Global Business Environments and Strategies MNI301J

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Additional Resource

Learn without limits.

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Purpose

The purpose of this additional material is to:

- remind you of the resources you need to prepare for the exam
- To provide a recap of module content preparation material
- To provide the format/structure of the examination paper

Resources needed

- The 4th edition of the prescribed textbook
- Tutorial letters 101, 501 and 502
- The Current PowerPoint (module recap)

Module recap

- Globalisation
  - What is globalisation
  - Types of globalisation
    - Market globalisation
    - Product globalisation
  - Drivers of globalisation
  - Evolution of globalisation
    - Process by which local business develop into a multinational business
- Methods for starting foreign production
  1. Contract manufacturing
  2. Licensing
  3. Direct investment in manufacturing

The global political, legal and technological environment

- PESTEL Model
  - The impact of the legal environment on investment strategies
  - Technological environment
- A political spectrum
  - democracy versus totalitarianism
- The legal dimensions that multinational enterprise need to consider
  - The laws of the domestic country
  - The laws of the foreign country
  - The international

The global economic environment

- Economic integration
  - Grouping countries by agreement or treaty on regional basis to form a trade block
- 3 levels of economic integration

1. **Global economic integration**
   - Facilitated by the rules and regulations of global institutions like world trade organisation (WTO) International Monetary Fund (IMF) and the World Bank
   - 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
2. **Regional economic integration**
   - Exists among countries located in the same geographical region.

Economic integration cont.

- **Bilateral economic integration**
  - A trade agreement between two countries.
  - It facilitates preferential treatment between the two signatories to the agreement.
- – Four stages of economic integration
  - Free trade areas
  - Custom unions
  - Common markets
  - Economic unions
- Economic integration yields both short and long term effects
  - short-term effects
    1. Trade creation
    2. Trade diversion
  - long term effects
    - Introduction of economies of scale production
    - Positive effects of learning curves and experience – costs of production reduced

Examples of major trade blocs

- Europe: European Union (EU)
- America: The North American Free Trade (NAFTA)
- Central American Common Market (CACM)
- Southern Common Market (MERCOSUR)
- African, Caribbean and Pacific (ACP)
- The Association of South East Asian Nations (ASEAN)
- Central African Customs and Economic Union (UDEAC)
- Southern African Development Community (SADC)

Objectives of SADC

- Too promote sustainable and equitable economic growth and socioeconomic development
- To promote common political values transmitted through democratic, legitimate and effective institutions
- To consolidate, defend and maintain democracy, peace, security and stability
- To promote self-sustaining development – collective self-reliance and interdependence of member states
- To achieve complementarity between national and regional strategies and programmes
- To promote and maximise productive employment and utilisation of resources of the region
- To achieve sustainable utilisation of natural resources and effective protection of the environment
- To strengthen and consolidate the long-standing historical, social and cultural affinities and links among people of the region
- To combat HIV/AIDS and other deadly communicable diseases
- To ensure that poverty eradication is addressed in all SADC activities and programmes
- To mainstream gender in the processes of community building

World bank Countries classification

- Economic classification of countries
  - Low income
  - Lower income
  - Upper middle income
  - High income
- Phases of economic development
  - Developed countries
  - Less developed countries
  - Developing countries

Developed countries

- Countries with high income and some upper-middle-income
- Characterised by
  - Political stability
  - A high educated and literate population
  - High levels of innovative and entrepreneurial activity
  - High levels of both industrial and information technology
  - High living standards for citizens

Inflation

- Higher inflation rates in one country is relative to the inflation rates in other countries and hence the **country's currency depreciates** relative to those of other countries
- Banks offer higher interest rates to attract more money **(economic confidence)** while governments raise interest rates to slow down economic growth in attempt to dampen demand **(political move).**
- Different economic policies affect international business financial decisions
  - Foreign currency- dominated loans versus local currency-dominated loans depending on which is more favourable.
- Higher interest rates adversely affect international company involved in mainly importing and favourably affect international company involved mainly in exporting.

