1.0. Introduction

This chapter covers two major components of learning objectives/outcomes that are likely to examine via coursework or examination. Therefore this chapter is important to build the basic aspects of international business. This chapter will also enables students to build their knowledge base in order to have a better understanding in the rest of the areas of international business.

1.2. Patterns and trends in international business

Wall, Minocha and Rees (2010) identified broad range of important and measurable trends in international business activity. These trends are:

1. Rapid growth in world trade and investment
2. Rapid growth in cross-border mergers and acquisitions
3. More liberalised markets on global scale
4. More globally-dispersed value chains
5. Bi-polar to tri-polar (triad)
6. Growth of regional trading arrangements
7. Growth of bilateral investment and trade treaties
8. Growth of sovereign wealth fund (SWFs)
9. Growth of ‘defensive techniques’ to combat global insecurity
10. Changing area patterns of international cost

1.2.1. Rapid growth in world trade and investment

There are two key important areas that should be considered in order to determine the growth in world trade and investment. These two indicators are:

- Foreign direct investment (FDI): refers to international investments in productive facilities such as plant, machinery and equipment.
- Export of goods and services

The FDI has increased fivefold in real terms, from US$ 400 billion in 2000 to US$1800 billion in 2007. The developed, developing and transition economies, latter including South East Europe and Common of Independent States, all saw continued growth in inward FDI, following the global dip in inward FDI in 2000-2003 period.

Export of goods and services has increased by 5% from 1980 to 2007 in real terms. High income economies (GNP=US$11,456 per capita or more) have accounted for most of this growth in absolute value of global exports. However the developing economies (GNP=US$935 or less) have increased their share of global exports. This trend has resulted in the export to GDP ratio of the developing economies/countries. The contribution of developing countries to international business is an issue that must be considered.
1.2.2. Rapid growth in cross-border mergers and acquisition

There has been a rapid growth in cross-border mergers and acquisition (M & A) since 1990s, despite a decline over the 2000-03 periods. Between 1990s and 2007 the value of the global cross border M & A rose eightfold from around US$200 billion per annum in 1990 to over US$1600 billion per annum in 2007.

Much of this activity (M & A) has been concentrated in financial services, insurance, life sciences, telecommunications and the media, with M & A being a key factor in accounting for the rise in FDI noted in figure below.

Largely as a result of cross border mergers, that 100 largest MNEs increased their foreign assets by almost 11% in 2006 alone, their foreign sales by 9% and their...

1.2.3. More liberalised markets on global scale

In figure 1.1. and 1.2, the rapid growth of foreign direct investment (FDI) and its relevance for cross-border mergers and acquisition (M & A) by multinational enterprises (MNEs).

The table below indicated the growth in regulatory changes affecting FDI by national governments. Also it can be seen that the overwhelming majority of these changes are regarded as being ‘more favourable’ to FDI flows.

<table>
<thead>
<tr>
<th>Item</th>
<th>1993</th>
<th>1995</th>
<th>1997</th>
<th>1999</th>
<th>2001</th>
<th>2003</th>
<th>2005</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>No of countries that introduce changes</td>
<td>56</td>
<td>63</td>
<td>76</td>
<td>65</td>
<td>71</td>
<td>82</td>
<td>92</td>
<td>58</td>
</tr>
<tr>
<td>No of regulatory changes</td>
<td>100</td>
<td>112</td>
<td>150</td>
<td>139</td>
<td>207</td>
<td>242</td>
<td>203</td>
<td>98</td>
</tr>
<tr>
<td>Regulatory changes in more favour of FDI</td>
<td>99</td>
<td>106</td>
<td>134</td>
<td>130</td>
<td>193</td>
<td>218</td>
<td>162</td>
<td>74</td>
</tr>
<tr>
<td>Regulatory changes in less favour of FDI</td>
<td>1</td>
<td>6</td>
<td>16</td>
<td>9</td>
<td>14</td>
<td>24</td>
<td>41</td>
<td>24</td>
</tr>
</tbody>
</table>

1.2.4. More globally dispersed value chain

With more market liberalisation comes increased worldwide competition which, together with rapid technological change, has placed increased pressures on large firms to adopt the most efficient and appropriate production and marketing locations if they are to survive and prosper. With improved international communications helping MNEs to coordinate and control geographically-dispersed activities, including service functions, the result has been increased propensity for MNEs to shift certain production and service activities to low-cost centres overseas. Alternatively, MNEs are engaged in an unending search for increased competitive advantage in terms of costs, resources, logistics and markets and are increasingly willing to reconfigure the geographical locations of their activities accordingly as shown in the figure below.
For example, use the so called transnationality index (TNI) to illustrate the increased international dispersion of production and service activities by MNEs. TNI is measured using:

- Foreign assets: Total assets
- Foreign sales: Total sales
- Foreign employment: Total employment

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales of foreign affiliates of MNEs</td>
<td>31,197</td>
<td>19.3</td>
<td>8.8</td>
<td>8.4</td>
</tr>
<tr>
<td>Total exports of goods and services</td>
<td>7,430</td>
<td>15.8</td>
<td>8.7</td>
<td>4.2</td>
</tr>
<tr>
<td>Employment of Foreign affiliates (thousands)</td>
<td>81,615</td>
<td>5.3</td>
<td>5.5</td>
<td>11.5</td>
</tr>
<tr>
<td>Total assets of foreign affiliates</td>
<td>68,716</td>
<td>17.7</td>
<td>13.7</td>
<td>19.3</td>
</tr>
</tbody>
</table>

Table 1.1: globally dispersed value chains
Source: Adapted from World Development Report 2008

Table 1.2: Comparison of Transnationality Index to FSTS Index
These figures and the table above show that there is a rapid growth in international orientation by the top MNEs.

