

WEEK 1: THE INTERNATIONAL BUSINESS ENVIRONMENT - DIFFERENCE IN POLITICAL ECONOMY

Learning outcomes

- ❖ Classify the key features and issues in the global environment in which international business takes place;
- ❖ Explain the impact that the environment has on the internationalisation process of a business organisation; and
- ❖ Demonstrate an understanding of the role of entry mode choice and other strategic issues in order to succeed in international business

What is an international business?

Any firm that engages in international trade or investment

- International business differs from domestic business due to:
 - National culture
 - Political, economic, and legal systems
 - Labour and environmental standards
 - Foreign exchange
- It is also about:
 - The study of trade theory and the environment faced by firms as they look to internationalise
 - The strategies and entry modes pursued by firms as they seek to internationalise (expand from being a local firm to going international)

The political economy

- How the political, economic, and legal systems of a country are interdependent
 - They interact and influence each other
 - They affect the level of economic well-being in the nation

Political systems

- The system of government in a nation
- The dimensions it is assessed based on are interrelated
 - Systems that emphasise collectivism tend to lean toward totalitarianism
 - Those that place a high value on individualism tend to be more democratic
 - However, a large grey area exists in the middle
- Assessed according to:
 - The degree to which the country emphasises **collectivism** as opposed to **individualism**

Collectivism	<ul style="list-style-type: none"> • Stresses the primacy of collective goals over individual goals <ul style="list-style-type: none"> - The needs of society as a whole are generally viewed as being more important than individual freedoms - An individual's right to do something may be restricted on the grounds that it runs counter to "the good of society" or to "the common good" - Can be traced to the Greek philosopher, Plato • Today, collectivism is equated with <u>socialists</u> <ul style="list-style-type: none"> - Advocate state ownership of the basic means of production, distribution and exchange - Manage to benefit society as a whole, rather than individual capitalists • In the early 20th century, socialism split into: <ul style="list-style-type: none"> - Communism: socialism can only be achieved through <u>violent</u> revolution and totalitarian dictatorship (e.g. USSR, China, North Korea) <ul style="list-style-type: none"> ○ In retreat worldwide by mid-1990s - Social democrats: socialism is achieved through democratic means, turning their backs on violent revolution and dictatorship (e.g. France, Germany, India) <ul style="list-style-type: none"> ○ Underlying view that the government makes the best decision for country ○ Retreating as many countries move toward free market economies ○ State-owned enterprises have been <u>privatised</u>
Individualism	<ul style="list-style-type: none"> • An individual should have freedom in his own economic and political pursuits (e.g. USA, GB) • Stresses that the interests of the individual should take precedence over the interests of the state • Can be traced to the Greek philosopher, Aristotle, who argued that individual diversity and private ownership are desirable • Individualism is built on 2 central tenets: <ul style="list-style-type: none"> - Individual economic and political freedoms are the ground rules on which a society should be based - Welfare of society best served by allowing the pursuit of <u>individual</u> economic interest • Implies democratic political systems and free market economies (i.e. Capitalism)

- The degree to which the country is **democratic** or **totalitarian**

Democracy	<ul style="list-style-type: none"> • “Government of the people, by the people, for the people” – Abraham Lincoln • A political system in which government is by the people, exercised either directly or through elected representatives <ul style="list-style-type: none"> - Direct: citizens directly involved in decision making - Representative (most common form): citizens elect individuals to represent them, they then form a government, whose function is to make decisions on behalf of the electorate • Ideal criteria of a democratic state: <ul style="list-style-type: none"> ✓ Individual right to free expression and organisation ✓ Free media ✓ Universal adult suffrage and regular elections ✓ Limited terms for elected representatives ✓ Fair and independent court systems
Totalitarianism	<ul style="list-style-type: none"> • A form of government in which 1 person or political party exercises absolute control over all spheres of human life and prohibits opposing political parties <p><i>Communist totalitarianism</i></p> <ul style="list-style-type: none"> • The communist party monopolises power • Kim Jong Yun - Korea <p><i>Theocratic totalitarianism</i></p> <ul style="list-style-type: none"> • Political power is monopolised by a party, group or individual that governs according to <u>religious</u> principles <p><i>Tribal totalitarianism</i></p> <ul style="list-style-type: none"> • A political party that represents the interests of a particular <u>tribe</u> monopolises power <p><i>Right-wing totalitarianism</i></p> <ul style="list-style-type: none"> • Permits some individual <u>economic</u> freedom, but restricts individual <u>political</u> freedom • Nazi Germany

