INTERNATIONAL BUSINESS MANAGEMENT

Course Revision

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COURSE REVISION

- The following topics highlight the prime learning points for the course
- They are not intended to indicate the contents of the exam paper
- Where the course revision topics have been extracted from a set of lecture slides you are recommended to familiarise yourself with the original set and do background reading
- Do not neglect other topics covered during the year

QUESTION 1: COMPULSORY

- You must do Question 1
- For the remaining questions you choose 3 out of 5
- Spend no more than 45 minutes on each question – the early points are easier to get than the later ones.

TOPIC 1: ECONOMIC RISK ANALYSIS FOR EMERGING ECONOMIES

ECONOMIC RISK ANALYSIS (ERA)

- IMF uses quantitative analysis for evaluating economies
- Economic risk is present in all countries, but most significant in emerging and developing economies
- Guidelines devised at Greenwich evaluate the security of doing business in the country
- Emerging and developing countries tend to trade in a narrow range of products and depend on cash flow
- The three main measures of a country's financial standing:
  - GDP – how much is it producing?
  - Inflation – how well controlled?
  - Current Account – are the imports affordable?
- The first part of compulsory Exam Question 1 uses simple IMF-style quantitative formulas to measure economic performance against a standard
- The second part of the question identifies and evaluates the main economic factors in order to make a qualitative investment decision in the country

FINDING THE DATA

- Most of the data is available from the World Bank
  - The data is for all countries, not just emerging or developing economy clients of The Bank
- One piece of data, for the current account/GDP, comes from the IMF World Economic Outlook (WEO)
- In the exam the data will comprise the World Bank figures + CAD/GDP
- The data sheet will be a Word file
- The exam will focus on an emerging economy

ERA EXAM QUESTION PART I: QUANTITATIVE DATA

- “Examine the data set provided on (*Country X)*, considered to be an emerging economy. Identify the three most recent key economic indicators and examine the economic risk associated with the country. You should include a remark on the financial rates of return investors would require as a consequence of the risk. You are expected to critically analyse, in brief, the value of taking such a strictly quantitative approach to risk analysis.”

  [10 marks]

1. GDP GROWTH

- Question: is the economy growing at a sustainable rate?
- Answer: target 2.0-3.0% developed, **6.0-10.0% emerging** and 7.0-11.0% developing economies
- Gross domestic product (GDP) measures everything produced in the country regardless of nationality
- Real (constant prices) GDP increases show genuine growth in the economy
- Positive, steady growth is always good but the gains may be unevenly distributed
- Undesirable GDP conditions:
  - High growth – rising wages, inflation, imports and interest rates
  - Low growth – poor exploitation of resources, poor competitiveness, low wealth creation
  - Recession – wealth destruction, hysteresis effects

GDP GROWTH TARGETS

- Need to find a balance between a booming economy and recession
  - An overheating economy with high inflation is usually treated with high interest rates
  - A recessionary economy with low inflation is usually treated with low interest rates
  - Stagflation (low growth, high inflation) is a challenging paradox!
- Rate of return should match the risk

GDP RISK AND RETURN FOR EMERGING ECONOMIES

- Emerging economies can sustain high rates of growth as unemployed resources are brought into the economy – e.g. migration from countryside to cities

	GDP	Risk/Return
Recession	<3.9%	High
Low growth	4.0-5.9%	Medium
Sustainable	6.0-10.0%	Low
Boom/overheating	10.1%+	High

2: INFLATION

- Question: Are prices under control?
- Answer: compare the inflation with the 2.0% target
- Various measures of inflation (RPI, CPI). World Bank use GDP deflator accounting for the nominal change in GDP i.e. reveals real GDP change
- The GDP deflator is inflation for all output, not a basket of goods
- High inflation
  - High inflation means constant adjustment to prices
  - Usually necessitates high interest rates.
  - Debts values are eroded over time
- Low inflation/Deflation
  - Low inflation is too narrow a target, can slip into deflation
  - Deflation may require negative interest rates – tricky!
  - Some consumers may wait for further price reductions
  - Debts values increase over time
- Some positive rate of inflation is desired

