

Tutorial letter 202/1/2015

Global Business Environments

MNI3701

Semester 1

Department of Business Management

IMPORTANT INFORMATION:

This tutorial letter contains important information about your module.

BAR CODE

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1 INTRODUCTION

This tutorial letter seeks to provide guidelines on how you were expected to answer the five short essay questions contained in Assignment 02. You are urged to study these guidelines together with the corresponding references in your textbook and study guide. Should you have any queries, please feel free to contact one of your lecturers.

2 COMMENTS ON ASSIGNMENT 02 SEMESTER 01, 2015

Unlike Assignment 01, which focuses on multiple choice questions, Assignment 02 requires students to produce written short essays, in response to the questions set. These questions require carefully written answers. The written format requires a response similar to what will be expected from you when writing the forthcoming semester examination. Therefore, it is a preparation and revision for the semester examination.

Unfortunately, many students struggle with the written format required in response to examination questions. Hence, the nature and type of questions presented in this assignment, is an attempt to expose you to the type of examination questions you can anticipate in the semester examination.

You are, therefore, urged to ensure that you are comfortable with these answers, and that you agree with the material they encapsulate.

3 ASSESSMENT CRITERIA FOR ASSIGNMENT 02 SEMESTER 01, 2015

Question 1:

Tax incentives are designed by many governments to attract foreign direct investment (FDI). Discuss the SIX types of tax incentives, their advantages, and their disadvantages.

(10 marks)

Answer:

Tax incentives frequently serve to attract investments to a particular destination. Often FDIs are attracted to such destinations. These incentives are frequently designed according to a country's specific tax regime and tax treaties with other countries. The overall purpose is to offer investors the opportunity to minimise their tax liability.

Tax incentives are designed to induce investors to invest in a particular locale by:

- impacting the size, location or specific industry that investors could target;
- influencing the cost and potential profitability of the investment;
- influencing the risks attached to such an investment.

Incentives are particularly appropriate for this purpose, relative to other factors such as the: influence of macro-economic fundamentals, the availability of natural resources, market size, level of income, skills development, infrastructure availability and political and economic stability. These considerations are particularly applicable to understanding FDI profiles in response to incentives.

Pivotal to understanding decisions that drive the direction of FDIs, is the need to understand the various types of tax incentives. These are articulated in the textbook (Aregbeshola, et al, 2011:214-215).

They include the following:

- Lower corporate income tax rates.

- Tax holidays.
- Investment allowances and tax credits.
- Exemptions from indirect taxes.
- Export processing zones.

The advantages and disadvantages pertaining to these incentives can be tabulated as follows:

ADVANTAGES	DISADVANTAGES
<ul style="list-style-type: none"> • <u>Lower corporate tax rates</u> <ul style="list-style-type: none"> - Simplicity of administration. - Revenue costs more transparent. 	<ul style="list-style-type: none"> • <u>Lower corporate tax rates</u> <ul style="list-style-type: none"> - High return firms benefit. - Tax avoidance through transfer pricing. - Existing investment benefit disproportionate. - Dubious as to how home country tax authorities benefit.
<ul style="list-style-type: none"> • Tax holidays <ul style="list-style-type: none"> - Simplicity of administration. - Tenuous contact with tax administration. 	<ul style="list-style-type: none"> • Tax holidays <ul style="list-style-type: none"> - Tend to focus on short term projects. But at the expense of tax avoidance. - Distorts competition. - Costs of reporting revenue distorted.
<ul style="list-style-type: none"> • <u>Accelerated depreciation</u> <ul style="list-style-type: none"> - Same benefits as investment allowances. - Non-discriminatory in terms of fixed assets. - Taxable income now closer to consumption-base. 	<ul style="list-style-type: none"> • <u>Accelerated depreciation</u> <ul style="list-style-type: none"> - Administrative burden tedious. - Discriminatory in terms of investments with delayed returns.
<ul style="list-style-type: none"> - <u>Exemption from indirect taxes</u> <ul style="list-style-type: none"> - Minimum contact with tax administration. 	<ul style="list-style-type: none"> • <u>Exemption from indirect taxes</u> <ul style="list-style-type: none"> - Indirect taxes have limited benefits. - Prone to abuse.

<ul style="list-style-type: none"> • <u>Export processing zones</u> <ul style="list-style-type: none"> - Contact with tax administration is nil. Beneficial if tax administration is corrupt. 	<ul style="list-style-type: none"> • <u>Export processing zones</u> <ul style="list-style-type: none"> - It distorts location decisions. - Results in tax leakage, in respect of untaxed goods in the market.
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You are expected to discuss the content of this table in detail.

Question 2:

Leaders can have many attributes which may vary across cultures as leadership can be influenced by cultural differences.

- 2.1 What are these differences?
- 2.2 How do they influence leadership?

