MNB3701 study notes

PRINCIPLES OF GLOBAL BUSINESS MANAGEMENT (MNB370-1)

LEARNING UNIT 1: CHAPTER 1: GLOBALISATION AND INTERNATIONAL BUSINESS

1.3 DEFINING GLOBALISATION

Globalisation refers to the increasing integration of production, development and communication amongst nations on a worldwide/international scale.

Globalization is a process of interaction and integration among the people, companies, and governments of different nations, a process driven by international trade and investment and aided by information technology. Globalisation is the process by which businesses or other organisations develop international influence(s) or start operating on an international scale.

The key interlinked factors influencing the tendency towards globalisation are as follows:

- **GATT** (General Agreement on Tariffs and Trade (GATT) Definition: Multilateral international trade treaty first created in 1947 and frequently amended. ... GATT was active under that name from 1947 until 1994, when WTO was founded. The records of GATT are now managed by WTO in Geneva) and **WTO** (The World Trade Organization (WTO) is the only global international organization dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments.)
- Structural shift in the world economy
- Integration and operational velocity of financial markets
- Diffusion of computer-based technologies and information systems
- The “agile” corporation
- Competitiveness based on supply chains

WTO – The World Trade Organisation and GATT – General Agreements on Tariffs and Trades

WTO is the only global international organisation feeling with the rules of trade between nations. It's purpose is to ensure that global trade commences smoothly, freely and predictably. It creates and embodies the ground rules for global trade among member nations, offering a system of international commerce. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations.

GATT – mainly deals with trade in goods, it is used for ordering international trade relationships which brought the WTO into being.

Perspectives of globalisation

Culture- process of transformation in the spatial organisation of social relations and transactions that generate flows and networks of activity.

Economic- the growing, interdependence of countries worldwide through the increasing volume and variety of cross-boarder transactions in goods and services, international capital flows and technological advances.

Forces of globalisation

1. *Political forces – factors such as trade barriers , recognition of intellectual property rights, move towards privatisation as well as establishing common technical structures.*
2. *Economic forces – includes increasing world trade, rising income levels, efficient financial markets , increasing competition and trafficking government involvement.*
3. *Social forces – includes growing consumerism, conveying consumer tasks and improving lifestyles, education and skills.*
4. *Technological forces – includes industrialisation of nations , improved transportation and networks and the influence of the information and telecommunication revolution, including the internet and e-commerce.*

The face of globalisation (Capitalist globalisation)

Globalisation involves:

- economic integration
- the transfer of policies across borders
- the transmission of knowledge
- cultural stability
- the reproduction, relations and discourse of power
- it is a global process, a concept, a revolution and an establishment of the global market free from socio-political control

This suggests a free society where the invisible interchange of supply and demand regulates sales and purchases.

MNCs – multinational corporations

A corporate organisation that own/ controls production of goods or services in atleast one country other than is home country . MNCs see both benefits and furnaces of globalisation . Globalisation gives businesses access to markets that would have been difficult to react in the past, access labour at cheap prices.

The good

Globalisation has collapsed the world into a small village. The tremendous increase in world exports is in line with the increase in firms taking advantage of location-specific advantages. Improvements in world exports have contributed to employment creation, trade-creation, national prosperity and human prosperity.

Globalisation has helped improve life expectancy from 52.5 years in 1960 to 71.2 years in 2013. Almost every country has benefited from medical advances that are stimulated by globalisation.

The distribution of technology has helped reduce associated costs and has improved accessibility to state-of-the-art technology by less privileged communities in the world. Cost reduction and accessibility have transformed the way people communicate and interact. The advancement of transport technology has made it faster, safer and more comfortable to travel across global geographies at a relatively cheaper rate.

The concept of location-specific advantages has helped create sustainable jobs in some offshore locations that were previously unattractive for locating production facilities. The multiplier effects of economic gains have trickled down to the greater number of the population and have helped reduce the household poverty level.

The bad

Unfortunately, globalisation is not impervious to weaknesses, fiduciary risks, crookedness and malignity. The allotment of the proceeds is lopsided and the level of underdevelopment in less privileged societies has worsened. Labour maltreatment has been challenged.

Prominent among the arguments levied against globalisation is the unintended consequence of job losses. The pressure created by international competition has necessitated the relocation by MNC's of their production facilities to lower cost production centres, thereby depriving the higher cost facility.

Africa has not really benefited from economic globalisation. The dependence on its resources has been worsened by globalisation. Many manufacturing firms have been forced to close operations while existing ones are producing far below capacity as a result of intense competition from MNC's from advanced economies. The dumping of goods on developing markets by MNC's from advanced economies has worsened market development in the less-privileged communities. Culprits of dumping are agricultural producers from USA and UK due to lopsided regulatory provisions per the General Agreement on Tariffs and Trades (GATT). Agricultural tariffs from the Uruguay Round hurt less privileged countries which the frameworks were meant to help emancipate from abject poverty. Raw materials from Africa attract no import duties yet it is a crime if any beneficial material is exported from Africa to European Union. As far as tariff barriers are concerned, explains why more than 90% of the global coca-producing countries produce less than 4% of global chocolates.

The main injustice adopted by Western countries and strictly enshrined in the Dispute Settlement Understanding (appendage of the WTO's framework) says it is fair to subsidise agricultural produce in the advanced economies at the expense of less-equipped farmers in the developing world. Farm produce from Africa is deemed inferior and inadmissible to Western markets except for products regarded as raw materials.

The ugly

With the current form of globalisation, millions of avoidable losses of livelihood are being recorded among smallholder farmers globally especially in the developing world. Within its current form, globalisation advances the interests of capitalism at the expense of the globally poor and the working class. Anti-globalisation in this context stands for the dislike towards the current form of corporate personhood and all forms of economic suppression of the less privileged community and its members.

The world has witnessed various socioeconomic mishaps over the past few years proving anti-globalisation protesters right. All dissensions towards the current form of globalisation have a single goal – to seek a globally inclusive solution to unfair global trade and unfavourable capital market systems.

The journey ahead – new thinking

Across the world advocates of reforms to the current formula of economic globalisation have suggested a rewrite of guiding principles of the allotment of global goods in an equitable manner. This appeals to the global poor, victims of environmental pollution and weak political states which are victims of intimidation from MNC's.

1.4 HISTORICAL DEVELOPMENT OF GLOBALISATION

The evolution of globalisation is rooted in historical events. Indeed, this was a forerunner of inter-regional, symbiotic trading arrangements between people, countries and nation-states. It served as a catalyst to the development of undeveloped countries, foreshadowing a greater degree of regulated trade in these countries.

But, the real focus of the historicity of globalisation concentrates on the advent and duration of slavery and colonisation, as more countries fell under the political jurisdiction of more powerful nations such as the United Kingdom and France. This state of affairs persisted for centuries; only the emancipation of slaves and the liberalisation of these countries served as a stimulus to further globalisation.

The evolution of modern trading and investment arrangements, with their corresponding financial and capital operations, together with various economic integrations, stemmed, it is argued, from this emancipation process. Ultimately it also gave rise to unprecedented political and economic alliances.

1.5 TYPES AND FORMS OF GLOBALISATION

1. Globalisation of markets
   - Merging of historically distinct markets into one global market
2. Globalisation of products
   - Sourcing of goods and services from locations around the globe to take advantage of location specific advantages.
   - Cheaper labour, energy, land and capital

The manifestation of globalisation are determined by the scope of production and market processes. Complementing these manifestations are the unique structures of the supply side of globalisation, as epitomised by **multinational corporations (MNCs)** and the location of their production facilities, so as to minimise barriers, while maximising global economic relations.

Drivers of Globalisation

1. Changes in political environment

The Changes in the political environment can be credited with two developments, namely the creation of global economic/trade regulatory bodies - the General Agreement on Tariffs and Trade (GATT) in 1947,; - and the collapse of communism.The collapse of communism infused a paradigm shift in the global business landscape.

2. Changes in technological environment

While foiling trade barriers and the shift in political ideologies have aided the process of globalisation, technological invention and innovation are accelerating the process. Evidence suggests that four main components of technological innovation have contributed immensely to the global exchange of ideas and opinions, trade and investments, research and education, as well as the movement of people, products and services.

These main components of technological innovation are:

- e-mail and
- videoconferencing,
- the Internet and the World Wide Web,
- company Intranets and Extranets
- advances in transportation technology

1.6 CAPITALIST GLOBALISATION AND ANTI-CAPITALISTS

The positive aspects of globalisation are the benefits of economic integration , trade liberalisation , knowledge transmission and diffusion , cultural stability , power coalitions , globalisation and free markets and the phenomenon of socio-political control , coupled with improvements in world health care.

These affirmations are constantly being countered by the antagonism emanating from the anti-globalists who argue against the alleged benefits of globalisation . They do so, citing the "impervious weaknesses " of globalisation as evidenced by negatives such as the risks involved , the inequitable apportionment of resources to the disadvantage of poor countries , and the capricious policies of institutions such as the **IMF** (The International Monetary Fund is an international organization that aims to promote global economic growth and financial stability, to encourage international trade, and to reduce poverty.), **the World Bank** (The World Bank is an international financial institution that provides loans to countries of the world for capital programs . It comprises two institutions : the International Bank for Reconstruction and Development (IBRD), and the International Development Association (IDA), **the WTO** (deals with the global rules of trade between nations . Its main function is to ensure that trade flows smoothly , predictably and freely as possible), and **the International Labour Organisation (ILO)** (The ILO has integrated many of its existing technical projects into five flagship programmes , designed to enhance the efficiency and impact of its development cooperation with constituents on a global scale(.. It is enlarged upon with reference to the poor employed in agricultural communities , who are feeling the effects of the imposition of agricultural tariffs.

The aggressive manifestation of globalisation in the form of the establishment of international trade agreements (such as the North American Free Trade Agreement (NAFTA) , with its preference for tariff eradication , at the expense of the poor) is also discussed in this chapter.

NAFTA - has two supplements : the North American Agreement on Environmental Cooperation (NAAEC) and the North American Agreement on Labour Cooperation (NAALC).

Most economic analyses indicate that NAFTA has been beneficial to the North American economies and the average citizen, but harmed a small minority of workers in industries exposed to trade competition . Economists hold that withdrawing from NAFTA or renegotiating NAFTA in a way that re-establishes trade barriers will adversely affect the

U.S. economy and cost jobs. However, Mexico would be much more severely affected by job loss and reduction of economic growth in both the short term and long term.

1.7 THE FUTURE OF GLOBALISATION

Notwithstanding such antithetical reasoning, the protagonists of globalisation remain optimistic about the future of globalisation. This optimism is being driven by the predilection of many global players for the promotion of economic globalisation and, more particularly, increasing economic integration. Furthermore, these initiatives are being galvanised in the face of growing poverty and inequality, deprivation, increasing joblessness, hunger and anger, on the part of the disadvantaged *populace. "The journey ahead – new thinking", is devoted to discussing these disparities, which are exacerbated by the lopsided power distribution within the institutions of globalisation.*

The role of anti-globalists is pivotal in countering these injustices. In short, all of these developments are compatible with the capitalist agenda, which is intent on making globalisation work, with the aid of MNCs and other agents of globalisation, such as the BRICS coalition, with its unique ethnic composition, which is advancing the economic interests of emerging markets.

THE FUTURE OF GLOBALISATION

Strengthening social inclusion - "As societies become ever more polarized and the risks of great-power conflict rise to unprecedented levels since the end of the Cold War, we have to look closely at the lessons taught by history so as never to forget them."

Embracing opportunity - "Taking advantage of interconnected and complex global markets, we can bring together diverse viewpoints and approaches to create strategic business models that will make people around the world more prosperous and self-sufficient, particularly if they have the training and education to compete in a new global economy."