INFLATION AND RISK/RETURN

- Most central banks are targeting 2.0% CPI inflation
- Some central banks will accept overshoots and undershoots for short periods, others (e.g. ECB) will accept only an undershoot
- On balance, 0.0-2.0% inflation is probably considered low risk
- World Bank data shows inflation as GDP deflator

Inflation Rate	Inflation Type	Risk
<0.0%	Deflation	High
0.0-0.9%	Low	Medium
1.0-3.0%	Price stability	Low
>3.1%	High	High

3: CURRENT ACCOUNT DEFICIT - CAD

- Question: how great is the short-term trade burden?

- Answer: compare the current account deficit (CAD) and the gross domestic product (GDP)

- CAD itself is not a worry:
  - It is funded from the capital account
  - It may be small compared to the total assets and liabilities
  - It may be a sign of strong domestic growth
  - The capital account could be showing good foreign investment

- CAD/GDP percentage
  - It should be relatively stable over the years
  - It should be greater than -2% (i.e. -2.1% is high risk, -1.9% is low risk)

CURRENT ACCOUNT DEFICIT – CAD

- For developing economies CAD can be a cause for concern
  - Fall in investment means imports cannot be afforded
  - A fall in exports creates a higher dependency on foreign funds

- A high surplus can also be cause for concern
  - Economic growth is dependent on demand in other countries
  - Domestic consumers have less access to desirable imports
  - The government needs to counter pressure on the currency to rise in value
- Risk Values

	Low Risk	High Risk
CAD/GDP	>-2.0%	<-2.0%

CRITICISM OF THE IMF QUANTITATIVE APPROACH

- Many feel that the IMF style of analysis does more harm than good
- Criticisms:
  - It is a creature of the US and Europe
  - It has a neo-liberal agenda for low government spending, privatisation and debt repayment
  - It treats all countries the same
- IMF's defence
  - It is invited by the host government
  - It is the last resort – everything else has failed
  - The worse the taste the better the medicine

FOCUS POINTS

- Memorise the targets – could be represented as graphs?
- Be sure to match the rate of return to the risk level
- Include a short paragraph [4 points] on why this snapshot, prescribed approach is not suited to all countries all the time. This sets you up for answering Part II which is qualitative.

ERA EXAM QUESTION PART II: FDI INVESTMENT DECISION

- The second half of Exam Question 1 concerns the best target for foreign direct investment (FDI) by a company

In your considered opinion, how attractive is (Country X) as a destination for foreign direct investment (FDI)? Taking a long-term view, you should build up a case for a specific company making an FDI investment. The business case should be a credible argument based on qualitative analysis of the data you consider most relevant to the investment decision.

[15 marks]

- The decision of which sector of the economy to invest in can only be based on the information in the datasheet – no credit will be given for special knowledge!
- The FDI decision should identify and analyse the most appropriate economic factors

FACTORS INFLUENCING FDI

- The economic factors that are appropriate to the FDI decision depend upon the nature of the investment – it is therefore an opportunity for creative thinking by entrepreneurs
- FDI entrepreneurs need to analyse trends in the data to uncover any new opportunities
- It is also important to identify specific data that indicates new opportunities
- To help you remember the most important factors, we have a Greenwich mnemonic:

GLIFTS

GREENWICH MNEMONIC - GLIFTS

- GLIFTS is only there to help you remember – it should not be referenced!
- It will point you towards the most basic information, but you can use any factor you think is important
- GLIFTS will give you up to 6 economic factors – at least 5 are needed for the exam

USING GLIFTS

- G – GDP per capita growth rate (the trend). May indicate a growing productivity, higher spending.
- L - Life expectancy. Gives you an idea of the general well being of the population and the degree to which the government is looking after everyone
- I – Inflation (GDP deflator): is the trend steady or out of control? Indicates the economic competency of the government
- F – FDI, measure of how well the country is attracting foreign investors, particularly the trend
- T – Technology
- S – School

