plants using ordinary sewing machines require.

The New Balance story raises some interesting questions. On the one hand, it suggests that firms in developed countries can avoid shifting production to low-wage locations abroad by upgrading the skill levels of work at home. Indeed, the reality is that while the overall manufacturing workforce in the U.S. has been shrinking, productivity has actually been rising, with the result that American manufacturing output has soared 100 percent over the last several years. But what are the limits to this? Should we be concerned about them? Moreover, what are the costs and risks associated with New Balance’s approach? What might happen if demand spikes up sharply or drops precipitously? Is New Balance at a disadvantage because it owns and operates some factories, whereas competitors such as Nike do not? Only time will tell if New Balance’s approach represents a long-term competitive advantage for the company.79
International Development

International Management: Living at 35,000 Feet?

Purpose

To give a snapshot of what life is like as an international manager, to discuss the implications of that life, and to present some of the execution challenges companies face in running their international operations.

Instructions

Read the following short case. Then have a class discussion around the questions raised at the end of the case. Alternatively, your instructor will divide the class into groups of three to six students and ask each group to consider the discussion questions and develop a list of their three most important reactions or ideas (20 minutes). If time allows, your group could then make brief presentations about its findings to the class (20 minutes). You may conclude with a general discussion about life as an international manager and what implications that may have for corporations (15 minutes).

Have Manager, Should Travel?

Accounting powerhouse PricewaterhouseCoopers (PWC) is a bona fide global empire, with some $32 billion in revenues in 2013. Driving that revenue is more than 180,000 employees serving clients in over 150 countries from almost 800 offices. Ellen Knapp was one of the executives who helped build that PWC empire. During her tenure as PWC's chief knowledge and information officer, Knapp's role was to expand PWC and keep its empire running well. As such, she spent much of her time traveling overseas.

Knapp's was hardly a unique situation. She once survived three international red-eye flights crammed into less than a week. In the process, she ran into a colleague in London who was about to endure two such flights in two days. On another occasion, she ran into an acquaintance from consulting giant McKinsey at the Philadelphia airport. He was bound for New Delhi while Knapp was in transit to London and Frankfurt.

These days, international travel is not confined to CEOs who hop on corporate jets for two-week-long business trips spanning a dozen time zones. The growth of international business means that managers such as Knapp slog through airports as they crisscross the globe on their firm's behalf. But at least Knapp could fly business class. Lower-ranking employees in most companies endure international travel wedged into economy seats.

Nevertheless, how did Knapp survive such grueling travel burdens? Being extremely organized, dedicated, and optimistic certainly helped, as did being amazingly immune to jet lag. On the home front, Knapp had few complications because her two children were grown. Her two administrative assistants also kept Knapp plugged in at the home office. PWC helps its traveling executives by holding meetings near big airports and providing office support when they arrive at a company outpost.
ON A GLOBAL STAGE

If you are wondering why executives such as Knapp have to travel overseas so much, the answer can be summed up in one word: bonding. Most travel is aimed at building relationships and trust between employees scattered around the world. The idea, at least in theory, is that over time better relationships encourage more cross-border information sharing and greater collaboration. That said, some question whether direct, face-to-face contact is the best, if not only, way to encourage international sharing and collaboration. Clearly, many believe that relationship building requires plenty of informal face time (e.g., over lunch). Nevertheless, whether traveling really pays off or not is debatable. But one thing is certain—it makes airlines happy.

Discussion Questions to Address

1. How does the work life of an executive such as Knapp sound to you? Attractive? Tiring? Why or why not?
2. How can executives manage this kind of travel if they have younger kids at home? What if they also have spouses with demanding careers?
3. Is all this flitting around the world really necessary? How might technology be used to eliminate some of this travel? What are the potential costs and benefits? To whom? The limitations? Can technology really substitute for relationship building, especially in far-flung corporate empires?

Source: Adapted from The Economist. (1999). On a wing and a hotel room, January 9, 64; see also: www.pwc.com/gx/en/about-pwc/facts-and-figures.jhtml.

From Theory to International Practice

Hitting Home: Understanding Your Local “China Syndrome”

Purpose

To conduct an analysis of companies that import from and export to China in your local environment.

Instructions

Your instructor will place you into small groups to do research, outside of class, in order to answer the following questions:

- Which companies are major importers from and exporters to China in the local environment (city, state, province, region, etc.)? What industries do they represent?
- What efforts, if any, are being made to encourage or help local companies to export to China (or to discourage imports)?
For some general background information about China as well as tips for exporting into the Chinese market, visit one or more of the following links:


Many national, state, and local government agencies provide help to local firms wanting to do business abroad. For instance, as part of the U.S. Department of Commerce, the Commercial Service is a government agency that helps American firms do business in China and other countries. The U.S. Commercial Service has been in existence for over two decades and has thousands of trade experts in more than 100 American cities and 150 government offices outside the United States (e.g., in American trade centers and embassies). If the class is small enough, your instructor may have your groups make brief presentations (10 minutes) about your findings to the class. This may be followed by a discussion about the level of involvement with China by local firms. Alternatively, your instructor may make this an individual assignment and have you write a report and ask you to take part in a general class discussion on the issues raised.

Notes


35. The Economist, Insider aiding; The Economist, Walls in the mind; The Economist, In the nick of time: A special report on EU enlargement; La Guardia, The anti-European question.


66. Pisano and Shih, Restoring American competitiveness.


ON A GLOBAL STAGE


