GLOBAL BUSINESS ENVIRONMENT MNI 301-J

Aregbeshola R Adewale

aregbra@unisa.ac.za

012 429 8505

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Introduction

- Purpose of group discussions
- Your study material
  - study guide
  - text book
  - relating the study guide to the text book
- Activities
  - Format of the examination
    multiple choice questions
    essay questions
    total mark
    pass mark
    duration of the examination
- Assignments
  - Compulsory MCQ assignment 1
  - compulsory MCQ assignment 2

LEARNING OUTCOMES

AT THE END OF THIS DISCUSSION CLASS, YOU SHOULD BE ABLE TO:

- Clearly define Global Business
- Identify and interrogate the dynamics of Global Business
- Discuss the relevance and challenges of Global Business
- Understand the practical approaches to internationalisation of business
- Define and understand the benefits and challenges of globalisation
- Differentiate between the types of globalisation and their relevance in international business
- Exemplify the role of culture in international business context
- Integrate cultural dimensions with leadership styles
- Understand the global competitive strategies and the associated challenges
- Global corroborative and strategic a alliances
- Regional economic integration and their associated gains and challenges

GLOBALISATION

- What is globalisation?

  In summary:

  globalisation can be described as the modernity of global interdependency of nations that permeates every human endeavour with various magnitudes, in causes and consequences

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Perspectives of globalisation

culture and economic:

Cultural perspective - a process which embodies transformation in the spatial organisation of social relations and transactions [...] generating transcontinental or interregional **flows** and **networks** of activity, interaction, and the exercise of power" (Held, et al. 1999:16)

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Perspectives of globalisation

Economic:

Economic perspective - the growing interdependence of countries worldwide through the increasing volume and variety of cross-border transactions in goods and services and of international capital flows, and also through the more rapid and widespread diffusion of technology (Johnson and Turner (2004)

