1 Facts and figures about internationalization

1.1 Internationalization in general

The KOF Index of Globalization offers a helpful and longsighted view of internationalization. Produced by the Swiss Federal Institute of Technology in Zurich, it looks at the phenomenon in very broad terms taking into account economic, social and political internationalization. The index published in 2010 covers the period from 1970-2007. For this reason, the facts and numbers which follow do not take account of the financial and economic crisis of 2008-2009. However, this is anything but a disadvantage, since strategic management publications, like the strategies themselves, need to be oriented towards longer term trends and not the vagaries of the marketplace (KOF, 2010a, p. 1).

The KOF Index is based on 24 variables. Beyond the overall Index of Globalization there are three sub-indices (Dreher, 2006, pp. 1091 ff.; KOF, 2010b).

- The sub-index for **Economic Globalization** includes first of all figures for specific economic movements like trade and FDI. In addition, restrictions like tariffs and non-tariff barriers are included.
- The **Social Globalization** of a country is measured by personal contact, information flow and cultural proximity. Personal contact includes measures such as foreign population as a percentage of total population and telephone traffic with other countries. Information flow includes data on internet use and the availability of television sets. This is because these media cross borders and play a central role in spreading information and ideas internationally. Cultural proximity measures the internationalization of consumption by including, among other things, data on the numbers of McDonald's restaurants and IKEA stores.
- The sub-index for **Political Globalization** uses variables such as the number of foreign embassies and membership of international organizations.

The variables used to compute the index and the three sub-indices all yield a number for each country ranging from 1 (lowest) to 100 (high-

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est). The variables and the sub-indices are all weighted, using principal component analysis (Dreher, 2006, pp. 1091 ff.; KOF, 2010b).

Figure 1.1 gives figures for the Index of Globalization from 1970 through 2007 for the world, for Switzerland, and for Vietnam. Switzerland and Vietnam have been chosen as two countries which differ both from the world average and from each other:

- For the world as a whole, the graph shows a trend in which scores are continually rising. Over the 37 years represented in the graph the index climbed from 35 to 57, representing an increase of more than 60%. After the fall of the Berlin Wall in 1989 scores rose particularly strongly. However, social internationalization has stagnated since 2001. The KOF figures thus clearly suggest a gap between the economic and political integration of the world's countries on the one hand and social integration on the other. One manifestation of this gap might be the regular popular protests seen at G8 summit meetings.
- In 1970 Switzerland was at a much higher level of internationalization than the world as a whole. This is true both for the overall index and for all three sub-indices. Up to the year 2000 the overall internationalization index and the two sub-indices for Economic Globalization and Social Globalization continued to climb, moving above 90. For the overall index the rise from 1970 - 2000 equates to more than 55%. The Political Globalization sub-index was already at 97 in 1993. Since 2000, scores have fallen off slightly, though they remain extremely high. This slight fall should not be taken to indicate that Switzerland's internationalization has decreased. As explained above, for each variable per country and year the highest value is transformed into the index value 100 and the lowest value into the index value 1. The scores in between are calculated in a linear way. This means that the fall in the index value for Switzerland may be attributable to a fall in its relative score, compared with other countries.
- Until 1975, the end of the war, Vietnam had a very low index value of 24. And in the period to 1995 the index value did not climb very far; Vietnam's internationalization at that time was based almost entirely on political moves. But since 1995 internationalization in Vietnam has been in full swing, building above all on improved social integration. The sub-index for social internationalization rose from 14 in 1995 to 31 in 2007, an increase of over 120%.