Global monetary systems and foreign exchange

- Foreign exchange is a money of a foreign country in the form of bank deposits drafts or financial claims on an economic agent of another country.
  - Foreign exchange transaction
  - Direct and indirect quotes
  - Bid, ask and spread
  - Spot and forward transactions
  - Currency swaps
  - Cross–rates
  - Arbitrage

The political economy of global trade

- Political economy imply that governments can employ protectionist measures to regulate the quality and quantity of goods and services that are traded between the country and the outside markets.
- The main reasons for this government advocacy are mainly to:
  1. Protect local jobs
  2. Import substitution
  3. Protection of infant industries
  4. Reduction of reliance on foreign suppliers
  5. Attraction of local and foreign investment
  6. Reduction in balance of trade payments or deficits
  7. Promotion of exports
  8. Political objectives or retaliation
  9. Protection of national sovereignty
  10. Antidumping remedies

Instruments of trade policy

- Trade barriers are adopted to discourage the free flow of goods, input materials and services across international borders. Instruments used include:

1. Tariffs
    - Ad valorem tariffs
    - Export tariffs
    - Transit tariffs
2. Subsidies
    - Discourage foreign imports
    - Gaining export markets
3. 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 licence
    - 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.

Trade barriers

- Implications of trade barriers
  - Are arbitrary and discriminatory and subjectively applied :- may breed counter tariffs
  - Require special training, supervision and administration
  - Add to the microeconomic problems
  - Encourage special-interest privileges:- breed concessions to trade allies and outcasts the rest
  - Increase government intervention both on business and households

Global Financial management

- **Scope of multinational financial management**
  - Capital budgeting
  - Capital structure
  - Working capital management
- **Cash and liquidity levels are determine through 3 motives**
  - The transaction motive
  - The precautionary motive
  - The speculative motive
- **Positioning funds optimally**
  - Transfer pricing
  - Multilateral netting
  - Tax havens
  - Fronting loans

Types of foreign exchange risk

- Translation exposure / accounting exposure
  - Effects on financial statements of foreign subsidiaries translated into parent company statements
- Transaction exposure
  - Effects of foreign exchange on current cash flow/ working capital
- Economic exposure
  - Effects of foreign exchange on future cash flow

International investment and capital budgeting

- 3 major areas of decision making for financial management
  - Capital budgeting
  - Capital structure
  - Working capital management
- Capital budgeting: both foreign investment and domestic capital budgeting use same theoretical framework, however for international investment, the following are considered vital
  1. A distinction must be made between cash flows to the project and cash flow to the parent company
  2. Cash flow to the parent company often depend on the form or source of financing for the project.
  3. 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
  4. Differing rates of inflation between countries could affect competitive positions and thus affect the extent and value of cash flow over time
  5. 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
  6. Capital structure decisions and calculation of cost of capital (discount rate) are complicated, especially where host country subsidised loans are used for project financing.
  7. 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
  8. 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

Risks related to capital budgeting

- Political risks:
  - Imposition of of foreign trade and investment barriers
  - Exchange controls
  - Regulation blocking the remittance of earnings to parent companies
  - New tax regimes and increased tax rates
- Economic risks:
  - Possible mismanagement of country's economy that could adversely affect the profitability growth and survival of the businesses in that country
  - Inflation leads to depreciation of the currency of that country
  - Reliable information on macroeconomic trends have to be evaluated with the view to their possible impact on cash flows expected from projects in that country
- Approaches to risk adjustment
  - Treat all foreign risk as single issue by increasing discount rate applicable to foreign projects relative to the rate for domestic projects
  - Adjust all relevant cash flow forecasts of the investment or project to pertinent foreign risk

Structure of the Exam

- Exam paper has two sections

1. Section A (20 marks)
   - 20 multiple choice questions
2. Section B (50 marks)
   - 3 Essay type questions (25 marks each)
   - Choose any 2 of the 3 questions

Thank you