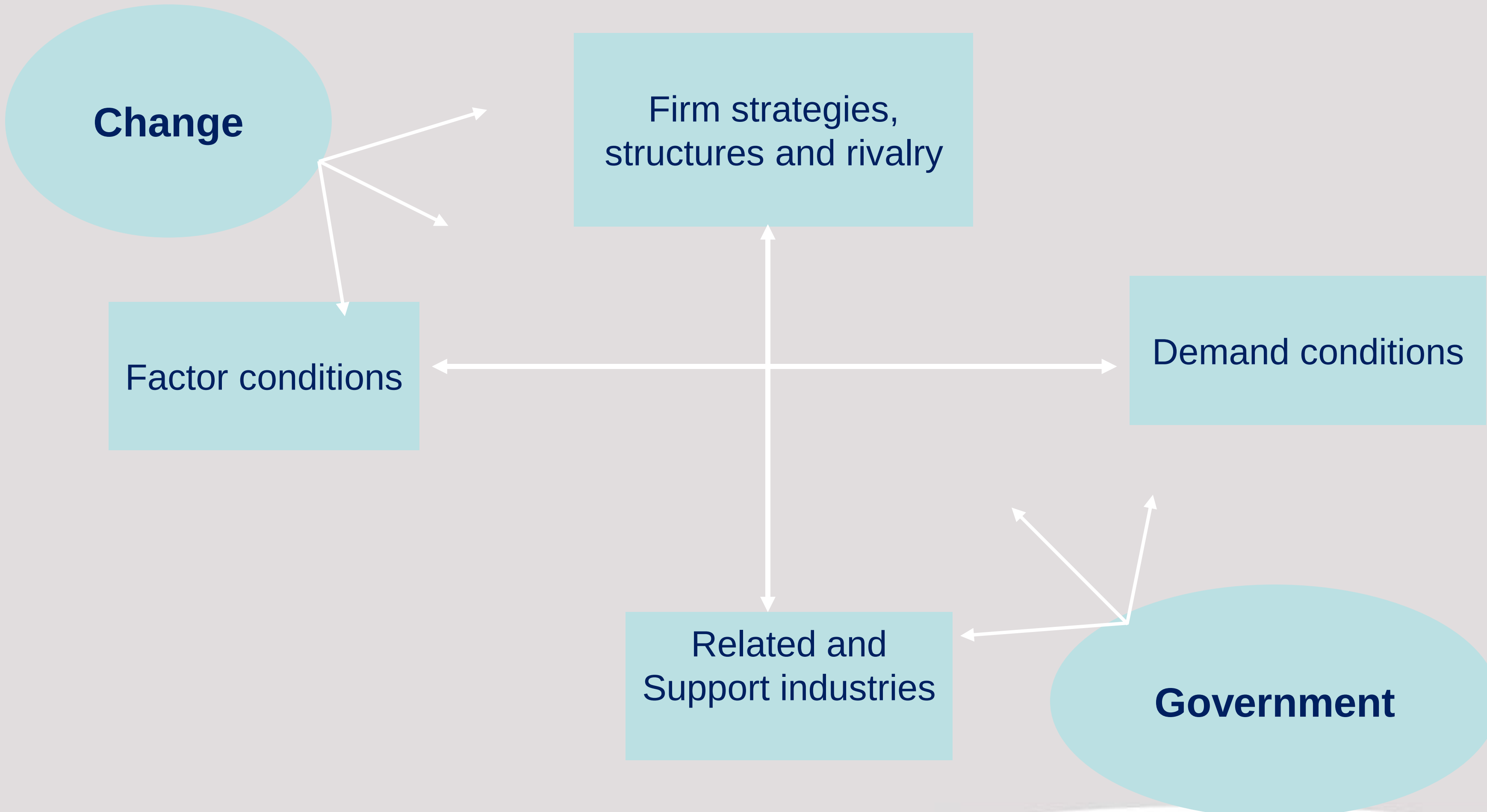
Factors influencing foreign investment

- National economic performance
- Political stability
- Attitude of investors
- Government policy
- Availability of infrastructure
- Labour regulations
- Availability of a working banking and financing institutions
- Government bureaucracy
- General business environment
- Quality of life and the cost of living in a country

international trade theories

- Mercantilism
- Absolute advantage
- Comparative advantage
- Heckscher-Ohlin theory of ‘factors of production’
- The Leontief paradox
- Product life-cycle theory
- New trade theory – questioning diminishing returns in favour of increasing returns to specialisation
- Porter’s Model of national competitive advantage:
    - factor conditions
    - demand conditions
    - related and supporting industries
    - firm strategies, structures and rivalry

Porter ‘diamond model’ for national competitive advantage



Forces driving globalisation

- Political forces
- Economic forces
- Social forces
- Technological forces

Economic integration

- Free Trade Zone
- Free Trade Area
- Customs Union
- Common Market
- Economic Union
- Political Union

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Barriers to foreign market entries

TWO FOLD: TARIFFS AND NON-TARIFF BARRIERS:-

Tariff barriers- financial levies on imports – taxes or duties

- customs duties
- ad valorem tariffs
- specific duties
- Formula or related duties
- surcharges
- sin taxes
- environmental levies
- ordinary levies (fuel levies)

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Barriers to foreign market entries

Non-tariff barriers – quantitative trade restrictions on imports (non-monetary trade restrictions)

- import license
- quotas
- product standards
- local contents
- embargoes and sanctions
- special import restrictions
- prohibitive goods
- import deliberate bureaucracy

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Cases for government intervention in trade

Economic

- To protect local jobs & firms
- To protect consumers
- To protect foreign reserves
- To nurture infant industries
- To promote local manufactures
- To engender local branding
- As a tool for trade remedy
- Economic retaliation

Political

- To advance political agendas
- For national security
- Food security
- To gain political recognition
- To win electoral votes

Trade remedies

Unfair trade remedies

- Anti-dumping
- Countervailing

  - offsetting the benefits of subsidy

Fair trade remedies

- Safeguards

  - industrial safeguards
- Agricultural safeguards
- Special safeguards

  - offsetting excessive imports

Economic Integration

Definition:

- grouping of countries by agreement or treaty.
- ensuring free movement of persons, goods, capital, and services; by following a coordinated policy in the economic, financial, and social fields; and by pursuing a common policy with regard to non-member countries.