OTHER INTERESTING DATA…

- An entrepreneur will browse data looking for items of interest
- This is when your creativity reaches its peak!
- Some data that might catch your eye and deserve further consideration:
  - Poverty Headcount
  - Malnutrition
  - Immunisation
  - Boy/girl ratio in education
  - Water access
  - Agriculture, industry, services added value
  - Gross capital formation
  - Time to start a business
  - Net migration
  - Total debt service

SOURCES

- World Bank

<http://databank.worldbank.org/data/views/reports/ReportWidgetCustom.aspx?Report_Name=CountryProfile&Id=b450fd57>

- IMF (for CAD/GDP) – latest World Economic Outlook report

<http://www.imf.org/external/ns/cs.aspx?id=28>

- Australia CAD/GDP – Mr Wood.com.au

<http://economics.mrwood.com.au/statistics/goal/goalcadgdp.asp>

- US Debt Service – Creditflowinvestor.com

<http://www.creditflowinvestor.com/FederalDebtService.htm>

- IMF paper on MRR – Boorman, J. and S. Ingves (2001), <u>Issues in Reserves Adequacy and Management</u>

<http://www.imf.org/external/np/pdr/resad/2001/101501.pdf>

- Bank of England current account information sheet

<http://www.bankofengland.co.uk/publications/speeches/2006/speech271.pdf>

- IMF guide to financial terminology

<http://www.imf.org/external/pubs/ft/eds/Eng/Guide/file6.pdf>

- UN debt service ratio definition

<http://esl.jrc.it/envind/un_meths/UN_ME069.htm>

FOCUS POINTS

- Prepare a range of case study companies in advance and think about what they need from the economy
  - Apple – expanding economy, educated workforce, growing access to high technology
  - GSK pharmaceuticals – rising life expectancy, evidence or rising medical spending
  - Starbucks coffee plantation – low education, low urban growth, low industry/services value added
- Don’t just list your observations, each economic factor should serve your ultimate investment decision

QUESTIONS 2-6: UNCOMPULSORY

- 5 questions, you choose 3 of them
- Each requires a mini-essay answer:
  - Start with a theory or conceptual framework and criticise it
  - Bring in a case study as a test of the theory/framework in a deductive style
  - Suggest improvements to the theory/framework

