MNB3701 EXAM PACK 2018 EDITION

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PART A: NOTES

LEARNING UNIT 1: GLOBALISATION AND INTERNATIONAL BUSINESS

1.1 Definition of globalisation

The concept of globalisation has different meanings to different people depending on their experiences. It is important to note that globalisation has several meanings and connotations to different people.

Basically, globalisation can be defined as a process of interaction and integration among the people, companies and governments of different nations. It is a process driven by international trade and investment aided by information technology. This process has effects on the environment, culture, political systems, economic development and prosperity and on human physical well-being in societies around the world.

- Victims of slavery and colonialism perceive globalisation as the invasion of communities by imperialists
- Business people perceive globalisation as a process which facilitates the development of trade in cash crops, precious metals, knowledge dissemination, human capital transportation and technological innovations
- From a sociological perspective Arjun Appadurai perceives globalisation as a combination of different components in the world. Globalisation is viewed as the pulling together of human and non human resources to make the world a single entity. On the other hand, John Tomlinson perceives globalisation as process of deterritorialisation and cultural integration through free flow and interaction of people from different parts of the world.
- From an economic perspective globalisation facilitates economic integrations and bilateral engagements. The economic integrations include cross border trades, investments, migration, international capital flow (inflows and outflows), bilateral and multilateral trade arrangements.
- The United Nations comes up with a definition asserting that globalisation should be viewed in an economic context. The United Nations define globalisation as

free trade, which includes removal of tariffs and other impediments to the free flow of capital, goods, labour and services.

- ❖ Economists define globalisation as the assimilation of national economies into one huge international economy via foreign direct investment, migration, trade, capital flow and trade.

1.2 Types and forms of globalisation

There are 8 main forms of globalisation: financial, political, social and economic, cultural, ecological, technological, and geographical.

Financial globalisation – world's financial systems have become intimately interconnected.

Political globalisation – refers to the amount of political cooperation that exist between different countries. Examples include global organisations such as World Trade Organisation (WTO), United Nations (UN) etc.

Social globalisation – refers to the sharing of ideas and information between and through different countries. The Internet and social media is at the heart of this. Examples of social globalisation include internationally popular films, books and TV series. Social globalisation is often criticized for eroding cultural differences.

Economic globalisation – refers to the interconnectedness of economies through trade and exchange of resources. No national economy really operates in sisolation – national economies influence each other.

Cultural globalisation – harmonization of world cultures at the expense of clear different local cultures.

Ecological globalisation – the planet must be treated as single ecological system (ecosystem) rather than a collection of separate ecological systems.

Technological globalisation – technological revolution has meant that the Global Village has expanded to every corner of the globe with growth in travel communication and computer technology and mobile smart phones communications.

Geographical globalisation – geographers now see a borderless world, dominated by worldwide concerns about trade, politics, culture, economics and other relationships.

1.3 Capitalistic globalisation and anti-capitalistic globalisation

Capitalism is defined as a system where economic distribution and production are owned by private entities in order to accumulate profit. Globalisation promotes capitalism. The removal of restrictions on free trade has encouraged privately owned institutions to flourish. Globalisation and capitalism go hand in hand. In its current form globalisation only advances the interests of capitalism at the expense of the global poor and the working class.

Anti-globalisation is a form of resistance to global integration. The first anti-globalisation protest was directed towards the implementation of the North American Free Trade Agreement (NFTA) by the Mexican government in 1994. The first global scale anti-globalisation campaign was organised in Seattle, Washington in 1999

Anti-capitalists or anti globalists are people who are antagonistic or against globalisation. These people argue against the alleged benefits of globalisation. Anti globalists cite the weaknesses of globalisation such as:

- The inequitable apportionment of resources to the disadvantage of poor countries
- The capricious policies of institutions such as the IMF, the World Trade Organisation and the International Labour Organisation (ILO).
- Globalisation lead to job losses
- The aggressive manifestation of the globalisation in the form of the establishment of international agreements (such as the North American Free Trade Agreement (NAFTA) with its preference for tariff eradication at the expense of the poor).

