4TH EDITION

Global Business Today

CHARLES W.L. HILL

GLOBAL BUSINESS TODAY 4

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For June and Mike Hill, my parents

ABOUT THE AUTHOR

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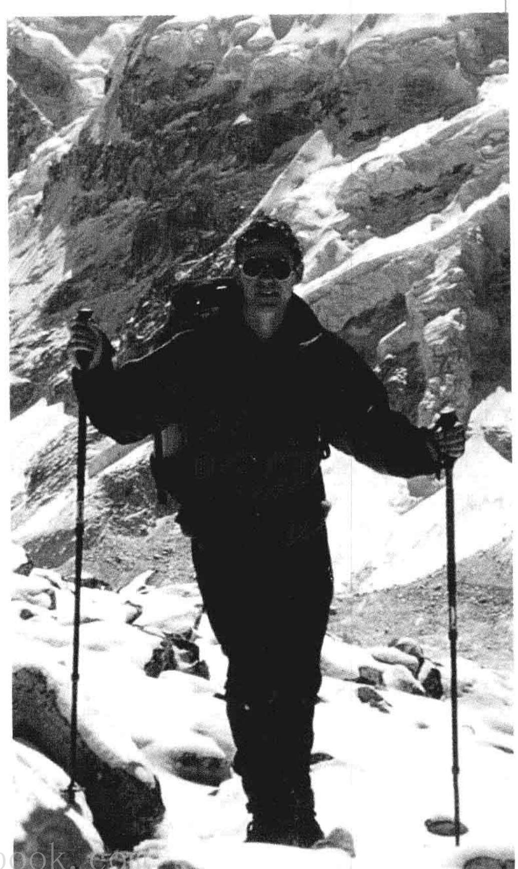
Professor Hill teaches in the MBA and executive MBA programs at the University of Washington and has received awards for teaching excellence in both programs. He has also taught on several customized executive programs.



Global Business Today is intended for the first international business course at either the undergraduate or the MBA level. My goal in writing this book has been to set a new standard for international business textbooks: I have attempted to write a book that (1) is comprehensive and up-to-date, (2) goes beyond an uncritical presentation and shallow explanation of the body of knowledge, (3) maintains a tight, integrated flow between chapters, (4) focuses on managerial implications, and (5) makes important theories accessible and interesting to students.

COMPREHENSIVE AND UP-TO-DATE

To be comprehensive, an international business textbook must:

- Explain how and why the world's countries differ.
- Present a thorough review of the economics and politics of international trade and investment.
- Explain the functions and form of the global monetary system.
- Examine the strategies and structures of international businesses.
- Assess the special roles of an international business's various functions.

This textbook does all these things. Too many other textbooks pay scant attention to the strategies and structures of international businesses and to the implications of international business for firms' various functions. This omission is a serious deficiency, because the students in these international business courses will soon be international managers, and they will be expected to understand the implications of international business for their organization's strategy, structure, and functions. This book pays close attention to these issues.

Comprehensiveness and relevance also require coverage of the major theories. Although many international business textbooks do a reasonable job of reviewing long-established theories (e.g., the theory of comparative advantage and Vernon's product life-cycle theory) they tend to ignore such important newer work as:

- The new trade theory and strategic trade policy.
- The work of Nobel Prize-winning economist Amartya Sen on economic development.
- Samuel Huntington's influential thesis on the "clash of civilizations."
- The new growth theory of economic development championed by Paul Romer and Gene Grossman.
- Recent empirical work by Jeffrey Sachs and others on the relationship between international trade and economic growth.
- Michael Porter's theory of the competitive advantage of nations.
- Robert Reich's work on national competitive advantage.
- The work of Douglass North and others on national institutional structures and the protection of property rights.
- The market imperfections approach to foreign direct investment that has grown out of Ronald Coase and Oliver Williamson's work on transaction cost economics.
- Bartlett and Ghoshal's research on the transnational corporation.
- The writings of C. K. Prahalad and Gary Hamel on core competencies, global competition, and global strategic alliances.

The failure of many books to discuss such work is a serious deficiency considering how influential these theories have become, not just in academic circles, but also in the world at large. A major proponent of strategic trade policy, Laura Tyson served for a time as chairperson of President Clinton's Council of Economic Advisors. Robert Reich served as secretary of Labor in the Clinton administration. Ronald Coase won the 1992 Nobel Prize in economics, giving the market imperfections approach new respectability. Two years later, Douglass North won the Nobel Prize in economics for his work showing how a nation's economic history influences its contemporary institutions and property rights regime. More recently still, Amartya Sen won the Nobel Prize for his work on economic development. The work of Bartlett, Ghoshal, Hamel, and Prahalad is having an important impact on business practices.

I have incorporated all relevant state-of-the-art work at the appropriate points in this book. For example, in Chapter 2, "National Differences in Political Economy," reference is made to the new growth theory, to the work of North and others on national institutional structures and property rights, and to the work of Sen. In Chapter 5, "International Trade Theory," in addition to such standard theories as the theory of comparative advantage and the Heckscher–Ohlin theory, there is detailed discussion of the new trade theory and Porter's theory of national competitive advantage. The empirical work on the relationship between trade and economic growth is also examined in this chapter. In Chapter 6, "The Political Economy of International Trade," the pros and cons of strategic trade policy are discussed. In Chapter 7, "Foreign Direct Investment," the market imperfections approach is reviewed. Chapter 11, which deals with the strategy of international business, draws extensively on the work of Bartlett, Ghoshal, Hamel, and Prahalad.

In addition to including leading-edge theory, in light of the fast-changing nature of the international business environment, every effort is being made to ensure that the book is as up-to-date as possible when it goes to press. A significant amount has happened in the world since the first edition of this book was published. The Uruguay Round of GATT negotiations was successfully concluded and the World Trade Organization was established. The European Union moved forward with its post-1992 agenda to achieve a closer economic and monetary union, including the establishment of a common currency in January 1999. The North American Free Trade Agreement passed into law, and Chile indicated its desire to become the next member of the free trade area. The Asia-Pacific Economic Cooperation forum (APEC) emerged as the kernel of a possible future Asia Pacific free trade area. The former Communist states of Eastern Europe and Asia continued on the road to economic and political reform. As they did, the euphoric mood that followed the collapse of communism in 1989 was slowly replaced with a growing sense of realism about the hard path ahead for many of these countries. The global money market continued its meteoric growth. By 2001, more than $1.5 trillion per day was flowing across national borders. The size of such flows fueled concern about the ability of short-term speculative shifts in global capital markets to destabilize the world economy. These fears were fanned by the well-publicized financial problems of a number of organizations that traded derivatives through the global money market, such as Barings Bank. The World Wide Web emerged from nowhere to become the backbone of an emerging global network for electronic commerce. The world continued to become more global. Several Asian Pacific economies, including most notably China, continued to grow at a rapid rate. New multinationals continued to emerge from developing nations in addition to the world's established industrial powers. And increasingly, the globalization of the world economy affected a wide range of firms of all sizes, from the very large to the very small.