1.2.5. Bi-polar to Tri-polar (Triad)

The old bi-polar world economy, which was dominated by North America and Europe, has moved on to a tri-polar world economy dominated by the ‘triad’ of North America, the European Union and South-East Asia. These three regions now account for around 80% of the total value of world exports and 84% of world manufacturing value added.

![Graph showing World GDP Real 2000 GDP ($billions)](image)

**Figure: 1.4: World GDP Real 2000 GDP ($billions)**

1.2.6. Growth of regional trading arrangement

There has been a rapid growth in regional trading blocs and in associated regional trading arrangements (RTAs), which give preferential treatment to trade in goods and services between members of these blocs. Only countries within the particular regional trading bloc (e.g. the EU, NAFTA) benefit from these RTAs, which have increased substantially in number over the past decade or so. This has led to the growth of ‘insiderisation’, i.e. attempts by MNEs to locate productive facilities inside these various regional trading blocs in order to avoid the protective and discriminatory barriers which would otherwise face their exports to countries within these blocs.

Such arrangements, under which two or more countries agree to reduce the trade barriers between themselves, have been proliferating during the past decade, aided by a faltering Doha Round. According to the latest data, some 474 RTAs had been notified as on 31 July 2010, up from 240 in the year 2000. G-15 member countries
too have been part of this trend and are currently members of over 50 RTAs. Of these, 17 are regional agreements involving groups of countries while around 35 others are bilateral in nature (www.g15.org, 2010).

Some of the regional trading arrangement includes, NAFTA, MERCOSUR, US-Chile free trade agreement, AFTA, SAFTA, ECOWAS etc.

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![Figure 1.5: Increase in regional trade agreements](image1)

*Source: Cullen and Parboteeah (2010)*

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![Figure 1.6:](image2)
1.2.7. Growth of bilateral investment and trade treaties

There has been a rapid growth in bilateral (two country) investment and trade treaties, which can take various forms, the major ones being bilateral investment treaties (BITs) and double taxation treaties (DTTs). The number of bilateral investment treaties (BITs) is continuing to rise, despite having reached already impressive numbers. At the end of 2009, a total of 2,750 BITs had been concluded (UNCTAD 2010: 81). According to UNCTAD (2010: 81), 295 agreements with investment provisions – apart from BITs and double taxation agreements – had been signed at the end of 2009.

1.2.8. Growth of sovereign wealth funds (SWFs)

Sovereign wealth funds (SWFs) are government owned investment vehicles managed separately from the official reserves of the country. They have usually been accumulated by those governments as the result of high global commodity prices for their exports. High energy (e.g. oil), food and other primary product prices over recent years have meant that an estimated US$500 billion is now available for potential investment by countries such as United Arab Emirates, Saudi Arabia, Dubai, Kuwait, China, Norway, the Russian Federation and Singapore, amongst others. SWFs will often be invested in projects with high risk but high expected returns. In 2009, Barclay Bank raised US$7 billion of funds from this sources rather than accept UK government funding to help it cope with the liquidity crisis of the ‘credit crunch’. In 2009 there were 70 SWF in 44 countries with asset ranging in value from US$20 million to more than US$500 billion in United Arab Emirates.

![Figure 1.7: SWF investment trends](image)
Source: Barbary et al (2010, p.2)

1.2.9. Growth of ‘defensive techniques’ to combat global insecurity

The global growth of FDI and increasingly ‘footloose’ activities of MNEs have already been documented as widely-used indicators of globalisation. Many argued by drawing attention to parallel between the rapid growth in formal, legal cross-border relationship and the rapid growth of in a wide range of illegal cross-border relationship including activities associated with terrorism. Some of the
characteristics of globalisation reviewed are seen as conducive to such growth, especially the weakening of power and control by nation states and the proliferation of new, less detectable methods of communication.

Due to the 9/11 terrorism activities, additional insurance premiums required as a ‘defensive technique’. In the airline industry alone it has been estimated that global insurance premium rocketed from US$1.7 billion in 2001 to US$6 billion just one year later in 2002. It was estimated that the whole global economy was impacted by 9/11 attack on USA and cost more than US$2625 billion over the period of 2001 to 2008.

Below is a list of sectors that are likely to be targeted for greater spending, and companies that could benefit:

**Intelligence**
- Axsys Technologies
- FLIR Systems

**Intelligence gear**
- Argon ST
- Applied Signal Tech

**Cyber security/**
- ManTech International

**Information technology**
- CACI International
- NCI Inc
- SAIC

**Unmanned aerial vehicles**
- Northrop Grumman
- Boeing Co
- AeroVironment Inc

### 1.2.10. Changing area patterns of international cost

Of particular interest to international business location is the area pattern of international labour cost, both wage and non-wage (employer’s social security contribution, holiday pay, etc). In any case it is not just overall labour costs that are important but these costs in relation to labour productivity, as can be seen from table below (1.3)
When MNEs decide to locate their business, it is important to look other factors rather than only considering labour cost. However, a more complete assessment of true labour costs would use the idea of relative unit labour cost (RULC), which are explored further below.

**Relative Unit Labour Cost**

Labour cost per unit of output is determined by both the wages of the workers and the output per worker (labour productivity). International competitiveness, in terms of unit labour cost is influence by exchange rate. For example depreciation of the currency makes exports cheaper in terms of foreign currency and therefore can even compensate for low labour productivity and high money wages. Therefore RULC can be expressed as:

\[ RULC = \frac{Relative\ Labour\ Costs}{Relative\ Labour\ Productivity} \times \frac{Relative\ Exchange\ Rate}{100} \]

**1.3. Other international patterns/trends**

A number of other patterns and trends are likely to be relevant to different types of international business activity.

