BRIEF CONTENTS

LONG CONTENTS

CHAPTER 1

GLOBALIZATION OF MARKETS AND COMPETITION

LEARNING OBJECTIVES

By the end of the chapter you should be able to:

- Define globalization from a macro environment perspective
- Identify the forces pushing towards globalization and the forces pushing for localization
- Define what globalization means for firms
- Identify the various steps of globalization for firms
- Make a distinction between multinational and global firms
- Spell out the benefits and pitfalls of globalization
- Position an industry or a business on the global/multi-local mapping

INTRODUCTION

Chapter 1 defines what 'globalization' means, firstly from a geopolitical and economic point of view, and secondly for business enterprises. It looks at the many political, technological, social and economic factors that have driven globalization, as well as those restraining it. It describes how many companies have evolved, over time, from 'national' to becoming 'international', then 'multinational' and finally 'global' firms. Based on an example, the chapter looks at how a *multinational* company having foreign subsidiaries can become *global* by extending its operations worldwide and adopting a competitive configuration through strong coordination and integration of its international activities across borders. The benefits and constraints of globalization are both described. Some factors still push towards a local approach to management, on a country-by-country basis, and the factors inducing this localization are analyzed.

Finally the global/multi-local mapping matrix is presented as a tool to position industries, companies and businesses according to the relative importance they place on global versus local approaches. The chapter ends by introducing some of the societal issues associated with globalization.

THE PHENOMENON OF GLOBALIZATION

Since the 1960s, international trade, investment and migration have all grown much faster than the world economy. Firms have multiplied their presence outside their country of origin, employing more and more people and selling and buying technology internationally (see Table 1.1). More and more products are sold in similar stores, with similar features and carrying a common brand across the globe. Factories that were prosperous in the Western world have been closed and transferred to lower-cost countries. English is now considered the *lingua franca* for major business transactions. Events happening in one location are visible in real time everywhere thanks to the internet and social networks such as Facebook or Twitter. This is what is commonly referred to as the process of 'globalization'.

In today's business world, managers, politicians, journalists and academics commonly refer to concepts such as 'globalization', 'global industries', 'global competition', 'global strategies' and so on.

Table 1.1 Globalization data

	2014 prices	Index (base 100 in 1982 at constant rate)				Average growth rate 1983–2014
	(US$ bn)	1982	1990	2000	2014	
World GDP	77,283	100	162	189	347	4.0%
Trade (export of goods and services)	23,409	100	166	217	546	5.4%
Foreign direct investment (inward stock)	26,039	100	203	553	1,723	9.3%
Foreign direct investment (inflows)	1,228	100	273	1403	1,025	7.5%
Cross-border mergers and acquisitions	399	100	497	2,880	759	6.5%
Sales of foreign affiliates of multinationals*	36,356	100	171	405	702	6.3%
Assets of foreign affiliates of multinationals*	102,040	100	234	700	2,558	10.7%
Exports of foreign affiliates of multinationals*	7,803	100	141	353	583	5.7%
Royalties	310	100	232	461	1,639	9.1%
Employment of foreign affiliates *(number)	75,075	100	136	267	430	4.7%
Daily foreign exchange transactions	5,343	NA	100	135	476	6.7%

* Multinational companies are defined as firms having more than 50% equity in wholly owned enterprises abroad or at least 10% equity in joint ventures.
Source: Data from UNCTAD (2015), Table I.5, and Bank for International Settlements (2014).

While those terms are widely used, their exact meaning is often not well understood. For some people, globalization is considered to be the intrusion of foreigners into local communities. Its effect is viewed as a destruction of the social fabric within nations. For others, it means freedom of movement, entrepreneurship, an exchange of cultures and harmonization. As far as the corporate world is concerned, some are certain it means 'to expand the company's presence abroad'; for others, it means 'standardizing a product and selling it to the world'; for others still, it denotes an approach to management in which decision making is centralized at corporate headquarters. There are many reasons for this confusion. One relates to the fact that the phenomenon of globalization describes macroeconomic changes and political change, while for the business world it denotes a strategic and managerial issue. While the concept of globalization is relatively new, the phenomenon is not. There have been periods in history when the world was without borders, and citizens, products and money could move around freely. Theories have been developed to explain and advocate free trade and globalization from the macro point of view, and to explain the process of globalization from the business point of view (Insert 1.1). As far as the business world is concerned, before the 1970s the most frequently used terminology, when referring to integrated operating across the world, was 'international', 'multinational' or occasionally 'trans-national'. Even if we ignore the East India Company, which started in the early seventeenth century, modern corporations such as Unilever, Nestlé and Procter & Gamble were operating all over the world by the end of the nineteenth century. They are known as multinational companies, but nobody would have called them global 50 years ago. The global concept appeared in the early 1970s and progressively invaded boardrooms, classrooms and editorial offices. What is the exact meaning of globalization? What forces generated it? And what are the consequences for firms?