Dramatic changes - "Another significant challenge is how to develop a workforce with a productive mix of employment relationships (e.g., temporary, independent contractor, full-time) that can meet the needs of the organization while at the same time remaining flexible enough to adjust to market changes and disruptive technology."

The localisation parallel - "The globalization of one country's product is the start of localization in a regional market; then the localized product will be sold globally."

LEARNING UNIT 2:CHAPTER 2: INSTITUTIONAL FRAMEWORKS AND THE ROLE OF GOVERNMENTS

2.1 AIM

2.2 LEARNING OUTCOMES

After you have studied this learning unit, you should be able to:

Provide an overview of global institutional frameworks

Outline the importance of the Corruption Perceptions Index

Identify the types of worldwide governance indicators

Elaborate on the role of government in a country’s investment environment

2.3 GLOBAL INSTITUTIONAL FRAMEWORKS

Business interactions between MNCs and national institutional frameworks are delineated by the provisions /codes of practice of global supervisory institutions . (Business interactions between Multinational Corporations (MNCs) and national institutional frameworks are bound by the codes of practice of global supervisory institutions . The major global supervisory institutions are the World Bank, the International Monetary Fund and the World Trade Organisation.

The World Bank

- It comprises two institutions : the International Bank for Reconstruction and Development (IBRD), and the International Development Association (IDA). The World Bank is a component of the World Bank Group.
- These international financial institutions were created with the objective of financing the reconstruction of European countries out of the destruction caused by World War II.
- The World Bank was created with the mission of financing the reconstruction of European countries out of the desolation of World War II. Later, poverty alleviation and various initiatives were also added to the World Bank activities.
- Its stated goal is the reduction of poverty.
- The activities of the banks were very limited and their relevance at the time was marginal . The brief was later expanded to include a focus on global poverty alleviation as well as various initiatives to boost economic growth and three other strategic components were incorporated in the World Bank Group eg. ***International Finance Corporation (IFC), the Multilateral Guarantee Agency (MIGA) and the International Centre for the Settlement of Investment Disputes (ICSID)***.

- The World Bank and its subsidiaries provide various supports and concessions to sovereign states. **Under such arrangements, a series of funding opportunities are provided to augment infrastructural development , skills and capacity development , education , health care , sanitation , and improved quality of life and life expectancy.**

The International Monetary Fund

- The International Monetary Fund (IMF) was established after World War II at the United Nations conference held in Bretton Woods in 1944. The primary focus of the IMF was to try and avoid a repeat of the competitive currency devaluation as was the case in the 1930s which resulted in the Great Depression.

- The organisation 's objectives ***are to promote international monetary co-operation, capital market integration, ensuring and regulating financial stability, furthering international trade and investment, enhancing employment creation/stability, nurturing global economic growth and development, and creating poverty alleviation globally as well as making resources available to member countries in financial difficulty.***
- The most prominent policy prescription administered by the fund during the 1980s was the Structural Adjustment Programme (SAP). It was intended to address the debt-burdened conditions of many developing countries, essentially as a result of ever increasing recurrent expenditures by their governments.
- Given limited industrial capacity and weak growth, governments in many developing countries assume the responsibility of being the largest employers of labour. As a result of this the provision of wages, salaries, amenities and various forms of social support are central to socioeconomic stability.
- The central focus of SAP was on the reduction of social spending and constricting the existing social support of the population.

The World Trade Organisation

- The World Trade Organisation (WTO) was also established at Bretton Woods in 1944 and originally known as the General Agreement on Tariffs and Trade (GATT), until it was transformed
- The World Trade Organization (WTO) is an intergovernmental organization that regulates international trade. The WTO officially commenced on 1 January 1995 under the Marrakesh Agreement, signed by 123 nations on 15 April 1994, replacing the General Agreement on Tariffs and Trade (GATT), which commenced in 1948. It is the largest international economic organization in the world.[5][6] The WTO deals with regulation of trade in goods, services and intellectual property between participating countries by providing a framework for negotiating trade agreements and a dispute resolution process aimed at enforcing participants' adherence to WTO agreements, which are signed by representatives of member governments[7]:fol.9–10 and ratified by their parliaments.[8] Most of the issues that the WTO focuses on derive from previous trade negotiations, especially from the Uruguay Round (1986–1994).
- The organisation is charged **with the responsibility of facilitating trade liberalisation / economic openness, trade agreements/treaties negotiation, regulation trade relationships between and amount nations, trade dispute resolution / settlement, and facilitating growth through the free trade mechanism.**

  ✓ **Trade liberalisation –** organisation advocates for the removal of all barriers to trade openness. WTO is able to enforce conformity with the established global rules on the removal of tariffs and barriers that inhibit free movement of goods and services across international borders.

  ✓ **Negotiation of treaties and agreements** – organisation serves as a referee for parties in potential trade negotiations. Of importance is the need to ensure equal partnership in trade agreements, ensure equity of purpose and equitable allotment of proceeds from trade between participants. This role helps to strengthen the negotiating power of less developed and developing countries in trade negotiations that involve more economically powerful and politically mighty countries.

✓ **Regulate trade relationship between nations** – organisation to monitor trade relations among nations, especially member countries, and ensure harmonious engagement through free, fair and unrestricted trade arrangements.

2.4 CORRUPTION PERCEPTIONS INDEX – scores countries on how corrupt their governments are believed to be, the score ranges from 0-100.

- Is seen as an enormous hindrance to growth and development across the world, but its impact has been felt more in developing countries. Although documented evidence across the world suggests that every country has some traces of corrupt practices, its prevalence and recklessness in the developing world is a serious concern.
- The globally recognised platform for judging a country's level of corruption is Transparency International.

Corruption Perceptions Index, 2017

- The CPI currently ranks 176 countries "on a scale from 100 (very clean) to 0 (highly corrupt)". Denmark is the least corrupt country in the world, ranking consistently high among international financial transparency
- Corrupt practices occur mainly in situations of abuse of power, bribery, a lack of transparency in governance, little respect for the rule of law and imprudent/ irresponsible governance.
- In the developing countries, one of the notable characteristics of underdevelopment is a weak institutional framework and strong individual persona. Evidence abounds on abuse of power, not only by the political leadership, but also their cohorts as well.
- Judicial rulings that contravene the personal interests of power individuals are disregarded.
- Highest bidders can in some instances even buy justice.
- There is documented evidence to suggest that a prevalence of corruption increases the cost of doing business. This proposition presupposes that corrupt countries are not particularly attractive to "clean" foreign investments, especially given the difficulties they may encounter for their refusal to pay bribes.

2.5 WORLDWIDE GOVERNANCE INDICATORS (WGI)

- Are global measures of the efficiency and effectiveness of political leadership. This platform is one of many such platforms that is established and gauged by the World Bank.
- The bank treats this specific objective as a project, with a pool of dedicated team members. The team created by the bank reports on the aggregate performance of countries on all the measurable indicators. The report also covers the individual performance of countries on specific measureable indicators of administrative efficiency.

Dimensions of Governance

- ✓ **Voice and Accountability –** looks at freed of speech and accountability of political leadership to the population /community . Counties are ranked based on their adherence to the principles of human liberty . It measures the extent to which the general population are free to express their views and opinions on issues of public interest or concerns, without fear of intimidation or persecution.
- ✓ **Political Stability and Absence of Violence –** Peaceful transfer of power from one government to the other is an important measure of political maturity. It considers the smooth running of the political mandate and absence of social unrest, violent protests and destruction of lives and properties . Electioneering violence and diabolical prejudiced politics have continually manifested as an appalling characteristic of developing counties.
- ✓ **Government Effectiveness -** The effectiveness of political leadership in ensuring objective policy formulation, efficient policy implementation and stringent evaluation of policy effectiveness are important components of virtuous leadership. The skill with which the political class recognises and appreciates efficient civil service /public services, which are resistant to the corruptions of biased politics, is a good indication of high performance on the Government Effectiveness ranking.
- ✓ **Regulatory Quality -** The quality of regulatory framework , especially the historical architecture of the enabling rules and regulations , are important determinants of regulatory efficiency. Eg. It is important for any new promulgation or amendment to existing regulations to be based on the historical experience of the people and the new reality.
- ✓ **Rule of Law -** relates to the perceptions and amount of respect that political leaders have for the regulatory and adjudicating instruments of state.
- ✓ **Control of Corruption** - is a major impediment to growth especially in developing countries.

The World Bank Investment Climate Survey Database

- A platform that was established to measure the level of transparency in the process of establishing a business in a country . The level of corporate competitiveness with a specific focus on the private sector is measured.

- ***The World Bank incorporates seven measurable indicators in the survey:***
  - ✓ Firm's perceptions – firms are interviewed to measure their general perception about the investment climate in the country of interest . Given a set of ranking ranges , their perception about the adequacy of the investment climate of the country is compiled and analysed.
  - ✓ Infrastructure and Services – for any business to take-off and be sustainable , the provision of, access to and affordability of necessary infrastructure and services are imperative. There is no denying that the availability , access and affordability of basic infrastructural facilities will go a long way in influencing the investment climate of a country.

- ✓ Finance – operating capital, especially working capital, is the mainstay of every business. The availability of, and access to, required financial support for a start-up as well as for existing business is an important gauge of the conduciveness of the investment environment of a country. Although financial institutions profit by providing funding to entrepreneurial outfits, the cost of such capital as well as the ability of fledgling outfits to access such support remains daunting, and these challenges appear to be the most conspicuous hindrance to entrepreneurial development in developing countries.
- ✓ Government Policies – the economic orientation of a political leader is influenced by their political philosophy. A political leader with a democratic philosophy would most likely embrace a free-market economy and resolve to provide an enabling environment for entrepreneurial development. Such a leader would most probably restrict government participation in economic activity to regulatory and supervisory commitments, while the market agents would be charged with the responsibility of determining the optimal allocation of production resources as they deem fit, with minimal government intervention.
- ✓ Conflict Resolution and Crime – the working relationship between employees and employer may hit a wall at a point in time. While conflicts and disagreements are obstacles in business operations, especially between employees and employers, such challenges and their ultimate effects on business operations should be ephemeral and inconsequential. If any labour dispute or industrial relations actions precipitate

  Capacity and Innovation - Input resources are converted into finished products through production processes with the aid of a qualified and skilled work force. The country's competitiveness will be influenced by the availability of a workforce capable of helping a business achieve its targets and long term objectives as well as an appropriate human resources strategy. The ability of a country to provide the necessary support to spur innovation in a way that aids a firm's competitiveness will influence the country's rating.

  Labour Relations - Labour relations and the strength of organised labour unions as regards dispute resolution is important for a healthy operational environment as well as a reduction of lost productive hours as a result of prolonged strike actions. Labour relations should be aimed at stimulating strategic human capital engagement and interaction with other resources to bolster a favourable perception about the investment climates of a country.

Public Integrity Index

This measures the accessibility of citizens as well as the existence, efficiency and effectiveness of institutions that hold a government accountable and responsive. Good governance requires proper assessment. Measure promoting integrity and countering corruption are no exception. In a global economy good governance is seen as a parameter of competiveness and investors account for such factors when deciding where to locate their operations. Governments are responsible for providing evidence based information on the results of their policies. This keeps them accountable.

Transparency International developed a scientific toolkit for measuring the extent to which the civil service of a country is judged free from corrupt practices. The integrity of a political system and leadership are best measured through the quality of the social services that are delivered to the people, as well as the extent of fiscal discipline that is demonstrated by the political leadership.

2.6 THE ROLE OF GOVERNMENT

The government in every country have a crucial role to play in ensuring peaceful coexistence among their people, and the global world at large. It is the central role of the government to provide an enabling environment that ensures the realisation of fundamental human rights and unrestricted access to basic serves.

