GLOBAL BUSINESS ENVIRONMENT MNI 301-J

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Introduction

- Purpose of group discussions
- Your study material
  - Tutorial letters 501 and 502
  - the new edition of the prescribed text book
  - relating the study materials to the text book
- Activities
  - Format of the examination
    multiple choice questions
    essay questions
    total mark
    pass mark
    duration of the examination
- Assignments
  - Compulsory MCQ assignment 1
  - compulsory MCQ assignment 2

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LEARNING OUTCOMES

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

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

GLOBALISATION

What is globalisation?

In summary:

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

Types of globalisation

Globalisation of market:

The merging of historically distinguishable and separate national markets into one global marketplace. Integration of separate national markets, segregated by national boundaries, into a single regional or global marketplace (through economic integration, trade blocs and/or bilateral relations)

Types of globalisation...

Globalisation of production:

The sourcing of goods and services (including production assets and processes) from locations of bounty around the globe to gain location-specific advantages in labour, resources, processes and/or capital. Locating operational sites or production factories at areas or countries that yields the best comparative advantage

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Forces driving globalisation

(A) The changes in the political environment:

(1) The *creation of global economic/trade regulatory bodies*

(2) *The collapse of communism*

(B) Changes in the technological environment:

(1) E-mail and videoconferencing

(2) The Internet and the World Wide Web

(3) Company Intranets and Extranets

(4) Advances in transportation technology

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International trade theories

- Mercantilism
- Absolute advantage
- Comparative advantage
- Heckscher-Ohlin theory of ‘factors of production’
- The Leontief paradox
- Product life-cycle theory
- New trade theory – questioning diminishing returns in favour of increasing returns to specialisation
- Porter’s Model of national competitive advantage:

