CORE- XV

INTERNATIONAL BUSINESS MANAGEMENT

SUB CODE 18MTT42C

UNIT 2

INTERNATIONAL BUSINESS ENVIRONMENT

Meaning of International Business Environment Environment means the surrounding. International business environment means the factors/activities those surround/ encircle the international business. In other words, business environment means the factors that affect or influence the MNCs and transactional companies. Factors that affect International Business include Social and Cultural factors (S), Technological factors (T), Economic factors (E), Political/Governmental factors (P),. International factors (I) and Natural factors (N). (STEPIN) William F. Glueck defined the term environmental analysis as, “the process by which strategists monitor the economic, governmental/legal, market/competitive, supplier / technological, geographic and social settings to determine opportunities and threats to their firms.” “Environmental diagnosis consists of managerial decisions made by analysing the significance of data (opportunities and threats) of the environmental analysis

ECONOMIC, POLITICA,L LEGAL AND TECHNICAL ENVIRONMENT

ECONOMIC ENVIRONMENT

The economic environment relates to all the factors that contribute to a country's attractiveness for foreign businesses. The economic environment can be very different from one nation to another. Countries are often divided into three main categories: the more developed or industrialized, the less developed or third world, & the newly industrializing or emerging economies.

Within each category, there are major variations, but overall the more developed countries are the rich countries, the less developed the poor ones, & the newly industrializing (those moving from poorer to richer). These distinctions are generally made on the basis of the gross domestic product per capita (GDP/capita). Better education, infrastructure, & technology, healthcare, & so on are also often associated with higher levels of economic development.

Clearly, the level of economic activity combined with education, infrastructure, & so on, as well as the degree of government control of the economy, affect virtually all facets of doing business, & a firm needs to recognize this environment if it is to operate successfully internationally. While analyzing the economic environment, the organization intending to enter a particular business sector may consider the following aspects:

- An Economic system to enter the business sector.
- Stage of economic growth & the pace of growth.
- Level of national & per capita income.
- Incidents of taxes, both direct & indirect tax
- Infrastructure facilities available & the difficulties thereof.
- Availability of raw materials & components & the cost thereof.
- Sources of financial resources & their costs.
- Availability of manpower-managerial, technical & workers available & their salary & wage structures.

POLITICAL ENVIRONMENT

The political environment refers to the type of the government, the government relationship with a business, & the political risk in the country. Doing business internationally, therefore, implies dealing with a different type of government, relationships, & levels of risk.

There are many different types of political systems, for example, multi-party democracies, one-party states, constitutional monarchies, dictatorships (military & non-military). Therefore, in analyzing the political-legal environment, an organization may broadly consider the following aspects:

- The Political system of the business;
- Approaches to the Government towards business i.e. Restrictive or facilitating;
- Facilities & incentives offered by the Government;
- Legal restrictions for instance licensing requirement, reservation to a specific sector like the public sector, private or small-scale sector;
- The Restrictions on importing technical know-how, capital goods & raw materials;
- The Restrictions on exporting products & services;
- Restrictions on pricing & distribution of goods;
- Procedural formalities required in setting the business

TECHNOLOGICAL ENVIRONMENT

The technological environment comprises factors related to the materials & machines used in manufacturing goods & services. Receptivity of organizations to new technology & adoption of new technology by consumers influence decisions made in an organization.

As firms do not have any control over the external environment, their success depends on how well they adapt to the external environment. An important aspect of the international business environment is the level, & acceptance, of technological innovation in different countries.

The last decades of the twentieth century saw major advances in technology, & this is continuing in the twenty-first century. Technology often is seen as giving firms a competitive advantage; hence, firms compete for access to the newest in technology, & international firms transfer technology to be globally competitive.

- Level of technological development in the country as a whole & specific business sector.
- The pace of technological changes & technological obsolescence.
- Sources of technology.
- Restrictions & facilities for technology transfer & time taken for the absorption of technology.

CULTURAL ENVIRONMENT

The cultural environment is one of the critical components of the international business environment & one of the most difficult to understand. This is because the cultural environment is essentially unseen; it has been described as a shared, commonly held body of general beliefs & values that determine what is right for one group, according to Kluckhohn & Strodtbeck.

National culture is described as the body of general beliefs & the values that are shared by the nation. Beliefs & the values are generally seen as formed by factors such as the history, language, religion, geographic location, government, & education; thus firms begin a cultural analysis by seeking to understand these factors. The most well-known is that developed by Hofstede in1980.

His model proposes four dimensions of cultural values including individualism, uncertainty avoidance, power distance & masculinity.