Reflecting this rapid pace of change, in this edition I have tried to ensure that all material and statistics are as up-to-date as possible as of 2004. However, being absolutely up-to-date is impossible since change is always with us. What is current today may be outdated tomorrow. Accordingly, I have established a home page for this book on the World Wide Web at www.mhhe.com/hillgbt4e. From this home page the reader can access regular updates of chapter material and reports on topical developments that are relevant to students of international business. I hope readers find this a useful addition to the support material for this book.

BEYOND UNCRITICAL PRESENTATION AND SHALLOW EXPLANATION

Many issues in international business are complex and thus necessitate considerations of pros and cons. To demonstrate this to students, I have adopted a critical approach that presents the arguments for and against economic theories, government policies, business strategies, organizational structures, and so on.

Related to this, I have attempted to explain the complexities of the many theories and phenomena unique to international business so the student might fully comprehend the statements of a theory or the reasons a phenomenon is the way it is. These theories and phenomena are typically explained in more depth in this book than they are in competing textbooks, the rationale being that a shallow explanation is little better than no explanation. In international business, a little knowledge is indeed a dangerous thing.

INTEGRATED PROGRESSION OF TOPICS

Many textbooks lack a tight, integrated flow of topics from chapter to chapter. In this book, students are told in Chapter 1 how the book's topics are related to each other. Integration has been achieved by organizing the material so that each chapter builds on the material of the previous ones in a logical fashion.

Part One

Chapter 1 provides an overview of the key issues to be addressed and explains the plan of the book.

Part Two

Chapters 2, 3, and 4 focus on national differences in political economy and culture and the implications of these differences for ethical decision making. Most international business textbooks place this material later, but I believe it is vital to discuss national differences first. After all, many of the central issues in international trade and investment, the global monetary system, international business strategy and structure, and international business operations arise out of national differences in political economy and culture. To fully understand these issues, students must first appreciate the differences in countries and cultures.

Part Three

Chapters 5 through 8 investigate the political economy of international trade and investment. The purpose of this part is to describe and explain the trade and investment environment in which international business occurs.

Part Four

Chapters 9 and 10 describe and explain the global monetary system, laying out in detail the monetary framework in which international business transactions are conducted.

Part Five

In Chapters 11 through 16, attention shifts from the environment to the firm. Here the book examines the strategies and structures that firms adopt to compete effectively in the international business environment. These chapters explain how firms can perform their key functions—manufacturing, marketing, R&D, and human resource management—to compete and succeed in the international business environment.

Throughout the book, the relationship of new material to topics discussed in earlier chapters is pointed out to the students to reinforce their understanding of how the material comprises an integrated whole.

FOCUS ON MANAGERIAL IMPLICATIONS

Many international business textbooks fail to discuss the implications of the various topics for the actual practice of international business. This does not serve the needs of business school students who soon will be practicing managers. Accordingly, the usefulness of this book's material in the practice of international business is discussed explicitly. In particular, at the end of each chapter in Parts Two, Three, and Four—where the focus is on the environment of international business, as opposed to particular firms—there is a section titled "Focus on Managerial Implications." In this section, the managerial implications of the material discussed in the chapter are clearly explained. For example, Chapter 5, "International Trade Theory," ends with a detailed discussion of the various trade theories' implications for international business management.

In addition, each chapter begins with an opening case that illustrates the relevance of chapter material for the practice of international business. Chapter 2, "National Differences in Political Economy," for example, opens with a case that describes the challenges faced by people in sub-Saharan Africa because of lack of economic development due in large part to corrupt government and bad economic politics.

I have also retained the closing cases to each chapter. These cases are also designed to illustrate the relevance of chapter material for the practice of international business. The closing case to Chapter 2, for example, looks at the changing political economy in India. This case helps to illustrate the impact of foreign direct investment on the economic growth of the country.

Another tool that I have used to focus on managerial implications are Management Focus boxes. There is at least one Management Focus in each chapter. Like the opening case, the purpose of these boxes is to illustrate the relevance of chapter material for the practice of international business. The Management Focus in Chapter 2, for example, looks at how piracy in the video game industry threatens the growth of the entire industry.

ACCESSIBLE AND INTERESTING

The international business arena is fascinating and exciting, and I have tried to communicate my enthusiasm for it to the student. Learning is easier and better if the subject matter is communicated in an interesting, informative, and accessible manner. One technique I have used to achieve this is weaving interesting anecdotes into the narrative of the text—stories that illustrate theory. The opening cases and focus boxes are also used to make the theory being discussed in the text both accessible and interesting.

Each chapter has two kinds of focus boxes—a Management Focus box (described above) and a Country Focus box. Country Focus boxes provide background on the political, economic, social, or cultural aspects of countries grappling with an international business issue. In Chapter 3, for example, one Country Focus box discusses how large banking institutions are offering Islamic financial services for their customers in Pakistan.

Just how accessible and interesting this book actually is will be revealed by time and student feedback. I am confident, however, that this book is far more accessible to students than its competitors. For those of you who view such a bold claim with skepticism, I urge you to read the sections in Chapter 1 on the globalization of the world economy, the changing nature of international business, and how international business is different.

WHAT'S NEW IN THIS EDITION

The success of the first three editions of *Global Business Today* was based in part upon the incorporation of leading-edge research into the text, the use of the up-to-date examples and statistics to illustrate global trends and enterprise strategy, and the discussion of current events within the context of the appropriate theory. Building on these strengths, my goals for this revision have been threefold:

1. Incorporate new insights from recent scholarly research wherever appropriate.
2. Make sure the content of the text covers all appropriate issues.
3. Make sure the text is as up-to-date as possible with regard to current events, statistics, and examples.

As part of the revision process, changes have been made to every chapter in the book. In addition, I am introducing four significant changes to this edition.