There is no one well-established definition of globalization. Here we will posit as a working definition: 'The process by which people, products, information and money can move freely across borders'. As a consequence, markets may tend to converge, providing opportunities for the standardization of products, for production centers to be (re)located to more economical places around the world, and

INSERT 1.1: THEORIES OF GLOBALIZATION

Macro theories: free trade and globalization

The *theory of comparative advantage*, proposed in the early nineteenth century, stated that under free trade, nations will maximize wealth if they export the goods for which they have a relative advantage (Ricardo, 1967). The idea is that countries should concentrate on the production of those goods and services at which they are most efficient and export them, whilst buying in other products from abroad. The total global production of goods and services will then be higher than when separate countries try to produce everything themselves. As a theoretical example, imagine two similar industrial parks, one in Malaysia and the other based in the Philippines, both with 10,000 workers, and both producing electrical products. Both sites employ 5000 workers (half their total effort) to produce computer motherboards and 5000 workers to make videogame consoles. The Malaysian operation is able to produce 10 million motherboards per year and the Philippines' 8 million, while the Malaysians produce 200,000 consoles to the Philippines' 250,000. Malaysia has, therefore, demonstrated a comparative advantage over the Philippines for motherboards and Philippines has a comparative advantage over Malaysia for consoles. The total global output in the current situation will be 18 million motherboards and 450,000 consoles per year. For better results, Malaysia should concentrate on producing motherboards and trading them, while the Philippines should focus its efforts on consoles. In this situation the global output rises to 20 million motherboards and 500,00 consoles, marking an 11% increase in both motherboards and consoles.

World-system theories suggest that globalization is the product of nationalistic, capitalistic, colonial and international expansion (Wallerstein, 1974, 2000; Robinson, 2004). For instance, from the sixteenth century the colonial expansion of Spain, Portugal, the Netherlands, Britain and France created a global market for a certain number of commodities. Later, the USA and Japan themselves became colonial imperialistic global powers. In other words, since the appearance of modern shipping vessels and navigation systems, truly global trade has become possible.

Marxism views globalization as the result of the tendency of the return on capital to decrease, forcing capitalists to find new territories to exploit. Lenin argued that the ultimate stage of capitalism was imperialism.(Marx and Engels, 1848; Lenin, 1917). The argument is that the profits of firms tend to decrease because of intense competition. Firms react by merging and looking for markets outside their national boundaries, creating global oligopolies, for example Lafarge Holcim, Apple, Samsung.

Network society theories see globalization as the result of the vested interests of a transnational capitalistic class (managers, politicians, bureaucrats, bankers), as well as of supranational organizations such as the WTO, UN and EU (Castells, 1996; Sklair, 2000). Advances in telecommunications and the rise of the internet have made it possible for business to be done globally, both in terms of financial transactions and internationally connected production systems.

Technological cultural theories propose that information technologies have led to a convergence of culture (Robertson, 1992; Ritzer, 1993). Very similar in essence to McLuhan's 'Global Village' concept,[1] these theories state that thanks to technology, people in different countries increasingly tend to share a common culture and consumer choices, making global product design and production possible and desirable.

World 3.0 This theory, developed by Professor Pankaj Ghemawat,[2] holds that humanity has followed four stages of social, political and economic organization and trade. The first stage (World 0. 0) refers to the prehistoric period in which societies were organized into thousands of tribes surviving by hunting and gathering, and where human interactions were limited to those between the members of tribes with practically no external trade. The second stage (World 1.0) refers to the formation of political entities in the forms of cities or empires (China, Sumer, Aztec), governing several thousands to millions of peoples (mainly farmers) under a political power structure (an empire or kingdom). Mostly economically self-sufficient, these states introduced some international, but limited exchange mechanisms (such as trade via the Silk Road). World 2.0 started in the seventeenth century with the colonial expansion of European powers and the creation of nation states. The first multinationals, such as the British East India Company, extended their reach as far as Asia. During the nineteenth century, thanks to transportation and communication innovations, multinational firms from Europe, America and Japan developed. After a decline between the two world wars, global development exploded and saw the formation of the modern business juggernauts such as Nestlé, General Electric and Siemens that we see today. The driving force of World 2.0 in the post-war years was a progressive deregulation and integration of markets. World 3.0 is predicted to evolve, following the global financial crisis of 2008, as a world that is characterized by a high level of market integration but also a high level of government regulation in what has been called *semiglobalization*.

Micro theories: corporate globalization

Transaction cost theories posit that multinational firms result from the economic benefits of internalizing costs of transaction rather than relying on contracts to regulate contact with international economic agents (Buckley and Casson, 1976).

Resource-based theories suggest that firms take advantage of their proprietary assets (technology, capital) to expand their presence in international markets (Barney, 1991).

Resource seeking theories explain the global expansion of firms by their desire to obtain resources they don't have (Dunning, 1993).

for R&D laboratories to be distributed across countries. As we will see, this implies a more centralized management of firms. Before examining the many aspects of corporate life impacted by the phenomenon of globalization, we will first look at the macroeconomic, technological and political factors that have generated such a global environment, and then look at how firms have changed their operations to take advantages of the new opportunities this environment offers.

INSERT 1.2: SOME GLOBAL DEFINITIONS

Globalization is the process by which people, products, information and money can move freely across borders.

Global industries are industries in which, in order to survive, competitors need to operate in the key world markets in an integrated and coordinated way. Industries such as aerospace, computers, telecommunication equipment, appliances, power generation, large industrial projects, insurance and re-insurance and corporate data transmission are examples of what a global industry means. In these sectors it is difficult to sustain competition if one does not cover (nearly) the whole world as a market, and if one does not integrate operations to make them cost and time effective.

Multinational companies are the companies that operate in various countries outside their countries of origin.

Global companies are multinational companies that operate in the main markets of the world in an integrated and coordinated way. Companies such as HSBC, Apple, Nestlé, Unilever and Nokia are global companies.

'Born global' companies have become multinational immediately upon or soon after being founded.