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The European Union

The euro

- The official currency of the European Union.
- On January 2, 2002, the new European currency, the euro, became official in 12 countries.
- The original currencies were no longer accepted in transactions after Feb. 28, 2002.
- Currently has 17 members with the ascension of Estonia on 1 Jan. 2011

The euro zone

- The European countries that adopted the euro as their official national currencies are known as the eurozone.
- Denmark, United Kingdom, and Sweden are not part of the eurozone, but remains part of the E U.
- More E U members are joining the eurozone.
- Currently has 27 members

Impacts of the euro

Advantages

- Greater business opportunity (enlargement of the market)
- Decrease in monetary transaction costs (forex)
- Price stability and equity amongst member nations
- Favourable variable revenue for companies listed on the EU stock markets

Disadvantages

- Possible loss of market share in national markets due to international competition
- Instability in the eurozone will affect their foreign trade partners (TDCA) – risk aversion
- Lower interest rates in the eurozone may lead to trade creation in the EU

Achieving a working economic integration

- Same / close geographical location of member nations
- Easy access to one another – an effective and efficient transport system
- Considerable natural resources and productive human capital
- Formal treaty / agreement
- Technologically advanced telecommunication system
- Effective and efficient banking and financial institutions
- Cultural adaptability/ homogeneity
- Geopolitical equity and socio-economic stability in member nations

Culture in international business

Definition of culture:

Culture is the system of shared beliefs, values, customs, behaviours, and artifacts that the members of society use to cope with their world and with one another, and that are transmitted from generation to generation through learning

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Culture!!!

Culture is more often a source of conflict than of synergy. Cultural differences are a nuisance at best and often a disaster."

Prof. Geert Hofstede,
Emeritus Professor,
Maastricht University.

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Components of culture

- Attitudes - a hypothetical construct that represents an individual's degree of like, dislike, conflicted or ambivalent for an item; they are the established ways of responding to people and situations that we have learned, based on the beliefs, values and assumptions we hold. Attitude become manifest through our behaviour.

- Beliefs - the assumptions we make about ourselves, about others in the world and about how we expect things to be; how we think things really are, what we think is really true and expected likely consequences of our behaviour.

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Components of culture

- Norms - the rules of behaviour that are part of the ideology of the group. Norms tend to reflect the values of the group and specify those actions that are proper and those that are inappropriate, as well as rewards for adherence and the punishment for dissidence.

- Values - beliefs of a person or social group in which they have an emotional investment (either for or against something). Values exert major influence on the behaviour of an individual and serve as broad guidelines in all situations

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Culture: C & E

Characteristics

- Culture is learned
- Culture is shared
- Culture is relative

  - no generally acceptable standard

  - no superiority of any culture over the other
- Culture is interrelated
- Culture is adaptive (it changes)
- Culture is symbolic

Elements

- Religion
- Social structure

  - individuals, families and groups
- Language
- Education
- Economic philosophy

  - Economic systems and structures
- Political philosophy

  - political structures and ideologies

Implications of religions on economy/ business

Christianity (Protestantism)

- Predominantly Protestant countries has had far greater economic implications than Catholicism (Max Weber, 1904)
- Better economically developed
- Ethics of hard work, productivity, savings, reinvestment of capital, wealth creation.
- Firmly established capitalism in Europe and North America

Islam

- Just profiteering acceptable
- Business dealings should be conducted justly, charitably and humbly.
- Payment and receipt of interest prohibited
- Reiterates the importance of honesty and honouring of contractual agreements/ obligations
- Strong political pressures to protect religious traditions