Chapter 4, "Ethics in International Business," was added due to an outcry for more expansive coverage of the important role that ethics plays. Ethical dilemmas arise frequently in international business because of the many cultural differences among countries. This chapter discusses the challenges companies face when forced to deal with human rights issues, environmental pollution, and corruption. There are also sections dealing with social responsibility and the sources of unethical behavior. The Management Focus addresses the risky nature of testing pharmaceuticals in developing nations. There is also a discussion about the unethical behavior of the leaders of large corporations, such as the frequently publicized Enron scandal. Throughout the chapter, current examples are interwoven with ethical theories to demonstrate the complex challenges that companies face.

"Another Cultural Perspective" boxes have been added to enhance the already popular "Another Perspective" boxes to further expand upon how culture is deeply embedded in the way companies operate internationally. For an example, see the Another Cultural Perspective box in Chapter 4, which highlights the importance of expatriate managers adhering to the cultural norms of the countries in which they work.

In every part, we have added a new feature called "Sustainability in Practice," compiled by Debra Rowe, professor of Environmental Systems and Behavioral Sciences at Oakland Community College. Dr. Rowe is also the Senior Fellow of University Leaders for a Sustainable Future. By offering this new feature on business and sustainable development, global business educators have a unique opportunity to help students understand how businesses are engaging in the solutions to sustainable development challenges. Sustainable development is about the triple bottom line—simultaneously fostering healthy economies, vibrant communities, and viable ecosystems. It requires using the best available knowledge and critical thinking about complex systems and how they can be maintained, even enhanced, over time. See Part 5 for a vignette about a carpet and textile company that changed its entire business philosophy in order to function in a more socially responsible manner.

This edition welcomes the addition of new GlobalEdge™ Research Tasks. By using the text and the GlobalEdge Web site, http://globaledge.msu.edu, students solve realistic international business problems related to each chapter. These exercises expose students to the types of tools and data sources international managers use to make informed business decisions.

Chapter 1: Globalization. All the statistics pertaining to globalization (such as the growth of world trade, output, and foreign direct investment) have been updated to incorporate the most recently available data. The chapter has been revised to include new material on the growing wave of protests against globalization, which began at the World Trade Organization meeting in Seattle in December 1999 and have continued at a steady pace since. The section dealing with the debate between scholars on the merits and drawbacks of globalization has been expanded. This debate is concerned with the impact of globalization on job security, income levels, labor policies, economic growth, the environment, and national sovereignty.

Chapter 2: National Differences in Political Economy. The section on economic development has been expanded to include a review of the work of Amartya Sen, who recently won the Nobel Prize in economics. Sen has argued that development should be assessed less by material output measures such as GNP per capita and more by the capabilities and opportunities that people enjoy. The discussion of differences in legal systems has been rewritten to give greater emphasis to the negative impact of corruption in a country on its economic development. There is also an expanded discussion dealing with the protection of intellectual property rights, which takes into account some recent developments, such as the decision by some governments to allow the sale of cheap generic versions of patented medicines—including a powerful new drug for treating AIDS—without permission from the patent owner.

Chapter 3: Differences in Culture. The Focus on Managerial Implications section of this chapter has been expanded to incorporate a more detailed discussion of the implications of difference in culture for business ethics. Although many ethical principles are universal, some are culturally bounded. When this is the case, international businesses may be confronted with some difficult ethical dilemmas.

Chapter 5: International Trade Theory. Over the past few years, a number of empirical studies have been published that look at the relationship between a country's "openness" to international trade and its economic growth. This work is now discussed in this chapter. The work gives empirical support to the theory of comparative advantage.

Chapter 6: The Political Economy of International Trade. The chapter has been significantly updated to reflect the recent activities of the World Trade Organization (WTO). This includes an assessment of the record of the WTO in resolving trade disputes between nations. There is also a review of recent multinational agreements, brokered by the WTO, to liberalize cross-border trade and investment in financial services and telecommunications. There is a discussion of the decision to allow China to enter the WTO. Finally, the revised chapter contains a discussion of the future of the WTO in the aftermath of the Seattle protests against globalization.

Chapter 7: Foreign Direct Investment. The chapter has been updated to include all recent statistics of trends in foreign direct investment. Recent data emphasize the important fact that the majority of cross-border investments in recent years have taken the form of mergers and acquisitions, rather than greenfield investments. The reasons for this empirical phenomenon are now discussed in the chapter.

Chapter 8: Regional Economic Integration. In January 1999, 11 member states of the European Union officially adopted a common currency unit, the euro. This chapter has been revised to include an expanded discussion of the merits and drawbacks of the euro, and a review and assessment of the early history of the euro. The chapter also includes a new discussion of the competition policy of the European Commission. This has become increasingly important to international businesses in recent years. For example, in 2001 the European Commission ruled against a proposed merger between two U.S. companies, General Electric and Honeywell, on the grounds that it would reduce competition in the European Union.

Chapter 11: The Strategy of International Business. An emerging theme in the strategy literature has been the extent to which multinational companies can leverage the skills and competencies of their foreign subsidiaries, using them to benefit the entire corporation. A new section has been added to Chapter 11 to discuss this important benefit of international expansion.

Chapter 12: Entering Foreign Markets. A new section in this chapter looks at the choice between acquisitions and greenfield ventures as alternative strategies for entering foreign markets and establishing a wholly owned subsidiary. The pros and cons associated with each alternative are now discussed in depth in the chapter.

Chapter 15: Global Marketing and R&D. Web-based information systems now play a crucial role in materials management in the international business. By tracking component parts as they make their way across the globe toward an assembly plant, Web-based information systems enable a firm to optimize its production scheduling according to when components are expected to arrive. A new section has been added to this chapter to discuss this trend.

INSTRUCTOR SUPPORT MATERIAL

Instructor's Manual/Test Bank

(Located on the Instructor's CD-ROM)

The Instructor's Manual, prepared by Veronica Horton of the University of Akron, contains chapter overviews, teaching suggestions, and lecture notes. The Test Bank portion for this edition, prepared and updated by Amit Shah at Frostburg State University, contains approximately 100 questions per chapter.

Computerized Testing for Windows (Located on the Instructor's CD-ROM)

A computerized version of the Test Bank allows the instructor to generate random tests and to add his or her own questions.

PowerPoint® Presentation Slides (Located on the Instructor's CD-ROM)

The PowerPoint presentation, by Jeanne McNett of Assumption College, contains a blend of material from the text and also new material, amounting to approximately 15 to 20 slides per chapter.

Instructor's CD-ROM (007-297372-2)

The Instructor's Manual, the PowerPoint® slides, and Test Bank are compiled in electronic format on a CD for your convenience in customizing lecture presentations.