National competitive advantage an attractiveness to investment, the role of government is diverse but specific – to create an investment-friendly environment in which all market participants are treated the same and access to business operational facilities is equitable.

- Has policies at its disposal to ensure achieving our stated tariff and trade policy.
- Protects certain industries from foreign competition.
- Protects consumers from unsafe products.
- Ensures the country remains sufficient as far as good is concerned.
- Uses trade remedies for unfair trade practices or disruptive competition due to increased imports.
- Protects foreign exchange reserves.

1. **Respect for the rule of law**

General government attitude, appreciation and protection of the entire national institutional framework are all contained in the rule of law. The checks and balances that are entrenched in the state administrative hierarchy are a constitutional provision of every democratic state, and as such, conformity with such provisions is immutable/undeniable.

According to the World Justice Project, the rule of law should contain the following universal principles: accountability, equitability, accessibility and integrity. Respect for the rule of law is manifested in:

- Government, its officials and agents, individuals and private entities are all accountable under the law.
- Laws are clear, publicised, just, applied equally and protect fundamental human rights.
- The process by which the laws are enacted, administered, and enforced is accessible, fair and efficient.
- Justice is delivered by an independent and neutral jury consisting of members of the community they serve. The just is also competent, ethical and acts timeously.

2. **Adjudication and enforcement**

The credibility of the judicial system depends on the trustworthiness of the entire system, the integrity and depth knowledge of the presiding judges and the efficiency of the law enforcement agencies.

3. Civil liberty and fundamental human rights

Civil liberty and fundamental human rights can be used interchangeably depending on the scope and magnitude of the specific legal provision.

4. Peaceful electioneering and transfer of power

The democratic process includes the formation of political parties and engaging in politics. In a fragile social system this could lead to social unrest and violence as has happened in many developing countries across the world. Countries that are known for more peaceful elections and a stable political economy are more likely to attract foreign investment.

5. Transparency in governance and polity

Governance comprises all the administrative activities that are associated with appointments, promotions and deployment of political officials regarding the business of the state. Collection of taxes and rates, appropriation of revenue generated in a transparent and equitable manner are some of the business of the state. The political philosophy and economic system of a country determines the role of government. The role of government in every country is determined by the philosophy that is adopted in the country, and ultimately the economic system that substitutes within the country.

To an MNC, the extent to which the political system exhibits administrative transparency is critically suggestive of administrative excellence and minimal incidence of corruption. It is important to ensure prudent and equitable allocation of state resources in a manner that engenders good governance and social trust.

2.7 CONCLUSION

This chapter has elaborated on the various global institutional frameworks which are looked in their own right. It culminates in a discussion that highlights their history and respective roles. Furthermore, worldwide governance indicators that are established by the World Bank are discussed. Lastly, the role of government regarding providing an enabling environment for economic growth and one that attracts foreign investment is investigated.

CHAPTER 4 – ETHICS AND CORPORATE GOVERNANCE IN INTERNATIONAL BUSINESS

Introduction

Agency risk – risk of management acting opportunistically and in own best interests as opposed to the interest of the shareholders.

This gives rise to need in corporate governance (CG).

CG applies to domestic as well as multinational corporations (MNC's)

CG is concerned with **structures and processes** associated with **management, decision-making** and **control** and governs the organisation from the top making the board of directors accountable for performance of the business plan.

International business, government and societies: ethical implications

Broad sense – CG refers to externally exerted control, for example – state, judiciary system, regulatory bodies. The purpose is to set ground rules to protect interested stakeholders and market

Narrow sense – CG refers to the internal control of organisations. Pinpoints director's responsibility to strategic direction, executive action, supervision and accountability. Also to supervise management.

Inclusive approach to CG - accountable to **all stakeholders, including government and society**

Ethical – what is not only good for oneself but also consider good of others.

4 core values:

- Fairness
- Accountability
- Responsibility
- Transparency

CG imposes ethical obligations on organisations, including MNC's

Theories of business ethics

Friedman's doctrine

Pursues profit maximisation at all costs as long as it complies with rules of law.

Investment in social expenditure must be kept to a minimum and only comply with business norms and legal requirements

Shareholders can invest in social projects in private capacity

Cultural relativism

Business ethics are a reflection of a particular culture "when in Rome do as the Romans do"

Differences in societal values, norms and customs

The righteous moralist

The home country's standard of ethics is what must apply in the host country where the MNC is operating

Certain behaviour may be offensive to local managers

The naïve immoralist

Expatriate managers working in host country follow business practices of other MNC's, for example bribery of local officials may be acceptable in host country but remains unethical

Utilitarian ethics

Traditional utilitarian approach – David Hume, Jeremy Bentham and JS Mills – the moral worth of actions is determined by their consequences.

An action is desirable if it leads to the best possible balance of good consequences over bad consequences.

Maximisation of good and minimisation of bad.

The best decisions produce the greatest good for the greatest number of people , for example cost-benefit approach to risk assessment (only if benefits exceed the cost will an outcome be pursued)

Drawbacks – measurement of utility such as the cost of job losses, how does one measure happiness

Kantian ethics

Immanuel Kant – everyone should be treated as a free person equal to everyone else

Everyone has a duty to treat others in this way

People have dignity and need to be respected as such

Rights theories

Human beings have rights and privileges that transcend national boundaries and cultures

Managers should make ethical decisions and not pursue actions that violate rights United Nations Declaration of Human Rights – all human beings are born free and equal in dignity and rights. They are endowed with reason and conscience and should act toward each other in a spirit of brotherhood

Everyone has the right to work

Everyone has the right to be paid equal pay for equal work

Everyone who works is entitled to just and favourable remuneration, providing adequate support for their family, including social benefits

Everyone has the right to form and join trade unions for the protection of their interest

Example – MNC's dumping waste into water without compensating citizens

Justice theories

Distributive justice – John Rawls

Each person should be allowed the maximum amount of basic liberty, compatible with a similar liberty for others, for example right to vote, freedom of speech.

That once basic liberty is ensured, inequality in basic social goals (income and wealth distribution) should be allowed only if it benefits everyone.

Difference principle – no relevant differences among people that can justify unequal treatment.

Corporate social responsibility and sustainable development

CSR – the ethical behaviour of a company towards the society they operate in. Business must contribute to the sustainable economic development by working with employees, their families, the local community and society to improve their lives. They must share a part of their profit.

CSR uses the inclusive stakeholder approach

Examples of CSR – Black Economic Empowerment, health concerns, education, Ubuntu

Corporate Social Responsibility reporting – the problem of disclosure

Motivation driving triple bottom line reporting (economic, social and environmental)

CSR reporting – transparent, reliable and accurate – to build confidence of stakeholders

CSR reporting – sustainability reports

Impact of MNC's on economy, environment, human rights, labour practices, product responsibilities, working conditions and social performance

Multinational enterprises and global governance

Global governance takes form of treaties, customary international law and formal and informal institutions.

The global institutions include United Nations, World Trade Organisation and International Monetary Fund.

The regional institutions include BRICS.

CHAPTER 6 – THE GLOBAL MONETARY SYSTEM AND FOREIGN EXCHANGE MARKET

Introduction

Money market:

- Deals primarily with trading of short term financial instruments
- High liquidity and large yields
- Financial commitments are reversible
- High volatility and high risk but high short term returns
- Central bank – bankers' bank which regulates entire financial and capital markets of the country
- Amending possible effects from failures of external markets

Component of money markets:

1. Commercial banks

- act as intermediary between central bank and consumers of financial services
- act as intermediary between lenders fo surplus units and borrowers from deficit units
- safeguard lenders' investments and deliver agreed dividends to investors
- reinforcing trust by using control measures to carefully select creditors and minimise bad debts

2. Discount houses

- Used for borrowing huge sums of money for short term returns
- Trade using bills of exchange
- There are 3 types of bills

i. Domestic bills – financial instruments issued by domestic market participants to raise immediate funds with possible maturity in not too distant future eg. Post-dated cheque

ii. Foreign bills – international dimension as guarantee that payment will be made

iii. Government treasury bills – backed by government of issuing country , short term ie. Not more than a year. It is used to regulate money supply in the economy, to tame inflation and to mitigate exchange rate volatility

Evolution of the global monetary system

During the World Wars countries preferred to receive international settlements in gold rather than a convertible currency – this became known as the gold standard era

The instability in the financial market worsened exchange rate volatility which caused the abandonment of the floating exchange rate which had been adopted by countries at the time.

The shortage of gold supply triggered global financial crisis.

Policy initiative from the Bretton Woods convergence was to create a globally acceptable platform for financial transaction in a reasonable convertibility environment.

The gold standard (1876 – 1944)

- First attempt to create a globally acceptable unit of account, a standard metric for accounting and exchange of goods and services
- Tied the monetary value of currencies to a relatively scarce precious metal – gold – with a stable value as a guarantee of store of value
- Price mechanism helps to ensure market safety
- Economic depression of 1930's along with the instability in the economic and political environment ended the gold standard era

The Bretton Woods agreement and the fixed exchange rates system

- 1944 – pathway to global prosperity
- addressed gold standard weaknesses, currency volatility and post-war popularity and strength of the US Dollar

After WW II there were the following developments:

- emergence of USA as superpower and global economic force
- Protectionism as a policy drive to catapult countries out of economic crisis
- Increasing popularity os US Dollar as medium of exchange and store of value
- Recovery packages and structured interventions from USA – Marshall Plan of 1948 and China Aid Act of 1948
- Global acceptance of the gold exchange standard as a uniform measure for the clearance of foreign currencies in exchange for US Dollars

The conference created global financial institutions such as International Monetary Fund (IMF) as the central institution to craft, implement and supervise the ground rules of the international financial market.

Existing global monetary values were fixed against the US dollar and every country held their foreign reserves in US dollars instead of gold.

Former British Protectorates and Common Wealth nations fixed their own currencies against the pound and foreign reserves were held in pounds – issued by the Bank of England.

Upon creation of the IMF, US dollar assumed 3 functions aimed at ensuring lasting financial stability:

1. Intervention currency – tool to regulate swings in value of domestic currencies. The Reserve Bank buys and sells the US dollar to stabilise domestic currency value (forex intervention) and to preserve the value of the domestic currency.
2. Common denominator for all currencies – single currency for store of value means that every currency revolves around USD.
3. Standard of value for different national currencies – globally accepted measure of monetary value

World Bank created post-war to aid reconstruction and recovery from socioeconomic destruction.

The floating exchange rates system (1973 to date)

Central banks serve as country's representative of IMF for market monitoring and supervising, and through the National Treasury is curator of national fiscal and monetary policies.

By 19 March 1973 the international monetary / currency system had changed to flexible (floating) exchange rates.

Floating nature of currencies based on the price mechanism (forces of supply and demand) eliminates artificial value assumptions of currencies.

Clean floats – unhindered market mechanism allowed to determine exchange rates Dirty floats – any intervention in market to influence exchange rates because does not portray the true value

Market supervision is required because the market may work badly.

The global monetary organisations

The global monetary system is a consolidation of all elements of monetary transactions across international borders.

It assembles savings from surplus economic units and allocates credit to deficit production units.

It creates and manages money as national legal tender and international store of value.

Reinforced by regulatory bodies

Currency conversion / convertibility

Conversion – the process of converting one domestic currency into another

Reinforced by principle of willing seller and willing buyer

Partial convertibility is the convertibility of a transaction into a current account instrument but subject to regulatory approval before settlement.

Convertibility – the ease at which a currency can be exchanged for another foreign currency within confines of applicable supervision.

Main function of monetary organisations within currency conversion process are to determine the value of local currency that is being exchanged for a foreign currency and to keep accurate records of the profile and volume of transactions that individuals conduct within financial markets.

This is to regulate and supervise the flow of foreign currency in and out of the country.

Currency / exchange rates determination

Value of currency is determined by price mechanism – demand and supply.