LEGAL ENVIRONMENT

The legal system refers to the unique systems of regulations, laws and rules that affect the choices made by individuals in any society and that govern the ways these individuals are responsible for their decisions and actions. For the MNC, of more importance is the international business law system representing the law and rules of any nation that affect the types of business decisions made in that country.

TYPES OF LEGAL SYSTEM

Different types of legal system can be divided into the following categories:

- **Common Law:** which is practiced in Great Britain and its former colonies, for example, the United States, is more susceptible to challenge, change, and amendment. The common law system is based not on federal administration but on judicial interpretation of the law as well as on customs or usages existing within the nation. Under common law, decisions made by the court are based on preceding judicial judgments rendered by prior courts.

- **Statutory law**: Common law countries depend not only on case law but also on statutory law (legislation) the law passed by the government. This can also be a source of legal variation between countries. For example, the US Freedom of information Act is more far reaching than similar UK legislation, so that transactions between the government and companies have to be more transparent in the USA than in UK.

- **Code law**: This is the world's most common system. It is explicit codification in written terms of what is and what is not permissible. Such laws can be written down in criminal, civil and commercial codes, which are then used to determine the outcome of all legal matters.

- **Religious law** This law is based on the officially established rules governing the faith and practice of a particular religion. A country that applies religious law to civil and criminal conduct is called a theocracy. In Iran, for example, a group of mullahs, or holy men, determine the legal it or illegal it through their interpretation of the Koran, the holy book of Islam. Religious laws can create interesting problems for firms. Consider the teaching of the Muslim holy book, the Koran, which denounces charging interest on loans as an unfair exploitation of the poor. Muslim firms and financial institutions have had to develop alternative financing arrangements to acquire and finance capital

Bureaucratic law: which is practiced in many communist countries as well as dictatorships, is law that is set by the country's current leadership. This law is subject to change rapidly, when regimes change. In the summer of 2003, the citizens of Hong Kong feared that the Chinese government would impose an antisubversion law on the island, as is in place on the mainland. This law, which could be used to quell future protests in Hong Kong, contradicted the concept of "one nation, two systems" that has existed between China and Hong Kong since China took over possession of the island from Great Britain in 1997.

GLOBAL ECONOMIC INSTITUTION

The most radical changes have happened on the economic front in the last two decades, which have changed the entire mathematics of international business environment. The political events such as the disintegration of USSR have made the world a multi-polar entity. At the same time, the technological advances, particularly those in the field of information technology have made the world a smaller place. The strengthening of the global economic institutions, particularly WTO has led to a major integration of the nations. However, the main driving force behind these developments remains the economic environment. Irrespective of the nature and size of business, no business entity is left insulated from the global changes. The competition is right on the door of every business. Therefore, anyone aspiring to excel in business, no business entity is left insulated from the global changes. The competition is right on the door of every business. Therefore, anyone aspiring to excel in business needs to understand these economic environmental variables and master, with dexterity, the techniques to gain maximum advantage out of them. The most profound of the changes is the dislocation of local competition.

Some of major changes in the past decades are:

- Capital movement rather than trade have become the driving force of the world economy.
- Production has become disassociated from employment.
- Primary products have lost their traditional association from the industrial economy.
- The economics seems to have a greater influence on the politics, than vice versa
- The ideology of nation controlling the economy is primarily rejected.

There is a realization of the benefits of free market economy. The established principles of economics have been redefined and we understand the economics of interdependence and cooperation instead of protectionism. The old rules of competition are also undergoing a change. From a direct head on confrontation, the businesses are developing the niches where each of the players grows and excels.

MACROECONOMIC TRENDS

This unit focuses only on the most recent economic situation, particularly the status in the last five years. The students are advised to refer to standard text books on the subject to have an overview of the economic situation of the yesteryears. Focusing on the years gone by shall divert the focus of this unit.

The present status of the world economy can best be defined as beginning on a strong note. As a number of major developed economies managed to rebound from the notable's slowdown in late 2005, many developing countries maintained the momentum of broad and solid growth. A measurable moderation is expected, however, in the second half of

2006, with the annual growth of world gross product (WGP) for 2006 as a whole at about 3.6 per cent the same pace as in 2005 and marginally. The global projections are based on the weighted average of projected individual-country growth rates using the gross domestic product (GDP) valued in 2000 dollar prices for each country. Other global projections tend to use GDP valued in purchasing power parity (PPP) dollars. When using those weights, the United Nations global forecast for world economic growth would be 4.8 per cent for 2006.

IMF – WORLD BANK –UNCTAD – WTO-

4 MAJOR INTERNATIONAL ECONOMIC INSTITUTIONS

Almost every country exports and imports products to benefit from the growing international trade.