Video Collection (007-297375-7)

This edition also includes an improved video collection, consisting of NBC News footage and original business documentaries for each chapter. Professor Video Notes and student video exercises will be available online. For a comprehensive lineup of video selections for each chapter, please see the Online Learning Center for complete details.

Instructor Resources and Online Learning Center

This password-protected instructor section of the book Web site, available to adopters of *Global Business Today,* will provide coverage of the latest in online news and links relating to international business, countries, and situations referenced in the text. Other online and downloadable teaching resources will be available for the instructor as well.

STUDENT RESOURCES

Global Business Plan Project and Resource CD

Every new copy of *Global Business Today* includes the Global Business Plan Project and Interactive Atlas CD. Using the latest in Flash technology, global business becomes fun and accessible. Designed by Les Dlabay of Lake Forest College for use in his own international business classes, the global business plan project helps students create their own plan to launch a new business venture. Students can solve realistic problems through interactive exercises exploring core frameworks such as Foreign Direct Investment or Historical Exchange Rates. Additionally, eight videos complemented by cases and discussion questions allow students to delve into current international business issues. These dynamic activities and study tools will help students gain a better understanding of competing in the global marketplace.

Student Online Learning Center

Online Learning Center www.mhhe.com/hillgbt4e content is ancillary and supplementary and germane to the textbook. As students read the book, they can go online to take self-grading quizzes, review material, or work through interactive exercises. Hill's Global Business Today will include such items for the student as key term flashcards; other self-assessment links; and much more. OLCs can be delivered multiple ways—professors and students can access them directly through the textbook Web site, through PageOut, or within a course management system (i.e., WebCT, Blackboard, TopClass, or eCollege).

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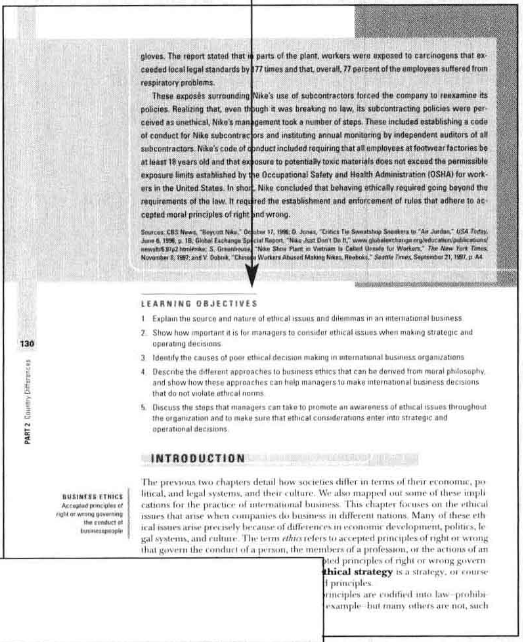
LEARNING FEATURES

Charles W. L. Hill's *Global Business Today* has a rich selection of learning features that highlight companies' ups and downs in the international business arena, stimulate learning and understanding, and challenge students to respond.

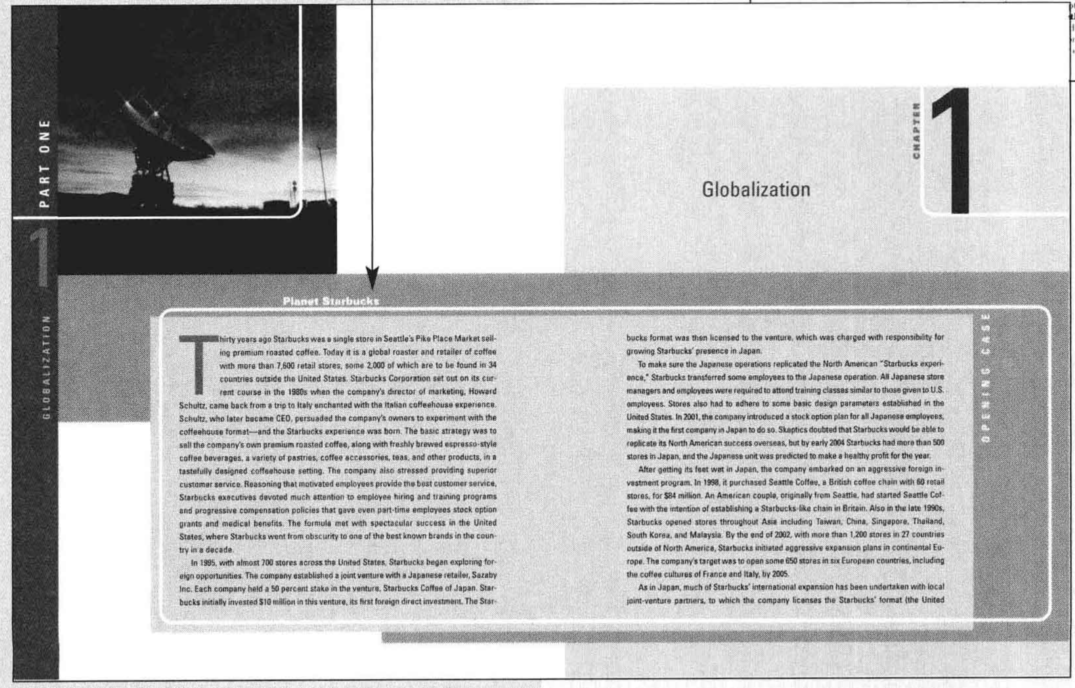
Learning Objectives

A chapter road map for your students, the Learning Objectives tell them what they will know after completing the chapter.



Opening Case

Each chapter begins with an engaging opening case that sets the stage for the chapter. These brief but interesting case studies introduce students to critical issues and often challenge their preconceptions. For actual countries/organizations providing rich, introductory examples, look to each chapter's opening case.



ANOTHER PERSPECTIVE

Ethical questions of foreign drug testing
Increasingly, U.S. drug companies are testing their drugs overseas. Popular sites are Russia, Poland, and Hungary. This is largely because they can find trial participants easily and the process is cheaper than in the United States because there are fewer governmental restrictions on protocols, the medical standards are high, and well-trained clinical trial investigators earn as little as a few hundred dollars a month. Thus, the testing goes more quickly and costs less. The company's goal is to determine if the drug is effective, and if so, get it to the market. When the trials are successful and the drug is marketed in developed countries, what if any obligation does the drug company have to the people who participated in the trials? Often the drug company won't market the drug in their country. Should drug companies do "parachute research," where they drop in, do their testing, and then leave? Or do they have a moral responsibility to continue treatment? Is there a difference if the drug in question is life-sustaining, such as an AIDS drug, or life-improving but not life-prolonging?