The more foreign investors demand goods and services from a domestic economy, the more the currency of that country will be required to pay for those demand, thereby generating surplus demand. The excess demand will push up the price of the currency.

Currency worth – the overall value of the currency relative to other currencies into which domestic currency can be converted.

Determinants of currency worth:

1. State of the domestic economy – overall health and capacity of the economy, the larger the size the greater the currency worth
2. Debt level of an economy – the weight of the debt compared to national GDP
3. Inflation level and the performance of the national current account – trade balance (imports less exports) and foreign earnings (foreign receipts versus foreign transfers)

4. Political economy – state controlled versus free economy, peace versus civil unrest

Foreign exchange markets

Global demand for tight controls on international flows of financial resources and instruments.

The foreign exchange market is the name attributed to every market agent that performs legitimate exchanges and conversions of domestic currency into foreign currencies.

The role of foreign exchange markets

1. Transfer - forex market facilitates the transfer of money from 1 country to another through the banking network. MNC's invest in countries that offer easy transfers of their earnings from their offshore investment locations back to their home countries
2. Credit – financial institutions generate credit from surplus units of the economy and lend it to deficit units through intermediation (maturity transformation)
3. Hedging – reduce the effects of possible foreign exchange volatility on the performance of an organisation

Exchange rates and domestic price levels

The law of one price and purchasing power parity

The law of one price – price of assets, services, goods and resources should be equal across global geographies when products are denominated in a similar currency. Price equity is established when economic activities are priced fairly in an efficient free market system.

Theory of the purchasing power parity (PPP) – prices of products should be comparatively the same when adjusted for national differences in inflation and exchange rate variances. Absolute PPP – prices should be equal across countries with disregard for effects of inflation and exchange rate differences. Relative PPP – prices adjusted across countries as influenced by variations due to inflation and exchange rates.

Exchange rates forecasting

Speculative econometric models – scientifically project the possible behaviour of a specific currency at a future period with variables of interest (growth, net export). Not an exact science, MNC's rather hedge financial risks.

Foreign exchange exposures / risks

Foreign exchange exposure is the risk associated with activities that involve a global firm in currencies other than its home currency. It is the risk that a foreign currency may move in a direction which is financially detrimental to the MNC.

There are 3 types:

1. **Transactional exposure** – measures the effects of exchange rate volatility on outstanding obligations that existed before the exchange rate changed but which were settled after the exchange rate changed. The MNC must pay its foreign suppliers in foreign currencies while receiving local currency from its customers.

2. **Translation exposure** – deals with the possible loss of financial value on the accounting books of a company in the process of converting the finances of a company's subsidiaries. It affects the conversion of foreign assets and liabilities into local currency.
3. **Economic exposure** – the extent to which the economic value of a firm can decline due to changes in the exchange rates. Strong, volatile exchange rates and political tension between MNC's and the host country affect the book value and operating cash flows of the MNC negatively causing a negative impact on the MNC's share price.

Challenges of foreign exchange exposure have direct and indirect impacts on the cost of doing business. MNC's are concerned with profit maximisation at the expenses of other stakeholder interests. This risk exists for businesses where the value of its future cash flows is dependent on the value of foreign currency where the business operates.

Managing foreign exchange exposures / risks

- **Forward exchange contract** – allows a company to set exchange rates at which it buys or sells a given quantity of foreign currency in the future. Businesses agree to purchase an amount of foreign currency on a specific date in the future at a predetermined exchange rate. FEC's mitigate fluctuations in exchange rates.
- **Foreign currency options** – enables an MNC to purchase or sell foreign currency under an agreement that allows for the right (but not the obligation) to undertake a transaction at an agreed future date. . FX options have the advantage of being flexible when trading whilst also mitigating volatile exchange rate fluctuations.
- **Perfect hedge** – simple method to match any outgoing foreign currency payments against foreign currency inflows received at exactly the same time.
- **Foreign currency bank accounts / loan facilities** – used when timing of inflows and outflows does not match. Surplus foreign currency is deposited into foreign currency accounts for later use, or by borrowing foreign currency for foreign currency purchases and using foreign currency to repay the loan.

LEARNING UNIT 7: CHAPTER 7: EVOLUTION OF THE GLOBAL MARKETS AND AFRICAN IMPERATIVES

7.2 LEARNING OUTCOMES

- provide an overview of the evolution of the global capital market
- distinguish between capital markets and financial markets
- explain the role of the capital market in an economy
- elaborate on the dynamics of the African capital market
- highlight the challenges of capital market development in Africa
- discuss the concept “Africapitalisation”

7.3 EVOLUTION OF THE GLOBAL CAPITAL MARKET

Equity markets are generally regarded as an organised process through which stocks are traded, both by exchanges and over the counter. This market consists of both the primary markets and the secondary markets.

- ***primary market –*** *financial markets where enterprises issue their newly issued shares and bonds directly to the general public/investors for subscription.*
- ***secondary markets*** *– financial markets where securities are traded after they have been offered initially in the primary market. Evidence suggests that most trading is done in the secondary market.*

7.4 THE ROLE OF THE CAPITAL MARKET IN AN ECONOMY

Almost all business dealings and transactions pass through financial markets, and the entire architecture of business practices is underpinned by capital market functionality.

Financial market – a market where short-term financial instruments re trade – sold and bought. The most important consideration is swift gains within a short period. Most of the instruments used in the financial markets are essentially designed to hedge against currency risks and more recently, the instruments have become affected by speculation.

Capital market – is a virtual monetary space where long-term financial instruments are traded – sold and bought. The capital market is a lot more resilient and enduring. Unlike financial markets, the capital market provides a cheaper platform for corporations to raise funds for capital-intensive projects, especially projects that are characterised by protracted payback periods. The main component of a country’s capital market are the equity markets (stock exchanges, investments banks and other related equity markets) and the credit market (development and asset-backed commercial banks, bond markets, insurances houses and other financial instruments of intermediation), most of which have been referred to above.

There is evidence that suggest that capital markets play very important roles in enhancing economic growth.

These contributions of capital markets are as follows:

- The capital market provides an important alternative source of finance for projects with a long-term repayment period.
- It bridges capital gaps in long-term financing.
- It provides investment opportunities for international and domestic portfolio investors.

7.5 THE DYNAMICS OF THE AFRICAN CAPITAL MARKET

Every system and economy has come sort of capital market. While economic agents thrive on efficient financial intermediation, the successful growth of financial efficiency largely depends on historical capability, developmental leadershi0p, institutional efficiency and integration with the global capital market. Capital markets in African countries are weaker, less capitalised, and more prone to system failures when compared with the capital markets in Western countries. Socioeconomic problems and political instability further complicate the growth of capital markets in African countries Although capital market development in Africa still faces some daunting challenges, its lesser integration with the global West has shielded it from various contagious effects of Western-originated market failures. With increasing realisation of Africacapital agenda (is a term coined by the author to agitate for the development of home-grown capital market acceleration and improved capitalisation across the continent, through spirited dedication and strong commitment form African patrols within the continent and the diaspora/movement.

The main damages caused to African countries by this policy originated from the swiftness with which the IMF and World Bank stimulated the recovery of the US dollar from its problems with currency runs between 1979 and 1980. The recovery was through destructive macroeconomic interventions by ruthless lenders. The bulk of loans to Africa were in the form of developmental project financing for projects designed and executed by Western governments. These loans never reached African shores but were quick to repatriate the cost of capital back to Western economies. These loans crushed economic productivity in Africa and created a huge capital gap. The free market economy was forced onto Africa in order to stop socialist ideology. This was also done to ensure free access to African resources and markets. This weakened Africa’s remaining strength in their fledging capital markets.

Thanks to the resource booms, many African capital markets have improved in efficiency and capitalisation and have attained global recognition. Recently the capital gaps have been bridged and projects have been financed through domestic debt and bond markets. This has reduced the cost of capital and strengthened Africa’s relevance in the global markets. Due to less integration with Western markets, Africa has avoided effects of Western market failures. Efforts towards intracontinental integration has spurred the “ Africapital’ agenda.

“Africapital ’ is the development of home-grown capital market acceleration and improved capitalisation across the continent through determined dedication and strong commitment from African patriots within the continent and in the diaspora.

7.6 CHALLENGES THAT HINDER CAPITAL MARKET DEVELOPMENT IN AFRICA

The development of capital markets in Africa has been trained by the greed and aggressive advancement of Western hegemony/domination. Historical documentation suggest that capital flights originated by Western-orientated MNCs, coupled with colonisation and a series of economic deprivations inflicted on the continent by the Western superpowers were the architects of capital market underdevelopment in Africa.

To escape economic hardship and its first cousin, political inability, skilled Africans began a mass exodus to the West and a brain drain of human capital followed in quick succession. The aftermath – weak financial capacity, extreme state inability to provide very basic amenities, erosion of trust and confidence in political leadership, unfettered gluttony and intolerance, socio-political and economic apprehension and the reality of the recent past – crime and violence.

Africa is not absolved /pardoned from its own catastrophes. To some extent, political leadership on the continent could have avoided some of the hindrances to capital market development. Endemic corruption, for example, is a major hindrance to capital market efficiency. Evidence of the negative impacts of patronage, partisan policies and various other vices on low capital market development abound. The level of unhealthy rivalry among the biggest economies on the continent is concerning. Rather than unite and integrate the units of fragmented and fledgling capital markets, self-praise and self-interest, is a new trend on the continent.

Another major constraint to capita market development in Africa can be attributed to low household savings. With low per capita gross domestic product and lingering economic growth, household income and consumption patterns are largely very unimpressive and their combined negative effects on domestic savings are pejorative/harsh. Although, the growth of the middle class of the continent has been unprecedented in recent history, household savings are still very small and this had been negatively affected wealth creation through financial intermediation.

7.7 THE NEW THINKING ON CAPITAL MARKET DEVELOPMENT AFRICAPITALISATION

Over the past few decades, renewed efforts at various levels, especially corporate and political, have been bearing fruits in improving the speed of capital market adjustments to developmental hearings.

In addition to generating funding through various arrangements, strong integration of capital markets within the continent will help to improve the functionality, efficiency and strength of the markets across the continent in bridging capital gaps and helping finance developmental projects. A good example is the creation of regional bourses and further integration of disjointed (and sometimes dysfunctional) national market platforms.

Concerted efforts are required to promote household savings and to galvanise household embracing of a wealth creation culture. In many African communities, an undue sense of entitlement and reckless spending are rife. A notable percentage of middle-lass people consume more than their income and they end up accumulating unrepayable debts that further their utter financial dependency. **The ability of governments to promote robust cultures of savings, through visible restructuring of financial markets, would help to boost the efficiency and effectiveness of the capital markets and, by extension, the ability of domestic markets to finance developmental projects that are capable of creating jobs and ultimately; alleviating property.**

Challenges that hinder capital market development

Capital flights from Western MNC's, colonisation and economic deprivations inflicted on Africa by Western superpowers are responsible for the underdeveloped capital markets.

Due to economic hardship many skilled Africans relocated in the West creating the brain drain of human capital. This resulted in weak financial capacity, inability of state provided amenities, erosion of trust and confidence in political leadership, crime, violence, intolerance and socioeconomic and economic uneasiness. The resource boom could have helped salvage Africa's future and prosperity but the West continues to enable Africa's dependence on their appalling aid and humanitarian support which has only plunged Africa into utter poverty.

The West continues to view Africa in a negative light. According to the West, Africa's adoption of import substitution development was counterproductive . They view the effects of wars and civil unrest in Africa to have a devastating effect on the macroeconomic basics. Poor economic performance is blamed on leadership failures. Little is said about the West's role. Although Joseph Stiglitz, former chief economist of the World Bank highlighted the negative effects of globalisation and financial liberalisation on Africa.

