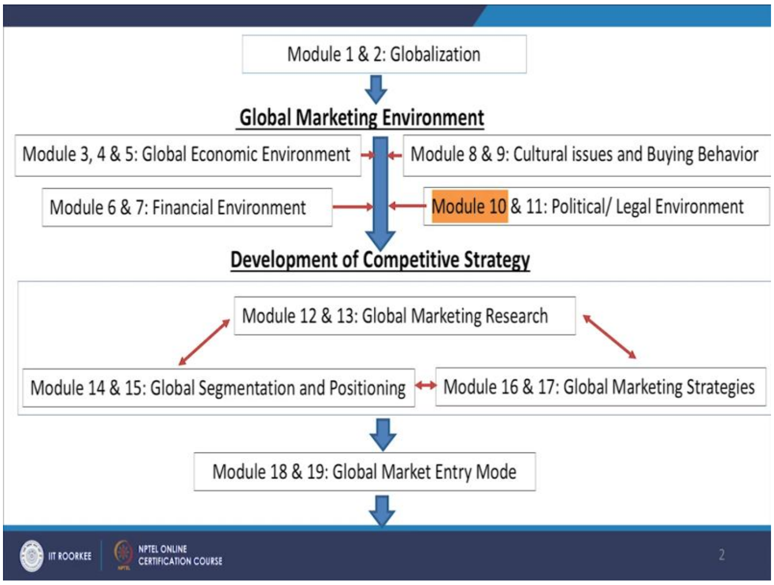
Global Marketing Management
Prof. Zillur Rahman
Department of Management Studies
Indian Institute of Technology - Roorkee

Module - 2
Lecture - 10
Political and Legal Environment - Part I

Welcome to this course on Global Marketing Management. And now we will talk about the global;

(Refer Slide Time: 00:30)



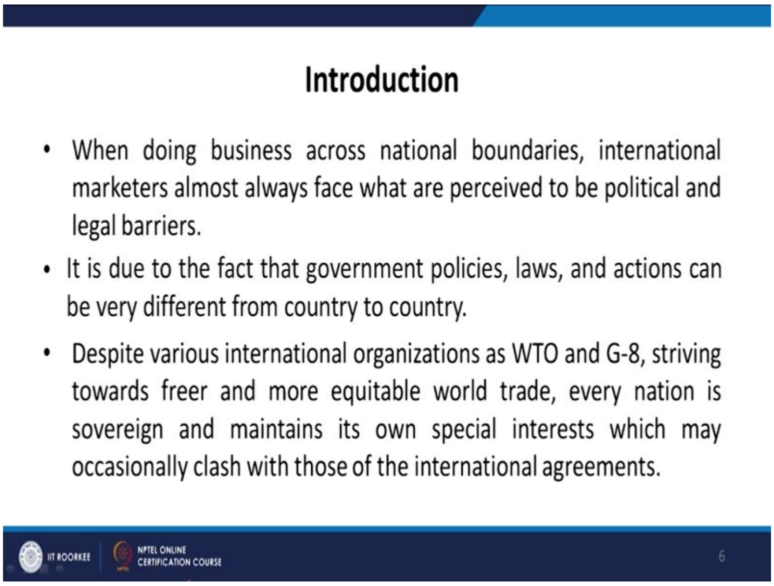
Or the legal environment which is spread over 2 modules, that is module 10 and module 11. So, module 10 is largely based on a political environment. Now, just to keep things in perspective, keep in mind that government of every nation, of each nation, they decide what kind of businesses will be conducted within their boundaries. So, what will be produced, how it will be produced and who produces it, what will be consumed, how much, and by whom.

So, this is very important to understand the political environment of the different countries in which the company operates. And there will be to, different types of political environment. That is, political environment that prevails in the home country and then in the host country and the international political environment that is prevailing across the world. So, in this module, we will, after giving a brief introduction, we will talk about the political environment;

(Refer Slide Time: 01:33)

How to go about a political, understanding political environment is through understanding the role of individual governments and the social pressures and political risks. Because this social pressures, they decide on what kind of legal environment and political environment that will prevail in a country. And then, we will see how terrorism is affecting the world economy.