ANOTHER CULTURAL PERSPECTIVE

The issue of giving meaning across cultures
One difficulty in making ethical decisions across cultural borders is that expatriate managers may interpret a local cultural practice in the way such behavior would be understood in their home culture. If the manager does not attempt to understand the practice's meaning in the local culture, the manager may miss a huge step in ethical analysis. For example, Western standards would fail to properly interpret Muslim women's practice of covering their heads and faces in conservative Muslim cultures. Remember to consider context when conducting an ethical analysis. In such a process, a local informant can be helpful. At the same time, be aware of the ethical trap of cultural relativism captured in the adage, "When in Rome, do as the Romans do."

(Example from H. Lane, M. Maznevski, M. Mendenhall, and J. McNett, *The Blackwell Handbook of Global Management: A Guide to Managing Complexity,* 2004.)

Another Perspective

With four to five examples per chapter, Another Perspective and Another Cultural Perspective boxes provide students an alternate way of thinking about important global issues presented in the text. These not only hone students' critical thinking skills but also give a deeper understanding of a topic nearby.

COUNTRY FOCUS

ISLAMIC BANKING IN PAKISTAN

The Koran clearly condemns interest, which is called *riba* in Arabic, as exploitative and unjust. For many years, banks operating in Islamic countries conveniently ignored this condemnation, but starting about 25 years ago with the establishment of an Islamic bank in Egypt, Islamic banks started to open in predominantly Muslim countries. By 2001, some 170 Islamic financial institutions worldwide managed over $150 billion in assets, making an average return on capital of more than 16 percent. Even conventional banks are entering the market— both Citigroup and HSBC, two of the world's largest financial institutions, now offer Islamic financial services. Until mid-2001, only Iran and the Sudan enforced Islamic banking conventions, but in many other countries, customers could choose between conventional banks and Islamic banks.

In July 2001, Pakistan became the third country to require its banks to adopt Islamic methods. The transition to Islamic banking in Pakistan may determine the fate of Islamic banking elsewhere in the world. Conventional banks make a profit on the spread between the interest rate they have to pay to depositors and the higher interest rate they charge borrowers. Because Islamic banks cannot pay or charge interest, they must find a different way of making money. Pakistan's banks are set to experiment with two different Islamic banking methods—the *mudarabah* and the *murabaha.*

A *mudarabah* contract is similar to a profit-sharing scheme. Under *mudarabah,* when an Islamic bank lends money to a business, rather than charging that business interest on the loan, it takes a share in the profits that are derived from the investment. Similarly, when a business (or individual) deposits money at an Islamic bank in a savings account, the deposit is treated as an equity investment in whatever activity the bank uses the capital for. Thus, the depositor receives a share in the profit from the bank's investment (as opposed to interest payments) according to an agreed-on ratio. Some Muslims claim this is a more efficient system than the Western banking system, since it encourages both long-term savings and long-term investment. However, there is no hard evidence of this, and many believe that a *mudarabah* system is less efficient than a conventional Western banking system.

The second Islamic banking method, the *murabaha* contract, is the most widely used among the world's Islamic banks. It seems set to become the most popular method in Pakistan, primarily because it is the easiest to implement. In a *murabaha contract,* when a firm wishes to purchase something using a loan—let's say a piece of equipment that costs $1,000—the firm tells the bank after having negotiated the price with the equipment manufacturer. The bank then buys the equipment for $1,000, and the borrower buys it back from the bank at some later date for, say, $1,100, a price that includes a $100 markup for the bank. A cynic might point out that such a markup is functionally equivalent to an interest payment, and it is the similarity between this method and conventional banking that makes it so much easier to adopt.

Whichever method is most widely used, observers expect the transition from traditional to Islamic banking to be challenging. One fear is that there could be large-scale withdrawals by depositors, driven by worries that they could suffer in the absence of fixed interest rates. Another concern is that the country needs to have a tight regulatory regime to ensure that unscrupulous borrowers using a *mudarabah* contract do not declare themselves bankrupt, even when their businesses are running a profit. A third concern is that the uncertainty created by the transition will scare off foreign investors, leaving Pakistan starved of capital.

Sources: "Forced Devotion," *The Economist,* February 17, 2001, pp. 76–77; "Islamic Banking Marches On," *The Banker,* February 1, 2000; and F. Bokhari, "Bankers Fear Introduction of Islamic System Will Prompt Big Withdrawals," *Financial Times,* March 6, 2001, p. 4.

following a path for transformation. Siddhartha offered the Noble Eightfold Path as a route for transformation. This emphasizes right seeing, thinking, speech, action, living, effort, mindfulness, and meditation. Unlike Hinduism, Buddhism does not support the caste system. Nor does Buddhism advocate the kind of extreme ascetic behavior that is encouraged by Hinduism. Nevertheless, like Hindus, Buddhists stress the afterlife and spiritual achievement rather than involvement in this world.

Country Focus

Country Focus boxes provide real-world examples of how different countries grapple with the political, economic, social, or cultural issues facing them.

SUSTAINABILITY IN PRACTICE

INTERFACE: AN ENVIRONMENTALLY SUSTAINABLE COMMITMENT TO BUSINESS AND MATERIAL MANAGEMENT

The following case study describes a company's efforts to be both profitable and environmentally sustainable.

Interface, Inc., is the world's largest manufacturer of carpet tiles and upholstery fabrics for commercial interiors. But Interface's core vision is not about carpet or fabrics per se; it is about becoming a leading example of a sustainable and restorative enterprise by 2020 across five dimensions: people, place (the planet), product, process, and profits. That is a substantial challenge for a company that in 2000 had 27 factories, sales offices in 110 countries, annual sales of $1.3 billion, over 7,000 employees, and a supply chain heavily dependent on petrochemicals.

Founder and Chairman Ray Anderson presented this challenge to the organization in 1994. "After 21 years of unwittingly plundering the earth, I read Paul Hawken's book *The Ecology of Commerce* (Harper 1993). . . . It convicted me on the spot, not only as a plunderer of Earth, but also as part of an industrial system that is destroying Earth's biosphere, the source and nurturer of all life. . . . I was struck to the core by Hawken's central point, that only business and industry, the major culprit, is also large enough, powerful enough, pervasive enough, wealthy enough, to lead humankind away from the abyss toward which we are plunging. It was an epiphanal experience for me, a "spear in the chest." . . . I myself became a recovering plunderer. At Interface we call this new direction, climbing Mount Sustainability, the point at its peak symbolically representing zero environmental 'footprint'—our definition of sustainability for ourselves, to reach a state in which our petro-intensive company (energy and materials) takes nothing from the earth that is not naturally and rapidly renewable, and does no harm to the biosphere: zero footprint."