Globalizing is the phenomenon whereby the competitive structure of industries changes progressively from multinational to global. Industries such as telecommunications, processed food, personal care and retail are in the process of globalization.

Global integration and coordination are the organizational structure and management processes by which various activities scattered across the world are made interdependent. As examples, global manufacturing integration implies the specialization of factories and the cross-shipment of parts between different production sites; global product development requires the coordination of various research centers and marketing teams; global account management demands that different country subsidiaries provide a service according to a plan negotiated centrally and so on.

GLOBALIZATION FROM A MACRO PERSPECTIVE

Historically the world has experienced various periods of intense trade across continents and free movement of people and capital, in particular during the nineteenth century after the Napoleonic wars. After a decrease due to the two world wars of the twentieth century, several factors generated the emergence of the new economic environment that we call 'global'.[3] During the 1950s and the 1960s the convergence of several political, technological, social and competitive factors began to shape this new environment.[4]

WHAT ARE THE FACTORS THAT PUSH FOR GLOBALIZATION?

POLITICAL FACTORS: LIBERALIZATION OF TRADE AND INVESTMENTS

The main political factor has been the stabilization of post-war peace in Organisation for Economic Cooperation and Development (OECD) countries that allowed the development of free trade among nations. Two main organizations have been the source of trade liberalization – the General Agreement on Tariffs and Trade (GATT) (replaced by the World Trade Organization (WTO) in 1995) and the European Union – to which one may add the progressive opening of emerging nations to foreign investments.

The GATT, founded in 1946 by 23 nations, initiated a series of negotiations, called 'rounds', aimed at reducing tariff concessions to encourage the liberalization of trade. The Kennedy Round in the mid-1960s, the Tokyo Round in the early 1970s, the Uruguay Round in late 1980s, and the Doha Round in 2001 created an environment that fostered international trade, as shown in Figure 1.1.

The European Community (EC) was established on 25 March 1957 by the Treaty of Rome, which was signed by Belgium, France, Italy, Germany, Luxembourg and the Netherlands. The aim was to create a common market, and economic and political integration among the six member states. As a result goods, people and financial flows could move freely across countries. During the 1970s, the EC was enlarged with the entry of the UK, Ireland and Denmark, followed by Spain, Portugal and Greece in the 1980s, Sweden, Austria and Finland in the 1990s, and Poland, Lithuania, Latvia, Czech Republic, Slovakia, Slovenia, Malta, Hungary, Estonia, Cyprus, Romania, Bulgaria and Croatia in the early 2000s. In 1993 a Single Market which eliminated most legal and bureaucratic barriers was established among the member states. In 1999 a single currency, the euro, was adopted by 19 countries, and passport-free travelling without any border controls was allowed between 26 countries as part of the Schengen Agreement signed in 1985. Companies could integrate their operations across Europe to take advantage of a market of 500 million customers and gain economies of scale by specializing and concentrating their operations.

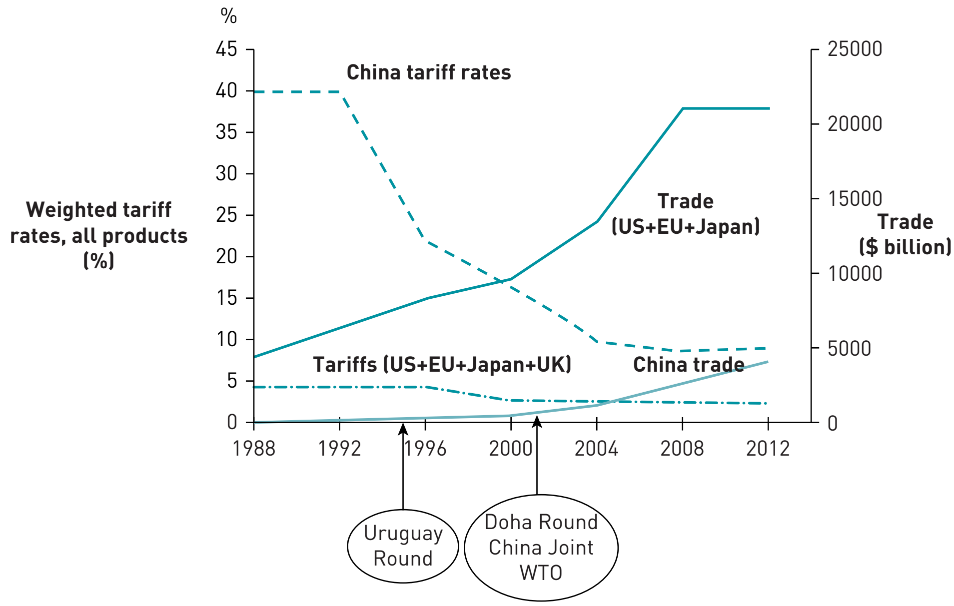

Figure 1.1 Tariff reductions and international trade

Source: Created using data from various World Bank Indicators.

In addition, from 1948 to 2008 the number of preferential trade agreements notified to the GATT/WTO increased from practically none to around 200 per year in the first decade of the twenty-first century.

Finally, in parallel with what was happening in the industrialized countries, the developing nations progressively adopted more positive attitudes towards foreign direct investment (FDI). At first, investment laws were designed to attract foreign investors in order to induce them to produce locally, but over the years the legislation has evolved toward a more open stance, favoring cross-border investments. Between 1992 and 2012, 2592 regulatory changes favorable to FDI were introduced worldwide, compared to 359 unfavorable changes.[5]

TECHNOLOGICAL FACTORS: TRANSPORT, COMMUNICATION, EDUCATION, SCIENCE AND PRODUCTION TECHNOLOGY

Another set of 'push factors' for globalization are related to technological progress that lowered the cost of transport and communication as well as the unit cost of production through economies of scale or the localization of productive capacities and sourcing in low-cost economies.