Culture in the workplace

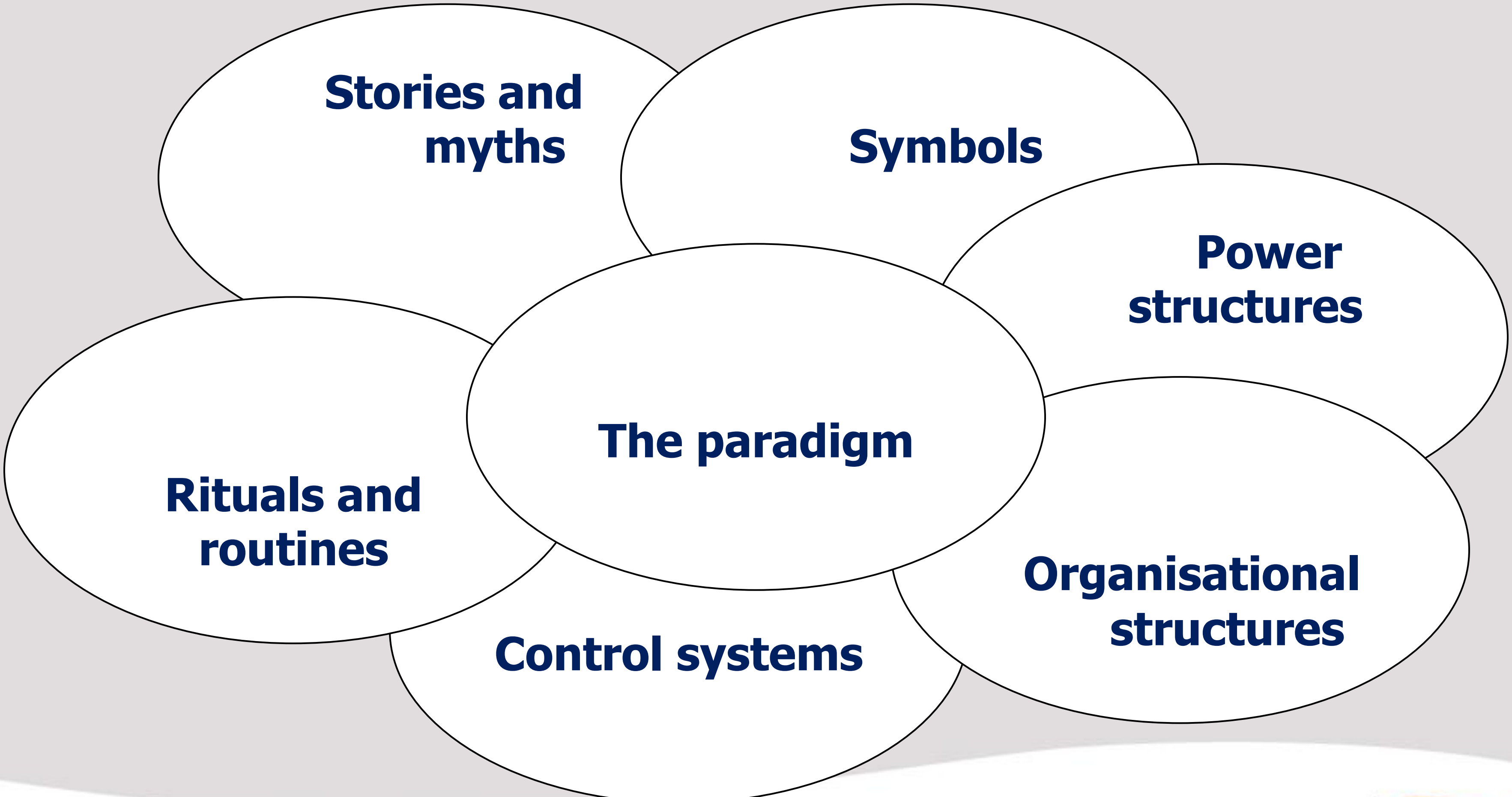
High-context

- Values long-term relationship
- Regards trust as very crucial in business negotiations
- Effective adverts must be emotion-oriented
- A good emotional social setting is essential for decision-making

Low-context

- Values contextual business relevance
- Places credence on specific terms of agreements and transactions
- More factual advert contents arouses patronage
- Impersonal decision-making process, while avoiding conflicts of interests

The cultural web of an organisation



Hofstede's cultural dimensions

- Power distance index

  - equal distribution of power
  - blind obedience of orders is a characteristic of a high power distance society
  - concentration of power is rebuffed in low power context societies

- Individualism/ collectivism

  - ties among individuals are loose
  - individual achievements are celebrated

- Masculinity/ femininity

  - in masculinity, men are assertive
  - differentiated gender roles and responsibilities

- Uncertainty avoidance

  - the extent to which a society accepts and prepares for change
  - high uncertainty avoidance society is reticent to unstructured situations and abhors abrupt change
  - a low uncertainty avoidance society is characterised by risk taking, entrepreneurship, innovation and lesser regulatory framework