As a result, Interface has undergone considerable transformation in its effort to reorient the entire organization. Some positive results were achieved in the beginning. Through its waste elimination drive, the company has saved $165 million over five years, paying for all of its sustainability work and delivering 27 percent of the group's operating income over the period. Over and above that, since 1994, Interface, Inc., has reduced its "carbon intensity"—its total supply chain virgin petrochemical material and energy use in raw pounds per dollar of revenue—by some 31 percent. However, Interface recognized that sustainability means far more than that.

The company developed a shift in strategic orientation based on a "seven-step" sustainability framework, using the systems thinking of The Natural Step (www.naturalstep.org/). These steps include eliminating waste (not just physical waste, but the whole concept of waste); eliminating harmful emissions; using only renewable energy; adopting closed loop processes; using resource-efficient transportation; energizing people (all stakeholders) around the vision; and redesigning commerce so that a service is sold that allows the company to retain ownership of its products and to maximize resource productivity.

Throughout the business, all employees were trained in the principles of systems thinking. They were required to examine the impact of their work and how they could work more sustainably in their business area. Training was necessary, according to Andersen, because traditional education "continues to teach economics students to trust the 'invisible hand' of the market, when the invisible hand is clearly blind to the externalities. . . . The truth is, we have an essentially illiterate populace when it comes to the environment." The feedback on this training has been very positive and a great deal of progress has been made as a result. However, there were three areas where Interface could have improved the process.

The first is always establishing a positive environment for inspired employees, fresh from their training courses, to return to. The company found that employees became passionate as their understanding of sustainability grew, and they needed an outlet for action. Although there were many areas of good supportive management across the business, there were also too many areas where local managers were not prepared well enough to facilitate motivated employees wanting to make a difference. Issues of management and leadership explain why some of the expected progress did not happen in certain areas.

Second, people engage in different ways with sustainability issues, and learning programs need to provide the space to explore these differences. Programs need to be flexible enough to go into detail on a hot issue such as climate change, while the next question may well be about equity of resource use. To keep people motivated, programs need to maintain this flexibility.

Third, follow-up was not quick enough; it takes much more than two days for people to really understand sustainability. Sustainability issues need to be revisited again and again, as employees begin to understand how it impacts their daily lives. It is a big commitment to revisit these issues on an ongoing basis, but the company recognized that it was vital for employees to continually buy in.

Interface has also learned the importance of making sustainability a "whole company" approach. Those who "got it" quickest were inevitably those working in either the manufacturing or the research areas of the bu
talking about the environment, system
tution. A high number of the company

Sustainability in Practice

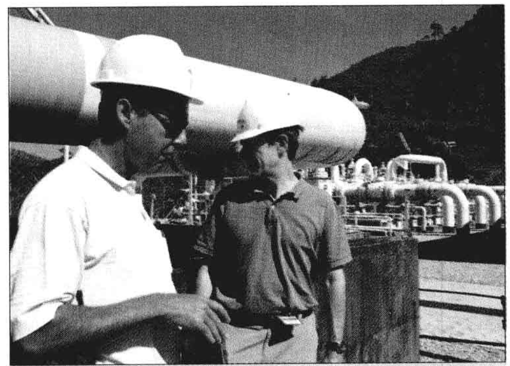
Located after each part, these vignettes illustrate how businesses are engaging in the solutions to sustainable development challenges.

MANAGEMENT FOCUS

UNOCAL IN MYANMAR

In 1995, Unocal, an oil and gas enterprise based in California, took a 29 percent stake in a partnership with the French oil company Total and state-owned companies from both Myanmar and Thailand, to build a gas pipeline from Myanmar to Thailand. At the time, the $1 billion project was expected to bring Myanmar about $200 million in annual export earnings, a quarter of the country's total. The gas used domestically would increase Myanmar's generating capacity by 30 percent. This investment was made when a number of other American companies were exiting Myanmar. Myanmar's government, a military dictatorship, had a reputation for brutally suppressing internal dissent. Citing the political climate, the apparel companies Levi Strauss and Eddie Bauer had both withdrawn from the country. But as far as Unocal's management was concerned, the giant infrastructure project would generate healthy returns for the company and, by boosting economic growth, a better life for Myanmar's 43 million people. Moreover, while Levi Strauss and Eddie Bauer could easily shift production of clothes to another low-cost location, Unocal argued it had to go where the oil and gas were located.

However, Unocal's investment quickly became highly controversial. Under the terms of the contract, the government of Myanmar was contractually obliged to clear a corridor for the pipeline through Myanmar's tropical forests and to protect the pipeline from attacks by the government's enemies. According to human rights groups, the Myanmar army forcibly moved villages and ordered hundreds of local peasants to work on the pipeline in conditions that were no better than slave labor. Those who refused to comply suffered retaliation. News reports cite the case of one woman who was thrown into a fire, along with her baby, after her husband tried to escape from troops forcing him to work on the project. The baby died and she suffered burns. Other villagers report being beaten, tortured, raped, and otherwise mistreated when the alleged slave labor conditions were occurring.



When Unocal made contractual agreements with the government of Myanmar, human rights advocates took notice. Villages were uprooted to make room for a pipeline, and some villagers were forced to work on the pipeline in poor conditions. Unocal may escape legal liability, but should it?

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CHAPTER 4 Ethics in International Business

Management Focus

Management Focus boxes illustrate the relevance of chapter concepts for the practice of international business.

Evaluating Porter's Theory

Porter contends that the degree to which a nation is likely to achieve international success in a certain industry is a function of the combined impact of factor endowments, domestic demand conditions, related and supporting industries, and domestic rivalry. He argues that the presence of all four components is usually required for this diamond to boost competitive performance (although there are exceptions). Porter also contends that government can influence each of the four components of the diamond–either positively or negatively. Factor endowments can be affected by subsidies, policies toward capital markets, policies toward education, and so on. Government can shape domestic demand through local product standards or with regulations that mandate or influence buyer needs. Government policy can influence supporting and related industries through regulation and influence firm rivalry through such devices as capital market regulation, tax policy, and antitrust laws.