- International communication
- International travel
- International growth in leisure pursuits
- International growth in ageing populations
- International growth in currency transactions
- International growth in countertrade

Each of these patterns/trends are discussed below.

<table>
<thead>
<tr>
<th>Country</th>
<th>Total labour costs ($ per hour)</th>
<th>Total labour costs ($ per hour Index: UK = 100)</th>
<th>Labour productivity (Index UK = 100)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mexico</td>
<td>2.6</td>
<td>21.8</td>
<td>35.2</td>
</tr>
<tr>
<td>Korea</td>
<td>13.6</td>
<td>20.9</td>
<td>48.4</td>
</tr>
<tr>
<td>France</td>
<td>24.6</td>
<td>95.7</td>
<td>118.1</td>
</tr>
<tr>
<td>UK</td>
<td>25.7</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Japan</td>
<td>21.8</td>
<td>84.8</td>
<td>82.4</td>
</tr>
<tr>
<td>US</td>
<td>23.7</td>
<td>92.2</td>
<td>116.2</td>
</tr>
<tr>
<td>Germany</td>
<td>33.0</td>
<td>128.4</td>
<td>109.7</td>
</tr>
</tbody>
</table>

Table 1.4: Labour cost and labour productivity, 2006

1.3.1. International communication

There have been dramatic increases in various modes of international communication. For example, the time spent on international telephone calls has risen from 33 billion minutes in 1990 to over 120 billion minutes by the end of 2008. Internet usage is also rising exponentially, with the 2008 Human Development Report (UNDP, 2008) noting that the number of Internet hosts per 1000 people worldwide had risen from a mere 1.7 in 1990 to 136 in 2005/2006 with cellular mobile phone subscribers per 1000 people worldwide also rising from only 2 in 1990 to 341 in 2005/2006 (UNDP, 2008). Various studies have found a strong and positive correlation between the extent of telephone network and Internet usage.

1.3.2. International Travel

The number of international tourists has more than trebled from 260 million travellers a year in 1980 to over 800 million travellers a year in 2008. The growth of tourism is closely correlated with the growth of worldwide GDP and is an important source of income and employment for many developed and developing countries alike.

1.3.3. International growth in leisure pursuits

In 1880 some 80% of the time left over after necessities such as sleeping and eating were attended to, was used for earning a living. Today that percentage has fallen to below 40% over the average lifetime of an individual in the advanced industrialised economies and is projected to continue falling to around 25% over the next decade. This dramatic increase in leisure time availability in the higher-income advanced industrialised economies clearly has major implications for consumption patterns and therefore for the deployment of productive resources.

1.3.4. International growth in ageing populations

Between 1950 and 2008 the median age of the world’s population rose by only 3 years, from 23.6 years in 1950 to 26.5 years in 2008. However, over the next 40 years, the UN projects the median age will rise dramatically to 37 years by 2050, with 17 advanced industrialised economies having a median age 50 years or above. This has major implications for international business in terms of productive locations (e.g. adequate supply of labour of working age) as well as the range of products likely to be in global demand.

1.3.5. International growth in currency transactions

The daily turnover in foreign exchange markets has dramatically increased from US$ 15 billion in the mid 1970s to over US$2400 billion in 2008. This has contributed to greater exchange volatility, on occasions putting server pressure on national economies and currencies.
1.3.6. International growth in countertrade

When conventional means of payment for international transactions are difficult, costly or not available, then a range of barter (swap)-type transactions may be used instead. Whereas such ‘countertrade’ only accounted for 2% of the world trade in 1975, by 2008 over 20% of the world trade involved some elements of barter, with the former Soviet Union and the Eastern European economies particularly active in using countertrade.

1.4. Globalisation

1.4.1. Definitions

• Globalisation is ‘the process of transformation of local phenomena into global ones. It can be described as a process by which the people of the world are unified into a single society and function together. This process is a combination of economic, technological, socio-cultural and political forces’ (Croucher, S. 2003).

• Globalisation is about ‘a widening, deepening and speeding up of interconnectedness in all aspects of contemporary social life from the cultural to the criminal, the financial to the spiritual’ (Held et al 1999)

• Globalisation is process of ‘increasing global interconnectedness, so that events in one part of the world are affected by, have to take account of, and also influence, other parts of the world. It also refers to an increasing sense of a single global whole (Tiplady, R. 2003)

• Globalisation is a term used to describe ‘the worldwide movement towards economic, financial, trade and communications integration. Globalisation implies opening out beyond local and nationalistic perspectives to a broader outlook of an interconnected and inter-dependent world with the free transfer of capital, goods and services across national frontiers’ (Business Dictionary)

• Globalisation ‘refers to the shift toward a more integrated and interdependent world economy…[through] the merging of historically distinct and separate national markets into one huge global market place’ (Hill, C. 2005, p.6)

• Globalisation is a ‘process by which the whole world becomes a single market. This means that goods and services, capital and labour are traded on a worldwide basis, and information and the results of research flow readily between countries’ (Black, J. 2002)

• Globalisation is a process that ‘reflects a business orientation based on the belief that the world is becoming more homogenous and that distinctions between national markets are not only fading but, for some products, will eventually disappear’ (Czinkota, M., Ronkainen, I., Moffat, M. 1999, p.454)
1.4.2. Different perspectives on Globalisation

According to Wall et al (2010), there are five important perspectives on globalisation. These perspectives are

- Economist
- Political Scientist
- Sociologist
- International Relation Specialists

**Economists** focus on the growth of international trade, increase in international capital flows and the progressive dominance of the multinational enterprises (MNE) form of business organisation within domestic and global business activities.