- Long-term orientation

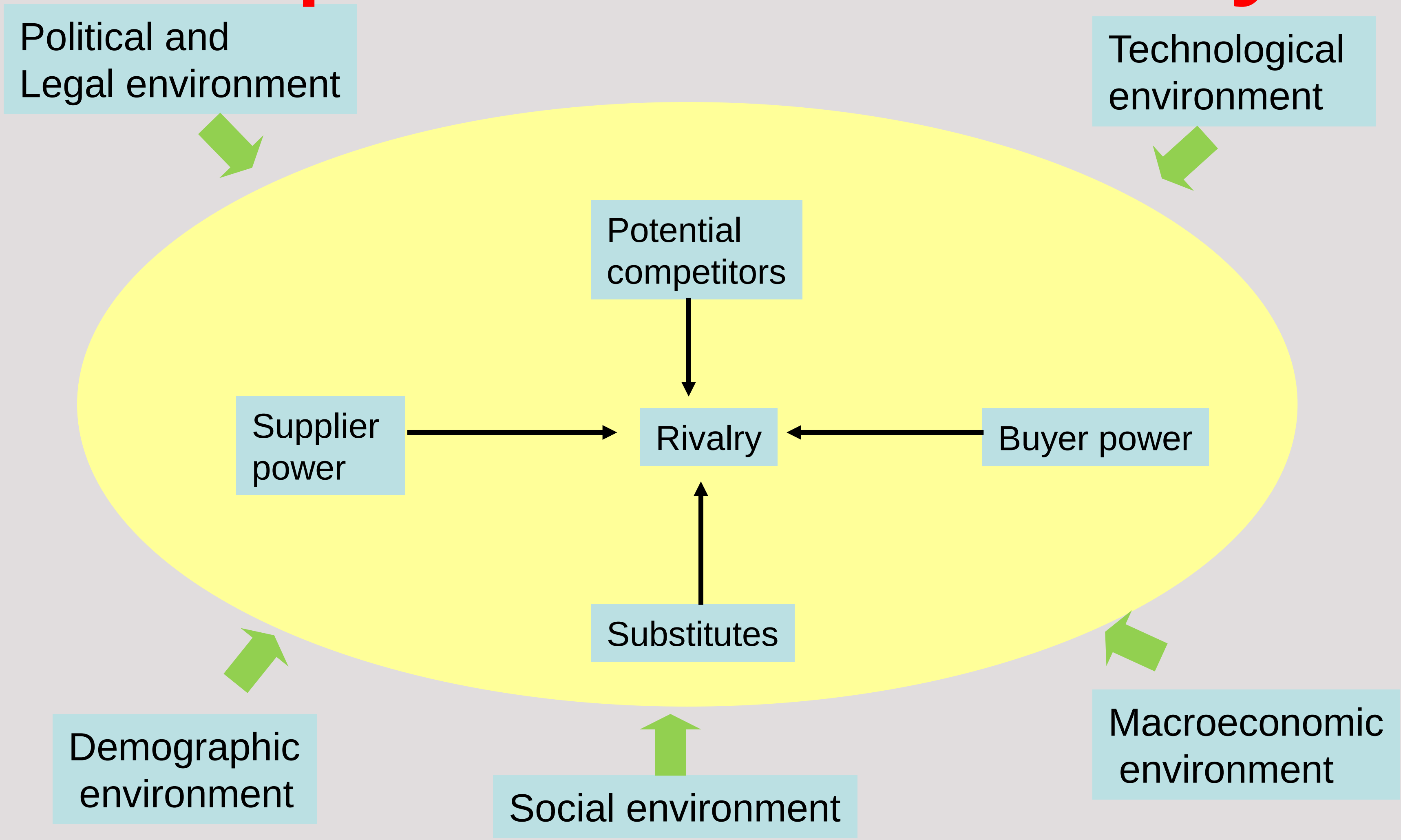
  - time preference on work, life and other perspectives
  - value dedication, hard work, tenacity; cherishes allegiance

International political, legal and tech. environment

- Introduction:

  Multinational enterprises (MNEs) operate in countries that are characterised by different political, legal, technological and economic frameworks, diverse levels of economic development, and economic conditions. These MNEs bring a frame of reference based on their domestic experience as well as lessons from foreign settings

The political economy



The legal environment

The legal environment is derived partly from the political climate in a country and has three dimensions:

1. The domestic laws of the exporter's country
2. The domestic laws of each of the exporting country's foreign markets, and
3. International law

Different legal systems

The legal systems of most of the non-socialist countries can be grouped into common law and code law.