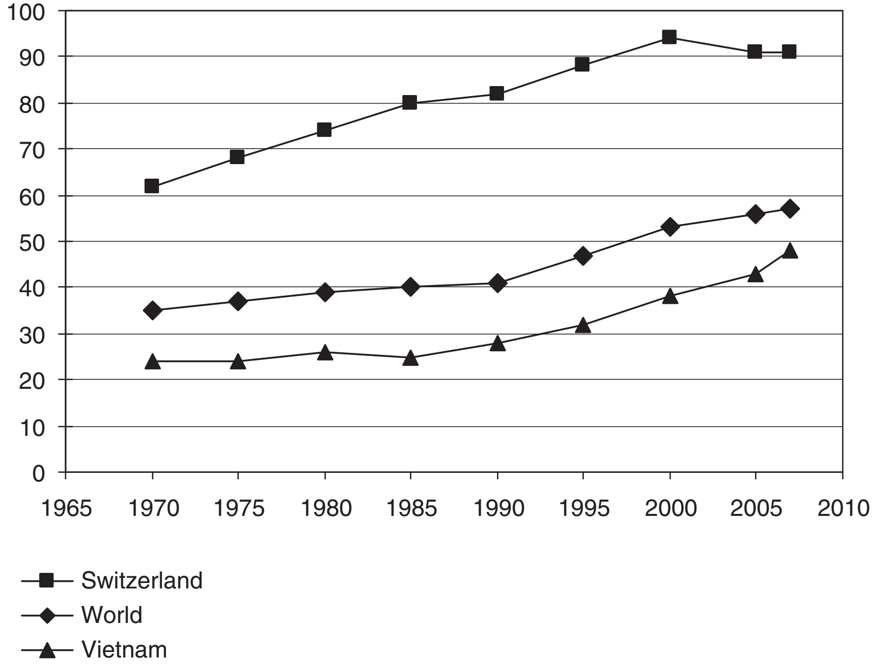

Figure 1.1: KOF Index of Globalization 1970 to 2007 for the world, for Switzerland and for Vietnam (data from KOF, 2010c; KOF, 2010d)

Internationalization has progressed to a very different extent in the various countries. Figure 1.2 gives the indices for eight countries for the year 2007:

- Switzerland, Germany and Poland are strongly internationalized. In these three countries social and political internationalization have progressed even further than economic international links, which are also strong.
- Thailand and China can be found in the upper mid range of countries. The degree of economic globalization corresponds to the country's overall Globalization Index. The lower level of social internationalization is balanced by strong political internationalization. Vietnam is in the lower mid range. The relatively high degree of economic internationalization is offset by low social internationalization.
- Bangladesh and Burundi are examples of nations with low levels of internationalization. The low globalization index is the result of low

Country	Globalization Index	Economic Globalization Sub-Index	Social Globalization Sub-Index	Political Globalization Sub-Index
Switzer-land	91	83	95	95
Germa-ny	84	76	86	94
Poland	81	77	77	95
Thai-land	64	69	49	80
China	63	57	53	87
Vietnam	48	60	31	56
Bangla-desh	46	36	20	76
Burundi	35	31	22	59

Figure 1.2: KOF Globalization Indices 2007 for selected countries
(data from KOF, 2010e)

economic and social globalization. This is compensated for by a high degree of political integration in the international community.

In summary, the long-term indices indicate a very remarkable increase in the globalization of our world since 1990. However, the indices for 2007 reveal vast differences between individual countries, both for the overall index and for the different sub-indices.

It is economic internationalization which is of particular relevance to the aims of this book and so Section 1.2 will now look more specifically at this.

1.2 Internationalization of the economy

Four key indicators provide evidence of the tendency for the economies of different countries to become increasingly enmeshed:

- The first two are exports and imports of goods and services. "Exports of goods and services represent the value of all goods and other market services provided to the rest of the world. They include the value of merchandise, freight, insurance, transport, travel, royalties, license fees and other services. … They exclude compensation of employees and investment income" (World Bank, 2010). In the same way "imports" embraces all goods and market services provided by the rest of the world. We can only identify an increase in globalization when exports and imports grow faster than the Gross Domestic Product (GDP). For this reason these two scores are expressed as percentages of GDP.
- The other two indicators derive from the Foreign Direct Investments (FDI), and are "net [outflows] or inflows of investment to acquire a lasting interest in or management control over an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvested earnings, other long-term capital and short term capital, as shown in the balance of payments" (World Bank, 2010). Enmeshment occurs as firms in the country under consideration invest in other countries. But economies also become enmeshed when the investment takes place in the reverse direction. This means that both outflows and inflows are relevant. To show the

trend to internationalization, annual outflows are expressed as percentages of GDP.