**Political Scientists** view globalisation as a process that leads to undermining of the nation's state and emergence of new forms of governance.

**Sociologists** view globalisation in terms of the rise of a global culture and the domination of the media by global companies.

**International relations specialist** tends to focus on the emergence of global conflicts and global institutions.

1.4.3. Key elements of globalisation

Although there are different views on globalisation, these views agree that globalisation comprises of three key elements. These three elements of globalisation are

- Shrinking Space
- Shrinking Time
- Disappearing Borders

**Shrinking Space**
The lives of all individuals are increasingly interconnected by the events of worldwide. People are increasingly perceive to be the case, recognising that their jobs, income levels, health and living environment depend on factors outside national and local boundaries. Some of the events that took place is summarised in the table below (Table 1.5).

**Shrinking Time**
With the rapid developments in communication and information technologies, events occurring in one place have almost instantaneous (real time) impacts worldwide.

**Disappearing Borders**
The nation state and its associated borders seem increasingly irrelevant as ‘barriers to international events and influences. Decisions taken by regional trading blocs (e.g. EU, NAFTA) and supranational bodies (IMF, WTO) increasingly override national policy making in economic and business affairs as well in other areas such as law enforcement and human rights.
<table>
<thead>
<tr>
<th>Time</th>
<th>Economical</th>
<th>Political</th>
<th>Technological</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Major currencies become convertible (1958–64)</td>
<td>Decolonization in Africa (15 countries become independent between 1958 and 1962)</td>
<td>Just-in-time” production implemented by Toyota</td>
</tr>
<tr>
<td></td>
<td>Development of the Eurodollar Market in London which contributed to the expansion of international liquidity</td>
<td></td>
<td>Increasing usage of jet engines in air transport (1957–72)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Offshore oil and gas production developed</td>
</tr>
<tr>
<td>1980s</td>
<td>Volcker Fed successfully extinguishes US inflation</td>
<td>Enlargement of the EU to 12 members</td>
<td>IBM introduces first personal computer (1981)</td>
</tr>
<tr>
<td></td>
<td>Lourve Accord promotes stabilization of major exchange rates (1987)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1990s</td>
<td>Indian economic reforms launched in 1991</td>
<td>Dissolution of the Soviet Union (1991) leads to the formation of 13 independent states</td>
<td>First website put online in 1991</td>
</tr>
<tr>
<td></td>
<td>Establishment of the WTO (1995)</td>
<td></td>
<td>Eurotunnel opens in 1994 linking the United Kingdom to continent</td>
</tr>
<tr>
<td></td>
<td>Asian financial crisis (1997)</td>
<td></td>
<td>The number of mobile phones increases due to the introduction of second- generation (2G) networks using digital technology</td>
</tr>
<tr>
<td></td>
<td>Adoption of the euror by 11 European countries (1999)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>China joins WTO (2001)</td>
<td></td>
<td>Container ships transport more than 70 percent of the seaborne trade in value terms</td>
</tr>
<tr>
<td></td>
<td>End of the Multi-fiber Agreement in 2005 (quantitative restrictions of textiles lifted)</td>
<td></td>
<td>Number of Internet users rises to 800 million in 2005</td>
</tr>
</tbody>
</table>

Table 1.5: Some of the Globalisation events took place


Notes compiled by Zubair
1.4.4. Features/characteristics of globalisation

- New markets
- New tools of communication
- New actors
- New rules and norms

New markets
- Growing global markets in services – banking, insurance, transport.
- New financial markets – deregulated, globally linked, working around the clock, with action at a distance in real time, with new instruments such as derivatives.
- Deregulation of antitrust laws and growth of mergers and acquisitions.
- Global consumer markets with global brands

New tools of communication
- Internet and electronic communications linking many people simultaneously.
- Cellular phones and mobile telephony.
- Fax machines.
- Faster and cheaper transport by air, rail, sea and road.
- Computer-aided design and manufacture

New actors
- Multinational corporations integrating their production and marketing, dominating world production.
- The World Trade Organisation – the first multilateral organisation with authority to force national governments to comply with trade rules.
- A growing international network of non-governmental organisations (NGOs).
- Regional blocs proliferating and gaining importance – European Union, Association of South-East Asian Nations, Mercosur, North American Free Trade Association, Southern African Development Community, among many others
- More policy coordination groups : G-7, G-8, OECD, IMF, World Bank

New rules and norms
- Market economic policies spreading around the world, with greater privatisation and liberalisation than in earlier decades
- Widespread adoption of democracy as the choice of political regime
- Human rights conventions and instruments building up in both coverage and number of signatories – and growing awareness among people around the world.
- Consensus goals and action agenda for development
- Conventions and agreements on the global environment – biodiversity, ozone layer, disposal of hazardous wastes, desertification, climate change
- Multilateral agreements in trade, taking on such new agendas as environmental and social conditions.
- New multilateral agreements – for services, intellectual property, communications – more binding on national governments than any previous agreements
1.4.5. Drivers of globalisation

Several key trends drive the globalization of the world economy and, in turn, force businesses to consider international operations to survive and prosper. Some of the key drivers of globalisation are illustrated in the below diagram

![Diagram showing the drivers of globalisation]

**Figure 1.8: Drivers of Globalisation**

Source: Cullen and Parboteeah (2010)

**Lowering Trade Barriers**

In the mid-1900s, worldwide tariffs averaged 45 percent. By the early 2000s, tariffs on industrial products fell to 3.8 percent. Tariffs are taxes most often charged to goods imported into a country. They have the effect of raising the price of an imported good (Cullen and Parboteeah, 2010). Tariffs tend to make foreign goods more expensive and less competitive with local goods. Trade is reduced because companies cannot compete with domestic producers.