1.4 The good/benefits/advantages of globalisation

The positive effects of globalisation are:

- Benefits of economic integration

- Trade liberalisation
- Free markets
- Socio-political control
- Improvements in world health care
- Growth and improvement in quality of living or living standards
- Employment creation
- Creation of meaningful and sustainable jobs in some offshore locations that were previously unattractive for locating production facilities
- Diffusion of technology has helped reduce costs and improve accessibility to technology by less privileged communities across the world

1.5 The bad/ugly/disadvantages/side effects of globalisation

- Job losses due to the pressure created by international competition
- Many manufacturing firms have been forced to close as a result of intense competition from MNCs
- Dumping of goods on the developing markets by multinationals from advanced economies

1.6 The future of globalisation

1.7 Possible examination questions to focus on

LEARNING UNIT 2: INSTITUTIONAL FRAMEWORKS AND THE ROLE OF GOVERNMENTS

2.1 Global institutional frameworks

Business interactions between Multinational Corporations (MNCs) and national institutional frameworks are controlled by the codes of practice of global supervisory institutions.

The major global supervisory institutions are:

- The World Bank
- The International Monetary Fund

- ❖ The World Trade Organisation

These institutions serve as watchdogs for trade relations and for the various market agents operating within the global marketplace.

In addition to the global supervisory institutions there are several global systems and institutional frameworks which sees to it that every country's regulatory mechanism conforms to the global norm.

Any country that violates the global investment regulations or laws will be excluded from participating in the global market place through several disciplinary measures.

2.2 Corruption perception index

2.3 Worldwide government indicators

2.4 The role of government

2.5 Possible examination questions

LEARNING UNIT 3: CULTURE AND INTERNATIONAL BUSINESS

3.1 Culture and international business

3.2 Culture and society

3.3 Levels of culture

3.4 Cross-cultural literacy

3.5 Culture in the workplace

3.6 Culture shock

3.7 Possible examination questions

LEARNING UNIT 4: STRUCTURING GLOBAL ENTERPRISES AND OPERATIONS

4.1 MNCs and their stakeholders: ethical implications

4.2 Theories of business ethics

4.3 Sustainable corporate social responsibility

4.4 Multinational corporations (MNCs) and global governance

4.5 Possible examination questions

LEARNING UNIT 5: THE GLOBAL TECHNOLOGICAL, INNOVATION AND INFORMATION ENVIRONMENT

5.1 The T in slept

5.2 Technology in a global business

5.3 Innovation in a global business

5.4 Information in a global business

5.5 Possible examination questions

LEARNING UNIT 6: THE GLOBAL MONETRAY SYSTEM AND FOREIGN EXCHANGE MARKET

6.1 The evolution of the global monetary system

6.2 Foreign exchange markets

6.3 Possible examination questions

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

7.1 Evolution of the global capital market

7.2 The role of the capital market in an economy

7.3 The dynamics of the African capital market

7.4 Challenges that hinder capital market development in Africa

7.5 The new thinking on capital market development Africa capitalization

7.6 Possible examination questions

LEARNING UNIT 8: FINANCIAL MANAGEMENT AND STRATEGIES IN A GLOBAL CONTEXT MARKETS

8.1 Definition of financial management

8.2 Approaches to financial management

8.3 Working capital management

8.4 Optimisation of operating cost

8.5 Transfer pricing

8.6 Multilateral netting

8.7 Centralised depository

8.8 Capital budgeting

8.9 Political and economic risk factors in capital budgeting

8.10 Financial risks in capital budgeting

8.11 Risk management in capital budgeting

8.12 Possible examination questions

LEARNING UNIT 9: INTERNATIONAL TRADE AND INVESTMENT

9.1 International trade and investment

9.2 Types of international investments

9.3 Capital controls

9.4 Recent developments in international trade

9.5 International trade theories

9.6 Trade creation and trade diversion

9.7 Trade barriers and the case for free trade

9.8 Possible examination questions

LEARNING UNIT 10: FOREIGN DIRECT INVESTMENT AND INSTITUTIONAL FRAMEWORK

PART B: PAST EXAMINATION PAPERS SOLUTIONS

MAY/JUNE 2018 FIRST PAPER

SECTION A MCQ

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5	1 p.23
6	2 p. 174
7	3 p.72-84
8	1 p. 24
9	2
10	2 p.2
11	
12	4 p. 243
13	3 p. 165
14	1