TOPIC 2: RISK & UNCERTAINTY

RISK VS UNCERTAINTY

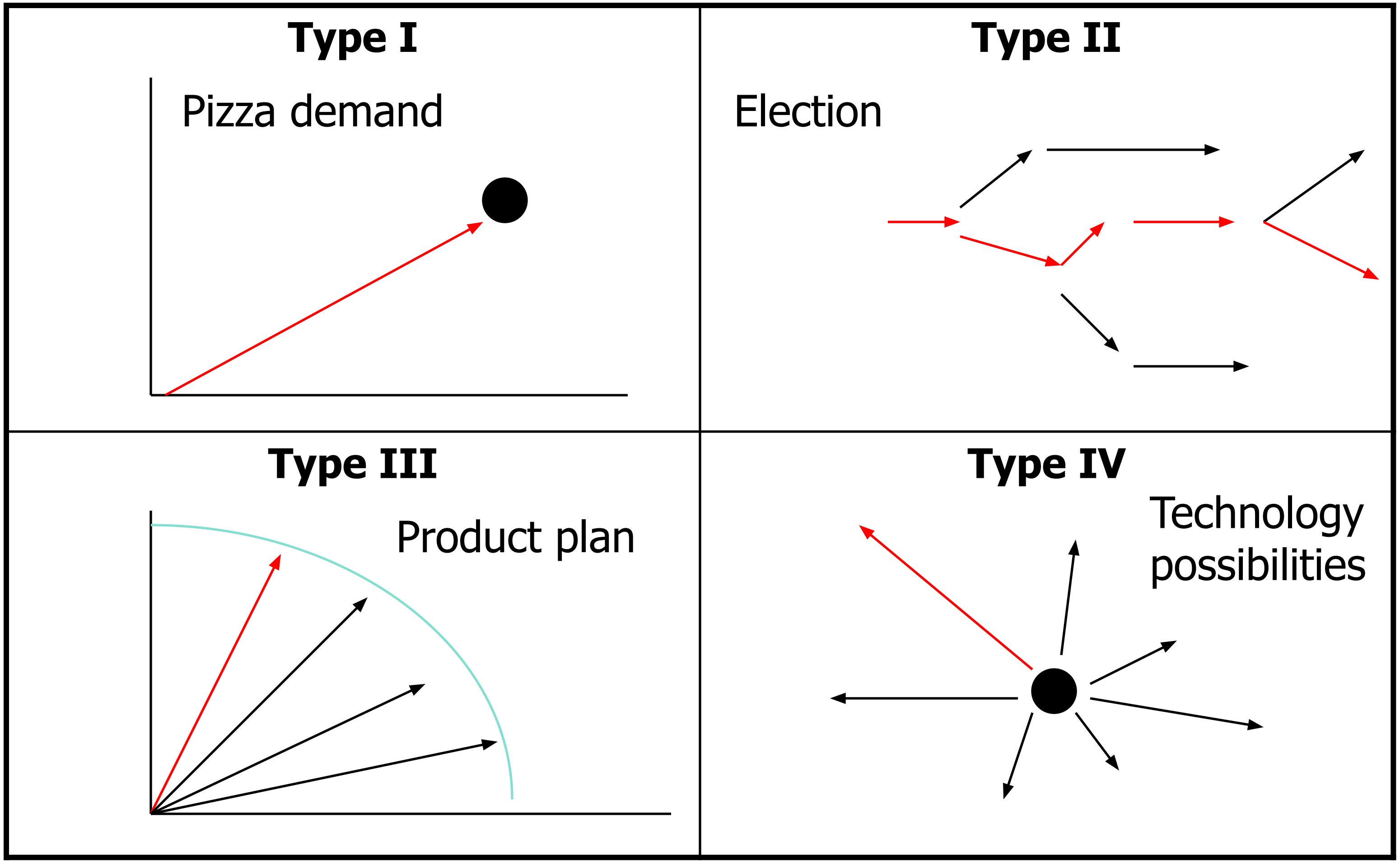
- Knight (1921)/ Chicago
  - **Risk** : When probabilities can be identified, eg. playing poker, roulette. Degree of aversion to risk largely irrelevant.
  - **Uncertainty** : when probabilities are too miniscule, population of events are large and assigning probabilities may not be meaningful.

- Opportunities for business
  - **Risk** – objective judgment, can be researched and planned, involves existing markets and/or products
  - **Uncertainty** – subjective judgment to convert uncertainty to risk, requires entrepreneurs who can forge new directions, involves new markets and/or products