The growth of international trade can be increased, if the countries follow a common set of rules, regulations, and standards related to import and export.

These common rules and regulations are set by various international economic institutions. These institutions aim to provide a level playing field for all the countries and develop economic cooperation.

These institutions also help in solving the currency issues among countries related to stabilizing the exchange rates. There are three major international economic institutions, namely, WTO, IMF, and UNCTAD.

WORLD TRADE ORGANIZATION:

WTO was formed in 1995 to replace the General Agreement on Tariffs and Trade (GATT), which was started in 1948. GATT was replaced by WTO because GATT was biased in favor of developed countries. WTO was formed as a global international organization dealing with the rules of international trade among countries.

The main objective of WTO is to help the global organizations to conduct their businesses. WTO, headquartered at Geneva, Switzerland, consists of 153 members and represents more than 97% of world's trade.

The main objectives of WTO are as follows:

a. Raising the standard of living of people, promoting full employment, expanding production and trade, and utilizing the world's resources optimally

b. Ensuring that developing and less developed countries have better share of growth in the world trade

c. Introducing sustainable development in which balanced growth of trade and environment goes together

The main functions of WTO are as follows:

a. Setting the framework for trade policies

b. Reviewing the trade policies of different countries

c. Providing technical cooperation to less developed and developing countries

d. Setting a forum for addressing trade-related disputes among different countries

e. Reducing the barriers to international trade

f. Facilitating the implementation, administration, and operation of agreements

g. Setting a negotiation forum for multilateral trade agreements

h. Cooperating with the international institutions, such as IMF and World Bank for making global economic policies

WTO has the following advantages:

(a) Promoting peace within nations:

Leads to less trade disputes. WTO helps in creating international cooperation, peace, and prosperity among nations.

(b) Handling the disputes constructively:

Helps in lesser trade conflicts. When the international trade expands, the chances of disputes also increase. WTO helps in reducing these trade disputes and tensions among nations.

(c) Helping consumers by providing choices:

Implies that by promoting international trade, WTO helps consumers in gaining access to a large number of products.

(d) Encouraging good governance:

Accelerates the growth of a country. The rules formulated by WTO encourage good governance and discourage the unwise policies that lead to corruption in a country.

(e) Stimulating economic growth:

Leads to more jobs and increase in income. The policies of WTO focus on reducing trade barriers among nations to increase the quantum of import and export.

INTERNATIONAL MONETARY FUND:

IMF, established in 1945, consists of 187 member countries. It works to secure financial stability, develop global monetary cooperation, facilitate international trade, and reduce poverty and maintain sustainable economic growth around the world. Its headquarters are in Washington, D.C., United States.

The objectives of IMF are as follows:

a. Helping in increasing employment and real income of people

b. Solving the international monetary problems that distort the economic development of different nations

c. Maintaining stability in the international exchange rates

d. Strengthening the economic integrity of the nations

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT:

UNCTAD, established in 1964, is the principal organ of United Nations General Assembly. It provides a forum where the developing countries can discuss the problems related to economic development. UNCTAD is headquartered in Geneva, Switzerland and has 193 member countries.

The conference of these member countries is held after every four years. UNCTAD was created because the existing institutions, such as GATT, IMF, and World Bank were not concerned with the problem of developing countries. UNCTAD's main objective is to formulate the policies related to areas of development, such as trade, finance, transport, and technology.

The main objectives of UNCTAD are as follows:

a. Eliminating trade barriers that act as constraints for developing countries

b. Promoting international trade for speeding up the economic development

c. Formulating principles and policies related to international trade

d. Negotiating the multinational trade agreements

e. Providing technical assistance to developing countries specially low developed countries

It is important to note that UNCTAD is a strategic partner of WTO. Both the organizations ensure that international trade helps the low developed and developing countries in accelerating their pace of growth. On 16th April, 2003, WTO and UNCTAD also signed a Memorandum of Understanding (MoU), which identifies the fields for cooperation to facilitate the joint activities between them.

Regional Economic Integration:

Economic institutions, such as WTO, IMF, and UNCTAD aim at promoting economic cooperation worldwide. A similar effort is made regionally through regional economic integration that is an agreement between the countries to expand trade with mutual benefits. Regional economic integration involves removing trade barriers and coordinating the trade policies of the countries.

It occurs because of various reasons, which are mentioned as follows:

(a) Shared culture:

Involves similarity in language, religion, norms, and traditions of the countries that prompt them to trade with each other. This commonality facilitates the smooth flow of communication among countries. Same language of the countries helps the organizations to understand the complexities of the targeted markets.