- Trade and FDI are to be seen as complementary approaches (Graham 1997, pp. 29 ff.): FDI creates cross-border trade. Production facilities based outside the home country will often rely on components imported from the home country. And the products produced outside the home country will be marketed in various countries, typically also being exported back to the home market. In many cases it is the FDI which creates the possibility of opening up new markets. This is particularly so if the products produced outside the home country are significantly cheaper than those produced at home.

Figure 1.3 shows changes in exports, imports, FDI outflows and FDI inflows expressed as percentages of GDP for the years 1988 to 2007. The table gives figures for the world as a whole, for Switzerland, and for Vietnam. The data can be interpreted as follows:

- Exports worldwide climbed from 18% in 1988 to 29% in 2007. This corresponds to an increase of over 60% in the period of twenty years. In the same period GDP went up by more than 80%. What this means is that in these twenty years exports almost tripled. If we look at the world as a whole, the volumes of imports and of exports are logically equal. For this reason there is no figure here for imports. Until 1996, Foreign Direct Investments represented just 1% of GDP. But after this the figure begins to rise. In 2007 as much as 5% of the world's GDP was being invested outside the home country. But here we cannot observe the same steadily increasing trend as we found for exports. FDI figures are influenced by the downturns and upturns of the economic situation.
- If we now look at the figures for Switzerland, in 1988 exports were already 36% of GDP, twice the figure for the world as a whole. By 2007 exports had grown to 56% of GDP. But Switzerland does not only have high exports. As a country with limited natural resources, its imports are also very high. Imports rose from 34% of GDP in 1988 to 47% in 2007. However, over the twenty years Switzerland's overall trade surplus has grown. The FDI figures are also impressive. Outflows grew from 4% of GDP in 1988 to 13% in 2007. And while Swiss companies have been making significant investments in other countries, Switzerland itself has also been an attractive target for foreign investors. Foreign investment into Switzerland also in-

creased in the period under consideration and since 1997 has remained well above the world average.

- The figures for Vietnam are significantly different from those for Switzerland, showing a trade deficit. But what stands out most is the scale of the increases over the period under consideration. Exports as a percentage of GDP have risen by more than 1800% and imports by over 500%. If we add the fact that GDP itself has risen by more than 6 times in this period, we can see that exports of products and services from Vietnam have risen by a factor of more than 100 in the last twenty years! Vietnam has not made significant investments in other countries, but Vietnam has become an important recipient of FDI. These investments have greatly contributed to the country's export growth. As **Inset 2.1** will show, many of the exports originate from production facilities set up by foreign companies.

Figure 1.4 shows the international economic integration of six specific countries for the year 2007. The countries divide clearly into three pairs. Switzerland and Germany are economically successful countries with strong international connections. Their economic success is based not only on a trade surplus, but is also rooted in FDI outflows. Because of their economic success, the countries are themselves attractive targets for foreign investors. Next, Thailand and Vietnam are strongly integrated with other countries through imports and exports of goods and services. While Vietnam still has a trade deficit, Thailand has a positive trade balance. FDI inflows will lead to further increases in exports and in the medium term both these countries will become economically stronger, with Vietnam transitioning to a trade surplus in the medium term. Finally, Bangladesh and Burundi are much less enmeshed. Imports and exports are both much lower. Unlike in Vietnam, here the trade deficits are not combined with FDI inflows. These countries currently lack the foreign investments which would be needed to boost their exports.