Economic systems

Market economies (capitalist)	<ul style="list-style-type: none">• <i>More likely to find in countries that focus on individualism</i>• All productive activities are privately owned (instead of owned by the state) and production is determined by the interaction of supply and demand• Government encourages free and fair competition between private producers (i.e. individualistic, democratic)
Command economies (communist/socialist)	<ul style="list-style-type: none">• <i>In countries where collective goals are given pre-eminence, the state may have taken control over many enterprises; markets in such countries are likely to be restricted rather than free (collectivist)</i>• Government plans the goods and services that a country produces, the quantity that is produced, and the prices at which they are sold• All businesses are state-owned, and governments allocate resources for “the good of society” (i.e. collectivist, totalitarian)• In a command economy, state-owned enterprises have little incentive to control costs and be efficient because they can’t go out of business
Mixed economies	<ul style="list-style-type: none">• Certain sectors of the economy are left to private ownership and free market mechanisms while other sectors have significant state ownership and government planning• Governments tend to own firms considered important to national security

WEEK 2: THE INTERNATIONAL BUSINESS ENVIRONMENT – LEGAL SYSTEMS, ECONOMIC DEVELOPMENT & TRANSITION ECONOMIES

Learning outcomes

- ❖ Understand how legal systems across countries differ;
- ❖ Explore why countries differ in the level of economic development;
- ❖ Discuss transition economies and their movement towards market-based systems; and
- ❖ Understand the implications of differences in the political economy of nations to international business

Legal systems

- The rules that regulate behaviour along with the processes by which the laws are enforced and through which redress for grievances is obtained
- Like the economic system of a country, the legal system is influenced by the prevailing political system
 - Collectivist inclined totalitarian states tend to enact laws that severely restrict private enterprise
 - Laws enacted by governments in democratic states where individualism is the dominant political philosophy, tend to be pro-private enterprise and pro-consumer
- 3 types of legal systems

Common law

- Based on tradition, precedent and custom
 - **Tradition:** a country's legal history
 - **Precedent:** cases that have come before the courts in the past
 - **Custom:** to the ways in which laws are applied in specific situations
- System evolved in England over hundreds of years and is used widely in the UK and former colonies (e.g. USA, Canada, Australia, NZ)
- Based on cumulative wisdom of judges and precedent
- Judges act as neutral referees and have the power to *interpret the law so that it applies to the unique circumstances of an individual case*
 - Flexible
- Supplemented by Statutory Laws

Civil law	<ul style="list-style-type: none"> • Based on detailed set of laws organised into codes • Most <u>common</u> form of law • Prevalent in more than 80 countries (i.e. Germany, France, Russia) • Based on codification of a very detailed set of laws • Judges have <i>less flexibility</i> than those in a common law system as they can only apply law rather than interpret it based on tradition, precedent and custom
Theocratic law	<ul style="list-style-type: none"> • Based on official religious teachings • Prevalent in some Middle Eastern (e.g. Iran, Saudi Arabia) and African countries (e.g. Nigeria) bound by strong Islamic faith • Based upon moral behaviour that governs faith and practice • Islamic law is the most widely practiced theocratic legal system in the modern world, although Hindu, Jewish and Catholic law are still practiced

- Why is a country's legal system important for IB?
 - Regulates business practice
 - Defines how business transactions can occur
 - Sets out rights and obligations of parties to a business transaction
- 4 important issues for IB based on legal systems