(b) History of political and economic dominance:

Affects the integration among the countries. For instance, the rule of Britishers has introduced the English language in India that later became a widely used language. Thus, former colonial power facilitates the shared culture and language. It is easy for organizations to target the markets, if culture and language is similar.

(c) Regional closeness:

Helps in maintaining strong economic relationships among the countries. The countries with same border have access to effective and direct transportation that increases the probability of trade between them.

Regional economic integration is done through various agreements.

INTERNATIONAL COMMODITY TRADING AND AGREEMENT

Commodity agreements

The market for commodities is particularly susceptible to sudden changes in the conditions of supply conditions, which are called supply shocks. Shocks such as bad weather, disease, and natural disasters are largely unpredictable, and cause commodity markets to become highly volatile. In comparison, markets for the final products derived from these commodities are much more stable.

As with petrol pump prices, the prices of finished goods rarely reflect changes in the prices of basic commodities from which they are derived. For example, cocoa and sugar prices fluctuate considerably as harvests vary from year to year, but the prices of confectionery rarely change from year to year. There are many reasons for this, including the following:

1. The cost of the commodity input, such as cocoa, represents a small proportion of total costs of the final product, such as a bar of chocolate. The price of chocolate is largely determined by the refining, manufacturing, and packaging costs of the manufacturer, and the retailer's costs including labour, rents and marketing costs.
2. Indirect taxes, like VAT, often form a larger proportion of the price than commodity costs, and such indirect taxes tend to remain stable of time.

3. The existence of stocks of commodities act as a buffer against sudden changes in commodity prices, so manufacturers will be using old stocks purchased at the old prices.
4. Futures contracts help reduce some of the underlying volatility in commodity markets. In the case of cocoa, the large confectioners, such as Nestle and Cadbury-Schweppes, agree cocoa prices in advance by fixing contracts with suppliers, such as those based in the Ivory Coast and Ghana, the two largest cocoa exporters.
5. Manufacturers and retailers may choose not to pass on cost changes following commodity price changes for a number of reasons, such as a preference for stable prices, or the need to remain price competitive.

COMMODITY AGREEMENTS

Commodity agreements are arrangements between producing and consuming countries to stabilise markets and raise average prices. Such agreements are common in many markets, including the market for coffee, tea, and sugar.

Example – The International Cocoa Agreement

In 2003, an agreement was made between the seven main cocoa exporting countries, Cameroon, Ivory Coast, Gabon, Ghana, Malaysia, Nigeria and Togo, and the main importing countries including the EU members, Russia, and Switzerland. The main purpose of this agreement was to promote the consumption and production of cocoa on a global basis as well as stabilise cocoa prices, which had been falling steadily. The agreement was planned to continue until 2010, but in that year it was decided to extend the agreement for a further two years, until 2012. In 2012 the signatories decided on a further extension, until 2026.

Commodity agreements often involve intervention schemes, such as buffer stocks, and usually only last for a few years, whereupon they are re-negotiated. They differ from cartels such as OPEC, largely because discussions and negotiations involve both producer and consumer countries, unlike cartels, which are established to protect the interest of producers only.

INTERNATIONAL COMMODITY AGREEMENTS (ICA) International commodity agreements are inter-governmental arrangements concerning the production and trade of certain primary products. Many developing countries which have embarked upon ambitious development programmes are in need of large foreign exchange resources to finance some of their development requirements like capital goods imports. But they have been facing the important problem of wide-fluctuations in the export prices of the primary goods i.e. agricultural products and minerals, which form a major part of their total exports. Apart form making the export earnings unstable, it has also been causing a deterioration in their terms of trade. Hence, there has been a growing demand for adopting stabilization measures to protect especially the interests of developing countries. International commodity agreements, it is believed, can help stabilize prices of the respective commodities.

Objectives of ICA The main objectives of the international commodity agreements are:-

1. Price Stabilization: Price stabilization is a very important purpose for which commodity agreements have been entered into.

2. The Promotion of Health and Morals: The outstanding example of international agreements for the purpose of promoting health and morals is the international regulation of trade in opium and narcotics. 3. Security Objectives: Inter governmental commodity agreements may also be useful as a preventive of war by preventing scramble for scarce strategic materials for national stock-piling or other security purposes.

4. The Conservation of Resources: The conservation of natural resources is a direct or indirect objective of nearly all international raw material schemes.

5. The management of surplus: Commodity agreements are sometimes entered into to manage the surplus during times of bumper crops, there may arise a problem of surplus. Such should be properly handled to avoid serious adverse effects on price and also to hold stock for the lean period.