Air, rail and road transport and the use of containers in maritime transport have reduced the cost of shipping goods from country to country as well as, in the case of air transport, enabling the travel of managers. The development of telecommunications has reduced the cost of information exchange between business units scattered around the globe (Figure 1.2). On the scientific front, from 2000 to 2007 the number of international students in the OECD countries increased by 59% to reach 2.5 million while the number of international co-authored scientific articles increased by 50%.[6]

Progress in manufacturing technology gave tremendous impetus to the need to concentrate production in world-class factories benefitting from huge economies of scale, thus encouraging the rationalization and integration of production systems. Besides manufacturing concentration, companies have been able to source components or services from low-cost countries, either by setting up their own operations or by purchasing locally.

Another source of economies of scale comes from the need to quickly amortize research and development (R&D) expenditure. Companies are confronted with dual pressures: R&D budgets are increasing

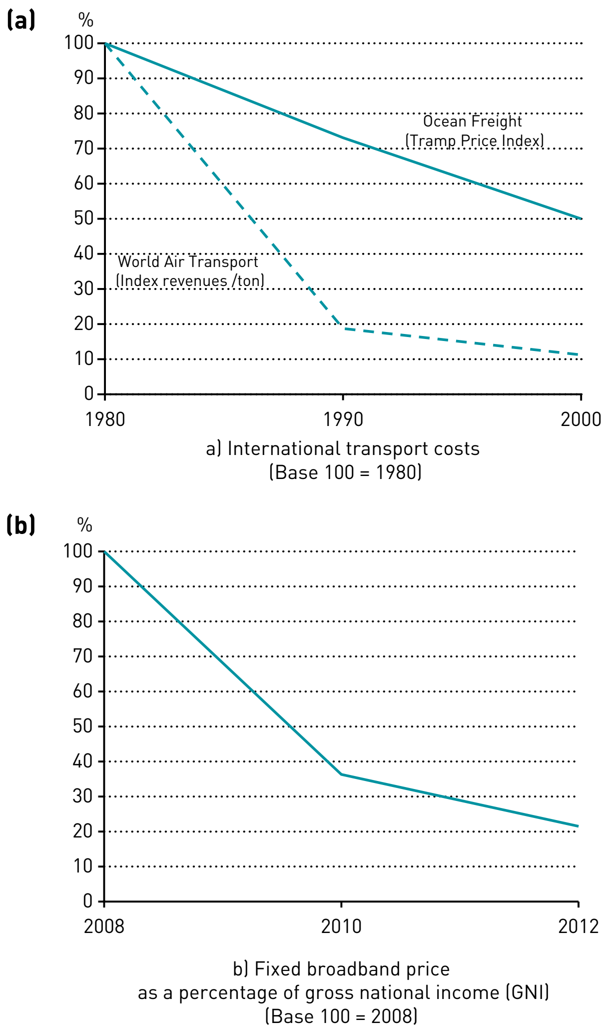

Figure 1.2 International transportation and communication costs

Sources: Author's own, using data from United Nations, World Trade Report 2008; International Telecommunication Union, Measuring the Information Society Report, 2014.

and the time elapsing between invention and commercialization is becoming shorter. For instance, it took 52 years for television to move from invention to large-scale commercial adoption and production, but the same step took nine years for the first personal computer (IBM 610) and just three years for the iPhone. For major appliances, it took seven years in the 1950s and 1960s to introduce a new model versus two years in the 1970s. The life cycle of Intel's 286 microprocessor was seven years while the 486 lasted five years.[7] As a consequence, companies need to launch products and services at the same time in all major markets in order to be able to recoup their investments.

Finally the advent of the internet has fostered the immediate transfer of media, social networking, and the long distance communication and on-line transactions that constitute the backbone of global communities today.

SOCIAL FACTORS: CONVERGENCE OF CONSUMER NEEDS

International air transport and the diffusion of lifestyles by movies and TV series have increased the brand awareness of consumers worldwide. Brands like Sony, Nike, Levi or Coca-Cola are known nearly everywhere. Kenichi Ohmae,[8] in his book *Triad Power*, has discussed the 'Californization of society' – teenagers in São Paulo, Bombay, Milan or Los Angeles listening to the same music, using the same iPhone or iPad and wearing the same pair of blue jeans and using Facebook, Instagram and YouTube. The convergence of customer behavior and needs is also facilitated by the urbanization and industrialization of societies. The less cultural and the more technical the product, the more likely that it can be standardized and appeal to consumers in all countries: smartphones, PCs, elevators, cranes, robots and internet platforms are products for which national differences do not matter much.