**Locate and Sell Anywhere**

Not only do MNCs trade across borders with exports and imports, but they also build global networks that connect different worldwide locations for R&D, supply, support services like call centers, production, and sales. Setting up and owning your own operations in another country is known as foreign direct investment (FDI).
That is, FDI occurs when an MNC from one country owns an organizational unit located in another country. Multinationals often build their own units in foreign countries but they also use cross-border mergers and acquisitions, such as the acquisition of the European company Arcelor for $32 billion by the Indian company Mittal Steel (Cullen and Parboteeah, 2010). Traditionally, most FDI was in manufacturing as MNCs sought low-cost production sites or locations near valued customers. However, in today’s global economy, FDI is growing in the service sector as well.

![Figure 1.9: Service FDI is Replacing Manufacturing](source)

**The raise of low cost countries**

Low-cost countries have two roles as drivers of globalization. First, they fuel trade and investments by MNCs looking for low-cost platforms to manufacture goods or secure services such as information technology and call centers. Second, some low-cost countries are becoming what the Boston Consulting Group calls rapidly developing economies (RDEs) (Cullen and Parboteeah, 2010).

Rapidly developing economies are LCCs such as China, India, Mexico, and Brazil that not only provide a low-cost production site but also have an expanding market for multinational sales. These countries as a whole are expected to see a $2.3 trillion growth in gross domestic product by the next decade as compared to the $3.15 trillion expected for the Triad during the same period (Cullen and Parboteeah, 2010).
However, this growth is a two-way street as RDEs are using the benefits of foreign investments to grow local companies rapidly into world competitors. The Chinese household appliance company Haier Group is a prime example. A $10 billion revenue company and number one in China for full-line appliances, Haier Group already generates 10 percent of its sales from outside of China (Cullen and Parboteeah, 2010).

The cost savings of locating in an LCC for a typical manufacturing organization are shown in figure 1.8. This significant cost difference between LCCs and the developed world encourages companies such as Motorola to set up operations in LCCs like China, or companies such as Walmart (previously Walmart) to source their goods or services from local LCC companies.

![Figure 1.10: Cost Advantages of LCC Manufacturing](image)


**Information technology and Internet**

The explosive growth in the capabilities of information technology and the Internet increases the MNC’s ability to reach customers in a global economy and to manage operations throughout the world. Since any website can be accessed by anyone with access to a computer, the Internet makes it easy for companies to go global. That is, with a global online population exceeding 600 million, individuals can shop anywhere and companies can sell anywhere (Cullen and Parboteeah, 2010).

Electronic communication (e-mail, the World Wide Web, etc.) allows MNCs to communicate with company locations throughout the world. Information
technology is also spurring a borderless financial market. Investors are going
global, and companies of the future will get their financing not in local stock or
bond markets but in global markets that seek the best companies worldwide (Cullen
and Parboteeah, 2010).

The decreasing price and increasing sophistication of computer systems also affects
globalization. Small companies can now have computer power that only the largest
multinationals could have afforded just a few years ago. Similarly, cheap and
readily available computer power allows companies in poorer nations to make
technological gains previously reserved for the rich (Cullen and Parboteeah, 2010).

The use of information technology and the Internet is also speeding up another
globalization driver. Since many companies now use the Web to search for
suppliers, it is easier to be a global customer (Cullen and Parboteeah, 2010).

**Increasing global products, services and customers**

When companies can sell the same product or deliver the same service regardless of
the nationality of the customer, the industry has a global product. When industries
have mostly global products, global competition is more likely (Cullen and
Parboteeah, 2010).

The rise of similar customer needs worldwide, customers are also crossing borders
and becoming global customers. Global customers look for products or services
ignoring national boundaries, seeking instead the best price and quality rather than
national location. Companies making industrial purchases are more likely than
individuals to become global customers. Seventy percent of the global e-commerce
comes from such business-to-business transactions (Cullen and Parboteeah, 2010).

Increasingly, similar customer needs and the willingness of customers to shop
globally encourage the speed of globalization because companies are more likely to
offer one product for everybody, allowing any customer to buy anything from
anywhere (Cullen and Parboteeah, 2010).

**Global Standards**

Increasingly, especially for technical products, global design standards are
common. Once a product standard is accepted globally or regionally, manufacturers
need only produce one or a few versions of a product and still can sell worldwide.
Because this is cheaper than making dozens of different versions, one for each
country, everyone benefits with a lower-cost product and companies face fewer
obstacles to selling outside of their own country (Cullen and Parboteeah, 2010).

Although global standardization has progressed substantially, it is not yet complete.
For example, Europe and North America have different formats for TVs and VCRs,
and one still needs a tri-band cell phone to access the systems in many countries.
And do not forget when you travel that electrical current and plug-ins often differ
from country to country (Cullen and Parboteeah, 2010).
Meeting formal standards for consistency in quality is now a requirement to do business in many countries. The International Organization for Standardization (ISO), in Geneva, Switzerland, developed a set of technical standards known as ISO 9001 for quality in manufacturing and ISO 14000 for environmental management (Cullen and Parboteeah, 2010).

