Critically differentiate between Charismatic, Transaction and transformational leadership

Charismatic Leaders are:

- Dominant and self-confident
- Convinced of their moral righteousness of their belief
- Able to arouse a sense of excitement and adventure of subordinates

Transformational leaders are:

- Motivate their followers by inspiring them
- Offer challenges and encourage individual development
- Consider individual as important contributors to the workplace
- Believe in achievement of higher collective purpose, mission and vision.

Transactional leaders are:

- Use their legitimate reward and coercive powers to give commands and exchange rewards for services rendered.
- Reward subordinates for their work performance
- View financial success as the key performance indicator that deserve rewards
- Reciprocate negotiations between leaders and their subordinates and mutual exchange relationships between them

Qualities of a developing economy

Developed countries

- Political stability, high levels of education, high standards of living and actively involved in international business and foreign trade

Developing countries

- Relative political stability , Improving educational systems, literacy rates and work- skills levels, Relatively efficient technological systems, Less dependence on agricultural and mining with an expanding industrial sector, Rapidly increasing financial services sectors, Improved social conditions and a higher quality of life than before, Increasingly involved in international business

Less- developed countries

- Political instability, government inefficiency, low levels of income, inadequate education and social services, and low level of international business involvement

Identify and discuss the reasons of tariff barriers

4 main reasons: PERD

- Political
- Economic
- Retaliation/trade wars
- Domestic policies

All of the above reasons fall into 10 points of discussion: 5P's and IRRAA

- Protection of local jobs: Domestic markets are protected from foreign markets to ensure jobs of its local citizens, given the socio-political conditions; government discourages the import of goods that are produced locally. Government may also erect barriers that discourage mergers and acquisitions and also FDI because of the possible job shedding.
- Protection of infant industries: These are sectors that are too immature to compete against established rivals- their level of protection is based on their strategic importance to the nations building of its economy.
- Protection of national sovereignty: country enjoys its full legal status, formulates its own policies and regulations. Governments protect their territories and choose their trade partners carefully.
- Promotion of exports: some theories suggest that the promotion of exports is good for economic enhancement and helping the manufacturers move a step closer to industrialisation
- Political objectives: Governments use instruments of trade policy to advance their political agenda. Such as sanctioning countries with poor human rights or child labour practices.
- Import substitution: This is based on the assumption that greater industrialisation creates greater wealth. The more the manufacturing activities the more the wealth is distributed. Provided that buying locally is cheaper, then requires more output so with more demand on output means there is a demand for more input.
- Reduction in the reliance of foreign suppliers: the more the country relies on a foreign supplier, the weaker or more vulnerable that country may become- especially if a dispute between the 2 countries arise.
- Reduction in deficits: Governments implement instruments of trade policies to achieve trade equilibrium. Tariffs are used to discourage imports while at the same time trying to promote exports.
- Attraction of local production and foreign investment: Subsidies and other institutional mechanisms are used to attract investments in areas that are of strategic importance to the economy. Governments will give concessions to investors who are able to provide the facilitation of the production of goods and services. These mechanisms may also be offered to foreign investors to help facilitate production where the country lacks that capability.

- Antidumping remedies: Governments will apply trade barriers to redress dumping. These are erected against any firm that sells its product in the overseas market at a price lower than the production cost in the home market.

Discuss and explain the role and benefits of quotas

Quotas: restrict the amount of goods and services that can be imported into a country over an accounting period.

- Import quotas – restricts quantity of imports – imposing of license
- local content requirements – to increase the local manufacturing capacity of input parts
- Buy national restrictions – to limit consumption of imported good – improve local brand loyalty and promote industrial capacity development.
- Voluntary export restraint - imposed on quantity of exports – used to avoid trade disputes
- Technical barriers – technical barriers to discourage importation – to protect citizens against hazardous and substandard products.

Clarify the implications of trade barriers

- It is arbitrary and discriminatory and is applied subjectively. Their application comes from political motives rather than economic motives. Tariffs tend to breed counter tariffs which essentially is a motivation for trade war
- The application of trade barriers requires special training, supervision and administration.
- The administration of trade barriers adds to the microeconomic problem of a country. E.g. when demand surpasses supply and production capacity is at its maximum and importing is the only viable option, the tariffs on the imported products will be too expensive to bring in.
- The application of tariff-barriers encourages special-interest-privileges which means there are concessions made to certain trade allies whilst the rest of the world are treated like outcasts. This drawback affects global economic development and feeds trade-diversion.
- Tariffs increase government intervention in trade and economic matters. The involvement of government should act as an enabling role but instead; the tariffs regulate the business environment and the household consumption.