(Refer Slide Time: 01:55)



Now, when doing business across national borders boundaries, international marketers must always face what are perceived to be political and legal barriers. Now, the different countries will obviously have different kind of political and legal barriers. So, when they, when a company wants to do business across national boundaries, it have to understand the different political and legal barriers.

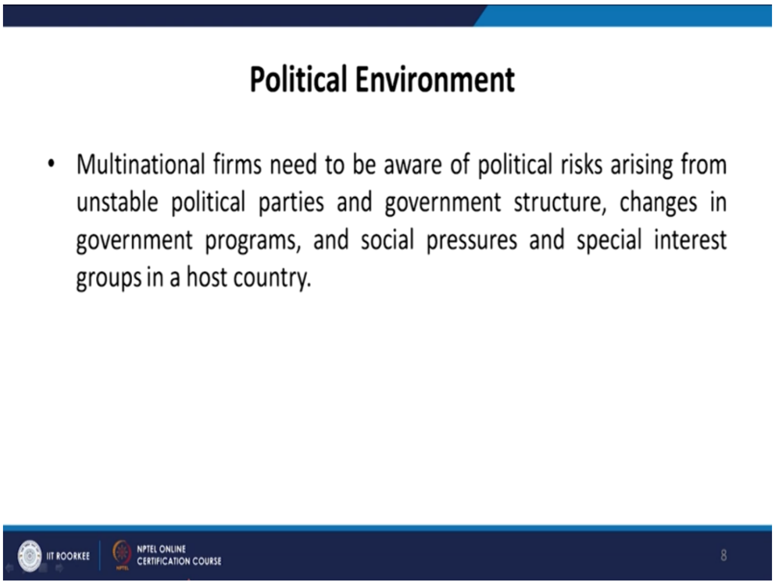
It is due to the fact that government policies, laws and actions can be very different from country to country, despite various international organizations such as WTO, G-8 striving towards freer and more equitable world trade. Every nation is sovereign and it maintains its own special interest which may occasionally clash with those of international agreements. For example, the WTO tries to keep on lowering the trade barriers.

While you will see that President Trump, he has imposed various kinds of barrier tariffs on imports from, not only from China but also from Europe, Canada and Mexico. So, the political environment includes many national and international political factors that can affect the company's operations.

(Refer Slide Time: 03:05)

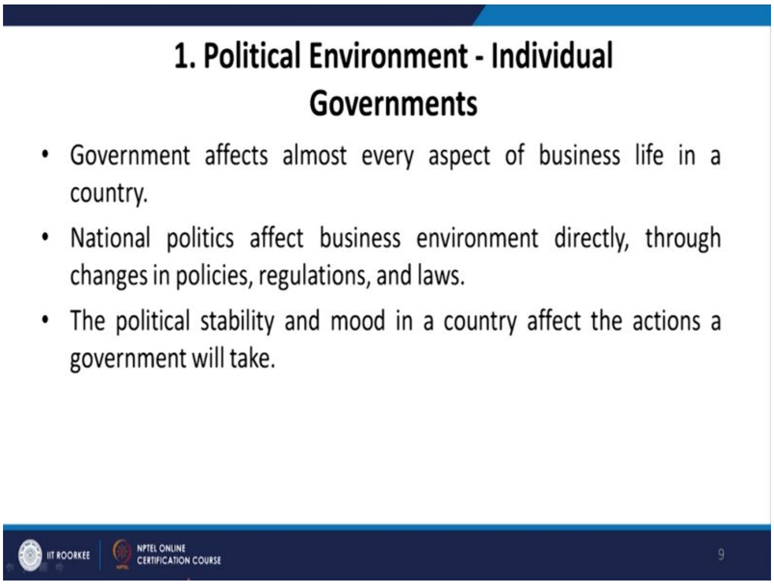
A factor is political when it derives from the government. And political environment comprises of 3 dimensions. 1 is the host country environment, the home country environment and the international environment. And dealing with the problems in international arena is the number 1 challenge facing international managers and occupies more of their time than any other management function.