COMPETITIVE FACTORS

The 1960s saw the emergence of Japanese competitors in markets that traditionally had been dominated by American or European companies. Japanese firms, and later Korean firms, adopted a global approach at the very beginning of their international expansion. One of the reasons was that they did not have many national subsidiaries and their international expansion coincided with the opening of trade barriers. Right at the beginning they designed products for the world market, creating global brands such as 'Sony', 'Panasonic' and 'Hyundai', and their efficient production systems gave them a cost advantage in electronics and automotive parts. Competitors had to adopt a similar strategy to survive. During the 1990s emerging competitors from China, India and Brazil also entered the global game. China became 'the factory of the world' by offering offshore low-cost production sites. In other parts of the emerging world, local manufacturers in Thailand, Indonesia, Vietnam, Turkey and Mexico provided OECD industries and retailers with low-cost garments, toys, tools and furniture.[9]

Another competitive force that pushed companies to globalize was the globalization of customers. During the 1970s, Citibank created a Global Account Management Unit to service corporate customers with international subsidiaries. Similar phenomena developed in the IT, telecom and consulting sectors, and also in the luxury segment of fashion and perfumes.

Figure 1.3 summarizes these political, technological, social and competitive 'push factors' that have fostered globalization.

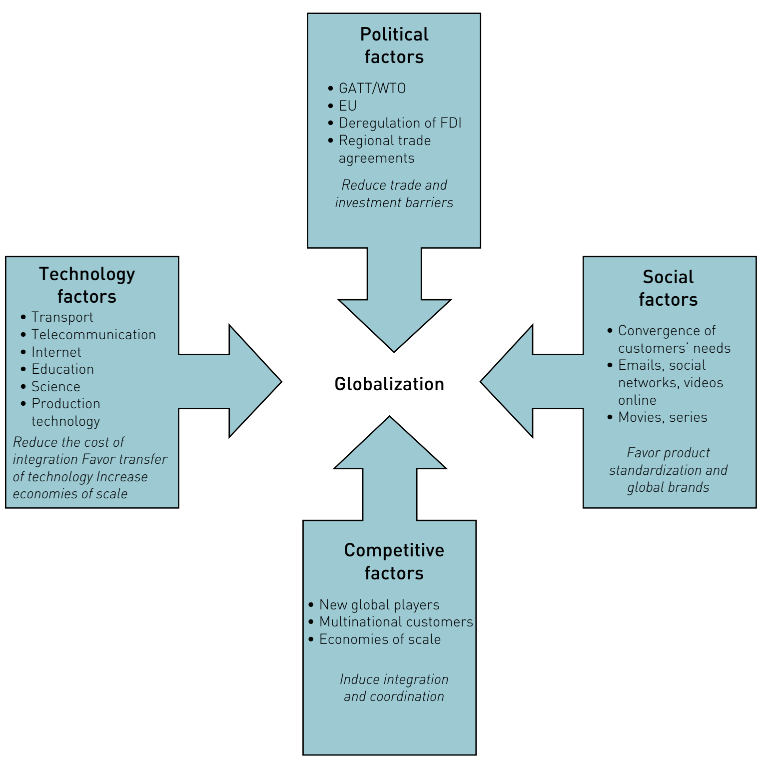

Figure 1.3 Globalization push factors

WHAT ARE THE FACTORS THAT WORK AGAINST GLOBALIZATION? THE LOCALIZATION PUSH

As mentioned earlier, globalization is associated with some degree of standardization of products and practices plus a high level of coordination and integration of activities in a company's value chain. Factors that oppose standardization, coordination and integration therefore work against globalization. One can group those factors into four main categories: cultural, commercial, technical and legal.

1 CULTURAL FACTORS: ATTITUDES, TASTES, BEHAVIOR AND SOCIAL CODES

When the consumption of a product or a service is linked to traditions and national or religious values, global standardization is not effective. Some products – for instance, Kretek (tobacco and clove) cigarettes in Indonesia or the Pachinko (pinball) game in Japan – are unique to one society and their globalization is nearly impossible, although one can argue that with innovative marketing it may not be. For example, Beaujolais nouveau wine, the arrival of which was typically a Burgundian and Parisian bistro event before the 1970s, is now available in Tokyo, Paris or New York on the same day; while Halloween (trick or treat) masquerades, a traditional US festivity, are now common in Europe. This shows that even highly culture-specific items can be appreciated by customers all over the world. However, it remains true that food and drink tastes, social interactions in business negotiations, attitudes towards hygiene, cosmetics or gifts vary from culture to culture, thus hampering a global product design or approach. In the Asia Pacific region, for instance, personal relationship building rather than legal contracts is the normal way to conduct business. One has to spend time and effort in building these personal ties, which in a US context would be largely considered a waste of time.

Religion may play an important role in limiting the effects of globalization, particularly in the domains of national cuisine or cultural products (such as films).

Nationalism can also be considered as an obstacle to globalization to the extent that it promotes a return to trade protectionism and a retreat from international agreements in certain societies (as shown by Brexit).

2 COMMERCIAL FACTORS: DISTRIBUTION, CUSTOMIZATION AND RESPONSIVENESS

In some sectors, distribution networks and practices differ from country to country and as a consequence the ways of managing the network, motivating dealers and distributors, pricing, and negotiation are hardly amenable to global coordination. For instance, the marketing and distribution of pharmaceutical products differs according to the country's health system. In some countries, such as Japan, doctors sell medicine, while in other countries pharmacists sell to patients who get a refund (or not) from their insurance company, while in yet other cases pharmaceutical products are delivered freely to the patient.

Responsiveness to customers' demands, as well as customization, are other factors which almost by definition defeat standardization. Private savings or current accounts to individuals, loans to small and medium-sized enterprises (SMEs), mortgages, consulting activities and individual architectural designs are activities in which a local presence and a fast reaction to customers' requirements are needed for competitive success. Although some practices, processes or methodologies can be standardized on a worldwide basis (consulting, engineering, architecture or auditing, for example), specific customer requests have to be taken into consideration, thus limiting globalization.