Steps to use in export/import transactions

- Importer obtains bank promise to pay on importer behalf (letter of credit)
- Bank promises exporter to pay on importer behalf
- Exporter ships to the bank trusting bank to pay (title is presented in the form of a bill of landing and requests b exchange)
- Bank pays exporter
- Bank gives merchandise to importer

- Importer pays bank

Discuss and evaluate the various foreign exchange exposures

Three main types of foreign exchange rate risks are identified, namely: translation (accounting) exposure; transaction exposure and economic. (1)

1. **Translation exposure or accounting exposure**

Definition: Translation exposure refers to the effects on financial statements of translating the business activities of foreign subsidiaries, expressed in the corresponding foreign locations' currencies, to the reporting/home currency of the parent multinational enterprise (MNE)

Translation exposure basically arises because a parent company must consolidate the financial statements of all its foreign subsidiaries into the parent company financial statement (1)

The financial statements of subsidiaries are usually prepared in terms of the foreign currency of the host country and then translated into the home currency to allow its components to be added to the account balances of the parent firm at the end of the financial year. Hence, foreign exchange exposure is sometimes referred to as accounting exposure. (1)

Where exchange rates fluctuate as they do under floating exchange rate systems, the value of account balances, as measured in the home currency, will also change and could produce either an accounting gain or loss relative to the translation of the prior period (1)

Although accounting gains or losses resulting from translation do not affect the cash flow transactions of the multinational enterprise (MNE), the psychology of financial markets can transmit adverse or favourable perceptions of the valuation of the multinational enterprise's (MNE's) ownership shares, and thus affect the cost of raising funds for the multinational enterprise (MNE) (2)

2. Transaction exposure

Definition: Transaction exposure refers to the extent to which a multinational enterprise's (MNE's) cash flow resulting from international transactions is affected by changes in exchange rates. (1) The common outstanding obligations of most multinational enterprises (MNEs) include the foreign exchange (currency) to be received for exports or paid for imports, the purchase on credit of services from foreign sources and what has been obtained through borrowing or lending in foreign currencies. These kinds of foreign exchange entitlements and obligations are susceptible to eventual value uncertainty due to the fluctuation in exchange rates of currencies, in which these receivables and liabilities are denominated. This uncertainty affects the original cash flows agreed to when the transactions occurred (3)

3. Economic exposure

Definition: Economic exposure refers to the extent to which a change in a bilateral agreement, impacting two currencies, of a multinational enterprise's dealings, affects the present value of the expected future cash flows for the multinational enterprise (MNE) (1)

Economic exposure differs from transaction and translation exposure:

- Economic exposure is a subjective concept that is not easily identified or measured. (1)
- Economic exposure has long-term implications, whereas transaction and translation exposures have short-term implications, and therefore recognising and dealing with it is far more important than dealing with the other two (1)

Economic exposure is a complex phenomenon and covers a wide spectrum of diverse risks, rising from the pricing of products, sourcing of supplies, future sales potential and cost trends in foreign markets, and the geographical location of foreign investments (1)

Discuss the three levels of global economic integration

GLOBAL, REGIONAL & BI-LATERAL (GRBL)

- **Global:** is facilitated by the rules and regulations of the institutions such as the WTO and IMF. These organisations establish rules and adjudicate trade-related disputes across the world. Promote global trade and investment through treaties that are ratified by member nations and to provide a platform for a fair trade and investment

- **Regional:** countries that are on the same geographical region. Membership is enabled through a treaty also validated by members. It benefits the nations by having the tariffs removed but there are light barriers that can still be imposed as long as they don't contravene the treaty agreement.

- **Bi-lateral:** trade relations and agreement between 2 countries, this facilitates preferential treatment between the 2 states.

Distinguish between the short-term and long-term effect of economic integration

- Static / Short term effects
- Dynamic/ Long term effects

Static/ short term effects:

Trade creation: occurs when production shifts to more efficient countries from inefficient domestic or outside countries. It could also occur as imports from a lower cost producer in

another country instead of domestic production from another higher-cost non-member producer country.

In other words, trade creation involves a shift in domestic consumption from high-cost domestic source to a lower-cost partner source as a result of getting rid of tariffs.

Trade diversion: occurs when production shifts to inefficient countries from more efficient outsiders. As a result, countries tend to import from a higher-cost producer member instead of importing a lowest-cost producer in the international market. Involves a shift in domestic consumption from a low-cost world source to a higher-cost partner source as result of the elimination of tariffs.