(Refer Slide Time: 03:36)



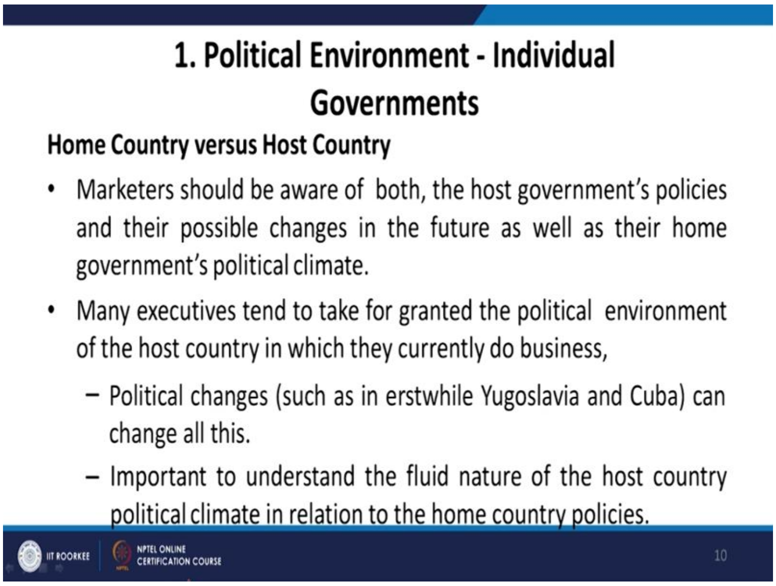
And multinational firms need to be aware of political risks arising from unstable political parties and government structures, changes in government programs and social pressures and special interest groups in a host country. Because that will affect what kind of operations a company can have and which in turn will determine the kind of profitability the company will earn or whether it will be able to achieve the objectives that it has or not. Now, look at the individual government.

(Refer Slide Time: 04:10)



So, governments affect almost every aspect of business life in a country. National politics affects business operations, environment directly through changes in their policies, regulations and laws. How much can be foreign ownership, how many, how much profit can be repatriated. So, these are the things that gets affected by the political environment. The political stability and mood in a country affects the actions of, actions that a government will take.

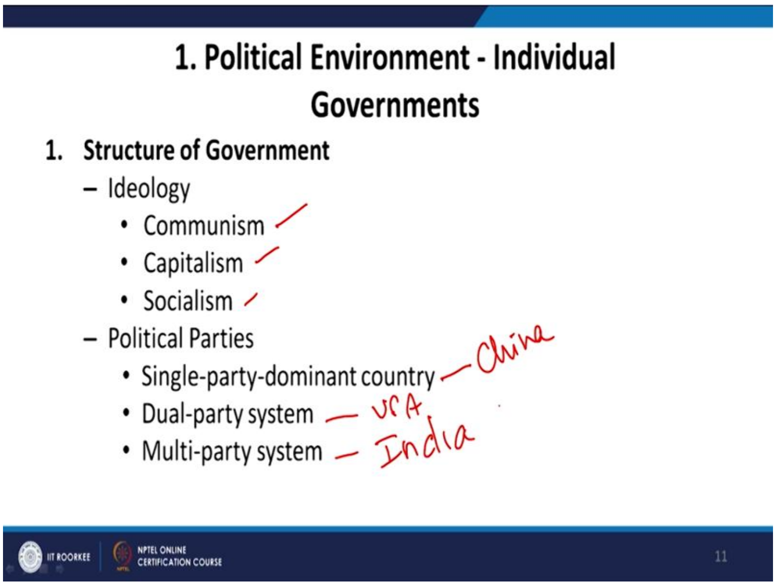
(Refer Slide Time: 04:37)



Now the, let us see at the political environment in the home country versus the host country. Now, there will be 2 different kind of environment. So, marketers should be aware of both the host country policies and their possible changes in the future, as well as their home country's political climate. Many executives, they tend to take for granted the political environment of the host country in which the country do business.