The widespread corruption in Africa is a major hindrance to capital market efficiency. Self -interest has created rivalry between the biggest economies in Africa whereas the markets should be integrated and united. Information on African capital markets is distorted by Western propaganda making it less attractive to potential investors, venture capitalists and foreign market participants.

Another constraint to African capital market development can be attributed to low household savings. This negatively affects wealth creation through financial intermediation.

The new thinking on capital market development – Africapitalisation

Renewed efforts by political and corporate agents have improved capital markets. Dangote Group signed a financing deal of USD 3.3 billion to finance construction of a petroleum refinery. The funding was raised mostly through domestic financial instruments.

Strong integration of capital markets within Africa will help improve functionality, efficiency and strength of markets across Africa in bridging capital gaps and financing developmental projects. The creation of foreign money markets and further integration of national market platforms is an example . The ability of governments to promote cultures of savings through restructuring of financial markets would boost efficiency and effectiveness of capital markets and the ability of domestic markets to finance developmental projects that create jobs and alleviate poverty.

7.8 CONCLUSION

Africa's market is striding towards achieving a notable presence not only in developmental projects, but also in household wealth-creation through robust savings (I think this is AFRICAPITALISATION) . A proposition was made for institutional intervention to make capital markets more attractive for household savings, being a global apparatus that is much need to galvanise capital market development and by extension, to alleviate poverty on the continent.

LEARNING UNIT 9: CHAPTER 9: INTERNATIONAL TRADE AND INVESTMENT

9.1 AIM

Introduce you to the realities of international trade and investment flows.

- Allow you to contour the predominant patterns and types of international investments, relative to inward and outward foreign direct investment (FDI) flows. • Sensitise you to the barriers to international investments, while highlighting the realities of capital controls.
- Expose you to recent developments in international trade, in the context of the modus operandi of the World Trade Organisation(WTO).
- Familiarise you with international trade theories , which provide the theoretical underpinning for international trade practices and the barriers to international trade, giving rise to the phenomenon of trade control.

9.2 LEARNING OUTCOMES

- Critically evaluate the importance of international trade and investment flows.
- Identify the patterns of international investments, highlighting the risks involved.
- Confirm and debate the dynamics of capital controls.
- Justify the applicability of international trade theories.
- Debate the arguments advanced against the free trade movement.
- Explain the purpose of non-tariff barriers, given the importance of tariff barriers.

9.3 INTERNATIONAL TRADE AND INVESTMENT

The catalyst to increased trade and investment flows is the proliferation of benefits flowing from globalisation, which has also intensified the volatility of capital flows, which is the emphasis of this section. Allusions to international capital flows raises the spectre of potential capital controls , notwithstanding the operation of multilateral trade agreements and free trade agreements . These constraints are a constant threat to the free flow of trade and investments , despite the influence of globalisation on patterns of international trade and investment flows.

Patterns and types of investments

Cross-border business activities need to be supported by banks and other institutions that provide the financial assets required by these activities.

An integrated global economy needs a financial system to funnel capital from countries with a surplus of savings to those with a surplus of investment opportunities . Banks provide capital for investment purposes and the stock exchange allows foreign access to domestic equity capital.

An example of this type of integration relates to the benefits flowing from a single currency, like the euro. The European Central Bank ensures that the monetary policy is applied consistently across members of the Eurozone.

This integration provides for stronger cross-border banking and investment flows. EU member countries can be the primary beneficiaries of this type of investment which increases the capital flows across Europe ’s borders . This is an example of financial globalisation.

While these international capital flows finance fixed capital investments, they also can support the funding of government deficits. This is a risk of international capital migration and the dangers inherent in the deployment of capital resources in foreign countries.

BARRIERS TO INTERNATIONAL INVESTMENTS

Investment barriers can be regulatory in nature. ***Regulatory barriers*** often take form of capital controls. More often than not, impediments exist which restrict direct capital flows across international borders, such as investments destined to fund project in host countries.

Such barriers could include the following:

1. **the risks associated with servicing capital debt due to uncertainties relating to interest rates, exchange rate risks and the prospect of currency devaluation.**
2. **The costs impairing certain types of capital borrowing, depending on whether its short-term bank debt, or bond issues, or the time frame attached to capital loans**
3. **Irresponsible capital borrowing by certain countries, which has resulted in various limits being imposed on this type of investment funding, in particular in cases where such funds are used to finance inordinate budget deficits, which is indicative of sheer recklessness on the part of the recipient country.**
4. **The prospect of some borrowers not being able to repay their capital loans on time, which increases the cost of capital for other borrowers who may never default on their loans.**
5. **The imposition of taxes and foreign currency flows by certain government, which can serve as a deterrent to international capital flows.**

CAPITAL CONTROLS

Capital controls are imposed to curb capital flight. Often this is due to a country's failing banking system which may result in bankruptcy, or as a result of a country's credit rating being downgraded.

Capital controls can be prohibitions or quotas on the amount of money that can be moved out of a country. They may be imposed due to a financial crisis facing a country. Recently capital controls are more lenient and assume the form of market-based controls such as taxes on certain types of capital flows, including changes to withholding taxes and certain liquidity requirements applicable to foreign funds. These types are more compatible with the globalisation process.

A market-based approach to capital control often targets a debt crisis even if short-lived. This is when a country manages to get out of its recession sooner than expected and money starts to flow into the country, often necessitating a financial transactions tax on the purchase of equity or bonds.

The goal of these controls is to manage exchange rate fluctuations and render local banks less vulnerable to a sudden outflow of capital. These measures restrict capital mobility limiting capital flows that could push a currency far above its intrinsic value and widening the country's trade deficit. They also prevent a borrowing frenzy which can cause financial instability.

The removal of capital controls could speed up the flow of much needed funds so as to boost savings in a country thereby providing for the poor while deepening the financial sectors of wealthy countries. This could encourage a more efficient allocation of credit rather than having to depend on the IMF for loans.

These measures are about timeous interventions by governments. The timeous imposition of capital controls is important for countries with high capital inflows.

Such controls come at a cost. They impose an administrative burden on governments – they must discriminate between different types of credit to discourage activities aimed at yielding quick profits.

Macro and microeconomic consequences must be considered – impact on foreign exchange markets and trade balance. All variables must be considered so as to optimise benefits.

RECENT DEVELOPMENTS IN INTERNATIONAL TRADE

The post-war period with its changing economic power has served as a catalyst for international trade development. This includes both regional and multilateral trade development. Trade liberalisation has taken on 2 approaches:

1. Focus on peace, safety, health and technical standards, currencies, treatment of foreign investors, protection of intellectual property, telecommunication services and enforcement of labour and environmental protection.
2. Concentration on reducing tariffs – China

Due to trade developments, trade pacts have been concluded. One such initiative are the free trade agreements entered into across EU countries.

The establishment of Regional Trade Agreements (RTAs) has complimented these agreements. RTAs compliment multilateralism. RTAs could eventually account for a huge share of global trade.

Dominant among such trade coalitions is the WTO. WTO is responsible for policing the world trade system, ensuring member countries adhere to the rules laid down in trade treaties. WTO has enormous scope and influence and facilitates the establishment of additional multilateral agreements between WTO member countries.

WTO rules allow rich countries to benefit from poor. It inflicts damage on more vulnerable countries by relying on the force of international law for policing compliance. WTO's rigid implementation of trade promotion is a threat to the democracy of weaker members. WTO panders to big governments and the interests of multinational enterprises particularly to dispute resolutions.

The slow growing world economy has caused many WTO members to be reluctant to reduce trade barriers. Many of the ills of the global economy are being blamed on the WTO, including rising unemployment, environmental degradation, poor working conditions in developing nations, falling real wage rates and rising income inequality. This is worsened by major trading nations' refusal to play by international trade rules. WTO still has a viable agenda to pursue – need for feasible anti-dumping policies, to confront aggressive protectionism and lack of protection for international property rights.

INTERNATIONAL TRADE THEORIES

These theories assume that free trade occurs, countries should not limit imports nor exports, and the market determines which producer survives as consumers buy those products that best suit their needs.

1. Absolute Advantage (Adam Smith)

   Different countries produce some goods more efficiently than others, implying that consumers should not have to buy these goods domestically, when they can buy the goods more cheaply abroad. In the absence of any restrictions, each country should specialise in those products that give them a competitive advantage. Countries should shift to efficient industries rather than compete in inefficient ones. The natural advantages are derived from the country's climatic conditions, access to certain natural resources or the availability of certain labour skills. Acquired advantage confirms that most goods produced today are manufactured rather than being a product of agricultural production. Countries that are competitive in manufactured goods have an acquired advantage which enables them to produce a unique product. Advantages in process technology stems from the ability to produce a similar product easily distinguishable from competitors. Acquired advantage through technology, can create new products while displacing old ones, and substituting traditional trading partnerships with alternative ones. One country has absolute advantage in the production of a product when it is more efficient than any other country in producing it.

2. Comparative Advantage (David Ricardo)

   This theory suggests that it is in the interests of a country to specialise in the production of those goods that it produces most efficiently and to buy goods it produces less efficiently from other countries. These efficiently produced require fewer input resources. A country's competitive advantage lies in producing more of a product that requires fewer input resources, even though it has an absolute advantage in producing both goods it needs. When engaging in trade with another country, these two trading countries can increase the combined production of both products, while consumers in both countries can consume more of both products . Both countries benefit from reciprocal trade due to the comparative advantage of specialisation. The theory of competitive advantage holds that the potential world production increases with unrestricted free trade, including countries that lack an absolute advantage in the production of a particular product. All free trade participating counties realise economic gains.

3. Heckscher-Ohlin Theory of Factor Proportions

   They argue that competitive advantage arises from differences in national factor endowments (resources such as land, labour and capital). The result of this is that nations have varying factor endowments, and thus differences in factor costs. The greater the factor endowment, the lower its costs. Countries will export those goods that require intensive use of factors that are abundantly available locally and will import goods that make intensive use of goods that are scarce. This theory tries to explain the pattern of international trade in the world economy and assumes that free trade is mutually beneficial. It argues that international trade is determined by differences in factor endowments rather than differences in productivity. It is relative not absolute endowments that are important. It states that a country's trading performance will depend on how different factor endowments are across countries when they start trading. This theory is the core of modern trade theory.

4. Mercantilism

This theory states that government intervention is the dominant driver of international trade. Historically, a country's wealth was measured by its holdings of treasure (gold). This translated into the conviction that countries should export more than they import, and if successful receive gold from countries that run up trade deficits. This theory impacted government policies by ensuring that their counties exported more than they imported by restricting imports and subsiding production that could not compete in domestic and export markets. This practice was unsustainable when home-based companies acquired technological leadership, ownership of raw materials abroad, and some degree of protection from foreign competition. Today neo-mercantilism has concealed the drive of mercantilism. This theory states that countries run a favourable trade balance in an attempt to achieve a political or social objective. This often results in an excessive state intervention in a country's economy. This theory is flawed because it maintains that trade is a zero-sum game in which a gain by one country results in a loss by another. Recently, neo-mercantilism has effected state intervention by equating political power with economic power, and economic power with a balance-of-trade surplus. Such counties boost their exports and limit their imports due to state intervention.