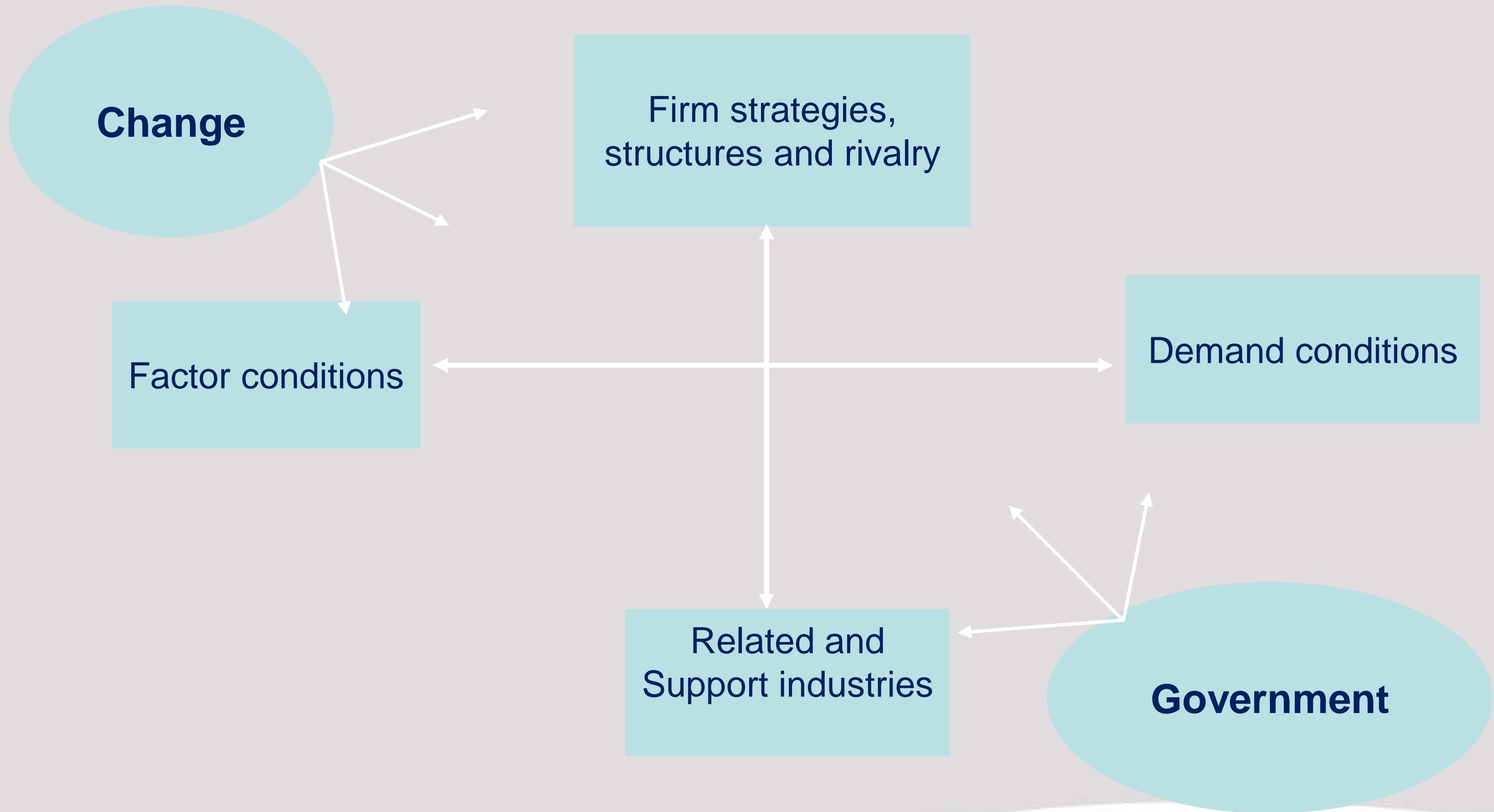
  factor conditions

  demand conditions

  related and supporting industries

  firm strategies, structures and rivalry

Porter’s model’ for national competitive advantage



Barriers to foreign market entries

TWO FOLD: TARIFFS AND NON-TARIFF BARRIERS:-

Tariff barriers- financial levies on imports – taxes or duties

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

Barriers to foreign market entries

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

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

Cases for government intervention in trade

Economic

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

Political

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

Economic Integration

Definition:

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

The European Union

The euro

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

The euro zone

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

Impacts of the euro

Advantages

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

Disadvantages

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

Achieving a viable economic integration

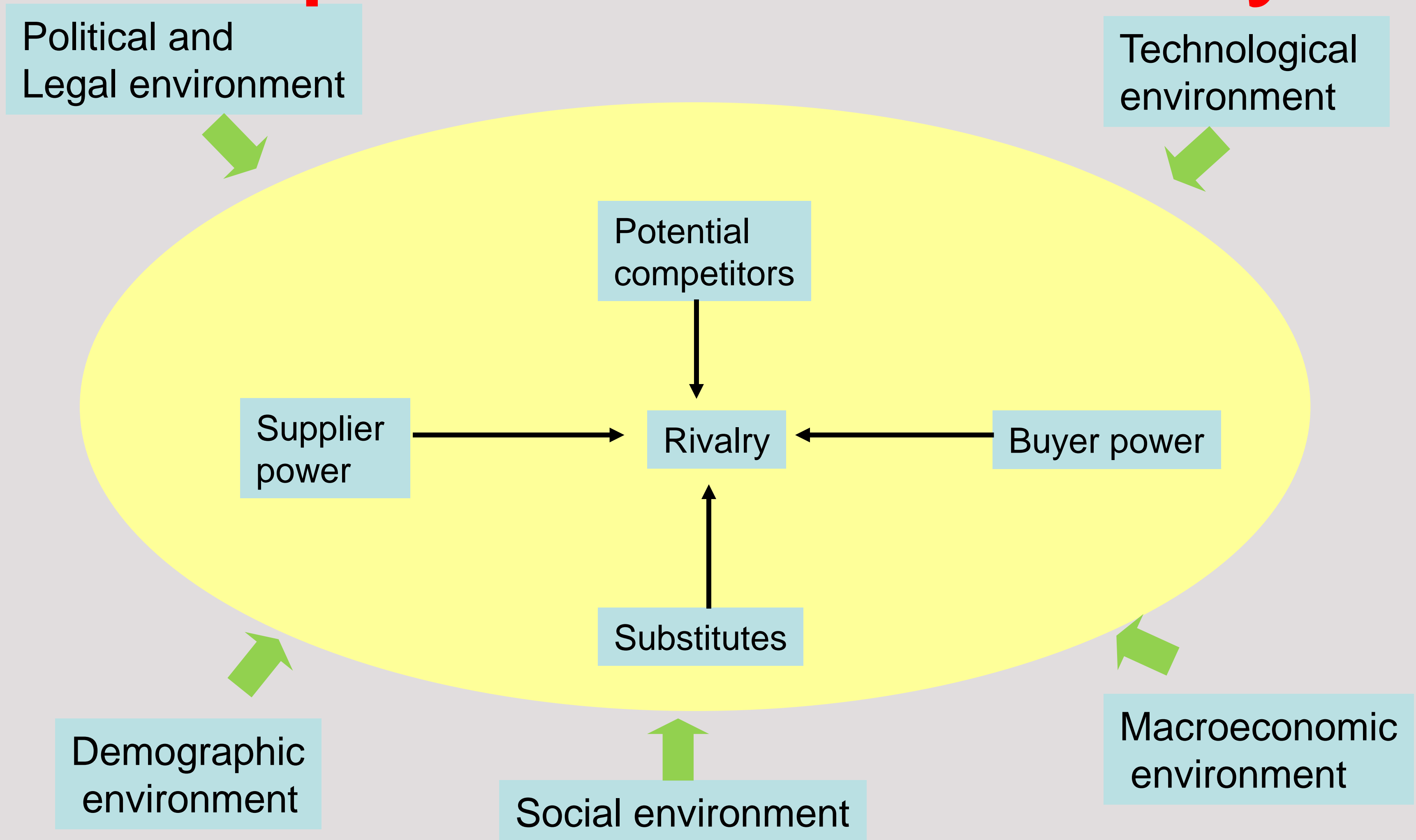
- Same / close geographical location of member nations
- Easy access to one another – an effective and efficient transport system
- Considerable natural resources and productive human capital
- Formal treaty / agreement
- Technologically advanced telecommunication system
- Effective and efficient banking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

International political, legal and tech. environment (The PESTEL Mode)

Introduction:

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

The political economy



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Strategic orientation of global firms

Multinational enterprises typically display one of four orientations, sets of beliefs or mindsets toward their international activities. These include an ethnocentric orientation, a polycentric orientation, a regiocentric orientation or a geocentric orientation

(The EPRG model – Schenk, 1988)

Strategic orientation of global firms

- **Ethnocentric orientation:** Adopts home country orientation; believes that everything that originates from its home country is best – centralised control system, standardised products, and key subsidiary personnel from home country. Rely on the values and interests of the parent country in formulating and implementing a strategic plan; strictly profit orientated. Mostly favoured by home countries of the MNCs.

- **Polycentric orientation:** The culture of the host country receives priority. Tailors strategic plan to meet the needs of the host country's culture and local demand – decentralised system, foreign subsidiary staffed with host nationals, use of initiatives and creativity encouraged. Profits are ploughed back to the host country for expansion and the growth of business operations. Mostly favoured by host countries of MNCs. .

Strategic orientation of global firms

- **Regiocentric orientation:** Interested in both profit as well as public acceptance (combining Ethnocentric & Polycentric approaches). Adopts the best strategy to address local and regional needs ***concomitantly.*** The corporate culture blended with host national flavour, integration of operations on regional basis, semi-decentralised.