According to the ISO, “ISO 9000 and ISO 14000 standards are implemented by some 634,000 organizations in 152 countries.” Meeting these standards means a company produces its products exactly as specified technically and environmentally (Cullen and Parboteeah, 2010).

1.4.6. Outcomes of Globalisation

**Hyperglobalists:** powerless nations at the mercy of ‘footloose’ MNEs which grow ever stronger.

**Transformation lists:** no clear predictions possible as to eventual outcomes of globalisation. Globalisation is characterised by set of mutually opposing tendencies (Giddens, 1990).

McGrew (1992) has tried to identify a number of these opposing tendencies:

- Universalisation versus particularisation
- Homogenisation versus differentiation
- Integration v fragmentation

**Universalisation versus Particularism**

Globalisation tends to make many aspects of life universal (assembly line production, fast food restaurant, consumer fashion), it can also help to point out the differences between what happens in particular places and what happens elsewhere. This focus on differences can foster the resurgence of regional and national identities.

**Homogenisation versus Differentiation**

While globalisation may result in an essential homogeneity (sameness) in a product, process and institutions (e.g. city life, organisation offices and bureaucracies), it may also mean that the general must be assimilated within the local. For example, human rights are interpreted in different ways across the globe etc.

**Integration versus fragmentation**

Globalisation creates new form of global, regional and transnational communities that unite (integrate) people across territorial boundaries (e.g. MNEs, international trade unions, etc). However, it also has the potential to divide the fragment communities (e.g. labour becoming divided along sectoral, local, national and ethnic lines).

This means outcomes of globalisation also can be reviewed in the following ways
Globalisation and the markets

Forces of globalisation would establish global markets for standardised products purchased in huge volumes by consumers worldwide.

Increasingly, the needs of customers are becoming more similar around the world. However, this convergence is not the same in all industries and for all products. The consumer electronics and pharmaceutical industries tend to have customers with similar needs. For example, antibiotics are needed throughout the world. If you wear soft contact lenses, you have a need for saline solution whether you live in Moscow, Idaho, USA, or Moscow, Russia. Bausch & Lomb can provide you with this solution almost anywhere in the world (Cullen and Parboteeah, 2010).

However, in industries where cultural differences, government requirements, income, and physical climate are important, common customer needs are less likely. For example, in spite of the worldwide love of the automobile, no company has succeeded in developing one car for all markets. Difference in income levels, fuel prices, roads and highways, government regulations, and consumer preferences for styles and options have made this a difficult challenge (Cullen and Parboteeah, 2010).

Globalisation and production

In some industries, such as the aircraft industry, no one country’s market is sufficiently large to buy all the products of efficient production runs. To be cost-competitive, firms in this industry must go global and sell worldwide. Industries where individual unit costs drop substantially with more volume tend to be more globalized. For example, Airbus hopes to sell over 700 A380s, its new super jumbo jet. Just to break even, it must sell over 500. The only way to do this is to sell to airlines all over the world. No one country could produce a demand of 500. Not surprisingly, as a result the civil aircraft industry is one of the most globalized.

Globalisation and the role of nation state

It has been argued that one of the major effects of globalisation is to threaten the notion of territorial nation state, in at least key respects;

- Its competence,
- its autonomy and, ultimately,
- its legitimacy.
Loss of competences

In a global economic system, productive capital, finance and products flow across national boundaries in ever-increasing volumes and values, yet the nation state seems increasingly irrelevant as a ‘barrier’ to international events and influences. Government often appears powerless to prevent stock market crashes or recessions in one part of the world having adverse effects on domestic output, employment, interest rates and so on. Attempts to lessen these adverse effects seem, to many citizens, increasingly to reside in supranational bodies such as the IMF, World Bank, EU, etc. This inability of nation states to meet the demands of their citizens without international cooperation is seen by many as evidence of declining competences of states, arguably leading to a ‘wide weakening’ of individual nation state.

Loss of autonomy

The increased emphasis on international cooperation has brought with its enormous increase in number and influence of inter-governmental and non-governmental organisations (NGOs) to such an extent that many argue that national and international policy formulation has become inseparable. For example, whereas in 1909 only 176 international NGOs could be indentified, by the end of 2008, this number exceeded 30,000 and still growing. International organisations and regimes, non-state actors, transnational bodies or national pressure groups, whose activities spill over into the international arena. “Non-state actors” or as Rosenau (1990) calls sovereignty-free actors, such as MNCs, international governmental and non-governmental organizations and ethnic groups influence the state’s authority in a situation of complex interdependence. Moreover, issues in global politics expanded to include economic, social and environmental questions (non-security issues often referred to as low politics) as well as geopolitical concerns.

Loss of legitimacy

There is some evidence that the relevance of nation state is declining, while others argue that state retains its positive role in the world through its monopoly of military power, which offers its citizens relative security in a highly dangerous world. The present era of global politics also involves the emergence of regional and global law (also described as cosmopolitan law or global humanitarian law) which challenges state sovereignty. Due to globalisation, some nations were forced to follow or modify their laws in accordance with international laws. This means sometimes some nations do not have any power to determine their own direction.

Pro-and anti-globalisation

1. Anti globalisation Protest
2. Globalisation, jobs and income
3. Globalisation and national sovereignty
4. Globalisation and world’s poor
Globalisation and the new rules and norms

Not only are new international institutions and trading blocs characteristic of a more globalised economy in which nation states have progressively less influence, but so too are the ‘rules and norms’ by which they seek to operate. Market oriented policies, democratic political frameworks; consensus goals involving social and environmental responsibility, growing multilateral applications of agreed rules were all identified as characteristics of globalisation. The importance of good governance and transparency, an absence of corruption and appropriate property rights to the establishment of sustainable globalised economic environment.