3 TECHNICAL FACTORS: STANDARDS, SPATIAL PRESENCE, TRANSPORTATION AND LANGUAGES

Technical standards in electrical, civil, chemical or mechanical engineering can create a burden for global companies. The economies of scale and cost benefits of global integration and standardization cannot be exploited fully when technical standards vary greatly. In certain cases, standards can be changed without major modification – for instance, mobile telephony does not represent a major hurdle for global manufacturing. In other instances, standards are not that easy to accommodate and require a specific local production line. This is mainly the case for beer or foods, for instance.

Spatial presence is a requirement for those industries which need to occupy a physical space in order to create and distribute their products and services. Retail banking, retailing, hotels, local telephones services, hospitals, entertainment, car dealerships are examples of industries where the services have to be produced locally. There are still some advantages in globalizing certain tasks (such as the back office functions of accounting, data processing, global sourcing, transfer of best practices), but the location constraint still limits globalization benefits. In the future, e-commerce is likely to reduce the spatial constraint considerably, particularly when it comes to non-physical services such as banking or movies on demand. E-commerce in physical products can also eliminate the spatial constraint as far as the customer interface is concerned, but it is still hampered by logistical constraints. The example of Amazon demonstrates that it is possible for a customer in Paris or in Rio de Janeiro to order a book but the customer will have to bear shipping costs that may eliminate the basic cost advantage of the e-bookstore. This is the reason why Amazon has established 82 fulfillment centers outside the USA, thus moving toward a more multinational business design.

The impediments of transportation are important if the cost of transport cancels out the benefits of concentrating production. Bulk commodities such as cement or basic chemicals are more economically produced in local plants than in global centralized units, despite the scale economies that could be gained: the cost and the risks of transport cancel out the benefits of centralized production. Similarly, when production systems are not scale-intensive and small productive units can achieve similar costs to large plants – in plastic molding, for instance – there are no major benefits in building a global production system.

Finally, language can be an additional constraint to global approaches. This can be significant when it comes to customer services, of which training services, personal banking, personal telecommunication and retailing are examples. However, there are two major trends that can reduce language constraints. English has become more and more the 'global language', and industries such as graduate business training or high-level consulting can use English without bothering with translation.

4 LEGAL FACTORS: REGULATION AND NATIONAL SECURITY ISSUES

Governments impose regulatory constraints that often work against globalization, either because they limit the free flow of personnel (regulation on working permits), cash (exchange controls, tax), goods (customs duties, quotas), or data (censorship, the internet and controls on electronic data interchange), or because they impose localization constraints (local content, local ownership and joint venture policies).

Over the years, thanks to the GATT/WTO, multilateral agreements (EU, ASEAN, NAFTA and so on), and International Monetary Fund (IMF) requests, government legislation is leaning towards more open contexts that favor globalization. However, some constraints still exist. Some sectors such as telecommunications, media, banking and insurance are still tightly controlled and some countries (such as China and India) or regional blocks (EU) still impose local content requirements.

Finally, governments are deeply concerned with national security and will prevent foreigners gaining too much control of their defence or strategic sector industries. In the defence sector, for instance, where R&D costs are huge and economies of scale significant, globalization would appear to be fully justified, but is in fact limited because of national security constraints. Since the 2001 Twin Towers destruction in

New York followed by a series of terrorist attacks in London, Madrid, Moscow, Beirut, Nairobi and Paris, governments have adopted measures that constrain the movement of people and products. Security becomes priority.

Figure 1.4 summarizes these localization push factors.

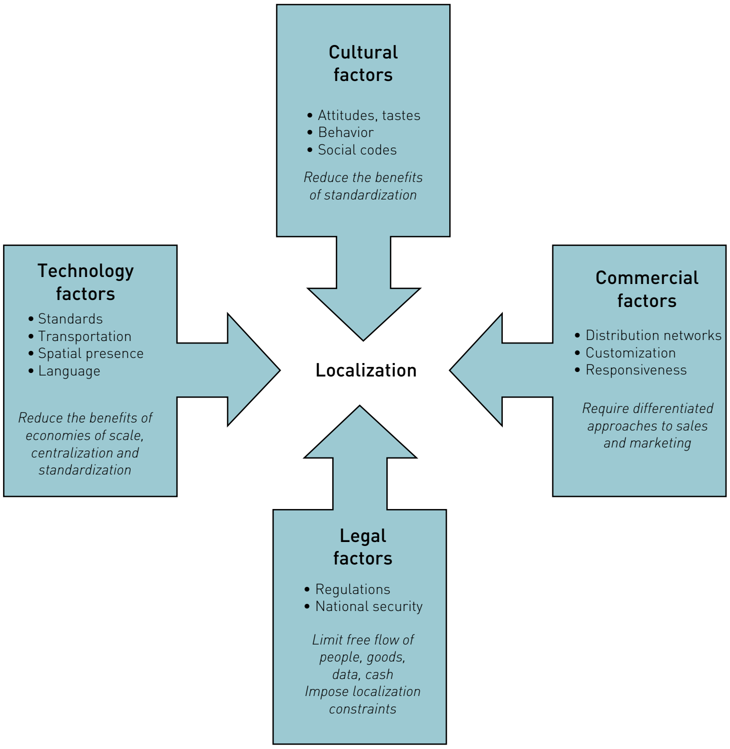

Figure 1.4 Localization push factors

THE BENEFITS OF LOCALIZATION

The benefits of localization, instead of a global integrated and coordinated approach, are essentially customer-oriented benefits that give firms increased market power and ultimately an increased market share. Those benefits are proximity, flexibility and quick response time.