Up to now we have looked at economic internationalization at the macro-economic level. But for strategic planning industry perspectives are also important. **Inset 1.1** and **Inset 1.2** describe internationalization in two different industries in different countries. These are the textile and garment industry in Vietnam and the watch industry in Switzerland.

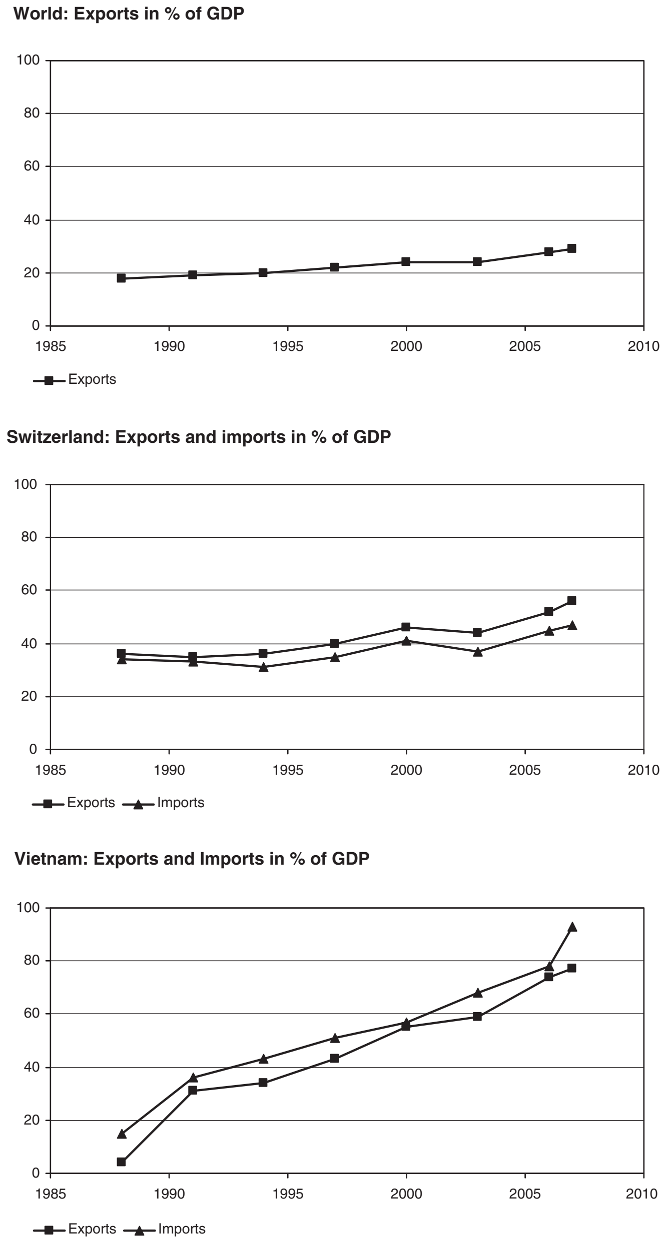

Figure 1.3: Economic internationalization 1988 to 2007 for the world, Switzerland and Vietnam (data from World Bank, 2010)