- **Common law** is generally based on precedents or past practices
- **Code law** is a comprehensive set of volumes having statutory force and covering the whole spectrum of the country’s law such as speed limit of 80 kph

Legal environment and the impact on investment strategies

- Companies deal with political and legal issues at different levels as they become more international
- If a company selects exporting as the mode of entry, management is not as concerned with the political process or with the variety of legal issues as would be the case with a FDI

Legal environment and the impact on investment strategies

- In countries where the legal framework for protecting investors is weak, entrepreneurs and managers cannot credibly convince investors that their money will be efficiently used and returned to them as high future returns
- The expectation of future conflicts of interest is reflected in low prices for shares at the time of offer and discourages entrepreneurs and managers from fully diversifying

Legal environment and the impact on investment strategies

- Evidence shows a strong positive relationship between the quality and efficiency of a country's legal system and its level of economic development
- Concentration of managerial ownership provides an important clue about the source and causal direction of the relationship

Technological environment

Definition

- Technology can be defined as the method or technique for converting inputs to outputs in accomplishing a specific task
- Technological innovation, then refers to the increase in knowledge, the improvement in skills or the discovery of a new or improved means that extends people's ability to achieve a given task

Impact of the technological environment

- Computer technology has had an enormous impact on education and health care
- The introduction of robots in many factories has reduced the need for labour
- The use of VCRs and micro-computers has become commonplace in many homes and business
- The introduction of nuclear weapons has made the destruction of the human race a frightening possibility
- Technology is a critical factor in economic development

Political involvement and its impact

- The greater the level of involvement in foreign markets, the greater the need to monitor the political climate of the countries in which business is conducted
- Changes in government often result in changes in policy and attitudes towards foreign business
- Nearly all present-day governments are active in their countries' economies
- The implications of government ownership to a company marketing abroad might be that certain sectors of the foreign market are the exclusive preserve of government enterprise
- Of primary concern to an exported should be the stability of the target country's political environment

Political risk

A checklist for assessing the political risk of a particular country will include the following aspects:

- Form of government and length of leadership in power
- Extent of leadership changes and history of government stability
- Volatility of electorate and popular support for leadership
- Role of military in politics and religious, ethnic or ideological splits

Political risk

- Amount of political participation allowed or tolerated through demonstrations, lobbies, professional associations and other informal interest groups
- Prospects for domestic political violence and internal security forces per 1 000 of the population
- History of coercion and regional political alliances
- Trade or labour disputes
- External threats to suppliers or markets

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The political environment

- The political environment in a company's home country and the host countries are important external influences on management
- An attractive economy may prove to be financially disastrous if host governments inflict heavy financial penalties on a company or if unanticipated events in the political arena lead to the loss of income-generating assets

The political system and its functions

- The political system is designed to integrate the parts of a society into a viable, functioning unit
- A country's political system has an enormous impact on how business is conducted domestically and/or internationally

The economic environment

The political and legal systems influence the types of economic system of a country:

Countries characterised by :-

- High levels of economic development;
- Enhancing strengths / supporting economic policies and strategies; and
- Prospects for sustainable future economic growth -

  present attractive opportunities for international business involvement

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Economic systems

Definition:

A country's economic system is defined as the structure and processes a country uses to allocate resources to conduct its commercial activities

Economic philosophy

- Prevailing economic systems, and legal systems, determine the potential benefits, costs and risks of doing business in a country
- Existing economic systems include: a **market** economy, a **command** economy, a **mixed** economy, and a **state-directed** economy
- Economies tend to lie somewhere on a continuum between a market economy and a command economy

Types of economic systems

A market economy

- Private ownership of the majority of land, productive facilities and other resources
- Freedom of choice, free enterprise and price flexibility

A command economy

- State ownership of land, productive facilities and other resources
- State planning of economic activity

Classification according to phases of economic development

From a developmental perspective, countries are classified as:

- **Developed** (industrialised)
- **Developing** (newly industrialising countries (NICs) or emerging economies)
- **Less developed (very poor countries)**

Further classification

- **Developed countries**
  - Political stability, high levels of education, high standards of living and actively involved in international business and foreign trade
- **Developing countries**
  - Relative political stability, improving educational systems, no longer extensively dependent on agriculture and mining and increasing international business involvement
- **Less- developed countries**
  - Political instability, government inefficiency, low levels of income, inadequate education and social services, and low level of international business involvement

Macro-economic issues in international business

Purchasing power parity

To accommodate differences in cost of living between countries, per capita GNP and GDP data have to be adjusted for differences in purchasing power between countries, by means of ‘purchasing power parity’ (PPP)

GNP (or GNI) and GDP

These are measures of a country’s economic activity during a specific period, normally a year.