If Porter is correct, we would expect his model to predict the pattern of international trade that we observe in the real world. Countries should be exporting products from those industries where all four components of the diamond are favorable, while importing in those areas where the components are not favorable. Is he correct? We simply do not know. Porter's theory has not been subjected to independent empirical testing. Much about the theory rings true, but the same can be said for the new trade theory, the theory of comparative advantage, and the Heckscher-Ohlin theory. It may be that each of these theories, which complement each other, explains something about the pattern of international trade.

FOCUS ON MANAGERIAL IMPLICATIONS

Why does all this matter for business? There are at least three main implications for international businesses of the material discussed in this chapter: location implications, first-mover implications, and policy implications.

LOCATION

Underlying most of the theories we have discussed is the notion that different countries have particular advantages in different productive activities. Thus, from a profit perspective, it makes sense for a firm to disperse its productive activities to those countries where, according to the theory of international trade, they can be performed most efficiently. If design can be performed most efficiently in France, that is where design facilities should be located; if the manufacture of basic components can be performed most efficiently in Singapore, that is where they should be manufactured; and if final assembly can be performed most efficiently in China, that is where final assembly should be performed. The result is a global web of productive activities, with different activities being performed in different locations around the globe depending on considerations of comparative advantage, factor endowments, and the like. If the firm does not do this, it may find itself at a competitive disadvantage relative to firms that do.

Consider the production of a laptop computer, a process with four major stages: (1) basic research and development of the product design, (2) manufacture of standard electronic components (e.g., memory chips), (3) manufacture of advanced components (e.g., flat-top color display screens and microprocessors), and (4) final assembly. Basic R&D requires a pool of highly skilled and educated workers with good backgrounds in microelectronics. The two countries with a comparative advantage in basic microelectronics R&D and design are Japan and the United States, so most producers of top computers locate their R&D facilities in one, or both, of these countries. (Apple, IBM, Motor Texas Instruments, Toshiba, and Sony all have major R&D facilities in both Japan and the Un States.)

Focus on Managerial Implications

At the end of nearly every chapter, Focus on Managerial Implications spotlights the managerial implications of the material discussed in the chapter.

CRITICAL THINKING AND DISCUSSION QUESTIONS

1. Review the Management Focus on testing drugs in the developing world and discuss the following questions:
   a. Did Pfizer behave unethically by rushing to take advantage of a Nigerian epidemic to test an experimental drug on sick children? Should the company have proceeded more carefully?
   b. Is it ethical to test an experimental drug on children in emergency settings in the developing world where the overall standard of health care is much lower than in the developed world, and where proper protocols might not be followed?
2. A visiting American executive finds that a foreign subsidiary in a poor nation has hired a 12-year-old girl to work on a factory floor, in violation of the company's prohibition on child labor. He tells the local manager to replace the child and tell her to go back to school. The local manager tells the American executive that the child is an orphan with no other means of support, and she will probably become a street child if she is denied work. What should the American executive do?
3. Drawing upon John Rawls's concept of the veil of ignorance, develop an ethical code that will (*a*) guide the decisions of a large oil multinational toward environmental protection, and (*b*) influence the policies of a clothing company to outsourcing of manufacturing process.
4. Under what conditions is it ethically defensible to outsource production to the developing world where labor costs are lower when such actions also involve laying off long-term employees in the firm's home country?
5. Are facilitating payments ethical?

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Use the globalEDGE™ site to complete the following exercises:

1. Promoting respect for universal human rights is a central dimension of all countries' foreign policy. As history has repeatedly shown, human rights abuses are everybody's concern. The United States stands ready to work with other governments and civil society to prevent the abuses of power. Begun in 1977, the annual Country Reports on Human Rights Practices are designed to assess the state of democracy and human rights around the world, call attention to violations, and—where needed—prompt changes in our policies toward particular countries. Find the annual Country Reports on Human Right Practices, and provide information on how the reports are prepared.
2. The Corruption Perceptions Index (CPI) is a comparative assessment of a country's integrity performance, along with related academic research on corruption. Provide a description of this index and its ranking. Identify the five countries with the lowest and five with the highest CPI scores according to this index.

Closing Case

The closing case wraps up the material in the chapter by relating the experience of a company to the practice of international business.

CLOSING CASE

ETCH-A-SKETCH ETHICS

The Ohio Art Company is perhaps best known as the producer of one of the top selling toys of all time, the venerable Etch-A-Sketch. More than 100 million of the familiar red rectangular drawing toys have been sold since 1960 when it was invented. The late 1990s, however, became a troubled time for the toy's maker. Confronted with sluggish toy sales, the Ohio Art Company lost money for two years. In December 2000, it made the strategic decision to outsource production of the Etch-A-Sketch toys to Kin Ki Industrial, a leading Chinese toy maker, laying off 100 U.S. workers in the process.

The closure of the Etch-A-Sketch line was not unexpected among employees. The company had already moved the production of other toy lines to China, and most employees knew it was just a matter of time before Etch-A-Sketch went too. Still, the decision was a tough one for the company, which did most of its manufacturing in its home base, the small Ohio town of Bryan (population 8,000). As William Killgallon, the CEO of the Ohio Art Company, noted, the employees who made the product "were like family. It was a necessary financial decision we saw coming for some time, and we did it gradually, product by product. But that doesn't mean it's emotionally easy."

END-OF-CHAPTER MATERIAL GEARED TOWARD YOUR STUDENTS

Key Terms and Summary

KEY TERMS

ad valorem tariffs, p. 200	free trade, p. 198	specific tariff, p. 200
administrative trade policies, p. 205	Helms-Burton Act, p. 210	subsidy, p. 201
antidumping policies, p. 206	import quota, p. 203	tariff, p. 200
countervailing duties, p. 206	local content requirement, p. 205	voluntary export restraint, p. 203
D'Amato Act, p. 210	quota rent, p. 203	
dumping, p. 206	Smoot-Hawley Act, p. 215	

SUMMARY

The objective of this chapter was to describe how the reality of international trade deviates from the theoretical ideal of unrestricted free trade reviewed in Chapter 5. Consistent with this objective, in this chapter we have reported the various instruments of trade policy, reviewed the political and economic arguments for government intervention in international trade, reexamined the economic case for free trade in light of the strategic trade policy argument, and looked at the evolution of the world trading framework. While a policy of free trade may not always be the theoretically optimal policy

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2. The Corruption Perceptions Index (CPI) is a comparative assessment of a country's integrity performance, along with related academic research on corruption. Provide a description of this index and its ranking. Identify the five countries with the lowest and five with the highest CPI scores according to this index.