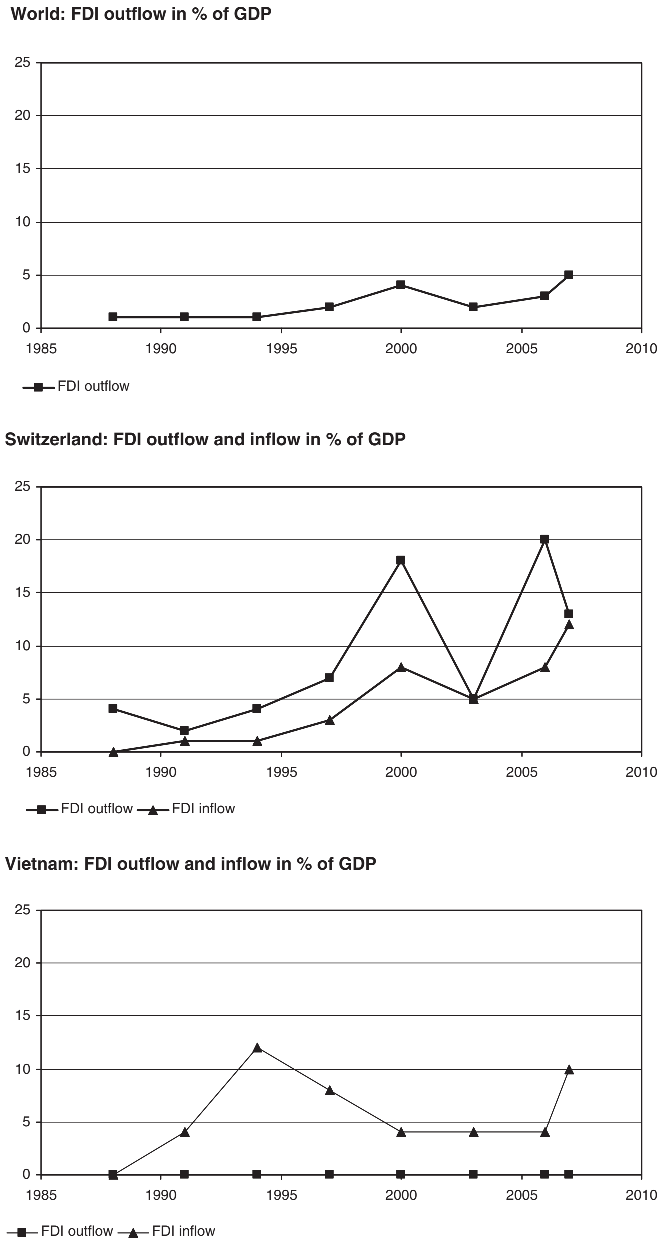

Figure 1.3: Economic internationalization 1988 to 2007 for the world, Switzerland and Vietnam (continued)

Country	Switzerland	Germany	Vietnam	China	Thailand	Poland	Bangladesh	Burundi*
Exports of goods and services in % of GDP	56	47	77	38	73	41	20	11
Imports of goods and services in % of GDP	47	40	93	30	65	44	27	47
FDI outflow in % of GDP	13	5	0	0	1	1	0	0
FDI inflow in % of GDP	12	2	10	4	5	6	1	0

* Data for 2006

Figure 1.4: Economic internationalization of selected countries for 2007 (data from World Bank, 2010)

Inset 1.1: Textile and garment industry in Vietnam

In 2005 the domestic product of the textile and garment industry in Vietnam was around 5.5 billion dollars (Pham, 2008, p. 37). Of this some 90%, or 4.8 billion dollars, was exported. As a result the textile and garment industry accounted for 15% of Vietnam's total exports in 2005 (Pham, 2008, p. 37). This figure is all the more striking, as Vietnam achieves much of its exports with crude oil, where there is little added value.

The textile and garment industry in 2005 was made up of around 2,800 separate firms. Of these, 560 were state-owned enterprises, 1,280 were privately owned Vietnamese firms, and the remaining 960 were FDI enterprises. The industry employs more than 2.1 million people, or just under 5% of all workers (Pham, 2008, pp. 35 ff.).

The FDI enterprises are mostly owned by Asian companies. Almost 95% of the capital invested has come from East and Southeast Asia. But the industry's exports go predominantly to the US and Canada (56%) and to Europe (15%) (Pham, 2008, pp. 35 ff.).