- **Geocentric orientation:** Views operations from a global perspective. Offers global products with local variations and employees are from different countries. Recruits the best people, notwithstanding their region or religion. Adopts a globally integrated systems and networking approach to strategic decision making, imbibed with a global mindset, encourages multiculturalism and global learning, adopts a global network of activities. (Typical of the U.S. MNCs)

Strategic orientation of global firms

Pressure to reduce costs	Low (Demand for local responsiveness)	High (Demand for local responsiveness)
High	Global strategy	Transnational strategy
Low	International strategy	Multidomestic strategy

Modes of entering foreign markets

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

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

Advantages and disadvantages of entry modes

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

Advantages and disadvantages…

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

Advantages and disadvantages…

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

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Currency Determination

Demand and Supply:

- People's desire for foreign goods and services
- Inflow of foreign capital
- Trading in international instruments
- Hedging or futures trading to ameliorate the possible impact of financial-related instability
- National productivity and exports capacity
- Inflation and the purchasing power parity
- Macroeconomic dynamics and the interest rates regime
- Markets effect and investors behaviour - bandwagon

Foreign Exchange

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

Functions of the FOREX Market

1 Converting currencies

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

Functions of the FOREX Market…

2 Financial risk aversion

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

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International Capital Flow

The movement of money from one country to another for the purpose of investment, trade or production. Capital flows occur within MNCs in the form of investment capital and capital spending on operations and R & D.

Funds are transferred from the headquarters to the subsidiaries, and vice versa. Funds are also transferred between and amongst subsidiaries.

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Forms of International Capital Flow

- Foreign direct investment (FDI):

  This is a capital-market transaction that permits a foreign economic agent, such as an individual, a firm or a government, to acquire a significant interest or controlling stake in the ownership of a domestic (locally domiciled) firm.

  The equity stake is always in the form of production assets, such as land and building, furniture and fittings, production processes and machineries, vehicles, and locally domiciled intellectual property.

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Forms of International Capital Flow

Foreign portfolio investment (FPI):

Portfolio investment occurs :-

1 when a foreign investor's equity ownership stake in a firm is less than 10% of the firm's total value.

2 when the foreign investor holds any amount of debt securities (such as corporate bonds) issued by the firm

3 When the investment of the foreign agent is easily reversible (mainly in the form of cash, financial assets or tradable assets)

Difference between FDI and FPI

- In the case of FDI, the lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise
- The invested assets in FDI transactions are not easily reversible, unlike in the FPI.
- In the case of FPI, investments are always in the form of 'soft assets' that are easily convertible, and easily reversible too.
- No long-term foreign presence , and the tenure of investment is determined by short-term gains

Advantages of FDI over FPI

Merits of FDI

- FDI uses capital markets in a way that does not destabilise the domestic capital market.
- FDI is sensitive to the needs, yearnings, aspiration and welfare of host countries
- Improves national pride in the innovation, development and use of new technologies

Merits of FPI

- Provides access and compensation for quick investments
- Sensitises investor of any sudden instability in the host capital market
- Provides impetus for high-risk investments through huge rakes on cost of capital

Currency Volatility/ exposures

This is a situation in which the value of a country's currency changes suddenly and frequently. This situation occurs mainly due to unstable microeconomic policies, events or circumstances.

Currency volatility signals instability in the country's capital market and thereby discourages both FDI and FPI

Specifically, currency volatility, if unchecked, may destabilise the economy, thereby discouraging inflow of foreign capital

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Types of financial exposures

There are three types of foreign exchange risks/exposures, namely the translation, transaction and economic foreign exchange rate risks (exposures).