- GNP (or GNI) is the market value of final goods and services newly produced by domestic factors of production, whether domestically or abroad
- GDP is the market value of production that occurs within the national borders of a country without regard to whether production factors are domestic or foreign

Measures of the level of economic growth

- Purchasing power – the value of goods and services, that can be purchased with one unit of a country's currency
- Purchasing power parity (PPP) is the relative ability of two countries' currencies to buy the same 'basket' of goods in these two countries
- The Balance of Payment (BOP) is a systematic record of all transactions between the residents of a country and the rest of the world during a given period, usually a year
  - The BOP is divided into the following accounts:

    The current account

    The financial account

Relevance of BOP

BOP statistics can help to:

- identify emerging markets
- warn international firms of policy changes in a foreign country that could affect its business climate and overall attractiveness
- Identify increased risk of lending in specific countries
- indicate reductions in a country’s foreign exchange reserves, which could be an indication that a country’s currency will depreciate in the future

Measuring inflation

Inflation is measured by the inflation rate, which is the percentage increase in the change in pries from one period to the next, (usually a year).

The inflation rate is measured by means of indices such as:

- Consumer price index (CPI)
- Core inflation rate (CPIX)
- Price changes in selected food items (CPI Food)
- Production price index (PPI)

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Implications of inflation for international business

High inflation rates lead to high interest rates

It can reduce domestic demand

It weakens the purchasing power of the local currency

it relatively increases the pricing of imported goods

It can adversely affect economic growth

Risk in the international environment

Environmental risk

- The threat that events in the environment will adversely affect a company’s ability to implement its strategies and achieve its goal

Government intervention

- Taxes
- Import controls
- Payments
- Legal issues
- Industrial disputes
- Operational interference
- Unfair public sector competition

Global collaboration and strategic alliances

Strategic alliance defined:-

It is ‘a cooperative arrangement between two or more local and/or global firms that can affect the competitive positioning of either participant in the market segment in which they set out to compete’

Reasons for alliances with foreign partners

- To seek out new markets as a way of sustaining or increasing growth in sales and profits
- To achieve lower development, research and marketing costs
- To share naturally dispersed resources
- To access natural resource deposits in other countries
- To do business in a politically more stable environment
- To learn new skills from competitors

Modes of entering foreign markets

The six most often used modes of entering foreign markets are:

1. Exporting
2. Licensing
3. Joint ventures
4. Franchising
5. Turnkey operations
6. Setting up of a wholly owned subsidiary in the foreign country(ies)

Advantages and disadvantages of entry modes

Entry mode	Advantage	Disadvantage
Exporting	Ability to realise location and experience curve economies	High transport costs Trade barriers Problems with local marketing agents
Turnkey contracts	Ability to earn returns from process technology skills in countries where FDI is restricted	Creating efficient competitors Lack of long-term market presence

Advantages and disadvantages…

Entry mode	Advantage	Disadvantage
Licensing	Low development costs and risks	Lack of control over technology Inability to realise location and experience curve economies Inability to engage in global strategic coordination
Franchising	Low development costs and risks	Lack of control over quality Inability to engage in global strategic coordination

Advantages and disadvantages…

Entry mode	Advantage	Disadvantage
Joint ventures	Access to partner's knowledge Sharing development costs and risks Politically acceptable	Lack of control over technology Inability to engage in global strategic coordination Inability to realise location and experience economies
Wholly owned subsidiaries	Protection of technology Ability to engage in global strategic coordination Ability to realise location and experience curve economies	High costs and risks

Global Money management

The process of budgeting, saving, investing, spending or otherwise in overseeing the cash usage of an organisation

Components of money management

- Minimising cash balances
- Reducing transaction costs
- Centralising depositories
- Judicious allotment of internal funds
- Optimal allocation of funds
- Multilateral netting

Foreign Exchange

- The foreign exchange market is a global market that provides both physical and institutional financial structure for foreign exchange transactions.
- The foreign exchange market is a virtual form of institutional arrangement – without a physical office location, or physical structure.
- The market determines and regulates exchange rates movement and transactional procedures through the agents of intermediation that are scattered across the globe.