Of these exports, it can be assumed that a large proportion originates from FDI enterprises. These companies were established in order to gain access to qualified workers with moderate wages. Investors from countries like Taiwan, South Korea and Japan enjoy immediate cost advantages when they can produce in Vietnam, rather than in the home country. In 2005, hourly wages in the textile and clothing industry were USD 8 for Taiwan and USD 7 for South Korea. In Japan the figure was USD 28. Compare these figures with the average for Vietnam, less than USD 0.5 (Dicken, 2009, p. 257). The transfer of production to Vietnam has not changed the customer relationships. Companies continue to supply their traditional markets in the US and Europe from their production facilities in Vietnam.

FDI enterprises have not only created jobs in Vietnam, but have also developed competences in design, production and sales. As a result, in the medium term it can be expected that the performance of other firms, the state-owned enterprises and privately owned Vietnamese companies, to improve as well. This will in turn increase exports from these companies too.

Inset 1.2: Watch industry of Switzerland

The Swiss watch industry is largely concentrated in the region known as the Jura and along the southern foot of the Jura mountains. In a few hundred square miles there is an industry cluster (Porter, 1990, pp. 179 ff.) which enjoys a dominant position in the worldwide market's upper price segment and luxury segment. The upper price segment comprises products priced at CHF 500 to CHF 2,000 ex works. The luxury segment has watches with an ex works price of more than CHF 3,000 (Federation of the Swiss Watch Industry, 2010a). Retail prices are about three times as much as the ex works price.

The Swiss watch industry is very strongly geared towards exports. More than 90% of the watches are exported. In addition, foreign tourists account for a large proportion of those watches which are sold in Switzerland. **Figure 1.5** shows watch exports for 1970-2007:

- Up to the early 1970s, the Swiss watch industry was active in all price segments. The watches all had mechanical movements.
- The invention of the electronic watch brought dramatic changes. The number of watches produced each year in Switzerland fell from 60 million in 1973 to only 15 million in 1983. Foreign made quartz watches forced the cheaper mechanical watches from Switzerland out of the market. As a result of the disappearance of these cheaper watches, the average price for a mechanical watch rose from CHF 39 in 1973 to CHF 164 in 1983 (Federation of the Swiss Watch Industry, 2010a).
- With the creation and successful launch of the Swatch, the Swiss watch industry regained a limited foothold in the low price segment, represented by prices up to CHF 200 ex works. In 2007 cheap watches represented 72% of units exported. However, these watches only amounted to around 8% of the total value of exports (Federation of the Swiss Watch Industry, 2010a).

As **Figure 1.5** shows, the average unit price tripled between 1990 and 2007. As a result, the upper price segment and the luxury segment now dominate within the Swiss watch industry, as shown in **Figure 1.6.**

Figure 1.7 compares the four countries which, in 2007, achieved exports of at least a billion Swiss francs:

- In terms of value, Switzerland is well out in front as the leading exporter of watches in the world. More than 85% of these exports are within the upper price segment and the luxury segment.
- In terms of units sold, China dominates the world market with more than a billion watches. With an average price ex works of CHF 6, China is almost a hundred times cheaper than Switzerland and still ten times cheaper than Switzerland in the low price segment. Based on the average price, Germany too belongs to the low price segment. But German watches are 25% more expensive than Swiss watches in the low price segment.