- **Proximity** is the capability to be close to the market, to understand the customer's value curve.
- **Flexibility** is the capability to adapt to customer demands in the various dimensions of the marketing mix: product/service design, distribution, branding, pricing and services. Ultimately, flexibility leads to customization.
- **Quick response time** is the ability to respond at once to specific customers' demands.

These three benefits are closely interrelated: proximity provides the basis for flexibility and flexibility provides the basis for a quick response time. All three give a competitive advantage when local cultural, technical, commercial and legal contexts vary so much from country to country.

THE BENEFITS AND PITFALLS OF GLOBALIZATION: THE MACRO PICTURE

In 1817, David Ricardo in his theory of comparative advantage[10] showed that it was beneficial to nations to specialize and trade goods in which they had a comparative advantage. This laid the foundation of trade theory, which itself is the underlying foundation of globalization: in a perfect global setting where goods, people, data and money flow freely, companies can adopt an integrated and coordinated approach to their operations and the competitive battlefield would be the world. Since Ricardo's time, partisans and adversaries of free trade have exchanged heated debates about the pro and cons of globalization for society. Table 1.2 summarizes those arguments.

Table 1.2 The societal benefits of globalization

Arguments in favor of globalization	Arguments against globalization
Creates overall wealth for all nations because specialization increases trade	Imposes a massive strain on labor forces both in developed countries (job destruction) and developing countries (sweatshops, child labor)
Reduces inflation because of cost efficiencies	Standardizes customer tastes. Reduces diversity
Benefits customers because of price reductions arising from cost efficiencies	Induces concentration of power in a few global corporations Introduces a 'law of the jungle' leading to domination by the strongest multinational
Better allocation of natural, financial and human resources	Harms the environment because of unrestrained exploitation of natural resources such as forests
Reduces corruption because of free-market trade	Reduces the capacity for nations to protect their national interests, cultures and values

The globalization debate gained political visibility during the 1990s. In Europe, the Treaty of Maastricht (signed in 1992) adopted the euro as a single currency, generating a heated debate on the loss of sovereignty and the advantages of further political and economic integration. In 1995, the North America Free Trade Agreement (NAFTA) created similar discussion. In Asia, after the 1997 financial crisis, globalization was questioned and, at the end of that decade, the WTO at the Seattle ministerial conference could not set up an agenda for launching another trade round because of public criticism of the whole concept of globalization. Since 2000 and particularly after the world 'subprime' crisis of 2008, there has been growing debate about the future of globalization. Some, such as Alan Rugman and others, have announced the 'end of globalization',[11] a concept that will be discussed in Chapter 15.

Despite all this political turmoil, some analysts think that the world is becoming progressively more integrated. According to the consulting firm McKinsey,[12] by 1997 the value of truly global markets represented approximately $6 trillion out of a total world output of $28 trillion (21%). In 1999, the firm anticipated that by 2030 the proportion of global markets would amount to $73 trillion out of $91 trillion (80%). However, as will be seen in Chapter 15, this forecast may be challenged.

GLOBALIZATION AT THE LEVEL OF THE FIRM

As mentioned previously, many firms from Western Europe extended their operations outside their country of origin into the Americas, Asia or Africa, most of them in the form of colonial implantations, from the seventeenth century onwards. Arab merchants penetrated the Southeast Asian region in order to organize trade. Following the industrial revolution, large corporations started the capitalistic movement of international investments in infrastructure projects and in the setting up of subsidiaries. The first wave of modern multinational expansion began in 1880 and declined after the First World War. This wave was made of 'free-standing' firms, legally incorporated in their native country but extending rapidly internationally via the creation of local subsidiaries. Except for the resource-based multinational, each local subsidiary was self-standing. By the end of the nineteenth century, firms such as Nestlé, Lever Brothers (Unilever), General Electric and Bayer were representative of this generation of multinational corporations. A second wave of corporate international expansion through local subsidiaries took place after the Second World War, launched by US and European companies and augmented later by Japanese companies. In the 1960s local subsidiaries were extended to more and more countries but started to progressively lose their autonomy and become part of an integrated global network.[13] Classically, over time firms have followed a sequential evolution, from being exporters, to the setting up of foreign subsidiaries, to the integration of operations across the world. From local, they became international, then multinational and now global. More recently, 'born global' companies have assumed a global setting from the beginning,[14] a development that will be discussed in Chapter 5.

To illustrate the traditional phenomenon of globalization let us take the simplified example of Otis Elevator Company.

EXAMPLE 1.1

Otis Elevators

Otis Elevator Company started in 1853 in New York and was soon selling elevators in Canada and Europe as well. In the 1960s it had many plants, service operations and sales offices all over Europe, where the company grew organically as well as by acquisition. Each subsidiary fought for a share of local markets. Competitors were either local national companies or subsidiaries of rival multinational companies. The Otis subsidiaries managed all the activities of the value chain (marketing, design, production, installation and service). For instance, the French subsidiary designed elevators for the French market, manufactured them in French factories, sold them with French sales forces and maintained them with a French after-sales organization – the management was essentially French. In Germany, Otis designed, manufactured, sold, installed and serviced elevators for the German market; and the same applied in nearly every major country – see Figure 1.5. In smaller countries, products or components were exported from major countries'