chapter were to review theories that attempt to explain the pattern of FDI between countries and to examine the influence of governments on firms' decisions to invest in foreign countries. The chapter made these points:

1. Any theory seeking to explain FDI must explain why firms go to the trouble of acquiring or establishing operations abroad, when the alternatives of exporting and licensing are available to them.
2. High transportation costs and/or tariffs imposed on imports help explain why many firms prefer FDI or licensing over exporting.
3. Firms often prefer FDI to licensing when: (i) a firm has valuable know-how that cannot be adequately protected by a licensing contract, (ii) a firm needs tight control over a foreign entity to maximize its market share and earnings in that country, and (iii) a firm's skills and capabilities are not amenable to licensing.
4. Knickerbocker's theory suggests that much FDI is explained by imitative behavior by rival firms in an oligopolistic industry.
5. Vernon's product life-cycle theory suggests that firms undertake FDI at particular stages in the life cycle of products they have pioneered. However, Vernon's theory does not address the issue of whether FDI is more efficient than exporting or licensing for expanding abroad.
6. Dunning has argued that location-specific advantages are of considerable importance in explaining the nature and direction of FDI. According to Dunning, firms undertake FDI to exploit resource endowments or assets that are location specific.
7. Political ideology is an important determinant of government policy toward FDI. Ideology ranges from a radical stance that is hostile to FDI to a noninterventionist, free market stance. Between the two extremes is an approach best described as pragmatic nationalism.
8. Benefits of FDI to a host country arise from resource transfer effects, employment effects, and balance-of-payments effects.
9. The costs of FDI to a host country include adverse effects on competition and balance of payments and a perceived loss of national sovereignty.
10. The benefits of FDI to the home (source) country include improvement in the balance of payments as a result of the inward flow of foreign earnings, positive employment effects when the foreign subsidiary creates demand for home-country exports, and benefits from a reverse resource-transfer effect. A reverse resource-transfer effect arises when the foreign subsidiary learns valuable skills abroad that can be transferred back to the home country.
11. The costs of FDI to the home country include adverse balance-of-payments effects that arise from the initial capital outflow and from the export substitution effects of FDI. Costs also arise when FDI exports jobs abroad.
12. Home countries can adopt policies designed to both encourage and restrict FDI. Host countries try to attract FDI by offering incentives and try to restrict FDI by dictating ownership restraints and requiring that foreign MNEs meet specific performance requirements.

Critical Thinking and Discussion Questions

CRITICAL THINKING AND DISCUSSION QUESTIONS

1. In the 1990s and early 2000s, Japanese FDI in the United States grew more rapidly than U.S. FDI in Japan. Why do you think this is the case? What are the implications of this trend?
2. Compare and contrast these explanations of FDI: internalization theory, Vernon's product life-cycle theory, and Knickerbocker's theory of FDI. Which theory do you think offers the best explanation of the historical pattern of FDI? Why?
3. Reread the opening case on Toyota. Drawing upon internalization theory, explain Toyota's decision to invest in U.S. production facilities, as opposed to exporting cars from Japan to the United States?
4. You are the international manager of a U.S. business that has just developed a revolutionary new personal computer that can perform the same functions as PCs but costs only half as much to manufacture. Your CEO has asked you to formulate a recommendation for how to expand into the European Union market. Your options are (i) to export from the United States, (ii) to license a European firm to manufacture and market the computer in Europe, and (iii) to set up a wholly owned subsidiary in Europe. Evaluate the pros and cons of each alternative and suggest a course of action to your CEO.
5. Explain how the political ideology of a host government might influence the process of negotiating access between the host government and a foreign MNE.

STUDENT SUPPLEMENTS

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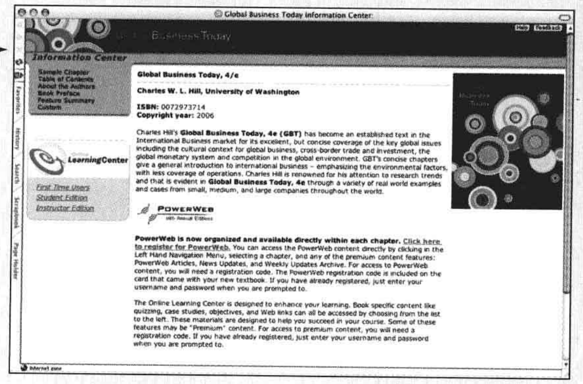

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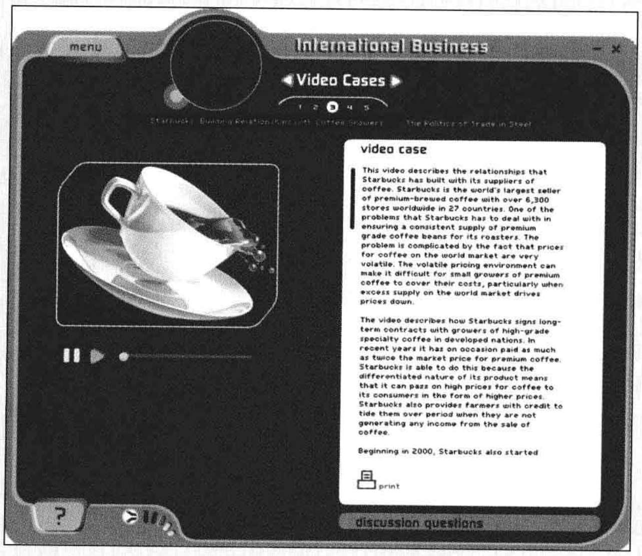
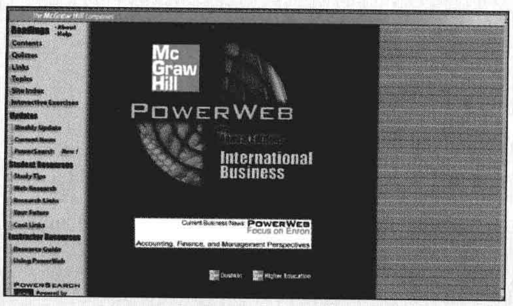
Global Business Plan and Resource CD-ROM



The Global Business Plan Project helps students create their own plan to launch a new business venture. As students work through the activities, they can link to terms, view video-clips, link to the text's Online Learning Center, or utilize our new "Business Around the World" feature. This feature allows students to research doing business in various countries by clicking on areas on the map to access business news and analysis, general facts, and business guidelines.

McGraw-Hill's PowerWeb



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