15	1
16	1 p. 196-200
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18	2 p.256
19	3 p. 203-204
20	3 p.252

SECTION B: OPEN ENDED QUESTIONS

QUESTION B 1

1.1 Explain fully what transfer pricing means (p164-66)

Transfer pricing is seen differently by different stakeholders:

- Tax collectors in the host country view transfer pricing as a fraudulent means of evading tax, by repatriating profits back to the home country of an MNC under the guise of reconciliation of subsidiary accounts.
- An MNC regards transfer pricing as the amount charged by one subsidiary operational resources transferred to another subsidiary of the same MNC. In this regard transfer pricing is the pricing of internal resources within a multinational network (in the form of assets – tangible and intangible, services and funds) that are moved from one subsidiary to another, within the foreign subsidiaries of an organisation or from the parent headquarters to the subsidiaries. For example, goods from the production division of an MNC may be sold to the marketing division that is based in another country of the same organisation.
- Transfer pricing involves moving taxable funds from regions of high tax rates to regions of low tax rates or tax havens.

1.2 Contrast forward exchange contracts with foreign currency options, Provide examples to substantiate your answers (p178-179).

Forward exchange contracts are a form of financial insurance taken to keep exchange rates at a fixed price for a specific date. In a nutshell, forward exchange contract is an agreement which a business agrees to buy a certain amount of foreign currency on a specific future date. The purchase is made at a predetermined exchange rate. By entering into this contract, the buyer can protect itself from subsequent fluctuations in a foreign currency's exchange rate. The intent of this contract is to hedge a foreign exchange position in order to avoid a loss or to speculate on future changes in an exchange rate in order to generate a gain.

Example of forward exchange contract

Baloyi Holdings has acquired equipment from a company in the United States of America, which Baloyi Holdings must pay for in 60 days in the amount of $150 000.To hedge against the risk of an unfavourable change in exchange rates during the intervening 60 days, Baloyi Holdings enters into a forward contract with its bank to $150 000 in 60 days, at the current rate.

On the other hand, foreign currency options is a form of insurance that grants the currency purchaser (the buyer) the privilege or rights (but not obligations) to buy or sell a specific amount of foreign currency within a specified period of time. Foreign currency options give the right but not the obligation to exchange money denominated in one currency into another currency at a pre-agreed exchange rate on a specified date.

In general, buying such an option will allow a trader or hedger to elect to purchase one currency against another in a specified amount by or on a specified date for an upfront cost.

Call option: is the right to buy the underlying security (foreign currency) for a fixed price (strike or exercise price) on or before a certain date.

Example of call option: Suppose you went shopping during a Christmas sale for a Sony camcorder, selling for $700 and the store had run out of the item. The store might issue a rain check which will permit you to go back to the shop within a month and buy the

camcorder for $700. Suppose the day you went back to the shop the camcorders were selling at $680 then you will throw away your rain check and buy for $680.

Put options: Give the seller the right to sell the underlying security for a fixed price

(strike price) on or before a certain date (the expiration date).

Example of a put: A simple example of a put option is car insurance. Suppose you buy a new BMW for $30 000 and you have it insured for $25 000. This means that in the event of an accident you have the right to sell the car to the insurance company for a price of $25 000. However, if the damage done to the car is slight and the car is worth $28 000 after the accident then you would obviously not exercise the option to sell the car.

The difference between forward exchange contracts and foreign currency options is that forward exchange contracts are binding. They cannot be reversed while foreign currency options are obligatory and binding.

1.3 Critically discuss the three types of foreign exchange exposure that Multinational Corporation (MNC) can encounter in the foreign exchange market (136-140)

Foreign exchange exposure refers to the risk a company undertakes when making financial transactions in foreign currencies. Foreign exchange exposure is classified into three types: Transactional; Translation and Economic.

Transactional exposure: Deals with the actual foreign currency transaction. 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 had changed. In a business all money transactions are meant for profits as its end result. There are chances that the final objective may be hampered if it is a foreign currency transaction.

If a company buys goods from a foreign country and payables are in foreign currency to be paid after three months, the company may end up paying much higher on the due date as currency value may increase. This will increase the company's purchase price

and the overall costing of the product compelling the profit percentage to go down or even convert to a loss.