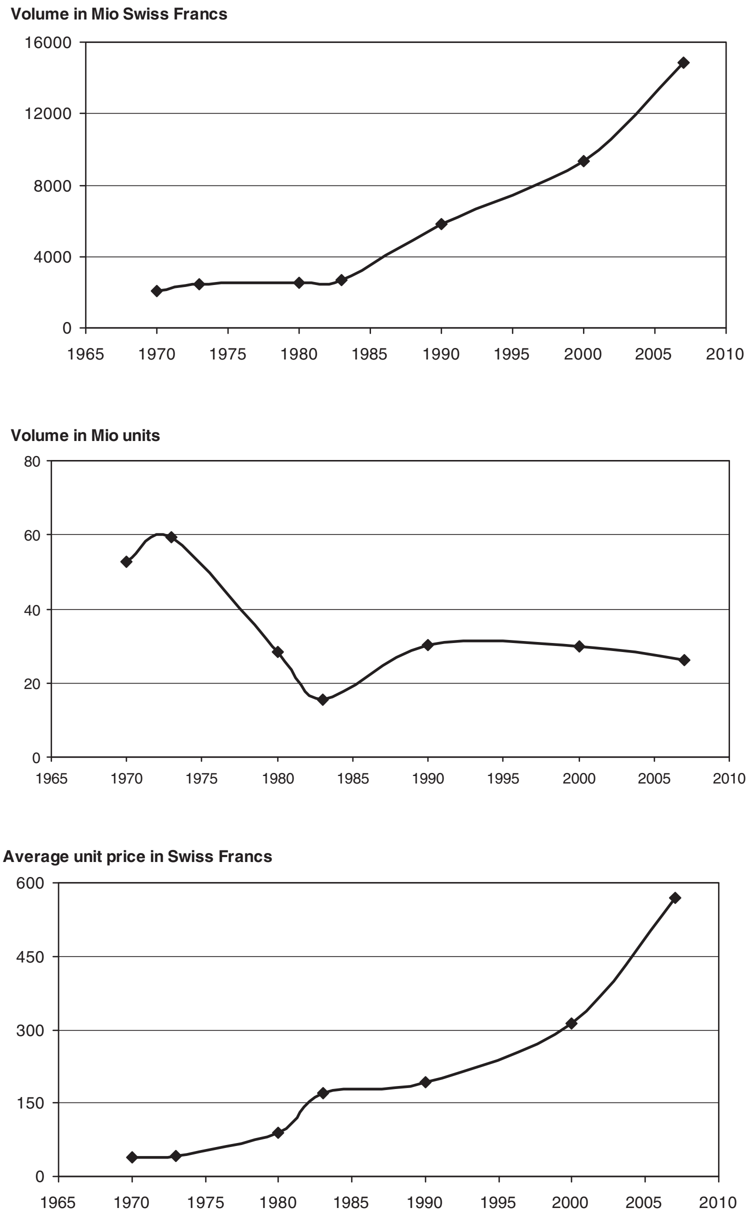

Figure 1.5: Watch exports from Switzerland 1970 to 2007
(data from Federation of the Swiss Watch Industry, 2010a)

Submarkets	Exports in mil. units	Av. export price in CHF	Exports in mil. CHF	Exports in %
CHF 0-200	18.7	64	1,200	8%
CHF 200-500	2.6	346	900	6%
CHF 500-3,000	3.7	1,324	4,900	33%
CHF 3,000+	1.0	7,800	7,800	53%
Total or average	26.0	569	14,800	100%

Figure 1.6: Submarkets of the Swiss watch exports 2007 (data from Federation of the Swiss Watch Industry, 2010a, rounded by the authors)

Countries	Exports in mil. units	Av. export price in CHF	Exports in mil. CHF
Switzerland	26	569	14,800
China incl. Hongkong	1,111	6	6,500
Germany	14	79	1,100
France	6	183	1,100

Figure 1.7: The four largest watch exporters 2007 (data from Federation of the Swiss Watch Industry, 2010a, rounded by the authors)

- The average price for French watches is just below the threshold between the low and medium price segments. This suggests that French exporters operate mainly in the low and medium price segments.

There are several reasons for the dominant position of Switzerland in the upper price segment and in the luxury class. The industry has a tradition of craftsmanship going back hundreds of years. This affords the expertise for the manufacture and design of watches which are technically and aesthetically outstanding. But it also brings prestige. And this prestige is not only associated with individual brands, but also embodied in the “Swiss made” label. The industry association sets out clear conditions which have to be fulfilled if products are to bear the “Swiss made” label: the movement and the watch have to be assembled in Switzerland and at least 50% of the value of the components of the movement must originate from Switzerland (Federation of the Swiss Watch Industry, 2010b).

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