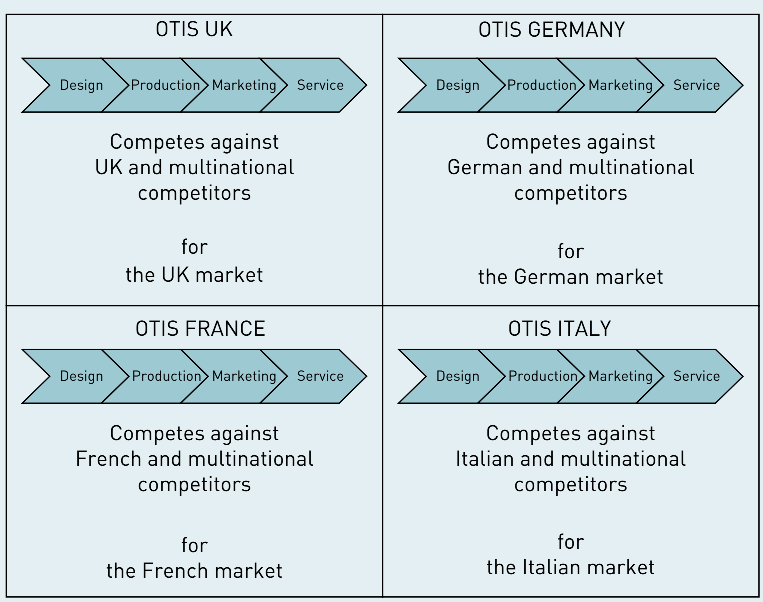

Figure 1.5 A multinational competitive configuration – Otis Elevators in the 1960s

subsidiaries. The operations were self-contained in each country and the results were evaluated on a country-by-country basis. Such a situation had prevailed since the early 1900s. It corresponds to what was referred as a multinational or multi-domestic world, in which multinational companies like Otis were competing in each main market of the planet.

By the end of the 1960s several key elements played a role in changing this competitive structure. One country manager at Otis perceived that the European business context was changing. First, the Treaty of Rome in 1957 had created the European Economic Community (EEC), at that time called the Common Market. This meant that tariff barriers across Europe were coming down; it became viable to produce components in one country and export them to other countries. This allowed the company to concentrate on the production of components in a network of specialized factories across Europe, each of them making one product category or one component. Components could be cross-shipped for ultimate installation in the various client countries. In 2015 Otis operated all over the world as 6 regional organizations, with 200 factories and 12 engineering facilities.

The benefits of such a system were obvious – by concentrating production the company could benefit from economies of scale, and some of the reduction in costs could be passed to the customers in the form of lower prices, leading to higher market share. Products could be designed for an entire market (standardized). Instead of having country segmentation one would have pan-European segmentation based on utilization, that is, high-rise buildings, low-rise buildings and so on.

Standardization would be possible only if customers in Europe – architects, engineers, real estate developers, housing departments and so on – shared a common view about what an elevator should be. Despite the differences in housing organization across countries, elevators were essentially technical products with very little cultural content and therefore able to be standardized. Only selling methods would vary from country to country. The Otis management perceived this as an opportunity to gain market share in Europe and engaged in the pan-European strategy depicted in Figure 1.6 in which design centers and factories were specialized and interdependent.

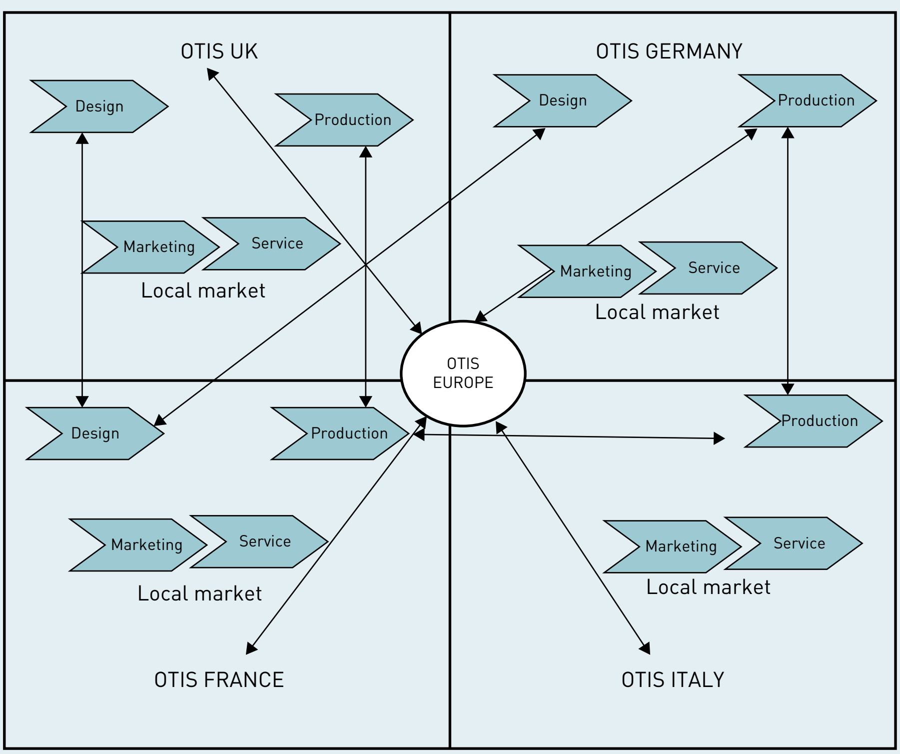

Figure 1.6 A global competitive configuration – Otis today