Translation exposure: Deals with the accounting representation. Also known as accounting exposure. It is easy to identify and comprehend. The exposure is due to the translation of books of accounts into the home currency. Translation activity is carried out on account of reporting the books to the shareholders or legal bodies. Gains and losses arising out of translation exposure do not have more meaning over and above the reporting requirements.

Economic exposure: Deals with little macro level exposure which may be true for the whole industry rather than just the firm under concern. The impact and importance of this type of exposure are much higher compared to the other two. Economic exposure directly impacts the value of a firm. That means the value of a firm is influenced by the foreign exchange. The value of a firm is the function of operating cash flows and assets it possesses. The economic exposure can have bearings on assets as well as operating cash flows. Identification and measuring of this exposure is a difficult task.

The three types of exposure are very important in enabling the international finance manager to analyse the exposure to foreign exchange. It helps to provide the right view of the firm's business and therefore take informed decisions.

1.4 Discuss the role of the capital market in the economy

Question B 2

2.1 Fully explain the four attributes that Porter's theory of competitive advantage is based on (p. 195)

Porter's theory (the diamond of national advantage) postulates four attributes which are very important for competitive superiority or advantage. Porter proposed a theory that includes the following attributes:

- **Demand conditions**: In a market economy the direction of production that is the kind of goods which are produced is determined by the needs of buyers.

Competitiveness in an industry is impossible to achieve unless demand conditions allow for the successful realization of a firm's products.

- **Factor conditions**: These are the inputs which affect the competition in any industry. These comprises of a number of categories such as human resources, physical resources, knowledge resources, capital resources and infrastructure resources. What determine their influence on competitiveness is their degree of efficiency and effectiveness of the way they are deployed within an industry.
- **Related and supporting industries**: Related industries should be a source of competitive advantage to the industry in question. Related industries are those in which firms can coordinate and share activities in the value chain when competing or those which involve products that are complementary. Technology development, manufacturing, distribution, marketing or service are all areas in which sharing of activities could occur.
- **Firm strategy, structure and rivalry**: The attribute focuses on the context in which firms are created, organised and managed as well as the nature of domestic rivalry. The sustainability of the firm's strategy, structure and rivalry potential are important factors for competitive advantage to be experienced.

2.2 Fully discuss the characteristics of an emerging industry and the relevant strategies that an MMC should consider

2.3 Discuss what is meant by the right theories as theory of business ethics

Right theories maintain that there are things we cannot do against individuals, because they are holders of moral rights. Having a right means having a special protection. It means that an interest that the right defends should not be frustrated.

Rights theories presupposes that human beings have fundamental rights and privileges that are above and across national boundaries and cultures. According to the theory all human beings are permitted to do something or entitled to have something done for them.

According to theory, moral rights are universal and not limited to a particular country or law. In this regard managers should implement moral rights when making decisions that have an ethical component.

In a nutshell, according to the theory, everyone has:

- The right to work
- The right to equal pay for equal work
- Entitled to just and favourable remuneration so that they will provide adequate support for their families
- Right to form and join trade unions for the protection of their interests.

The theory elaborates on what is right and wrong and how human beings should be treated in the workplace or in business circles. Any form of discrimination will be unethical. In this regard, multinational organisations through dumping goods on other countries are behaving in an unethical manner. The theory ensures that people's rights are protected.

3.1 Explain what the concept of Foreign Direct Investment (DFI) entails [7 marks] (p. 211-216)

Foreign direct investment (FDI) is an investment made by a firm or individual in one country into business interests located in another country. Generally, FDI takes place when an investor establishes foreign business operations or acquires foreign business assets, including establishing ownership or controlling interest in a foreign company. Foreign direct investments are distinguished from investments in which an investor merely purchases equities of foreign based companies.

3.2 Discuss the four major types of FDI: mergers, acquisitions, Brownfield investment and wholly – owned subsidiaries [8 marks] p.220 - 225

FDI mergers: the form of FDI which occurs when an MNC decides to partner with a foreign organisation on equal footing basis. The partner organisations share equally in the equity stake in the business as well as in the management and control.