5. Product Life Cycle (Raymond Vernon)

This theory highlights the USA's former dominance over a period of time, in developing new products such as cars, televisions, cameras, computers, etc. this stems from the country's preference to develop numerous consumer products as a result of consumer wealth and market size. However, not all products come from USA. Many new products originate from low cost production locations abroad, from where these products are exported to the USA. Vernon argued that many of the new products being exported overseas continued to be produced in USA. He argued that pioneering firms preferred to keep production close to the market and decision-making. This would safeguard them from risks associated with product development and distribution. He concluded that the demand for new products is based on non-price factors, and pioneering firms can charge relatively high prices for new products, which avoids the need for low-cost production sites. His reasoning was based on a particular focus on the life-cycle of a typical new product, the demand for which was growing rapidly in USA and limited to high income groups in other advanced countries. This forced these countries to import the new products rather than produce them themselves. This trend changed over time as demand for new products in these advanced countries started to grow. This then triggered the decision for these other countries to produce these new products in their home market. Consequently USA companies set up production facilities in those advanced countries abroad. This then limited the potential for USA to export. The completion of this cycle can be seen in advanced nations overseas whose market for these products are maturing, which meant that product standard and price became the main competitive weapons. Now producers operating in low cost locations are more likely to export to USA. This cycle of product development in USA eventually loses its advantage to overseas countries and will probably start repeating itself as other developing countries acquire a production advantage over USA. This could mean that USA may even become an importer of these products. This theory suggests continued global domination by USA through its manufacturing expertise, unique staffing policies and technological innovations.

6. National Competitive Advantage (Michael Porter)

The diamond of national advantage was developed by Porter and this theory states that there are four attributes which are important for competitive superiority. He stated that these attributes of a nation shape the environment in which local firms compete. The attributes are as follows:

- **Demand conditions**

  Firms start up production operations close to a potential market which is sustainable enough to drive a strong demand to justify the firm's manufacturing operation.

- **Factor conditions**

  A country has a competitive advantage when it has an absolute advantage pertaining to the availability of natural resources, and the relative availability of factors of production compared to other international locations.

- **Related and supported industries**

  These must be in close proximity to a firm's production facility. This emphasises the competitive advantage flowing from supporting facilities in similar industries.

- **Firm strategy, structure and rivalry**

  The sustainability of the firm's strategy, structure and rivalry potential that is important. For example, if barriers to market entry are low one can expect intensive rivalry between competing firms.

Porter incorporated two additional variables which can influence the national diamond. These are chance and government policies. Chance could include major innovations which shape the structure of industries and markets, allowing one country to supersede another in global competitiveness and market domination. Government policies refer to policies and regulations which can improve or detract from competitive advantage. Porter argued that firms are most likely to survive international competition when supported by these attributes. The effect of one attribute is dependent upon the state of others. Expansion of the national diamond through globalisation can improve the country's business environment and make it more competitive.

7. New Trade Theory (Paul Krugman)

This theory states that in certain circumstances countries should specialise in the production and export of particular products, not on the account of differences in factor endowments, but because in certain industries the world market can only support a limited number of firms. This is the case in commercial airline industries . Firms that enter the market first are able to build a competitive advantage that is at first difficult to challenge . Recently , through product innovation and technology, market dominance has been successfully challenged.

TRADE BARRIERS

These instruments of trade control are used by governments to constrain economic relations between countries, hereby influencing imports and exports.

Reasons for trade barriers

- **Protection of local jobs**

  Used as reason by governments when intervening in the regulation of trade flows. Leads to higher prices that cost consumers and make domestic products less competitive in the global market.

- **Infant industry argument**

  Governments who provide support for new industries through tariffs, import quotas and subsidies until the new industry is strong enough to compete with international firms. Protectionism, however fosters inefficiency. It is better for these industries to borrow from financial institutions and markets. Given its comparative advantage, these industries should survive initial start-up costs.

- **Import substitution**

  Volatile prices for key products cause unstable unemployment and incomes. This together with the cost structure of manufacturing inputs often renders the manufacturing process vulnerable and uncompetitive . Such countries resort to import substitution strategies by levying heavy import duties on those materials required for manufacturing forcing manufacturers to source inputs locally. This lays the foundation for infant industries while strengthening their technical and industrial skills base which promotes an integrated, diverse economy. However if protected industries do not become efficient , local consumers will end up subsidising them through higher prices and taxes . The solution – export led economic development. Unfortunately, import substitution may guarantee home market protection, but it will lead to a lack of advantage in international markets.

- **The use of restrictive standards**

  Restriction in international service business by setting technical and professional standards that may be difficult for firms and individuals to meet. Done by setting strict licensing and professional educational standards.

- **Reducing inordinate reliance on foreign suppliers**

  Through international supply chain networks, foreign suppliers are able to set prices. Governments may influence local industrialists to use preferred suppliers whose pricing models are more open to negotiation, thereby allowing industrialists to secure competitive prices for inputs. This implies exploiting home-based suppliers in order to secure a more viable competitive advantage.

- **Restricting the use of subsidies**

  Government limitation of funnelling subsidies to selected industries which are strategically important to the economy. This means channelling allowances to investors and industrialists who favour the local production of specific goods that are strategically important. This means using tools and mechanisms that are geared to influencing the passage and destiny of FDIs.

- **Controlling the balance of trade payments and deficits**

  The rise of a country's productivity relative to other trading partners will improve its competitive position. The more FDI that is attracted to a country, the greater the demand for its home currency. Such positive changes in productivity will change a country's trade balance. Highly productive means trade surplus, less productive means trade deficit. These have consequences for a country's balance of payments. Governments must regulate its trade flows, service trade and capital movements so as to manage its balance of payments, with the aid of government interventions or through the use of monetary and exchange rate policies.

- **Export promotion**

  Introduction of export promoting strategies to encourage and support specific industries in which a country can compete successfully. There are two catalysts to export expansion namely: -incremental internationalisation which presupposes that as a firm gains experience and results, can it progress into export mode, moving into a country dissimilar to its own, and, -the fact that some firms are born global, implying that they can export in an early stage of their lifecycle.

- **Anti-dumping policies**

  Dumping is the selling of goods in a foreign market at below their cost of production, or selling them below their fair market value. It may enable foreign producers to subsidise their product prices in a foreign market, and once they have driven out foreign competitors, they can then increase their prices. Anti-dumping policies are aimed at penalising foreign firms that engage in dumping via trade regulation. Some tariffs are substantial and stay in place for up to five years .

- **Political retaliation to achieve specific objectives**

Pragmatic nationalism views FDI both as a benefit and a cost for their country. It is the disadvantages that cause countries to retaliate. In pursuit of specific political or economic objectives, countries adopt a realistic stance and design policies that maximise national benefits and minimise national costs. Often countries are motivated to retaliate against countries who have poor human rights records, child labour, sweat shops, political tyranny and totalitarianism. This could be in the form of trade barriers targeting offending countries.

- **Protection of national sovereignty**

  Such protection implies the accommodation of local interest which should prevail over global interests.

The implications of trade barriers include the following:

- They are random and biased and applied subjectively. They could stem from political motives rather than economic ones.
- The assumption that their use requires special training, supervision and administration.
- The prospect of their adding to the microeconomic problems, like inflation.
- They encourage special interest privileges – special discounts to certain trade alliances.
- Increased government intervention.
- Reflection when imposing them as plans are put in place to facilitate free flow of goods, input materials and services across international borders.

TRADE CONTROL

Trade controls are divided into two groups:

1. Those that indirectly affect the amount traded, by directly influencing the prices of exports or imports
2. Those that directly limit the amount (quantity) of goods that can be traded.

Further distinctions are:

- **Tariff barriers**

  Taxes levied on imports or exports. Tariff barriers directly affect prices. A tariff (duty) is the most common type of trade control and a tax that governments levy on goods transported internationally. Tariffs collected by the exporting country are called export tariffs, if collected by the country through which the goods pass they are called transit tariffs, if collected by the importing country are called import tariffs.

- **Non-tariff barriers**

  May directly affect either price or quantity. They limit trade by enabling governments to alter product prices or the quantity of goods traded.

Tariff barriers

Trade restrictions via the imposition of tariffs allow governments to pursue certain political and economic actions deemed to be in the interest of trade flows and their impact on the country.

Import tariffs

Tax imposed on imports. This tariff effectively raises prices or it influences the quantity of foreign goods coming into a country. Governments gain because tariffs increase government revenue and domestic producers gain because tariffs afford some protection against foreign competition by increasing the cost of foreign goods. Consumers lose because they must pay more for certain imports. This may be due to imposition of an ad valoreum tax which is based on a percentage of the value of the imported item in the destination country. Import tariffs restrict supply thereby raising domestic prices. They reduce the overall efficiency of the world economy – domestic firms encouraged to produce locally that could have been produced more efficiently abroad. This leads to ineffective use of resources.

Export tariffs

The objectives are as follows:

- Raise government revenue through increases in global sales volumes
- Encourage foreign MNC's to initiate FDIs into the home country as a means of countering the threat of trade barriers.
- Use it to increase the cost of exporting, relative to FDIs and licensing
- Justify FDIs being preferred over exports as a means of entering foreign markets. • Diversify a MNCs customer base with home markets, ensuring capabilities and skills in the home country.
- Enable MNCs to stabilise fluctuations in sales associated with economic cycles or seasonality of demand by safeguarding their undue exposure to volatile international markets and minimise risks.
- Lower the aggregate costs associated with foreign market entry

Subsidies

Direct assistance from government in the form of a payment (cash loans, low interest rates, tax breaks and government participation in domestic firms) to companies to try make them more competitive. They achieve this by lowering production costs in order to help domestic producers. They do so by:

- Helping them compete against foreign imports
- Gaining export markets

In the interest of increased operational efficiency in those sectors (primarily agriculture) benefiting from subsidies, they will have to phase them out.

NON-TARIFF BARRIERS (QUALITY CONTROLS)

Import quotas

It is the most common type of quantitative import or export restriction in a given time frame. Import quotas raise prices because they limit supply, and they provide little incentive to use price competition to increase sales. Tariffs increase government revenue while quotas only generate income for those firms that are able to obtain and sell a portion of the limited supply of the product. Import quotas are not necessarily imposed to protect domestic producers, rather countries maintain quotas on products produced in a country. They do so by allocating importing rights to competing domestic firms in exchange for increased exports.

Voluntary export restraints (VER)

It is a quota imposed by the exporting country, typically at the request of the importing country's government. Import quotas and VERs benefit domestic producers by limiting import competition. VERs always raise domestic prices of imported goods due to the limited foreign supply of a particular product subject to a VER quota. VERs can have negative effects on political relations between affected countries.

Local content requirements

Governments may pressurise manufacturers to make a greater share of a given product in the local market. This LCR may be expressed in physical terms, as a percentage of component parts for a product to be produced locally, or in value terms for example 75% of the value must be produced locally. LCRs provide protection for domestic producers by limiting foreign competition. The restriction on imports raises the prices of the imported components, meaning the price of the final product is higher to consumers.

Technical barriers

They are introduced to discourage imports. For example, imposition of rigid environmental standards or high product standards may serve as a deterrent.

Free trade

Free trade emanates from the principles of absolute advantage. Free trade prevents wastage of national resources, which is due to the practice of minimising imports. Free trade forces should determine how much trade should be allowed with little or no government intervention. Free trade allows the possibility of countries sharing the advantages generated by trade activities in a way that favours their citizens. Free trade has brought down trade barriers to the reach of goods, it has succeeded in enhancing international interdependencies , which have the power to influence both markets and nations. Free trade seeks to restore the force of the global economy.

Trade protectionism intrudes on the process of global integration.

LEARNING UNIT 10: CHAPTER 10 – FOREIGN DIRECT INVESTMENT AND THE INSTITUTIONAL FRAMEWORK

- Explain the phenomenon of FDI
- Understand the underlying theories and principles of FDI
- Trace the trend of FDI flows globally, with specific reference to the major African economies
- Describe the types of FDI
- Discuss the importance of FDI to the home and host economies
- Explain the drivers or determinants of FDI direction
- Explain the challenges faced by developing countries in attracting FDI

What is foreign direct investment (FDI)?

