THE POLITICAL AND ECONOMIC ENVIRONMENT

A. THE POLITICAL/LEGAL ENVIRONMENT

1. Home country environment

- home country political environment can constrain the intl operations of a company by limiting the countries the intl company may enter (e.g. South Africa–US, Germany, Japan)

- triple-threat political environment – European firms doing business in Cuba, Nestle's problems with its infant formula controversy were most serious in a third market the USA

- bribery and corruption – what are the reasonable ways of doing business internationally?

- programmes by governmental organizations to promote exporting – export subsidies? Export subsidies are to the export industries what tariffs are to domestic industries

- financial activities – export credit agencies (e.g. FINNVERA) offer exporters the opportunity of transferring some of the risk to governmental organizations

- information services

- export-facilitating activities

- promotion by private organizations

- state trading (e.g. Cuba, China)

2. Host country environment

- Political risks

1) Ownership risk, which exposes property and life

2) Operating risk, which refers to interference with the ongoing operations of a firm

3) transfer risk, which is mainly encountered when companies want to transfer capital between countries

- political risk can be the result of government action or it can be outside the control of the government: **import restrictions** (on raw materials, machines, spare parts), **local-content laws** (e.g. the EU has a 45 per cent local-content requirement for foreign-owned assemblers), **exchange controls**, **market control** (US government threatened to boycott foreign firms trading with Cuba), **price controls** (can be used by a government during inflationary period; pharmaceuticals, food, petrol, cars), **tax controls** (a political risk when used as a means of controlling foreign investments) , **labor restrictions** (strong labor unions) , **change of government party**, **nationalization/ expropriation**

3. Trade barriers from home country to host country

Why do countries impose trade barriers to exports/imports?

- tariffs and non-tariff barriers (quotas, embargoes, administrative delays, local-content requirements)

4. Political risk-analysis procedure

Step 1: Issues of relevance to the firm

Determine critical economic/business issues to the firm. Assess the relative importance of these issues.

Step 2: Potential political events

Determine the relevant political events

Determine their probability of occurring

Determine the cause and effect relationships

Determine the government's ability and willingness to respond

Step 3: Probable impacts and responses

Determine the initial impact of probable scenarios

Determine possible responses to initial impacts

Determine initial and ultimate political risk

B. THE ECONOMIC ENVIRONMENT

1. Exchange rates

- weak currency (valued low relative to other currencies)
  strong currency (valued high relative to other currencies)

  What is the impact on exports/imports?

- devaluation/revaluation
- depreciation/appreciation
- stable exchange rates improve the accuracy of financial planning
- methods for insuring against adverse exchange rate movements are often too expensive for SMEs

2. Regional economic integration

- Countries have wanted to engage in economic cooperation and to provide large markets for member-country producers
- Free trade area – all barriers to trade among member countries removed, each member country has own trade policy towards non-members
- Customs union - all barriers to trade among member countries removed, common trade policy towards non-members
- Common market – same as above + factors of production move freely among members; Single European Act 1987
- Economic union – same as above + integration of economic policies; members harmonize monetary policies, taxation and government spending, common currency

QUESTIONS TO BE DISCUSSED

- Why is political stability so important for international marketers?
- Explain the importance of common European currency to firm selling goods to the European market.
- Describe the ways in which foreign exchange fluctuations affect a) trade b) tourism.
- Why a country's balance of trade may be of interest to an international marketer?