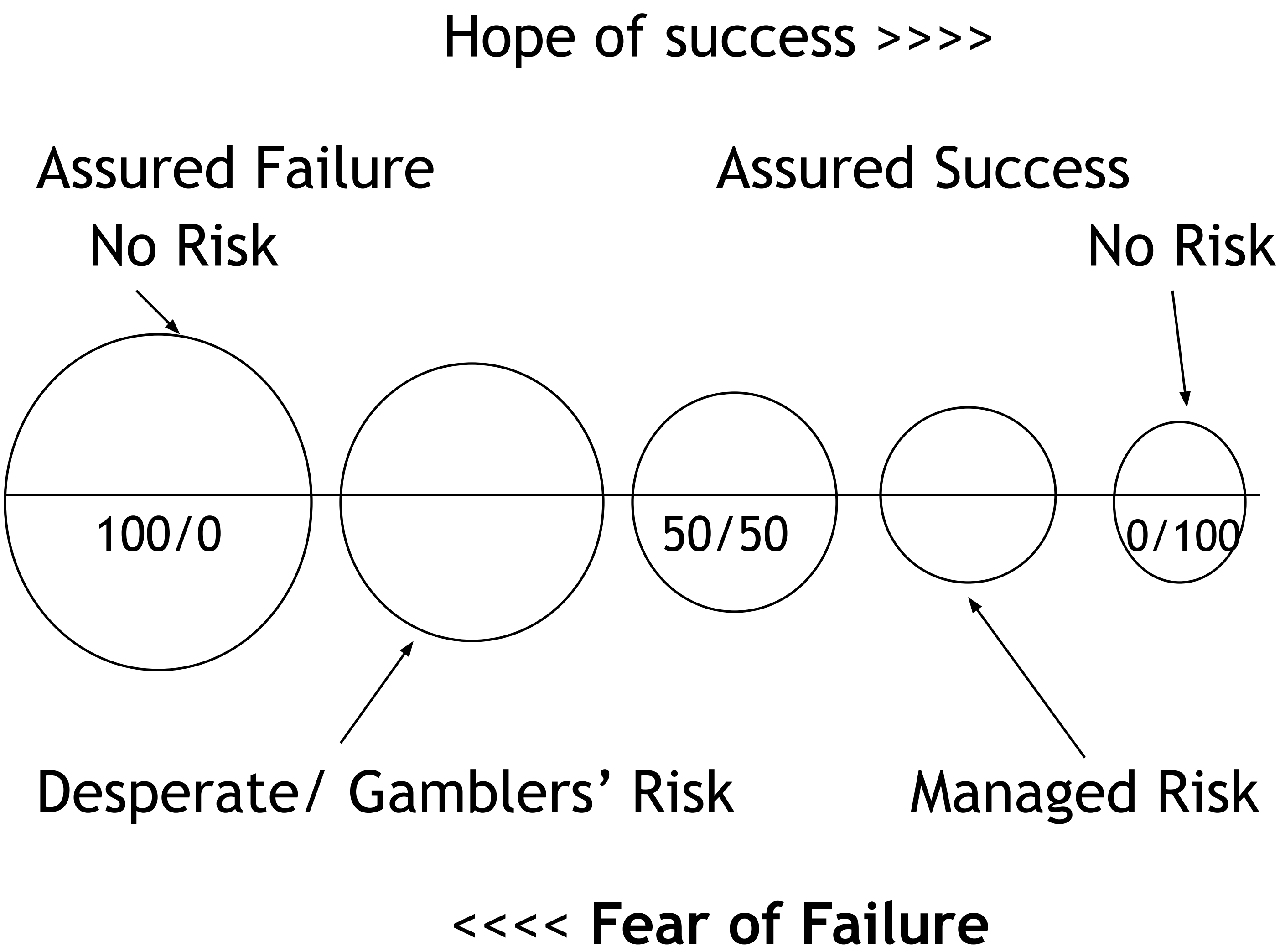
TYPES OF UNCERTAINTY

- Level 1 : past predictive, trend analysis
  - Predicting the demand for pizzas during tomorrow's football match
- Level 2 : discrete (binary) futures
  - Predicting outcome of elections next year – "if this then that"
- Level 3 : multiple futures
  - Predicting technological change in TV – 3D, 4K, internet
- Level 4 : true ambiguity
  - Predicting future of multi media – Google Glass, Apple Watch

UNCERTAINTY TYPES COMPARED…



RISK AND PLANNING



THE RISK/UNCERTAINTY CALCULUS

- Scale of potential harm
  - War vs local fire
- Likelihood of occurrence
  - Earthquake vs industrial dispute
- Capability to respond
  - Crisis management
- Effective deployment of capability
  - Risk taking vs Risk averse

RISK, UNCERTAINTY AND REWARD

- Risk is the strategist's best friend
  - The degree of risk is compensated for by the size of the reward
  - Where information is equally available risk calculations should be the same by all parties – no opportunity for arbitrage

- Uncertainty is the entrepreneur's secret weapon
  - The entrepreneur seeks new and exclusive information
  - The entrepreneur calculates a new, lower risk factor but benefits from the high returns calculated by others

RISK ANALYSIS STEPS

- Step I : Sorting Environmental Data
  - Performance : GDP, Inflation, BoP etc
  - Strategy: National Goals, Policies, etc
  - Context: Institutional and Ideological basis

- Step II : Relating the data
  - Determining Uncertainty Type
    - Past Predictive, Discrete Options, Multiple Options, True Ambiguity : Courtney's Model
  - Prediction & Scenario Generation