(20 marks)

Answer:

2.1 Cross-cultural, leadership differences.

International leadership is undoubtedly influenced by cultural differences, as manifested across international borders. Indeed, the attributes that are seen as characteristic of leaders vary across cultures, reflecting as they do different value systems. This raises questions as to the management of cultural diversity. These cross-cultural leadership differences can be enumerated as follows:

- Perceptual differences peculiar to national cultures.
- Attitudinal differences relating to preferred and distinctive leadership styles, which impact on styles of decision-making. These differences are often dissipated to make them manageable. Frequently, this leads to national and corporate cultures being tightly interwoven, making it increasingly difficult to distinguish between the two.
- Cultural differences also impact on the motivation and control of staff.

- Distinguishing attitudes towards universalism and particularism: with universalism stressing performance in the workplace, while particularism emphasises good relationships.
- Cultural diversity presupposes disparate worldviews. The difference between outer-directed and inner-directed leaders affects their worldviews. It impacts on practices such as strategy formulation/implementation, staff recruitment, development and retention and business/government relations.
- Cross-cultural differences frequently reflect differences in attributes and skills. Such differences usually influence managerial and leadership behaviour, relative to culturally disparate subordinates.
- Differences in attitudes influence task-orientated and relationship-orientated behaviour. These differences are cross-culturally determined.
- Cultural differences invariably impact assumptions as to what leadership styles should be implemented in a given, cross-cultural situation. This implies a preferred type of leadership style, relative to a given cross-cultural situation.

2.2 Leadership practices and cross-cultural differences

The question raised in this regard is “What differences do cultural disparities make in the area of international leadership styles and practices”? The following is noteworthy:

- The distinctiveness of a particular style of leadership, for example charismatic, transformational and transactional, begs the question as to which style is the most appropriate for international business.
- The adoption of specific leadership practices, styles and behaviour, in a particular cultural setting and workplace, calls for a distinctive approach to managing the dynamics in such a workplace. For instance, the prevalence of Ubuntu in the South African workplace warrants the acknowledgement of community relationships, reflecting the reality of group solidarity. This is in direct contrast to the leadership styles of many white, South African managers.
- Cultural differences imply the need for international managers to be well-informed as to the impact of such differences in the workplace.
- Such differences could impact the employment practices of MNEs, for example, whether they should resort to the practice of ethnocentrism or not.

- Cultural disparities could impact on the level of formality governing relationship between managers and subordinates in MNEs. For example, in some cultures, subordinates are encouraged to be informal in their relationships with superiors in other cultural settings. This cannot be condoned.
- Due to the impact of cultural differences on the “concept of time” and the use of social
- networks, it is important that international leaders familiarise themselves with these finer cultural nuance.

Question 3:

Four possible international strategies are available to a multinational enterprise (MNE). These are international, multi-domestic, global and transnational strategies. Discuss the key characteristics of each strategy.

(15 marks)

Answer:

The key characteristic of each strategy can be listed and described as follows:

3.1 International strategies

Firms pursuing international strategies, do so in response to low cost pressures and low pressures for local responsiveness. This amounts to taking products first produced for their domestic market and selling them internationally, with minimum local customisation. Microsoft is a good example of an MNE pursuing this strategy, which enables it to market its software, as part of a valuable core competency that foreign markets lack. It does so because of relatively weak pressures for local responsiveness and cost reductions.

The pursuance of this strategy presupposes the following:

- MNEs have no need to achieve economies of scale.
- A tendency to centralise Research and Development and product development at home.
- Gradually establishing manufacturing and marketing functions, over time, in each host country, where they are involved.
- Limiting local customisation of products in different foreign markets.

- Retaining head office control over product and market strategies.

3.2 Multi-domestic strategies

This presupposes strong pressures for local responsiveness, but not cost reduction: implying that the pursuance of this strategy enables MNEs to focus on increasing profitability by customising the firm's goods and services so that they provide a good match to tastes and preferences in different national markets.

By customising the product offerings to local demands, MNEs increase the value of that product in the local market; but, without compromising in the area of cost reduction. Indeed cost reduction often becomes difficult to achieve, due to: smaller production runs, and customization limitations, which would not be the case with mass production.

The South African mobile operator, MTN, exhibits many of the following key characteristics which are noteworthy, in the pursuance of this strategy.

- Customisation and adaptation of products in peculiar to the needs of each foreign market.
- The dearth of opportunities to realise economies of scale.
- Duplication of functions frequently occurs in each foreign market.
- Each foreign market yields its own peculiar competitive advantages.
- Decision-making is frequently decentralised, as a subsidiaries function.
- Independently in each market, with the co-ordination of sales and marketing taking place in each national market.
- Limited organisational learning and limited leveraging of core competencies.
- Cost structures are often higher across foreign markets, resulting in price differentials.

3.3 Global strategies

These are characterised by a strategic response to strong pressures for cost reduction, but where demands for local responsiveness are minimal.