Long Term Effects:

Introduction of economies of scale production

Positive effects of learning curves and experience – costs of production reduced

Distinction between budgeting for foreign investment and domestic capital budgeting

Both foreign investment and domestic capital budgeting use same theoretical framework, however for international investment, the following are considered vital

- A distinction must be made between cash flows to the project and cash flow to the parent company
- Cash flow to the parent company often depends on the form or source of financing for the project.
- The remittance of funds to the parent company must be recognised explicitly due to differing tax systems between countries as well as political/ legal constraints which could affect the international movement of funds
- Differing rates of inflation between countries could affect competitive positions and thus affect the extent and value of cash flow over time
- Unanticipated foreign exchange rate changes affect the value to the parent company of local project cash flow and accordingly have to be kept in mind in the capital budgeting analysis
- Capital structure decisions and calculation of cost of capital (discount rate) are complicated, especially where host country subsidised loans are used for project financing.
- Political risk that arises from adverse political events could have a negative effect on the availability and extent of expected cash flows from a project
- Terminal value is more difficult to estimate because purchases from the host, parent or third countries or private/public sector, may have widely divergent perspectives on the value of the project to tem

Three methods of foreign production

- **Contract Manufacturing**: Foreign producrt produces and sells, but company promote and distribute
- **Licensing:** Foreign company pays licensing fee for patents, trademarks and trade secrets.
- **Direct investment in manufacturing:** manufacturing facility in foreign market becomes newly owned entity.

Explain the four techniques that MNE's can use in position funds to optimise internal resources

It is the extent to which the home government and host government regulatory authorities allow the unrestricted transfer of funds.

MNE's can use any set of the following techniques to position funds:

- Transfer pricing,
- Multilateral netting,
- Tax havens,
- Fronting loans.

Transfer pricing: It is common practice in MNE's to transfer goods and services between parent companies and foreign subsidiaries. The transfer price is the internal price at which goods and services are transferred between entities within the MNE.

Funds can be moved out of country :

- By setting high transfer prices for the production inputs supplied to the subsidiary in country
- And setting low transfer prices for the products sourced from the subsidiary in country A.

In other words there is a large outflow of funds versus a small inflow of funds.

Transfer pricing can be used to address matters of tax liabilities, negative exchange rate movements and cross-border charges.

Multilateral Netting: Where subsidiaries of an MNE are involved in intra-company business, each subsidiary would generally owe one or more of the other subsidiaries and in turn be owed by the others.

Multilateral netting allows MNE's to reduce the sum of standalone transaction costs of individual subsidiaries.

Tax Havens: MNE's also use tax haven countries like the Bahamas, Jersey and the Canary Islands because they have a low or non-existent tax income rate.

A firm accomplishes this tax saving by establishing a wholly owned, non-operating subsidiary in the tax haven. All transfer of funds from foreign subsidiaries to the parent company are channelled through these tax havens.

Fronting Loans: this is described as a parent to a subsidiary loan that is channelled through a financial intermediary, which is usually a large international bank. In fronting loans, the parent company deposits the loan amount in an international bank, which lends the same amount to the foreign subsidiary. So the bank ends up being the front.

What are the motivations for firms to venture overseas

- Strategic intent to achieve objects such as increase of sales volumes through penetration of overseas markets
- Location-specific advantages: increase earnings, relative cost structures
- Theory of multipoint competition: competitors imitate each other whenever they encounter one another in the world market
- Theory of strategic behaviour: firms follow competitor strategy to maintain competitive balance
- Supplier company follows its clients not to be substituted
- Stagnant or saturated national/home market.

Critically identify and discuss the motivating factors for outsourcing over manufacturing

The **advantages of manufacturing** are:

- Lower costs
- Ensuring that the benefits of specialised investments, will accrue to the MNE outsourcing the manufacture of a particular product
- Improved scheduling
- Protection of product technology

The **advantages of outsourcing** are:

- Flexibility, allows the MNE to change suppliers as demand changes
- Lower costs, MNE's aren't always able to achieve this by making the product internally
- Levering the facilities and services of external manufacturers can lead to the development of new markets

Critically evaluate the key activties of MNE financial management

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

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

Critically discuss the various types of foreign market entry modes

Exporting: selling of products produced locally to other countries

- Advantages: increased production in home country results in higher domestic employment, and export sales generate valuable foreign exchange.
- Disadvantages: High transaction costs; Trade barriers to imports in the foreign country; and Problems with foreign marketing agents.

Turnkey projects: use of foreign experts in countries that restricts foreign direct investment.