FOCUS POINTS

- You should be aware that risk is a normal part of the business environment
- Risk requires meticulous analysis so that it is fully understood and the appropriate rate of return obtained
- Uncertainty does not yield the same assurances
- Competitive advantage comes from lowering company-specific risk
- Consider case studies where companies have invested in low, medium and high risk environments
- Political risk has a number of angles, principally 3 dimensions: procedural, distributive and catastrophic
- Consider case study examples for each dimension
- Consider how you can assess political risk

TOPIC 3: INTERNATIONAL TRADE

MERCANTALISM

- **Principal: wealth based on holdings of gold**

- **The Concept**: Trade is a zero sum game: one country gains at the expense of others
  - Drove the economic expansion in the 17^{th} /18^{th} centuries
  - Imperialism was also in line with military power
  - Colonies forced to export commodities and import manufactured products

- **The Limitations**:
  - De-industrialisation, brain drain, adverse movement of factors of production from colonies
  - Inefficient production
  - Rising inflation

- Current usage: neo-mercantilism is politically attractive

ADAM SMITH AND ABSOLUTE ADVANTAGE

- **Principle:** Adam Smith – both nations can gain from trade
- **The concept** : countries should specialize in producing those commodities in which they have an absolute advantage
  - The UK has an advantage in producing "scotch", while France has an advantage in "champagne"
  - Brings specialisation benefits – economies of scale, learning
  - Can derive from natural or acquired advantages
  - Results in absolute efficiency advantage
- **Limitations**: some countries have no absolute advantage, natural or acquired
- Current usage: applicable to some industries, particularly strategic

COMPARATIVE ADVANTAGE

- **Principle:** Ricardo (1817) – even a country with all absolute advantages is comparatively better at some things

- **The concept :**
  - two countries specialise in the areas in which they have a comparative advantage (and possibly an absolute disadvantage)
  - Depends on relative efficiency
  - The comparison is within the country
  - Opens trade to developing entrants

- **Limitations:**
  - Assumes factors of production are only mobile within countries

- **Current usage: basic theory of trade**

MERCANTILISM AND DEVELOPING ECONOMIES

- Mercantilism allows a country to build up industry based on export sales
- Import restrictions keep out the competition but consumers are worse off
- FDI substitutes for imports
- WTO will permit protection of infant industries using mercantilist policies but only until the industry reaches maturity and can compete with global rivals
- The mercantilist strategy has a time limit – the country must open its borders to international trade and its advantages once the country has established its own comparative advantages

FOCUS POINTS

- Familiarise yourself with the temptations of mercantilism and how countries think they can gain by using it
- Make sure you can critically analyse the theory, showing that it fails to capitalise on the gains offered by comparative advantage approaches
- Prepare a case study of a major developing/emerging economy that has used, or is using, mercantilism in some form to promote economic growth. How long can it last? What should it do next?

TOPIC 4: FIVE FORCES MODEL

PORTER’S PERSPECTIVE

- Asserted that industry attractiveness is not a function of specific technology or product attributes but of the wider industry structure
- Strategic positioning is one where the local conditions offer an advantage to the incoming foreign firm
- Intense overall competition offers little for the incoming firm
- Some competitive forces may be quite limited – there are compensations in strengths elsewhere

THE 5 FORCES MODEL

All forces work together to shape the competitive landscape of the industry

from "The Five Competitive Forces That Shape Strategy" by Michael E. Porter, *Harvard Business Review*, January 2008

THE BARGAINING POWER OF BUYERS

- The extent to which the buyer can influence the prices

- Can happen when…
  - Buyer group is large
  - Product is perishable
  - Low switching costs between suppliers
  - Threat of backward integration – they can manufacture the product themselves
  - Highly sensitive to price movements

POWER OF SUPPLIERS

- The extent to which the suppliers can influence the cost of production in the value chain

- Can happen when…
  - There is a credible threat of backward integration
  - There are monopsonistic tendencies in the market
  - The product is differentiated and there are high switching costs involved
  - The product is undifferentiated but available to other industries