Mergers assist the MNC to reduce the regulatory barriers or to force competition out of the market. The other advantage of mergers is that they allow MNCs to penetrate foreign markets easily and allows the foreign company to operate in the target market immediately. A merger also allows the foreign direct investor to inject useful financial and human capital into the existing business. This would immediately improve efficiency and operational capacity.

However, mergers have some disadvantages as well. The first disadvantage is on healthy competition in the host economy (the crowd out hypothesis). Mergers are bad for competition because it will drive away new entrants into the industry and competitive pressure will force other competitors out of the market. Through the crowd out hypothesis the eventual dominant force in the industry may maximize its oligopolistic advantages to influence production or price for the product through manipulation of market forces.

Acquisitions: This kind of FDI occurs when a strong MNC absorbs a weaker organisation in the host country. It occurs among organisations of same or related industries. The foreign investor takes over the existing business fully including the assets and management. The MNC takes over complete charge of the administration and management of the business. Acquisitions occur mainly through the absorption of weaker government parastatal for the purpose of upgrading and restructuring.

The advantages and disadvantages of mergers also apply here.

Brownfield investment: The form of investment which occur through the acquisition or lease of an existing operational facility. Brownfield arrangements occur when the government or company establishment takes over the controlling shares in an offshore organisation or leases the offshore organisation for the purpose of rendering certain services or production of specific goods. Green field investment is synonymous with privitisation drivers.

One challenge is the inability of the brownfield investor to fully and accurately estimate the level and depth of deterioration of the existing facilities that are being acquired or leased. Brownfield investment opportunities are limited.

Wholly-owned subsidiary (Greenfield Investment): A type of foreign direct investment which occurs when an MNC invests and builds production or operational facilities in an offshore market from scratch. This kind of FDI is a direct result of the foreign expansion corporate strategy of a firm. This approach is liked by most host governments because such investments have direct impact on infrastructural development. The Greenfield strategy allows a foreign organisation to own assets. Greenfield FDI is expensive in the short run but has long term benefits.

The strategy is not attractive to investors because of the huge capital required to start the investment and the operational process.

3.3 Elaborate on the advantages FDI has for the host country p. 222 - 229

Recipient businesses receive best practices management, accounting or legal guidance from their investors. They can incorporate the latest technology, operational practices and financing tools. By adopting these practices, they enhance their employees' lifestyles. That raises the standard of living for more people in the recipient country.

Recipient countries see their standard of living rise. As the recipient company benefits from the investment, it can pay higher taxes.

- ❖ **Employment opportunities**: FDI inflows to the host country create the possibility of absorbing more labour.
- ❖ **Technology spillover**: MNCs penetrate foreign markets with superior technological capabilities and the state of the art technology that enables efficiency and efficacy.
- ❖ **Systems improvement and human competence**: Offshore subsidiaries benefit from lean and flexible production systems. The host nation benefits from the system reengineering which improves the quality of services, products and reduce costs. Human competence and capability is also improved through specialised and focused participation or involvement.
- ❖ **Improves infrastructural development**: FDI has a positive impact on infrastructural development in the host community.

- **It promotes capital formation**: Inflows of foreign capital into the host economy create a platform for the injection of foreign currency into the system and this improves the status of the national current account.
- **It provides access to bigger international markets**: MNC uses its dominant international network to penetrate both nearby and distant markets for its products.
- **It creates production and systems linkages**: MNCs try to control sources that supply the input materials (backward integration) or the distribution network (forward integration).

MAY/JUNE 2018 SECOND PAPER

SECTION A: MCQ

QUESTION	ANSWER
1	1 p.216
2	1 p.10
3	4 p.217
4	3
5	1
6	2 p.174
7	3 p.72
8	1 p.24
9	2
10	2 p. 72
11	
12	4 p.242
13	3 p.165

14	1
15	3 nb same qn on 1st paper
16	1
17	3
18	2
19	3
20	3

SECTION B: OPEN ENDED QUESTIONS

QUESTION B 1

1.1 Explain the concept of globalisation (5)

Globalisation is a multi-faceted concept and people view globalisation from different perspectives. From a sociological perspective, globalisation is seen as a combination of various worldly human and non human components. It can also be viewed a s process of deterritorialisation, cultural integration and free flow of humanity. Globalisation is a process which emphasises the cross-border exchanges of goods and services. It also encompasses the free flow of people as market agents. From an economic perspective globalisation is the foundation which facilitates modern interactions and the engagement of market agents and market participants. Globalisation is all about trading and investment arrangements, financial and capital market operations, economic integration and various bilateral engagements. Economic globalisation involves various phenomena that ranges from cross boarder trades or investments, migration, international capital flows – inflows and outflows as well as bilateral and multilateral trade arrangements. In a nutshell, globalisation appears and manifests itself in several ways.