Contract law	<ul style="list-style-type: none"> • The body of law that enforces a contract • The parties to an agreement normally resort to contract law when 1 party feels the other has violated either the letter or the spirit of an agreement • A contract is a document that specifies the conditions under which an exchange is to occur and details the rights and obligations of the parties involved <ul style="list-style-type: none"> - Under a common law system, contracts tend to be very detailed with all contingencies spelled out (e.g. Australia) - Under a civil law system, contracts tend to be much shorter and less specific because many issues are already covered in the civil code (e.g. Germany) • Dispute resolution is often complex <ul style="list-style-type: none"> - Where to arbitrate and whose laws apply (i.e. host or home country?)
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	<ul style="list-style-type: none"> • Solution: <ul style="list-style-type: none"> - United Nations Convention on Contracts for the International Sale of Goods (CISG) - CISG establishes a uniform set of rules governing certain aspects of the making and performance of everyday commercial contracts b/w sellers and buyers who have their places of business in different nations - How disputes should be resolved - However not every country has agreed to it, which means it doesn't apply
Property rights and corruption	<ul style="list-style-type: none"> • Property rights refer to the legal rights over the use to which a resource is put and over the use made of any income that may be derived from that resource • Can be violated through: <ul style="list-style-type: none"> - Private action: theft, piracy, blackmail and the like by private individuals or groups - Public action: when public officials, such as politicians and government bureaucrats, extort income, resource or the property itself from property holders <ul style="list-style-type: none"> ○ Legally (e.g. excessive taxation) or illegally (e.g. bribes or blackmailing) ○ High levels of corruption reduce foreign direct investment, the level of international trade, and the economic growth rate in a country
Protection of intellectual property	<ul style="list-style-type: none"> • Property that is the product of intellectual activity e.g. computer software, a screenplay, music score, chemical formula of a new drug • Can be protected using: <ul style="list-style-type: none"> - Patents: grants the inventor of a new product or process exclusive rights for a defined period to the manufacture, use or sale of that invention - Copyrights: the exclusive legal rights of authors, composers, play writers, artists, and publishers to publish and disperse their work as they see fit - Trademarks: design and names, officially registered, by which merchants or manufacturers designate and differentiate their products • The philosophy behind intellectual property laws is to reward the originator of a new invention, book, musical record, clothes design, restaurant chain and the like for their idea and effort <p><i>How can IP be protected?</i></p> <ul style="list-style-type: none"> • Protection of IP differs from country to country <ul style="list-style-type: none"> - World Intellectual Property Organization

	<ul style="list-style-type: none"> - Paris Convention for the Protection of Industrial Property - Trade Related Aspects of Intellectual Property Rights (TRIPS) <ul style="list-style-type: none"> • To avoid piracy, firms can: <ul style="list-style-type: none"> - Stay away from countries where intellectual property laws are lax – hard to protect yourself - File lawsuits - Lobby governments for international property rights agreements and enforcement <p><i>Should IP always be protected?</i></p> <ul style="list-style-type: none"> • HIV/AIDS vaccinations? • Cures for cancer? • The air we breathe, the water we drink, the food we eat?
Product safety and liability	<ul style="list-style-type: none"> • Product safety laws set certain standards to which a product must adhere • Product liability involves holding a firm and its officers responsible when a product causes injury, death or damage • Criminal laws/civil liability laws <ul style="list-style-type: none"> - Civil laws call for payment and monetary damages - Criminal liability laws result in fines or imprisonment

Economic development

- Different countries have dramatically different levels of economic development
 - Natural endowments
 - Innovation and entrepreneurship
 - Education
 - Infrastructure
- Two ways to measure levels of economic development:
 - Gross national income (GNI) per capita
 - Purchasing power parity (PPP)
 - Adjusting GNI by purchasing power
 - Allows for a more direct comparison of living standards in different countries

Broader conceptions of development: Amartya Sen-Development as freedom (not on exam)