THREAT OF NEW ENTRANTS

- The threat from the market getting flooded with new players

- Can happen when…
  - There low barriers to entry in the market
  - When capital requirements are not very high
  - Exit costs are low, and there are no specialized assets created
  - Low economies of scale

THREAT OF SUBSTITUTES

- The ability to use another product for similar use

- Can happen when…
  - Different product can be used for the same purpose eg. email for mail
  - Technology changes product definition, ie credit cards as smart cards
  - Low switching costs

EXTENT OF INTER-FIRM COMPETITION

- An increase in the number of firms will increase competitive rivalry… will affect price, costs and volumes

- Can happen when
  - Industry growth is slow
  - Rivals are all similar size
  - There are high fixed/storage costs
  - Capacity augmented in large increments due to high economies of scale
  - Exit barriers are high
  - Competition is based around price – similar products,

FACTORS NOT FORCES

The competitive forces impact on profitability – some items are factors but do not in themselves impact on profitability

- High industry growth rate – suppliers may gain in power, there may be low entry barriers
- Technology – new advances are not attractive in themselves, established industries may be more attractive
- Government – Porter did not see this as a force since its impact depends on the policy details
- Complementary products – accompanying technology eg. fuel networks for vehicle
- The model is only a snapshot, the forces may shift in strength

ANDREW GROVE: SIX FORCES MODEL

- Model adds role of complementors to the Five Forces model

- Complementors are external powers that balance the forces within the industry

- Complementors include:
  - Government – eg. legislation that is inequitable
  - Pressure groups – eg. environmental lobby

- Porter would characterise these as factors

FOCUS POINTS

- Consider case studies that don't just illustrate how the model works but reveal additional insights into its weaknesses
- Some factors seem clear but it can be quite difficult to state what they mean in reality e.g. what's the difference between new entrants and substitutes?
- There are other market influences that Porter claims are not forces because they do not impact on profitability. How far do you agree with this?

TOPIC 5: INTERNATIONAL MARKETING

KOTLER: THE 4 PS

1. Product
   - Value of the product to the consumer
   - Adaptations
   - New product development
2. Price
   - International pricing strategy
   - Pricing risk
3. Promotion
   - Push versus pull
   - Branding decisions
   - International promotion
4. Place
   - Distribution Network

1. PRODUCT – DELIVERING VALUE

- Legal requirement
  - Safety – pharmaceuticals
  - Environment – cars
  - Non-tariff barriers
- Cultural awareness
  - Religious differences – eg. consumption of meat
  - Local customs – cup-holders for Americans
- Economic factors
  - Local disposable income levels
  - Conditions of use – eg. who will use it and how

Adaptation means additional cost so companies will always minimise changes to the product, process, marketing etc.

NEW PRODUCT DEVELOPMENT (NPD)

- Rate of NPD greater in countries where
  - It is an R&D intensive industry
  - Sales volumes are sufficient
  - Consumers can afford the value-added
  - Competition is intense

- Integrating R&D, production & marketing ensures
  - Project development driven by customer needs
  - New products are designed for ease of manufacture
  - Development costs are kept in alignment with demand
  - Time to market is minimized

- Pressure to standardise as much as possible

2: PRICE – INTERNATIONAL ISSUES

- Government controls
  - Minimum and maximum prices
  - Prohibition against dumping
  - Taxation
- Market diversity – national differences
  - Skimming – high price for short-term profit
  - Penetration – low pricing for market share
  - Cost-plus – calculated margin for long-term plan
- Price escalation in export
  - Cost-plus % calculation can rise exponentially with cost
  - Tariffs
  - Analysis to select appropriate end price
  - Exchange rate fluctuation
- Fixed and variable pricing

PRICING RISK

- Inflation
  - A "paper profit" may be pumped up by inflation on inventory
  - Tax is based on the paper profit
  - Costs of frequent price changes
- Exchange rate
  - Transaction risk – the revenue received reduces if customer changes the terms of the deal
  - Translation risk – reported revenues are undermined by currency changes
  - Fluctuation – may have to take a long-term view
- Arbitrage – grey imports
  - Customers may exploit price differences if transport costs have not be properly taken into account