Political changes such as in Yugoslavia and Cuba can change all this. And it is important to understand the fluid nature of the host country political climate in relation to the home country policies.

(Refer Slide Time: 05:20)



In order to understand government individual governments, you have to first look at the structure of the government. And in order to understand the structures of the government, look at the ideology. Whether it is communism, capitalism or socialism. And the number of political parties; is it a single-party dominated country, for example, China. Then dual-party, for example U.S. And then multiple-parties, for example India.

(Refer Slide Time: 05:50)

Also look at the government policies and regulations. Because it is the role of the government to promote a country's interest in the international arena for various reasons and objectives, such as national security, developing new industries and protecting the declining industries. Some government actively invest in certain industries that are considered important to the national interests.

Other governments protect fledging industries, new industries in order to allow them to gain the experience and size necessary to compete internationally. So, they protect the, protect domestic new industries so that they achieve size and learning curve effects. So, and they are now able to compete internationally. So, in general, the reasons for wanting to block or restrict trades are: 1 is national security.

(Refer Slide Time: 06:50)

Ability to produce goods necessary to remain independent. That is, self-sufficiency. And not exporting goods that will help enemies or unfriendly nations. Another reason can be to develop new industries. Idea of nurturing nascent industries to strengthen in a protected market.

(Refer Slide Time: 07:10)

And then, the third design can be protecting declining industries, so that they are able to protect and maintain domestic employment. For example, Japan's active industrial policy by the Ministry of International Trade and Industry in the 1960s and 70s is well known for its past success and has also been adopted by newly industrialized countries such as Singapore, South Korea and Malaysia.

(Refer Slide Time: 07:39)

And government use a variety of laws and policies and programs to pursue their economic interest. For example, the Baltic States of Estonia, Latvia and Lithuania controlled by the Soviet regime until the late 80s, have liberalized their economies significantly by opening up their economies to international trade and foreign direct investments as well as treating foreign companies no differently than domestic companies. As a result of their rapid transition to open market economies, they were formally inducted in the European Union in 2004.

(Refer Slide Time: 08:17)

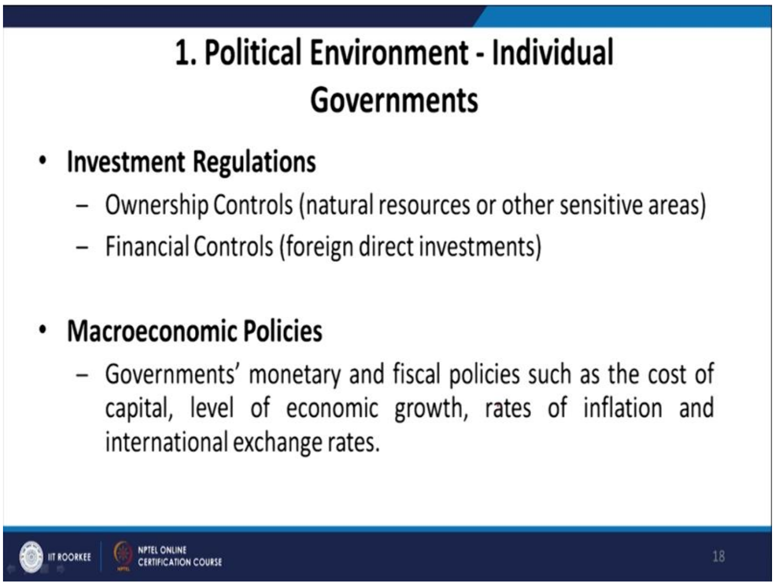
Then, government have various incentives and programs. So, government gives loans, subsidies or training programs to support export activities and specific domestic industries. Export promotion activities are also done by the government like export service programs, market development programs. And then, government procurement, government buys various goods. So, government itself is the customer, it engages in commercial operations through the departments and agencies under its control. So, government have made trade laws. So, the trade control can be broken into the following different categories.