Functions of the FOREX Market

1 Converting currencies

- The payments firms receive from exports, foreign investments, foreign profits, or licensing agreements may all be in a foreign currency. In order to use these funds in its home country, an international firm has to convert funds from foreign to domestic currencies.
- A firm may purchase supplies from firms in foreign countries, and pay these suppliers in their domestic currency.
- A firm needs to convert its local currency into the host country's currency in order to carry out offshore investments.
- A firm may want to speculate on exchange rate movements, and earn profits on the changes it expects. If it expects a foreign currency to appreciate relative to its domestic currency, it will convert its domestic funds into the foreign currency - currency speculation.
- Exchange rates change on a daily basis. The price at any given time is called the spot rate, and is the rate for currency exchanges at that particular time. To effectively manage international finances, it is important to continuously monitor the current exchange rates.

Functions of the FOREX Market…

2 Financial risk aversion

- The fact that exchange rates can change on a daily basis depending upon the relative supply and demand for different currencies increases the risks for firms entering into contracts where they must be paid or pay in a foreign currency at some time in the future.
- Forward exchange rates allow a firm to lock in a future exchange rate for the time when it needs to convert currencies. Forward exchange occurs when two parties agree to exchange currency and execute a deal at some specific date in the future.
- When a currency is worth less with the forward rate than it is with the spot rate, it is selling at forward discount. Likewise, when a currency is worth more in the future than it is on the spot market, it is said to be selling at a forward premium, and is hence expected to appreciate.
- A currency swap is the simultaneous purchase and sale of a given amount of currency at two different dates and values, in order to maximise transactional gains.

Activities of Int. Financial Mgt.

- Capital budgeting/investment: critically analysing, planning, managing, and mentoring of the organisation's portfolios (both in the short and long run).
- Maintaining an expedient capital structure: identifying and securing the most optimal sources of long term funding, and maintaining the most favourable combination of debt and equity levels.
- Working capital management: managing the level and the composition of the organisation's liquidity.
- Manage the books of account of the organisation in conformity with the globally acceptable standard and prescripts.
- Strive towards achieving a balance between the financial goals of the organisation and other stakeholders' interests in the organisation.

Transfer pricing

Transfer pricing refers to the setting, analysing, documentation, and adjustment of charges made between related parties for goods, services, and or use of property (including trade mark, goodwill and intellectual property).

Transfer pricing is simply the act of pricing of goods and services or intangibles when the same is given for use or consumption to a related party (e.g. Subsidiary)

Transfer pricing is the rates or prices that are utilized when selling goods or services between company divisions and departments, or between a parent company and a subsidiary. The transfer pricing that is set for the exchange may be the original purchase price of the goods in question, or a rate that is reduced due to internal depreciation

These prices may be:

1 Market-based: as determined by the demand and supply in the general market).

2 Artificially-determined: as determined by the supplier of the item itself based on self-judgement.

Benefits of Transfer pricing

- High Customs Duty – leading to under-invoicing of goods.
- Restriction on Profit Repatriation – leading to over-invoicing of raw materials transferred from parent country, hence compensating for locked forex.
- Ownership Restrictions (e.g. Insurance and banking sectors – since this leads to less than justified returns on the technology or knowledge invested in the JVs, MNEs circumvent it through over charging on royalties for technology, etc.

Problems with Transfer Pricing

- Tax evasion: multinational entities may set transfer prices on cross-border transactions to reduce taxable profits in their jurisdiction. In this case, governments are always enervated by tax losses.
- Movement of fund: MNEs use transfer pricing to move funds to tax havens or to circumvent profit repatriation restriction. Where this is done, governments generally consider the act as fraudulent and criminal.
- Performance bonus: if the performance bonus of managers are tied to book records, then the larger they benefit from transfer pricing, the better.
- Monopolist idea: transfer pricing does not encourage competition as the supplier-firm is featherbedded. Supplies are internal, so the supplier is not exposed to external competitive pressures – price and quality.