3: PROMOTION

- Push strategy
  - Emphasizes personal selling within the distribution chain
  - Requires intense use of a sales force
  - Suits low fixed cost, but high variable cost products
- Pull strategy
  - Relies on mass media advertising to end buyer
  - Suits high fixed cost, but low variable cost products
- Determining factors
  - Product type and consumer sophistication
  - Production system – pressure of economies of scale
  - Distribution system
  - Media availability

4: PLACE

- Different distribution systems due to
  - Country-specific differences
  - Consumer spending habits
  - Retail concentration
- Choosing the best distribution system
  - Financial strength of wholesaler or retailer
  - Distributor's knowledge and capability
  - The number and types of product lines
  - Retail format – large stores or local shops
- Choices for establishing the network
  - Local agent for entry period
  - Regional before national
  - Global system or local

3 MORE Ps

- Service industries have intangible aspects that need marketing
- Kotler felt 4 was enough
- In addition to the tangible 4Ps:

1. **People**

Staff skills, CRM, customer service

2. **Process**

Ease of contact, customer oriented logistics

3. **Physical Evidence**

Making the intangible tangible eg. free trials, showroom design, branding

FOCUS POINTS

- You need to do more than illustrate how the 4Ps work, you need to critically analyse
- This leads directly into the additional Ps, and perhaps also other mnemonics
- Kotler thought the 4Ps were sufficient, but then he would…
- Consider a case study that not only shows all the Ps in action but also provides further critical insights and recommendations

TOPIC 6: STRATEGIC ALLIANCES

STRATEGIC ALLIANCES TYPES

1. Joint Venture - JV
   - Partners create a separate firm
   - The joint venture shares capabilities and resources
2. Equity strategic alliance
   - Partners buy equity shares in each other or the JV
   - Share capabilities and resources
3. Non-equity strategic alliance
   - Contractual relationship share capabilities and resources
   - Similar to a supplier-buyer relationship, but closer
4. Global strategic alliance
   - Working partnership across national boundaries
   - Divides the global market, not operations

1: JOINT VENTURE

- Definition
  - The term “joint venture” tends to describe the purpose of the alliance rather than the structure
  - The JV could be a company or a partnership
  - A JV is a separate operation from its partners
  - The partners own equal shares
  - Both partners have to agree to terminate
- Specific advantages
  - Both partners are tied in
- Specific disadvantages
  - Restrictive
- Example
  - Toyota-GM NUUMI plant in California

2: EQUITY STRATEGIC ALLIANCE

- Definition
  - Partner firms take different sized shares
  - Often used for a new strategy (eg. new technology)
- Specific advantages
  - Can help to achieve economies of scale
  - Can bring a technology to market more quickly
  - Exploits a shorter product life cycle
- Specific disadvantages
  - Opportunism of one partner exploiting a new technology
  - One partner dominates
- Example
  - Automotive Fuel Cell Cooperation – Ballard 20%, Ford 30% and Daimler 50%

3: NON-EQUITY STRATEGIC ALLIANCE

- Definition
  - Partner firms share no ownership interest
  - No separate firm is created
  - Secured by simple contracts
- Specific advantages
  - Less knowledge is exchanged, so reduced risk
- Specific disadvantages
  - Not suited to complex relationships (eg. technology development)
- Example
  - Asahi Super Dry (beer) is brewed in the UK by Shepherd Neame for the local market

4: GLOBAL STRATEGIC ALLIANCE

- Definition
  - Partner firms share no ownership interest
  - No separate firm is created
  - Secured by simple contracts
- Specific advantages
  - Expands global market exposure
  - Avoids obstacles to full mergers
- Specific disadvantages
  - Companies are dependent on each other to uphold reputations
- Example
  - Oneworld Alliance – British Airways, Cathay Pacific, American Airways etc.

FOCUS POINTS

- Make sure you can clearly distinguish one type of alliance from another
- You need to be able to critically analyse them, not simply describe them
- Prepare case studies for each type and be ready to use one in significant detail
- The case study should be critical, revealing weaknesses in the neatness of the theory. Indeed, the case study may even straddle more than one kind of alliance.