(Refer Slide Time: 09:00)

Economic trade controls and political trade controls. So, the government can control trades through by 2 means. 1 is the, 1 is by economic controls that the government has and another is the political control that the government has. And for these the government has tariffs and non-tariff barriers that works to impede imports which might compete with locally produced goods. So, the government can use various tariffs and non-tariff barriers in order to change the course and direction and amount of trade, amount of imports that it has.

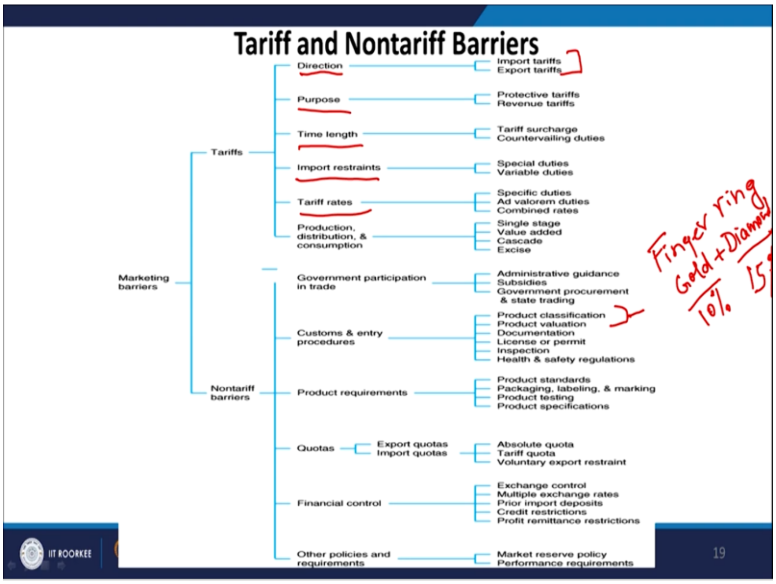
So, and that will make their locally produced goods competitive or uncompetitive. Governments have various other tools also. For example, embargoes and sanctions which are used as political trade controls. And then, there are export license requirements or product based trade controls. Then there are certain investment regulations. How many, how much can a foreign company owned in the host country, that is, that are called as ownership control. Ownership control of natural resources or other sensitive areas.

(Refer Slide Time: 10:19)



And another kind of investment regulation is the financial control. That is, foreign direct investment, how much it can invest. Then, government also have various macroeconomic policies to set the course of this trade. So, government's monetary and fiscal policies such as the cost of capital, level of economic growth, rate of inflation and international exchange rates. These charts, this chart shows the various tariffs and non-tariff barriers that the government have.

(Refer Slide Time: 10:53)



Tariff means that they directly affect the cost and non-tariff barriers means they indirectly affect the cost. So now, the tariff barriers come under various dimensions. So they, it can affect the direction; the purpose; the time length; there can be import restrictions; tariff rates; and production, distribution and consumption. And then, there are certain non-tariff barriers. So, when, when the direction, when the tariffs are towards direction, are directed, have a direction, they are called as import or export tariffs.

Then, there can be protective tariffs and revenue tariffs and so on. There can be single stage tax, value added tax, cascading tax and excise duties. Then, there are non-tariff barriers; are also used by government to determine the type of trade that will happen. So, government participate in trade. They have, they can have customs and entry procedures. For example, product classification.