FORMS OF COMMODITY AGREEMENTS

Commodity Agreements may take any of the four forms, namely, quotas, buffer stock, bilateral contract, and multilateral contract.

I. Quota Agreements:

International quota agreements seek to prevent fall in commodity price by regulating their supply under the quota agreement. Export quota are determined and allocated to participating countries according to some mutually agreeable formula and they undertake to restrict the export or production by a certain percentage of the basic quota as decided by the central committee or council. For instance, the coffee agreement among the major producers of Latin America and Africa limits the amount that can be exported by each country Quota agreements have already been tried in case of coffee and sugar, and commodities like tea and bananas have been suggested as prospective candidates for new agreements.

II. Buffer Stock Agreements: International Buffer Stock Agreements seek to stabilize the commodity prices by maintaining the demand-supply balance.

Buffer stock agreements stabilize the price by increasing the market supply by selling the commodity when the price tends to rise and by absorbing the excess supply to prevent a fall in the price. The buffer stock plan, thus, requires an international agency to set a range of prices and to buy the commodity at the minimum and sell at the maximum. The buffer pool method has already been tried in case of Tin, and Sugar, and commodities like Rubber, Tea and Copper have been suggested as prospective candidates for new agreements. The buffer stock arrangement, however, has certain limitations. It can be effected only in case of those products, which can be stored at relatively low cost without the danger of deterioration. Further, large financial resources and stock of the commodity are required to launch the programme successfully.

III. Bilateral/Multilateral Contracts: Bilateral contract to purchase and sell certain quantities of a commodity at agreed prices may be entered into between the major importer and exporter of the commodity. In such an agreement, an upper price and a lower price are specified. If the market price throughout the period of the agreement remains within these specified limits, the agreement becomes operative. But, if the market price rises above the upper limit specified, the exporting country is obliged to sell to the importing country a certain specified quantity of the commodity at the upper prices fixed by the agreement.

ETHICAL ISSUES IN INTERNATIONAL MANAGEMENT

Even the ethical issues differ from one country to another. A specific practice that is considered ethical in one country may be unethical in another country. The managers who are with multinational companies should be very careful and have the knowledge about the ethical and unethical values and should select only the ethical actions.

Some of the most common ethical issues that arise in multinational companies are with respect to human rights, corruption, environmental norms, practices of employment, moral aspects etc.

Employment Practices and Ethics

In most of the countries, employment practices may lead to ethical issues. Some of the specific conditions of one country may be considered as inferior in other countries where the multinational companies have their setups. It is suggested by many of the experts to have similar norms with regard to pay and work but this concept is not worked by any one.

Some of the employment norms are common in developing countries such as 12-hour workdays, minimal pay, daily minimum wages to the employees, protection coverage for workers in chemical companies etc. To what extent that the multinational companies follow the norms of the country in which they are being operating is the main concern.

Human Rights

Some of the basic human rights are not accepted in many countries. The human rights that are not universally accepted are freedom of speech, freedom from political repression, freedom of association etc.

One of such well-known illustration is the case of South Africa during the period when whites were ruling. Some of the basic political rights were denied from practicing for non-white people and a majority of south Africa constituted non-whites. Whites were provided with many privileges. The businesses that prevailed in South Africa were mostly from western countries. This lasted till the recent times of 1994. It is still not completely removed and this is practiced in some of the parts of South Africa.

Environmental Pollution

Ethical issues with respect to environmental pollution arise when the concerned regulations of the host country seems to be much inferior to the regulations of the home country. With regard to emission of waste and pollution, many regulations have been framed by all the countries. But these regulations may not be that strict in developing countries because when multinational companies of the host countries.

It is not fair on the part of multinational companies to pollute the developing countries. The MNCs should follow the environment pollution norms and take appropriate measures as per the government regulations with respect to the pollution in the host country and as per the regulations of the host country and after clearing the environment norms laid out by the respective governments.

Corruption

Corruption is also a major ethical issue in almost all the countries and is still prevailing. Corruption is in the government itself in all the countries. As these officials attract towards bribe, most of the international businesses bribe these officials and obtain the business and financial advantage, this act is completely unethical.

Moral Obligations

Some of the modern philosophers argue that the power of MNCs brings with it the social responsibility to give resources back to the societies. The idea of Social Responsibility arises due to the philosophy that business people should consider the social consequences of their actions.

They should also care that decisions should have both meaningful and ethical economic and social consequences. Social responsibility can be supported because it is the correct and appropriate way for a business to behave. Businesses, particularly the large and very successful ones, need to recognize their social and moral obligations and give resources and donations back to the societies.