1.2 Explain the role of the World Trade Organisation (WHO) in the promotion of the international trade of goods and services. How does this role differ from the role that GATT used to play? (6) pp. 23 – 24

The World Trade Organisation serves many purposes and performs many tasks. The organisation is responsible for facilitating trade liberalisation or economic openness, trade agreements or treaties negotiations, regulating trade relationships between and among nations; trade disputes resolutions and facilitating growth through the free trade mechanisms.

- ❖ **Trade liberalisation**: The organisation advocates for the removal of trade barriers to trade openness.
- ❖ **Negotiation of treaties and agreements**: The organisation serves as a referee for parties in potential trade negotiations so as to ensure equity of purpose and equal partnership in trade agreements.
- ❖ **Regulate trade relationships between nations**: The organisation monitors trade relations among nations and ensure harmonious engagement through free, fair and unrestricted trade arrangement.
- ❖ **Negotiate trade dispute resolution/settlement**: The organisation mediate, resolve and settle trade disputes especially among member nations.
- ❖ Facilitate economic growth through the free trade mechanism: WTO is responsible for fostering economic growth through free, fair and unprotected trade.

1.3 Discuss any three international trade theories that support the integrity of the market. (9) [190-196]

International trade theories include the following: absolute advantage, comparative advantage, Heckscher-Ohlin theory of factor proportions, mercantilism, product life cycle theory, national competitive advantage and new trade theories.

- ❖ **Absolute advantage**: According to this theory some countries produce some goods more efficiently than others. In this regard consumers should not buy goods domestically when they can buy those more cheaply abroad. Furthermore,

the theory postulates that each country must specialise in products that give it a competitive advantage. A country can have an absolute advantage in the production of a product when it is more efficient than any other country in producing it. DISCUSS THE PROS AND CONS OF THE THEORY

- **Comparative advantage**: According to this theory a country must specialise in the production of goods that it produces most efficiently and to buy goods it produces less efficiently from other countries.
- **Heckscher-Ohlin theory of factor proportions**: the theory argues that comparative advantage arises from differences in resources such as land, labour and capital. The theory argues that nations have different factor endowments. These different endowments explain the differences in factor costs: the greater the endowments the lower its costs. The theory predicts that countries will export those goods that require intensive use of factors that are abundantly available locally, while importing goods that make intensive use of goods that are scarce. The theory is influential in promoting international trade.
- **Mercantilism**: According to this theory, government intervention is the dominant driver of international trade. On the other hand, the theory states that countries should export more than they import. Through this theory countries try to favourable balances of trade in an attempt to achieve some social or political objectives.
- **Product life cycle theory**: The theory postulates that all new products are produced in the United States. The United States dominates in developing new products. This theory is ethnocentric in nature since it suggests continual domination of the global economy by the United States, through manufacturing expertise, unique staffing policies and technological innovations.
- **National competitive advantage**: The theory put forward four attributes which are important for competitive advantage or superiority. The theory includes factors such as demand conditions, factor conditions, related and supporting industries, firm strategy, structure and rivalry. These attributes of a nation shape the environment in which local firms compete.

- **New trade theories**: the theory postulates that in certain circumstances countries should specialise in the production and export of particular products not on account of differences in factor endowments but because in certain industries the world market can only support a limited number of firms. Firms that enter the market first are able to build competitive advantage that will be difficult to challenge. This theory explains why particular countries achieve international success in particular industries.

1.4 Discuss the role of capital market in the economy (5) [p.146]

Capital market is a virtual market space where long term financial instruments are traded – sold and bought. Capital market provides a cheaper platform for corporations to raise funds for capital intensive projects.