Economists view – economic effects of FDI

National treasury's view – composition and overall value

Environmentalist's view – ecological impacts

Political leader's view- socio-political and economic impacts

FDI definition – the category of international investment that reflects the objective of a resident entity (direct investor) in one economy obtaining a lasting interest in a direct investment enterprise located in a host country. **It is an investment in a business by an investor from another country for which the foreign investor has control over the company purchased and includes mergers and acquisitions, building new facilities, reinvesting profits earned from overseas company loans.**. Resident entities are largely multinational corporations (MNCs) that invest huge sums of capital and commit extensive valuable resources to their offshore presence for the sole purpose of a lasting, controlling, non-easily reversible business interests. This addresses the flow of capital and the direction of that flow. The issue of controlling shares and ownership structure was added by UNCTAD. The most relevant point is that domestic investors have the possibility of holding equity stakes in the MNC through participation in the stock market.

The philosophical approach to FDI

The radical view

Emanates from experienced and anticipated adverse effects of FDI on the economies of the home and host countries. This Marxist view was taken by people after WWII and stemmed from class struggle, hatred of the rich and opposition to private ownership / control of property. According to Marxism, FDI is used by MNCs to create further inequality, not only among countries but also between labour and the owners of capital. FDI is thought to generally impoverish host countries and enrich capitalist investors. This is achieved by repatriating profit earnings from the host country to the home country without regard for the financial market or economic prosperity of the exploited country. MNCs work through messy economic policies in the host country which creates distrust between the government and citizens.

FDIs is viewed as exploiting less-privileged individuals and treating labour as a mere tool in the production process. In situations where technology is adopted in the production process, it is done to reduce the importance of labour and to price labour even more cheaply.

The resulting economic reality and consequences of adopting the radical viewpoint are economically and socio-politically devastating. This view was popular in China, Brazil, Russian Federation, and many Asian and African countries.

Pragmatic Nationalism

This viewpoint believes that governments and labour should be open to embracing FDI. Openness to FDI should be guided by growth paths, environmental sustainability, and poverty alleviation, socioeconomic desires of the people and country, and socio-political goals of the country. The government should attract FDI that are strategic, relevant and suitable for the developmental agenda of the country without trading away human values of self-actualisation.

In order to attract the growth-inducing FDIs, governments encourage investors to locate their offshore subsidiaries by offering subsidies, tax holidays, low tariffs on imports, free tariffs on exports, low energy production costs and free land. Regulatory instruments are adopted to create conducive atmospheres for FDI, while restrictive instruments are put in place to force out and reject FDIs that are not strategic. This is the view of USA, Japan and European Union.

The free market view

This view is influenced by the interaction of market forces of supply and demand. This view is based on the theories of absolute advantage (Adam Smith) and the theory of comparative advantage (David Ricardo). It is also supported by the theory of market imperfection which supports the idea of guided market supervision through strong government involvement.

These theories lend credence to the importance of location-specific advantages as the main reason MNCs invest abroad, and justify why the creation of an investor-friendly environment would improve competition and efficiency. MNCs primarily venture abroad to source input materials that are scarce in their host countries, but operations are guided by regulatory intervention and effective supervision.

This view assumes that MNCs influence growth and development in host countries. MNCs are credited with using scarce resources beneficially while efficiently maximising the production process through superior technology and expert managerial supervision. The ability of MNCs to move large financial resources across borders to the host country is seen as a benefit to the host country. MNCs create employment if allowed to operate freely.

The free market approach is the most popular approach adopted by developed and undeveloped governments when it comes to attracting FDI. This view downplays the possible negative effects of MNCs so governments should monitor and manage negative effects of FDI.

Theories of FDI

It makes no sense for MNCs to venture abroad if the input materials are available locally, there is no production cost advantage and if the firm operates optimally locally while also able to sell everything it produces locally.

Horizontal FDI occurs when a firm manufactures the same set of products in every country where it operates.

Vertical FDI occurs when a firm conducts different production processes in different locations, thereby creating intra-organisational trade relations and cross-dependencies.

Why does MNC venture abroad to operate the same line of business while it could easily export its products to distant markets and take advantage of economies of large-scale production and avoid the risks associated with physical presence in a host country?

- High transport costs - transport costs can increase operating costs of MNCs. Also distance plays a role.
- Lack of tight control over sales in the foreign market- sales reps promote products with best incentives.
- The application of trade restrictions by regulatory bodies – the government of the importing country may discourage importing through tariff and non-tariff barriers. The host government supports FDI through subsidies and incentives, subsidised operating costs, tax/tariffs waivers on imported production machinery.
- Exporting does not support the diffusion of the organisational culture – exporting does not allow the producer the ability to fully represent the product and build a corporate image around the product. This discourages exporting in favour of FDI in the host economy. With vertical FDI, MNCs occupy their supply and distribution networks to implant their corporate culture, critical for distinguishing the firm from its competitors and creating competitive advantage.

Imperfect market behaviour (Internationalisation Theory)

This theory was proposed by Knickerbocker and based on his observations of oligopoly enterprises during the 1950s and 1960s in USA. Arguments in the support of FDI at the expense of other expansion strategies, applying equally to vertical and horizontal FDIs:

1. Market imperfection approach suggests that simple price mechanism does not fully explain what is produced and consumed. Governments often influence the choices made by both manufacturer and consumer through policies and regulations. Firms will thus adopt a physical presence in offshore markets that provide the best incentives and opportunities. With vertical FDI, firms seek location-specific advantages from offshore markets that integrate production processes as it save costs and achieves competitive advantage.
2. An oligopoly is an industry dominated by a few players. Industry players often follow the strategic behaviour of their competitors, hence players who venture abroad are followed by others. These major players compete rigorously in every market (theory of multipoint competition) reinforces why such firms venture abroad. Many such firms venture abroad in order to apply the same technology that offers them superior competitive advantage.

Trends in FDI Flows

The growth rate of sales volumes and assets of MNCs surpass global exports and gross fixed capital formation. The growth patterns of MNCs is testimony to the increasing global interdependence of nations which resulted in driving firms towards internationalisation. Of importance is the increasing shift in the orientation of firms from historical location specific advantage motives to process efficiency and spill-over products.

Significant changes in patterns and trends in FDI have been experienced recently. Firms are venturing abroad to seek cost efficiencies and to seek sustainable competitive collaborations in production and operational processes.

The flow of FDI refers to the movement of financial resources globally by MNCs. Investment flows are towards developing economies due to seeking competitive operational costs and no longer towards technology superior USA.

The stock of FDI relates to the monetary value of the total capital that is moved by MNCs globally. The financial value is an accumulation of resources committed to offshore locations over a protracted period of time, and includes physical money, tangible and intangible assets, retained earnings, offshore-generated funds (stocks listed on the host market), interests of investments, and other receivables. The stock of FDI signifies the financial benefits that accrue to a foreign economy through its attraction of FDI. FDI has recently become an important contributor to GDP of many developing economies, especially countries relying heavily on resources.

Types of FDI

The type of FDI depends on the strategic objective, political economy of the offshore market, and, the nature and strength of competition in the offshore market.

The types are:

- **Mergers** – MNC partners with a foreign firm on equal-footing. The firms then share equally in the equity stake and management of the business. Mergers are used to force competition out of the market or overcome regulatory hurdles. Example – GlaxoSmithKline. Motivations include, to begin operations in the target market immediately after concluding the merger (local firm already exists in the host market, very few resources required to start operations), and FDI will inject financial and human capital into existing business hereby improving operational efficiency and capacity. This translates into a competitive advantage. Drawbacks include negative effects on healthy competition in the host economy (driving away new entrants into the industry. A negative effect of the crowd-out hypothesis is that the eventual dominant force in the industry may manipulate market forces. Examples – ABSA/Barclays failed due to cultural differences. Challenges that are encountered especially in the implementation phase:

  1. Cultural differences are often overlooked because of emphasis on financial data rather than soft power / influences.
  2. Overstatement of resource capacity is done by limiting access to important data
  3. Poor communication and longwinded hierarchical flows of information leading to mistrust of management
  4. The level of uncertainty exacerbates problems of trust and allegiance, including down-sizing that occurs with mergers.

Failures in mergers often results in weakened shareholders' earnings, job losses and major financial losses. Reasons why mergers fail:

1. Unrealistic underlying assumptions – evidence based research is neglected and decisions are based on personal opinion.
2. Few opportunities exist for economical, low-commitment pre-testing – a guided segmental approach is not adopted because merger parties are in a rush to complete the process.
3. Superiority contests and unbending opinions by leaders of the merger – leaders are convinced that they possess all requisite knowledge, expertise and competence and are unwilling to enter into any argument by lower level employees.
4. Massive sunk cost and non-easily reversible up-front investment – a staggered flow of resources is more appropriate and reduces exposure.
5. Considerable ambiguity and a sense of time pressure – the critical aspect of merger arrangements is the understanding of each other's values, culture and managerial styles is traded off to panic and ill-conceived decision making.

- **Acquisitions** – a strong MNC absorbs a weaker firm in the host country. Occurs with firms in similar / related industries. This is possible if the government of the host country favours outright ownership of assets by foreign investors. The foreign investor takes over the existing business fully, including its assets and management. The name of the acquired either ceases to exist or exists alongside the name of the new owner. Example – Massmart. Motivations include taking complete administrative and managerial control of the business thereby reducing the risk of unmanageable disputes and cultural differences often found with mergers.

- **Brownfield investment** – occurs through the leasing or acquisition of an existing operational facility with the purpose of utilising the facility to produce specific products. Mergers and acquisitions deal with ownership structure of the firm while brownfield investments are carried out through lease arrangements and seldom acquisition. If acquisition occurs it is mainly through the absorption of a weaker government parastatal for the purpose of upgrading and restructuring and adopting state of the art technology which results in operational efficiency and profitability. Example – privatisation of British Rail which received capital injections from MNCs Novo Rail Alliance, Australia and Hong-Kong Atkins. Brownfield investment is a tool used by governments to upgrade their service delivery process through the involvement of private investors. Challenges include the inability of the brownfield investor to fully estimate the level of deterioration of the existing facilities that are being acquired or leased. These investments are limited in developed economies. Developing and underdeveloped economies have infrastructural gaps but institutional investment is discouraged due to market inefficiency and institutional inadequacies.

- **Wholly-owned subsidiaries (Greenfield investment)** – MNC invests and builds production facilities in an offshore market from scratch. This type of FDI is encouraged by the host government because of the direct impacts on infrastructural development. Wherever such a business is located, the entire community benefits from a good road network, uninterrupted supply of power, running portable water, good medical facilities and safety. Foreign firms are treated under the law as domestic operations and are accorded with all the rights and privileges. This strategy could be used to entrench the organisation in the marketplace, thereby making it difficult for competitors to enter the market. This is not an appealing approach to investment due to the huge outlay of capital. The MNC must be prepared to invest in infrastructure , the establishment of operational systems, as well as developing unskilled labour forces. Fledging socio-political and economic systems and institutional inadequacies may trigger political instability culminating in destruction of lives and property.

The advantages of FDI to the home and host economies

Merits of FDI to the home country

- **Balance of payment / trade advantages**

  FDI helps the home country to improve its trade balance which results in an improvement in the national current account. MNC sources inputs like raw materials, expatriates, capital, machines and equipment from the home country, all of which increase exports from the home country. MNC remits the cost of those exported materials back to the home economy in the form of transfer prices

- **FDI helps create job opportunities in the home economy**

  MNCs employ expatriates from their corporate headquarters as part of their ethnocentric staffing strategy. A major part of expatriate earnings is remitted back to the home country improving its national current account.