- Development should be measured less by material output measures, such as GNI per capita and more by the capabilities and opportunities that people enjoy
- The UN used Sen's ideas to develop the Human Development Index (HDI – **measures the quality of human life in different nations**) which is based on 3 measures:
 - Life expectancy at birth
 - Educational attainment

- Whether average incomes are sufficient to meet the basic needs of life (PPP based average income)
- Sen argues:
 - For the removal of poverty, tyranny and systemic social deprivation
 - Development requires greater “democratisation” of political communities to give citizens a voice in the important decisions made for the community

Levels of human development

HDI Rank	Country	HDI Value, 2013	Life expectancy at birth (years)	Mean years of schooling (years)	GNI per capita (2011 PPP \$), 2013
1	Norway	0.944	81.5	12.6	63,909
2	Australia	0.933	82.5	12.8	41,524
3	Switzerland	0.917	82.6	12.2	53,762
4	Netherlands	0.915	81.0	11.9	42,397
5	United States	0.914	78.9	12.9	52,308
183	Sierra Leone	0.374	45.6	2.9	1,815
184	Chad	0.372	51.2	1.5	1,622
185	Central African Republic	0.341	50.2	3.5	588
186	Congo (Democratic Republic of the)	0.338	50.0	3.1	444
187	Niger	0.337	58.4	1.4	873

Transition economies

- Those economies which have been characterised by a move towards greater democracy and economic liberalisation
- Often from centrally planned economic systems to market based (e.g. BRICS nations, former USSR countries, Central Asian Republics and some African States)
- Reasons for transition:
 - Totalitarian regimes failed to deliver economic progress (relative – spread of democracy)
 - Advances in telecommunications technology
 - The rising middle class
- The shift toward a market-based system involves:

Deregulation	<ul style="list-style-type: none"> • Removing legal restrictions to the free play of markets, the establishment of private enterprises, and the manner in which private enterprises operate
Privatisation	<ul style="list-style-type: none"> • Transfers the ownership of state property into the hands of private investors
Legal system	<ul style="list-style-type: none"> • The creation of a legal system to safeguard property rights

Box 1. Classification of transition economies

Transition economies in Europe and the former Soviet Union

CEE Albania, Bulgaria, Croatia, Czech Republic, FYR Macedonia, Hungary, Poland, Romania, Slovak Republic, Slovenia

Baltics Estonia, Latvia, Lithuania

CIS Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan

Transition economies in Asia

Cambodia, China, Laos, Vietnam

Implications for IB

Benefits	<ul style="list-style-type: none">• Do the long-term benefits outweigh the risks?• Size of the market, wealth of consumers, quality of labour force?• First mover advantages (for potential rising star country)? How strong are first mover advantages and can you obtain it?• Predictors of future economic well-being of country?<ul style="list-style-type: none">- Economic system- Property rights regime
Costs	<ul style="list-style-type: none">• Potential to pay off individuals to do business (i.e. bribes)• Sophistication of economy<ul style="list-style-type: none">- Infrastructure, supporting business (supply chain)• Legal factors<ul style="list-style-type: none">- Does legal structure exist if need for recourse?<ul style="list-style-type: none">○ Contract/property law?- Adhering to strict standards<ul style="list-style-type: none">○ Laws regarding labour, product safety, and environment?
Risks	<p><i>Political</i></p> <ul style="list-style-type: none">• The likelihood that political forces will cause drastic changes in a country's business environment that adversely affects the profit and other goals of a business enterprise• Tends to be greater in countries experiencing social unrest and disorder or in countries where the underlying nature of society increases the likelihood of social unrest• <i>Political stability is desirable (not often found in transition economies)</i>

	<p><i>Economic</i></p> <ul style="list-style-type: none">• The likelihood that economic mismanagement will cause drastic changes in a country's business environment that adversely affects the profit and other goals of a business enterprise <p><i>Legal</i></p> <ul style="list-style-type: none">• The likelihood that a trading partner will opportunistically break a contract or expropriate property rights
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