1.5. The Multinational Enterprises

A multinational corporation is “an enterprise that engages in foreign direct investment (FDI) and owns or controls value adding activities in more than one country” (Dunning 1993, 3).

MNCs thus have two characteristics.

First, they coordinate economic production among a number of different enterprises and internalize this coordination problem within a single firm structure.

Second, a significant portion of the economic transactions connected with this coordinated activity take place across national borders.

These two attributes distinguish MNCs from other firms. While many firms control and coordinate the production of multiple enterprises, and while many other firms engage in economic transactions across borders, MNCs are the only firms that coordinate and internalize economic activity across national borders.

1.5.1. Ranking Multinationals

There are three ways that size of the MNEs is calculated. These include

1. Foreign Assets
2. Transnationality Index
1.5.2. How important are MNEs

It is important to note that the world’s 100 largest MNEs alone accounted for over 15.3 million jobs and for annual sales in excess of $7000 billion in value. Only 14 nation states have GDP that exceeds the turnover of Exxon, Ford and General Motors (Wall et al, 2010).

Similarly in 2007 an estimated 79,000 MNEs, collectively controlled a total of around 800,000 foreign affiliates(subsidiaries), employed almost 82 million people worldwide and accounted for sales revenue of over US$ 31 trillion (equal to 11% of world GDP). The table below shows MNEs activity.

<table>
<thead>
<tr>
<th></th>
<th>2007 (US$ billions)</th>
<th>Average Annual growth rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales of foreign affiliates of MNE</td>
<td>31,197</td>
<td>19.3</td>
</tr>
<tr>
<td>Total exports of goods and services</td>
<td>7430</td>
<td>15.8</td>
</tr>
<tr>
<td>Employment of foreign affiliates</td>
<td>81,615</td>
<td>5.3</td>
</tr>
<tr>
<td>Total assets of foreign affiliates</td>
<td>68,716</td>
<td>17.7</td>
</tr>
</tbody>
</table>

Table 1.7: MNEs activity in global context
Source: Wall et al, 2010, p.31
Multinational and FDI

As mentioned earlier, attraction of FDI towards developed and developing countries are increasing significantly. This may benefit the economies in many respects. This mean with the rise of MNE, these companies may invest more in developing countries enforcing more economic and political stability in the developing countries.

Table 1.8: Inflow of FDI (US$ billions)

Source: UNCTAD survey, 2009

Multinational and globalised production

Based on the TNI, the largest 100 MNEs in their home economies between 1990 and 2006 suggests more firms are becoming MNCs and internationalisation of production is increasing.

Multinationals and the developing economies

Despite some common assets, such as market growth and size other location determinants differ quite significantly by country. The most favourable location assets for the 15 most attractive countries for FDI as follows

*Market growth*, developing and transition economies are generally favoured, such as China, India, Brazil, the Russian Federation, Indonesia, Viet Nam, Poland and Thailand.

*Market size*, the largest economies are favoured, either developed ones such as the United States, Germany and Canada, or emerging ones such as China, the Russian Federation and Brazil.

*Access to regional markets*, countries that are integrated into large markets, or which are close to large and growing economies, are favoured, such as Mexico, Germany, Viet Nam and Poland.
Presence of suppliers. mostly developed countries are favoured, such as the United Kingdom, Germany and France, and, to a slightly lesser extent, some developing countries such as India.

Business environment. (including government effectiveness, stability and quality of infrastructures), developed countries such as the United States, Germany and Australia are favoured. France is frequently mentioned for the quality of its infrastructure.

Skills and talent. developed countries such as the United States, Germany, the United Kingdom and France are favoured, but also some developing countries, such as India and Thailand.

<table>
<thead>
<tr>
<th>Home region</th>
<th>Most favoured destinations</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America (Canada</td>
<td>China, United Kingdom, The Russian Federation, Germany,</td>
</tr>
<tr>
<td>and United States)</td>
<td>Brazil, United States</td>
</tr>
<tr>
<td>Europe</td>
<td>United States, China, India, Brazil, The Russian Federation,</td>
</tr>
<tr>
<td></td>
<td>United Kingdom</td>
</tr>
<tr>
<td>Japan</td>
<td>China, India, United States, Brazil, Viet Nam, Germany</td>
</tr>
<tr>
<td>Developing Asia</td>
<td>China, United States, Indonesia, Australia, India, Viet Nam</td>
</tr>
</tbody>
</table>

Figure 1.11: FDI destination by home regions
Source: UNCTAD survey, 2009

Figure 1.12: The 15 most attractive economies for the location of FDI, 2009-2011 (Per cent of responses)
Source: UNCTAD survey, 2009

1.5.3. Types of MNE

There mainly three distinguished types of MNEs. They are
- Global corporations: views the whole world as their market place, with goods and services standardised to meet the need of consumer worldwide
International Business (MOD001055)  
Chapter 1: Introduction to International Business

Zubair Hassan  
zubair@ftms.edu.my or Zubai7@gmail.com

- Multidomestic corporations that comprise a relatively independent set of subsidiaries, each producing goods and services focused on particular local market
- Transnational corporations that integrate a geographically dispersed set of specialised activities into a single production process.