- **Skills and knowledge acquisition**

  MNCs learn new skills and technology from abroad which are transferred back home to improve production processes

Challenges to home countries posed by FDI

- Balance of payment problems – the initial capital outlay is huge and profits are usually reinvested to enable foreign entity to grow. Governments of host country may place a limit of amount of profit to be repatriated.
- The import promotion hypothesis may falter if the foreign subsidiary embarks on the production of resources that were imported to the offshore market from the home country.
- The import substitution hypothesis may cause unemployment in the home country

Advantages of FDI to the host country

- Creation of employment opportunities- given that production capacity is enlarged

- Technology spill-over from advanced economies with state of the art technology
- Systems improvement and human competence
- Stimulates infrastructural development and upgrade
- Promotes capital formation with inflows of foreign capital that improve the national current account
- Facilitates access to bigger international markets
- Creates production and system linkages and synergy within the organisation

Negative effects of FDI on the host nation

- Job losses through downsizing is concern for labour unions
- Environmental pollution
- Undue influence on regulatory systems because of political sway in favour of MNC business decisions

Advantages of FDI relative to portfolio investments

- FDI Does not destabilize domestic capital;
- FDI sensitizes investors to domestic communities needs;
- FDI offers opportunities for firms to internationalize operations beyond licensing and exporting;
- Spillover effects of FDI, i.e., transfer of new production technology;
- Local firms and governments build absorptive capacity;
- FDI aids economic growth where there is a lack of domestic resource capacity

The institutional determinants of FDI

- Institutional-backed liberalisation: institutional-backed economic openness encourages foreign capital inflow.
- Portfolio theory whereby high-risk investments are expected to yield above-average returns
- Domestic capital formation is a determinant of the destination of FDI

The African imperative

Inflows of FDI to Africa are low. This shortfall is due to infrastructure, capital gaps, social disturbances and armed conflicts. There is evidence to support the fact that most civil unrest and armed struggles in Africa are directly funded or initiated by Western interests. Another strong impediment to the attractiveness of Africa to inflows of FDI is that very little is known by foreign investors about the continent. Most media publications depict Africa as subject to extreme poverty and associated social ills.

The reason for inflows of FDI being low in Africa is due to unhealthy competition perpetrated by Western media. Another reason is the weak market hypothesis. Africa has the lowest GDP per capita globally. However little attention is paid to the informal sector and their effect on the economy. What of the rapid growth in mobile phone and internet penetration ? Surely if Africa is dominated by poor people how are the people able to afford these services?

particular industries. This leads to MNCs looking for ways of improving efficiency, which will make them better competitors. Domestic rivalry creates pressure to innovate in order to improve quality and reduce costs, and to invest in upgrading the country's advanced factors of production. All of this helps to create world-class competitors.

INDUSTRY COMPETITIVE STRATEGIES

The transition from an MNC's home country competitive advantage(s) to global competitive strategies often reflects the structure of the country's industries. This is because a country's industry structure often reflects that country's national endowments.

It must be borne in mind that requirements for success in particular industry segments change over time. Management can use these changes associated with the different stages of industry development to isolate the competitive advantages that can shape strategic choices. These evolutionary phases in the transformation of industries are discussed in the following subsections.

THE EVOLUTIONARY DEVELOPMENT OF INDUSTRIES

The structure of a country's industries can be characterised by distinctive evolutionary phases, which yield different competitive advantages of which MNCs can avail themselves.

Emerging industries

These are regarded as newly formed or re-formed industries that are the product of technological innovation, newly emerging customer needs or other social or economic changes.[16] Good examples of emerging industries are those that have come about as a result of internet-based social networking, satellite radio, telemedicine, surgical robots and online service industries. Businesses such as Uber (ostensibly a taxi service linking potential passengers and willing drivers) and Airbnb (connecting property owners and potential tenants through an electronic platform) are examples of this type of industry.

From the point of view of strategic choices, emerging industries are characterised by uncertainties. The absence of rules presents both a risk and an opportunity for potential investors. The strategic positioning of MNCs relative to emerging industries is critical and, if carefully articulated, could serve to reduce uncertainty in emerging industries.

The following characteristics are the hallmarks of emerging industries:

- There is technological uncertainty regarding the product standardisation that will eventually unfold. MNCs with proprietary ownership of certain technologies could capitalise on this uncertainty and reap the benefits of the competitive advantage.
- The prevalence of inadequate information about competitors could lead to competitor uncertainty, and uncertainty about the strength of demand vis-à-vis

buyers in the marketplace. Such uncertainty could present opportunities which could create one or more competitive advantages. For example, competitive advantages could be created in terms of first-time customers who are confused as to the availability of non-standardised products in an uncertain market space.
- There is uncertainty as to how predictably the experience curve applies to those wishing to enter emerging industries. This is due to doubt regarding the initial costs which could be incurred by MNCs seeking to penetrate such industries, together with uncertainty as to when corresponding costs will start declining.
- The dearth of entry barriers can be a catalyst to the formation of new firms.
- Raw materials and components are inaccessible, owing to suppliers not yet being ready to respond to the industry's needs.
- There is a need for high-risk capital, due to industry uncertainty.

The abovementioned characteristics should prompt MNCs to formulate global business strategies which have the potential to:
- improve the industry's structure, so as to alleviate uncertainty in the marketplace
- improve the quality of products to be sold in such markets
- build congenial relationships with suppliers and their distribution channels
- capitalise on technological uncertainty by entrenching their own technological dominance
- galvanise a core of reliable customers in the face of future competitors encroaching on this market space.

Growing industries

This phase of industry development implies a rapid increase in new competitors, often new entrants who are large competitors with substantial resources, and who have anticipated that this market will, eventually, vindicate itself as an attractive destination for MNCs and other competitors. A market of this nature has the capacity to support product and brand differentiation, as well as the resilience to support the financial resources needed for heavy market expenditure and growing price competition, with its impact on cash flows. An example of a growing industry is the building and installation of specialised kitchen cupboards.

Increasing demand in the marketplace is compatible with economies of scale and scope as market entrants increase production and service capacity to meet growing demand. This is conducive to increased investment in plant and equipment, R&D, as well as more rigorous marketing efforts to target specific customer groups. Such efforts require strong distribution capabilities, which will place a heavy demand on the capital resources of MNCs.

Global business strategies in growing industries would incorporate features such as:
- the ability to establish strong brand recognition
- the ability to expand production capacity to meet growing demand, including capacity in the area of service capability and the training logistics associated with such capacity

- product innovation so as to adapt products and skills to scaled-up operations in emerging market niches
- the competency and capacity to effect product differentiation from other competitors entering the market space
- the accompanying resources and skills to create unique product features and advantages, including strong capabilities in sales and marketing
- the ability to ensure repeat buying on the part of existing customers.

Mature industries

A maturing industry is one that is experiencing significantly slower growth. An industry is said to be mature when nearly all the potential buyers of the products in that industry are already users of the product. An example of a mature industry is the alcoholic beer industry.

Market demand in the mature industry consists mainly of repetitive or replacement sales to existing users. Growth hinges on the industry's ability to attract a few buyers and to convince buyers to increase their usage of the product. For instance, mature consumer goods typically have a growth rate of below 5 per cent, equal to the growth rate of the economy or the growth rate of the customer base.

Some of the catalysts in the transition to maturity relate to new technological advances or product innovations. Industry maturity has two implications for competitive advantage and the building of global business strategies:

1. It reduces the number of opportunities to establish a competitive advantage.
2. Opportunities for competitive advantage move from differentiation-based to cost-based factors.

MNCs therefore need to focus on low costs as a means of achieving competitive advantage in mature industries. To exploit low costs, consideration should be given to three cost drivers which can play a role in this regard, namely economies of scale, low-cost inputs and low overheads.

Maturing industries exhibit the following characteristics:

- Buyer demand and market share decline due to price cutting and increased advertising.
- The number of sophisticated buyers increases due to consumers' experience with the product. As they become familiar with competing brands, they are able to evaluate different brands.
- The abovementioned constraints put pressure on industry profitability.
- Increased competition encourages mergers and acquisitions from competitors, which drives the weakest competitors out of the industry.

In response to the abovementioned constraints, global business strategies for mature markets should be designed to:

- prune product lines and drop unprofitable lines

- place an appropriate emphasis on process innovation that allows for low-cost product design and manufacturing methods
- allow the MNC to pursue cost reductions wherever possible
- facilitate careful buyer selection, thereby focusing on less aggressive buyers
- pursue possible horizontal integration to acquire rival firms whose weaknesses can be exploited
- consider international expansion to markets where there is still growth.

Declining industries

MNCs operating in industries where demand is growing more slowly than the economy-wide average growth rate, or where it is even declining below the average GDP growth rate, find themselves stuck in what is known as declining or stagnant industries. Examples of declining industries include traditional, established retailers whose product offerings are dated.

MNCs in this predicament can consider diversifying into other related product-market segments so as to improve their cash flow. In more extreme cases, they could try and diversify into other industries which are not necessarily related, but this could be very costly.

Moreover, there may be strong competitors who are still able to achieve good performance in a stagnant market environment. These participants may prove to be a surprisingly formidable force, despite the stagnancy in the industry.

An MNC can pursue competitive strategies crafted with the purpose of allowing it to compete in declining or stagnant industries. However, the following constraints must be taken into consideration:

- The MNC's focus must be on industry segments that offer higher growth or a higher return.
- The MNC must concentrate on product innovation and quality improvement, on the condition that this can be achieved in a cost-effective way to differentiate the firm from competitors.
- Production and distribution efficiency must be emphasised by streamlining the production process and closing cost-ineffective production facilities.
- Cost-cutting measures implemented must be sufficiently drastic so as to generate a strong and sustainable cash flow.

These strategic initiatives have the potential to be successful, particularly where the industry's decline is slow and smooth, with some profitable niches remaining.

Fragmented industries

A unique characteristic of some industries is that they are populated by a myriad of small to medium-sized enterprises (SMEs), none of which have a substantial share of total industry sales. This is known as a fragmented industry. The most important competitive feature of a fragmented industry is therefore the absence of market leaders with substantial market share or widespread buyer recognition. Examples of this type of industry include landscaping, plant nurseries, real estate development, health and medical care and funeral services.

Fragmentation of the supply side of an industry takes place due to the absence of market leaders, the existence of low-entry barriers that allow MNCs to enter quickly and cheaply, and customers who require relatively small quantities of customised products (such as kitchen cabinets).

As fragmented industries consolidate over time due to slow growth and market maturity, stronger competition leads to weaker, inefficient firms being forced out of the industry. This trend is exacerbated by the formation of a greater concentration of larger, visible sellers.

However, it is the ease of entry to these types of markets that accounts for the fierce competition that SMEs face. This competition often comes from powerful suppliers and buyers who try to capitalise on the ease of entry.

Given this unique set of circumstances, global competitive initiatives designed for fragmented markets should enable MNCs to:

- pursue low-cost or differentiation strategies
- run tightly managed, decentralised firms through locally co-ordinated control, ensuring a high level of product service and local responsiveness
- manage standardised, efficient, low-cost facilities at multiple locations, which is conducive to building a low-cost advantage relative to local competitors
- increase added value by providing more after-sales service and product innovation
- concentrate on specialisation by focusing on product type, customer type, different types of orders and geographical areas.

CONSTRAINTS SHAPING INDUSTRY COMPETITIVE STRATEGIES

MNCs seeking to compete in the global marketplace typically face two types of competitive pressures – cost reductions and local responsiveness – that affect their ability to realise location economies and experience curve effects. Cost reductions often lead to the call for global integration, while local responsiveness urges MNCs to adapt locally.[17] In both national and international competition, pressures for cost reduction are pervasive. However, in international competition the pressure for local responsiveness – a reflection of different consumer preferences and host country demands – is unique. This in turn has an impact on industry competitive strategies, depending on the measure of industry evolution.

This dichotomy can exacerbate the tension that arises between the call for cost reductions on the one hand, and the pressures for local responsiveness on the other hand. Moreover, these constraints can actually impede the implementation of competitive strategies.