This strategy enables MNEs to focus on increasing profitability and profit growth by reaping cost reductions that come from economies of scale, including location economies.

Their strategic goal is to pursue a low cost strategy on a global scale.

Key characteristics of a global strategy include the following:

- Mutually interdependent subsidiaries.
- The marketing of standardised products to price-sensitive consumers.
- Global co-ordination of sales and branding.
- Centralised decision-making, control and reporting activities for functions such as production, marketing and research and development.

Coca-Cola would exemplify these characteristics with its strong control of product development, intellectual property and branding functions. Only limited localisation of these functions is allowed.

3.4 Transnational strategies

MNEs which simultaneously face both strong cost pressures and strong pressures for local responsiveness need to balance these competing and inconsistent demands arising from such divergent pressures. The general response to these divergent pressures is for MNEs – in this situation – to pursue a transnational strategy.

Many argue that MNEs have no choice but to resort to whatever it takes to deal with multiple pressures and challenges emanating from the global business environment, notably, cost and local responsiveness pressures. This means that they must try and realise location economies and experience effects leverage their products internationally, transfer core competencies and skills, while paying attention to local responsiveness.

Those pursuing a transnational strategy are trying to achieve low costs through location economies, economies of scale and learning effects. To this end, they differentiate their product offerings across geographical markets to account for local differences, fostering a multi-directional flow of skills between different subsidiaries in the MNE's global network of operations.

Therefore, the implementation of transnational strategies is marked by key characteristics, including the following:

- The establishment of production facilities in a few favourable locations, so as to focus on customisation while pursuing low costs.

- Centralised and decentralised decision-making: due to the necessity of managing trans-
- national strategies with the aid of matrix organisational structures. Caterpillar exemplifies this approach.

Question 4:

Many factors need to be considered when deciding on where to manufacture products on an international scale. The key factors are product, country and technological factors. Elaborate on the country factors in this regard.

(15 marks)

Answer:

Country factors play a pivotal role when it comes to locational decision-making, with reference to where to locate a manufacturing facility. These decisions are circumscribed by the need to minimise costs and improve product quality. Together with the influence of technological factors, country factors have a significant bearing on this decision. Therefore, there is a need to elaborate on these factors as follows.

They include the following:

- Differences in factor costs: some countries have a comparative advantage in producing certain products.
- Differences in the political economies and national cultures of countries influence the benefits, costs and risks of doing business in a country. This has an impact on the prospect of achieving location economies in the process. MNEs should, therefore, locate their manufacturing activities, where the economic, political and cultural conditions, including relative factor costs, are conducive to the performance of these activities.
- The presence of a global concentration of activities at certain locations.
- Location externalities and their role in influencing FDI decisions.
- Externalities include the presence of an appropriate skilled labour pool and supporting industries. Such externalities can play an important role in deciding where to locate manufacturing activities.

- The prevalence of formal and informal trade barriers, being the result of restrictive trade policies.
- Transportation costs, which differ significantly from one country to another.
- Foreign direct investment (FDI) rules and regulations, which differ from one country to the next.
- Future movements in exchange rates: instability in this regard, could affect location costs.

Question 5:

Capital budgeting is more complex for international investments than for purely domestic investments. Discuss the vital considerations that need to be taken into account before opting for capital budgeting.

(10 marks)

Answer:

Capital budgeting quantifies the benefits, costs and risks of an investment. This allows for the comparison of different investment alternatives, within and across countries. Because of the risks involved in international investment decisions, capital budgeting for foreign investments is circumscribed by a number of vital considerations, including the following:

- The need to make distinctions between project cash flows and parent company cash flows.
- The fact that it is not always possible to distinguish between operating cash flows and financial cash flows.
- The reality of funds being remitted to the parent company must be, explicitly recognised, on account of different tax systems in different countries.
- The prevalence of differential inflation rates between countries could affect the parent company's competitive position, insofar as the extent of project cash flows over time, are concerned.
- The reality of unpredictable foreign exchange rate changes, which will affect the value of project cash flows, relative to parent company expectations.
- The necessity of capital structure and cost of capital calculations, in respect of host

country loans used for project financing, can be complicated.

- The threat of political risks can have an impact on project cash flows.
- Terminal values pertaining to the project are difficult to estimate, due to differences in opinions and assumptions as to the actual value of the project.

4 CONCLUSION

The material you have been exposed to in this tutorial letter constitutes the basis for the assessment of the various short essay questions that you were required to respond to. Obviously, this material is not exhaustive. Rather, it is an attempt to point you to the most salient points pertaining to the various questions. You must follow up on this material by referring to your prescribed textbook and study guide.

We trust that you have found this tutorial letter useful and conducive to preparing for your forthcoming semester examination. We wish you success for this examination.

Your lecturers in Global Business Environments