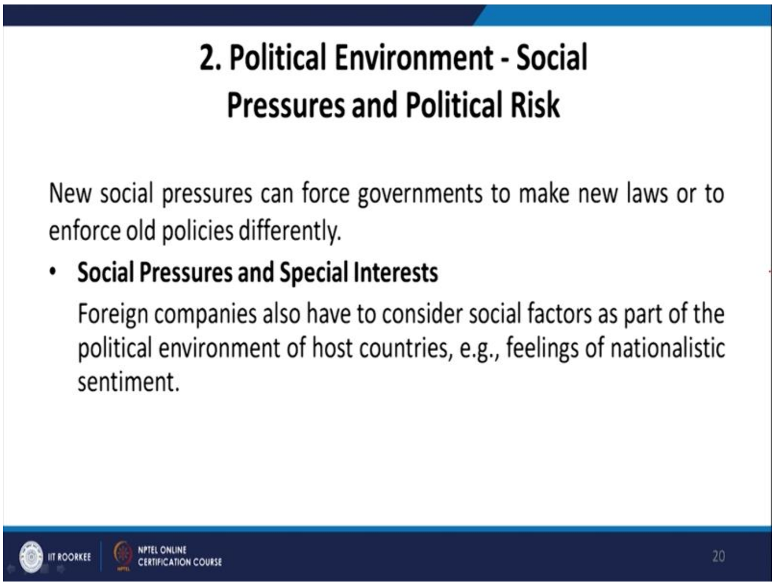
Whether this product, whether a finger ring that is made up of gold and also have a diamond on it. Now, how to treat this finger ring. Is it made up of gold or is it made up of diamond. And both these categories, they attract different types of duties. So, gold may have a 10% duty and the diamond may have a 15% duty. So, this will affect the custom, what amount of custom duties that it will attract.

Then there can be the type of documentation that is required, that are required. Whether it requires license of permit; what kind of inspections are there and various health and safety regulations; can we pack; then there can be product standards; it what kind of electricity goods that run of on electricity, they can be exported or imported. What kind of packaging is required, can we just package the goods and in a plastic box and sell it or do we need to have jute boxes or just paper boxes.

What kind of labelling and marketing and marking is required; what language to be used on each package; should we have a different language for each country where we are exporting. Then, what kind of testings and specifications will be used. Then, there are certain, quota is another type of non-tariff barrier. So, there can we export quotas; how much can be exported. And there can be import quota; how much can be imported.

There are financial controls and other policies and requirements. So, these are, this is the tariffs and non-tariff barriers that are available to the government in order to increase or decrease or change the direction of trade that will happen in the country.

(Refer Slide Time: 14:17)



Then, there are certain social pressures and political risks. So, new social pressures can force governments to make new laws or to enforce old policies differently. And there are certain special interests also. So, the foreign companies can also have to consider social factors as a part of the political environment of host countries, feeling of nationalistic sentiments. Now, how, if people want to buy made local, then what how a multinational company can enter and sell its products in that country. Then, let us see how to manage the political environment.

(Refer Slide Time: 15:03)

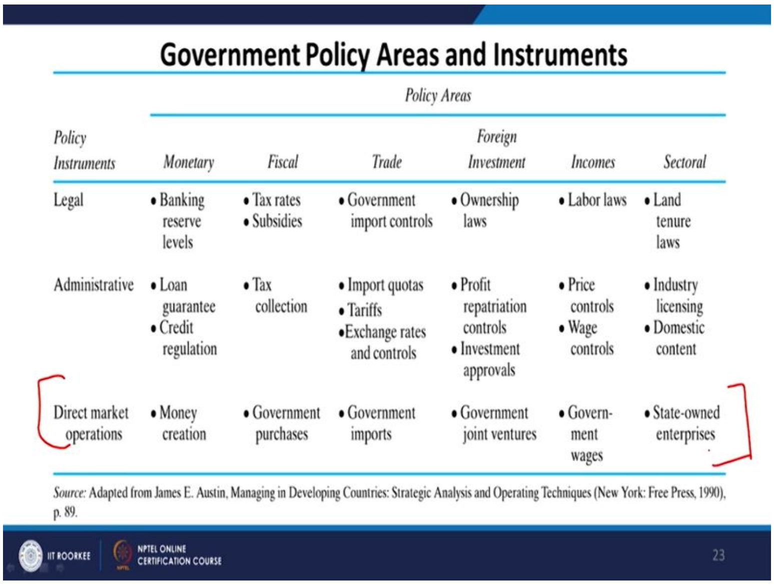
Expropriation refers to foreign government's takeover of company's goods, lands and other assets with compensation that tends to fall short of their market value. So, the government may cease the assets of a company and give some amount of compensation which is not equal to the market value. Confiscation is an outright takeover of assets without any compensation. So, they may confiscate assets over a period time.