1.5.4. Advantages and disadvantages of becoming a MNEs

According to Ajami et al (2006) MNEs may gain many advantages and also may face many challenges. Some of these advantages and disadvantages are discussed below:

Advantages gained by MNEs

Superior Technical Know-how

Most large MNCs have access to higher or advanced levels of technology, which was either developed or acquired by the corporation. Such technology is patented and held quite closely. Widespread application of such technology gives the MNC a strong competitive advantage in the international market, because it results in the production of efficient, hi-tech, low-priced products and services that command a large international market following. The Banamex Tricolor card technology developed by Citigroup is an example of how an MNC can obtain a competitive advantage by developing, patenting, and then exploiting an advanced technology (Ajami et al, 2006).

Large Size and Economies of Scale

Most MNCs tend to be large. Some of them, such as Wal-Mart and ExxonMobil, have sales that are larger than the gross national products of many countries. The large size confers the advantage of significant economies of scale to MNCs. Thus, an MNC such as Nippon Steel of Japan can sell its products at prices much lower than those of companies with smaller plants (Ajami et al, 2006).

Lower Input Costs Due to Large Size

The large production levels of multinationals necessitate the purchase of inputs in commensurately large volumes. Bulk purchases of inputs enable MNCs to bargain for lower input costs, and they are able to obtain substantial volume discounts. The lowered input costs imply less expensive and, therefore, more competitive finished products. Nestlé, which buys huge quantities of coffee on the market, can command much lower prices than smaller buyers can. Wal-Mart is able to sell its products at low prices relative to its competition due to both its bulk purchasing and its effective inventory control.

Ability to Access Raw Materials Overseas

Many MNCs lower input and production costs by accessing raw materials in foreign countries. In many of these cases, MNCs supply the technology to extract or refine the raw materials, or both. In addition to lowering costs, such access can give
MNCs monopolistic control over the raw materials because they often supply technology only in exchange for such monopolistic control. This control gives them the opportunity to manipulate the supply of the raw materials, or even to deny access, to the competitors for this raw material.

**Ability to Shift Production Overseas**

The ability to shift production overseas is another advantage enjoyed by MNCs. To increase their international competitiveness, MNCs relocate their production facilities overseas, thereby taking advantage of lower costs for labor, raw materials, and other inputs, and, often, utilizing incentives offered by host countries. Several major MNCs have set up factories in such low-cost locations as China, India, and Mexico, to name only a few.

**Scale Economies in Shipment, Distribution, and Promotion**

Scale economies allow MNCs to achieve lower costs in shipment expenses. The large volumes of freight they ship permit them to negotiate lower rates with the shippers. Some of the very large corporations, especially the oil giants, have operations that are large enough to justify the purchase of their own ships, which is an even more effective way to reduce costs. For example, the Marlboro cigarette advertisements or several Coca Cola promotions that have been released in different countries using standardized messages.

**Access to Low-Cost Financing**

As a result of their size, MNCs require large amounts of financing, and generally they are excellent credit risks. Therefore, they are the favored customers of financial institutions, which lend to them at their best rates. The lower cost of financing for the MNCs adds to their competitive strength. MNCs also have the advantage of access to different financial markets, which allows them to borrow from the source offering the best deal; the funds are then transferred internally to required locations.

**Diversification of Risks**

The simultaneous presence of MNCs in different countries allows them to more effectively bear the risk of cyclic economic declines. Generally these cycles are not the same among different countries. Thus, losses in one country can be offset by gains in other countries. Simultaneous operations also provide considerable flexibility to MNC operations, which enables them to diversify the political, economic, and other risks that they face in different countries. For example, if a Russian pipeline is shut down unexpectedly, nations such as Saudi Arabia have the necessary spare capacity to temporarily increase the supply of oil on the world markets in an effort to stabilize prices over the short term.
Disadvantages faced by MNEs

Business Risks

Since MNCs conduct business outside the borders of their own countries, they deal with the currencies of other countries, which renders them vulnerable to fluctuations in exchange rates. Violent movements in exchange rates can wipe out the entire profit of a particular business activity.

Host-Country Regulations

Operating in different countries subjects MNCs to a myriad of host-country regulations that vary from country to country and, in most cases, are quite different from those of the home country. The MNC has the difficult task of familiarizing itself with these regulations and modifying its operations to ensure that it does not overstep them. Regulations are often changed, and such changes can have adverse implications for MNCs. For example, a country may ban the import of a certain raw material or restrict the availability of bank credit.

Different Legal Systems

MNCs must operate under the different legal systems of different countries. In some countries the legislative and judicial processes are extremely cumbersome and contain many nuances that are not easily understood by non-natives. Some legislation can also prohibit the type of business activity the MNC would regard as normal in its home country.

Political Risks

Host countries are sovereign entities and their actions normally do not admit any appeals. There is little that an MNC can do if a host country is determined to take actions that are inimical to its interests. This political risk, as it is known, increases in countries whose governments are unstable and tends to change frequently.

Operational Difficulties

Multinationals work in a wide variety of business environments, which creates substantial operational difficulties. Unwritten business practices and market conventions often prevail in host countries. MNCs that lack familiarity with such conventions find it difficult to conduct business in accordance with them. A typical example is informal credit. In many countries retailers agree to stock goods of a manufacturing company only if they are offered a market-determined period of credit that is not covered by a written document. The accounting and sales policies of an MNC may not permit such arrangements.

Cultural Differences

Cultural differences often lead to major problems for MNCs. Many find that their expatriate executives are not able to turn in optimal performances because they are not able to adjust to the local culture, both personally as well as professionally.
the other hand, local managers of MNCs often have difficulties in dealing with the home office of an MNC because of culturally based communication problems. Inability to understand and respond appropriately to local cultures has often led MNC products to fail. Misunderstanding of local cultures, work ethics, and social norms often leads to problems between MNCs and their local customers, their business associates, government officials, and even their own employees.

Reference List/Further readings