Capital market can be defined as the market where medium and long terms finance can be raised.

The main components of the capital market are the equity markets (stock exchanges; investment banks; and other related equity markets) and the credit market (development and asset backed commercial banks, bond markets, insurance houses and other financial instruments of intermediation).

The main function of capital markets is to provide business organisations with the opportunity to hedge against financial risks.

Capital markets play a very important role in enhancing economic growth. The main contribution of capital markets are:

- They provide an important alternative source of finance for projects with a long term employment (payback) period.
- They help to bridge capital gaps in long term financing, especially through the stock markets and development banks.
- Provide an access for international and domestic portfolio investors which make it possible for governments and other deficit units to seek and access funding that is critical for growth inducing activities.

QUESTION B 2

2.1 Identify and discuss any four criteria for which the World Bank use to judge countries on the radar of efficient governance (12)

2.2 Fully discuss the characteristics of an emerging industry (5)

2.3 Discuss the rule of law as one of the barometers used by governments to ensure this role (8)

QUESTION B 3

3.1 Explain what the concept of Foreign Direct Investment (DFI) entails (7 marks)

Foreign direct investment (FDI) is an investment made by a firm or individual in one country into business interests located in another country. Generally, FDI takes place when an investor establishes foreign business operations or acquires foreign business assets, including establishing ownership or controlling interest in a foreign company. Foreign direct investments are distinguished from investments in which an investor merely purchases equities of foreign based companies.

3.2 Discuss the four major types of FDI mergers, acquisitions, brownfield investment and wholly owned subsidiaries. (8)

FDI mergers: the form of FDI which occurs when an MNC decides to partner with a foreign organisation on equal footing basis. The partner organisations share equally in the equity stake in the business as well as in the management and control.

Mergers assist the MNC to reduce the regulatory barriers or to force competition out of the market. The other advantage of mergers is that they allow MNCs to penetrate foreign markets easily and allows the foreign company to operate in the target market immediately. A merger also allows the foreign direct investor to inject useful financial and human capital into the existing business. This would immediately improve efficiency and operational capacity.

However, mergers have some disadvantages as well. The first disadvantage is on healthy competition in the host economy (the crowd out hypothesis). Mergers are bad for competition because it will drive away new entrants into the industry and competitive pressure will force other competitors out of the market. Through the crowd out hypothesis the eventual dominant force in the industry may maximize its oligopolistic advantages to influence production or price for the product through manipulation of market forces.

Acquisitions: This kind of FDI occurs when a strong MNC absorbs a weaker organisation in the host country. It occurs among organisations of same or related industries. The foreign investor takes over the existing business fully including the assets and management. The MNC takes over complete charge of the administration and management of the business. Acquisitions occur mainly through the absorption of weaker government parastatal for the purpose of upgrading and restructuring.

The advantages and disadvantages of mergers also apply here.

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development. The Greenfield strategy allows a foreign organisation to own assets. Greenfield FDI is expensive in the short run but has long term benefits.

The strategy is not attractive to investors because of the huge capital required to start the investment and the operational process.

3.3 Elaborate on the advantages FDI has for the host country (10)

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Recipient countries see their standard of living rise. As the recipient company benefits from the investment, it can pay higher taxes.

- **Employment opportunities**: FDI inflows to the host country create the possibility of absorbing more labour.
- **Technology spillover**: MNCs penetrate foreign markets with superior technological capabilities and the state of the art technology that enables efficiency and efficacy.
- **Systems improvement and human competence**: Offshore subsidiaries benefit from lean and flexible production systems. The host nation benefits from the system reengineering which improves the quality of services, products and reduce costs. Human competence and capability is also improved through specialised and focused participation or involvement.
- **Improves infrastructural development**: FDI has a positive impact on infrastructural development in the host community.
- **It promotes capital formation**: Inflows of foreign capital into the host economy create a platform for the injection of foreign currency into the system and this improves the status of the national current account.

- **It provides access to bigger international markets**: MNC uses its dominant international network to penetrate both nearby and distant markets for its products.
- **It creates production and systems linkages**: MNCs try to control sources that supply the input materials (backward integration) or the distribution network (forward integration).