Transaction	Translation	Economic
This occurs when the future cash flow of an MNC's transactions are affected by changes in exchange rates	Translation exposure arises when losses arise as a result of consolidating subsidiary statements into the parent accounts	The extent to which a change in the bilateral exchange rate between two currencies of an MNC's dealings affects the present value of expected future cash flows to the MNC

Managing translation/transaction exposures

- collect transaction debts as quickly as possible
- concentrate on and encourage cash sales instead of credit sales
- delay, as far as possible, paying obligations denominated in local currency
- pay all debts that are denominated in strong currencies as quickly as possible
- take the opportunity to buy fixed assets that are most likely to have a beneficial effect on cash flows in inflationary conditions.
- the use of lead and lag strategies to protect cash flows.
- keep inventory low to lower financial risks
- currency forward contracts
- currency swop
- use transfer pricing to move funds

Managing economic exposures

- Strategic dispersion of operational process across geographies
- Continuous monitoring of the microeconomic fundamentals
- Continuous monitoring of underlying factors and trend in the host and home nations
- Maintain lean inventory (just-in-time technique is appropriate)
- Conduct detailed analysis of the investment environment before venturing into a foreign market.
- Understudy political stability, socioeconomic peacefulness and economic pathway, as informed by the legal framework

Nationalisation

Defined:

The act of changing the ownership of production processes and assets from private to public, under the direct control and administration of the state.

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Nationalisation...

Justification:

- ✓ The drive to redistribute national wealth – collective prosperity
- ✓ Opportunistic behaviour by the private sector
- ✓ National security
- ✓ To advance economic interest (YPF in Argentina – the largest oil company)
- ✓ To score political point/advance political agenda

Nationalisation...

Implications (for business):

- ✓ *Signals instability in the investment environment*
- ✓ *Fear of ultimate expropriation*
- ✓ *Fear of losing sunk funds/costs*
- ✓ *Absolute forfeiture of investment if the legal framework is weak*
- ✓ *Value of assets and operational processes are lost*
- ✓ *Lost of invested capital*

Nationalisation...

Implications (socioeconomic):

- ✓ Furthers unemployment
- ✓ Poor service delivery
- ✓ Loss of productivity
- ✓ Breeds bureaucracy, greed, corruption and incompetence
- ✓ Rapid depreciation of productive assets
- ✓ Pressurises public funds (increases taxes)
- ✓ May precipitate inflation
- ✓ May aggravate social unrest, lawlessness and violence

Privatisation

- The selling of government-owned economic resources to private operators.
- It is an important strategy in the transition of command economies to market-based economies.
- Privatisation is adopted to reduce internal debt levels in a country.
- Through privatisation, government removes subsidies that are used to featherbed uncompetitive SOEs and labour.

Privatisation...

Defined:

The selling of government-owned and publicly directed economic resources (assets and processes) to private investors. The state cedes both ownership, control and administration of hitherto state-owned assets and processes to private investors (local or international) absolutely.

In case of partial privatisation, state retains some participatory shares in the venture.

Privatisation...

Motivations:

- The low-cost financing that is channelled blindly to these organisations is also allowed to generate efficiency gains.

- The process of privatisation, if well orchestrated and executed, may help a government to reduce debt levels or government internal deficits from funds generated through the sale of state assets.

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Drivers of Privatisation

There are two drivers of privatisation (especially in the 1980s)

Change in political ideology

- ✓ Privatisation began in Britain under Baroness Margaret Thatcher, the Prime Minister of the UK between 1979 and 1990
- ✓ British government divesting its business interests in British Airways, British Telecom, the British Airport Authority and British Petroleum.
- ✓ Canada under Prime Minister Brian Mulroney (1984–1993).

Economic pressure

- ✓ The pressure for local responsiveness
- ✓ The pressure for cost reduction
- ✓ The budgetary constraints faced by many countries as a result of the increasing economic swings further makes it impossible to funnel funds into SOEs.
- ✓ the increasing competition in many industries these days requires regular funding to carry out upgrades, expansion and reengineering, which is not easily affordable by governments.

Benefits of Privatisation

- ❖ Improving enterprise efficiency and headlines performance
- ❖ Developing a competitive industry that services consumers well and meets its financial obligations
- ❖ Accessing the capital, know-how and markets that permit business growth
- ❖ Achieving effective corporate governance and social responsibility
- ❖ Broadening and deepening financial/capital markets
- ❖ Securing the best price possible for the sale of state-owned assets

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