- Advantage: Less risky than conventional FDI, especially in political unstable countries.
- Disadvantages: Limited duration with no permanent market presence , Firm may create a future competitor as knowledge is transferred in the process

Licensing: an agreement where a licensor grants the rights to intangible property to a licensee (foreign firm)

Franchising: almost similar to licensing

- Advantage: franchisor includes low development costs as franchisee bears the costs and risks of opening up a market.
- Disadvantages: the maintenance of the standard and quality control of distant foreign operations, Strategic coordination is often difficult

Contract manufacturing: taking advantage of location economies by gaining access to cheap labour in overseas markets.

- Advantages: Contract manufacturing requires little capital investment.
- Disadvantage: - It may be difficult to control management practices; reliability and quality of supply - Control of intellectual capital may dissipate

Service sector outsourcing: availability of highly skilled workers at comparatively low wages

Management Contracts: foreign company is given right to run a company from day-to-day with no decision regarding ownership, financing or strategic changes

- Advantages: low risk entry strategy
- Disadvantages: likely to be short-lived if it doesn't lead to a more permanent arrangement

Joint ventures: establishing a new venture with a new identity jointly owned by two or more partners.

- Advantages: permanent arrangement with equity holdings by all partners
- Disadvantages: very difficult to coordinate global operations.

Wholly owned subsidiaries: the firm that owns more than 50% of the shares and effectively has management control of a foreign subsidiary.

- Advantages: - the firm retains effective control over its core capabilities and its revenues - It retains effective control over its operations
- Disadvantages: - it is most costly - risk of loss is significant - integration of different cultures create potential problems

Strategic alliances: collaborative agreements between two firms, often-same industry but no necessarily same countries.

- Advantages: - allow firms to benefit from a local partners' knowledge of country conditions - allow partners to share risks and costs associated with research and development including ne
- Disadvantages: - firms may relinquish control over their technology - may not have sufficient control over subsidiaries which operate under alliance agreement - may also be incompatible management styles- organisational cultures and control systems may lead to conflicts

Define Strategic alliance and justify the use of collaborative agreements

Strategic alliances are collaborative agreements between two companies often in the same industry working towards a common purpose. They are normally not from the same country.

Political considerations makes strategic alliance one of the feasible modes of market entry

Strategic alliance alows firms to benefit from:

Advantages

- Local partners knowledge of country conditions
- Share risks with partners
- Be politically acceptable
- Share costs associated with research and development including new products

Disadvantages

- Firms may relinquish control over its technology
- Firms may not have sufficient control over its subsidiaries
- Incompatible management styles
- Incompatable organisational cultures and controls
- Inability to engage in global strategic co0ordenation

For example in SA the Comair and British Airways alliance was a pionering venture in this field.

Distinguish between the three different types of economic systems

A COUNTRY'S ECONOMIC SYSTEM can be defined as the structure and processes a country uses to allocate resources and conducts its commercial activities. Economic systems encompass all the mechanisms and institutions that have been established concerning:

⇒ Production and consumption

⇒ Income and expenditure

Simply, an economic system could be regarded as a set of principles, processes, and techniques.

MARKET: An economic system in which economic decisions and the pricing of goods and services are guided by the interactions of the country's citizens and businesses, with little government interaction.

Market economies work on market forces such as supply and demand and are also the best determinants for the quantity and pricing of goods and services. This system requires customer sovereignty, entrepreneurial spirit and competition.

This economic system has the major portion of nation's land, productive facilities and other economic resources are privately owned by individuals or businesses as opposed to being owned by government/state.

COMMAND ECONOMY: This is an economic system in which the government owns the land, production facilities and other economic resources, and also plans the country's economic activities. The goods and services produced in a country, its quantities and prices are all planned by the government.

Command economy is consistent with the political ideology of Totalitarianism.

The aim of the system is for the government to achieve a wide range of political, economic and social objectives by controlling the allocation, production and distribution of resources.

MIXED ECONOMY: This is an economic system in which land, productive facilities and other economic resources are distributed more equally through private and government ownership.

The government tends to control certain sectors that are of national importance, notably the energy, transportation

Discuss the Political and Economic Risks associated with international capital investment.

Political risks stem from:

- Trade and investment barriers
- Exchange controls
- Requirements governing the remittance of earnings from subsidiaries to the parent company
- Promulgation of new tax regimes
- Cannot always be quantified with forecasting techniques

Economic risks entails prospect of economic mismanagement in foreign location:

- Uncontrolled inflation
- Impact of fluctuating macro-economic trends

These risks are **managed through cashflow projection adjustments**. Two approaches:

- Treat all foreign risks as a single issue by increasing the discount rate applicable to foreign investment, relate to the rate used for domestic projects
- Adjust all relevant, individual cask flow forecasts for the investment project, to reflect foreign risks.