And nationalization refers to a foreign government's take over for the purpose of making the industry a government-run industry. So, these can be various kind of political risk that may be there for this, for the company.

(Refer Slide Time: 15:53)

Then, there can be domestication policy or the phase-out policy refers to a company's gradual turning over management and operational responsibilities as well as ownership to local companies over time. Another political, another social pressure or political risk is comes in the form of countertrade. It is in the form of financing international trade, wherein price setting and financing are tied together in 1 transaction. It is essentially barter. The exchange of goods for goods but with some flexibility.

(Refer Slide Time: 16:35)



Government Policy Areas and Instruments

	Policy Areas					
Policy Instruments	*Monetary*	*Fiscal*	*Trade*	*Foreign Investment*	*Incomes*	*Sectoral*
Legal	• Banking reserve levels	• Tax rates • Subsidies	• Government import controls	• Ownership laws	• Labor laws	• Land tenure laws
Administrative	• Loan guarantee • Credit regulation	• Tax collection	• Import quotas • Tariffs • Exchange rates and controls	• Profit repatriation controls • Investment approvals	• Price controls • Wage controls	• Industry licensing • Domestic content
Direct market operations	• Money creation	• Government purchases	• Government imports	• Government joint ventures	• Government wages	• State-owned enterprises

Source: Adapted from James E. Austin, Managing in Developing Countries: Strategic Analysis and Operating Techniques (New York: Free Press, 1990), p. 89.

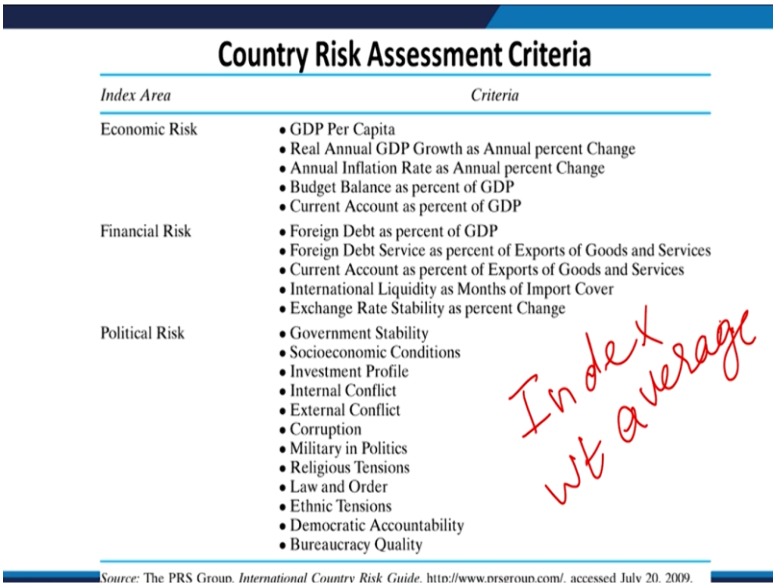
These are the government policy areas and instruments that government of every nation has, which can, through which they can manage the way, the trade within their boundaries. So, there are legal instruments, there are administrative instruments and there are direct market operations. Legal monetary instrument are banking reserve level, for example, CRR. Then, there are fiscal instruments, the tax rates and subsidies the government gives.

Then, there are trade instruments, government import control; what and how much can be imported. Then, government also use foreign investments tool. For example, ownership laws, what kind of, how much land can you own or what kind of investment that, foreign direct investment that account, that a foreign company can do in the host country. The various kind of labor laws, minimum wages, etcetera and land tenure laws.

So, the government lease the land to various businesses for 1 year, or maybe for 99 years. Then, there are certain administrative instruments available with the government. For example, loan guarantee, credit regulations, then the tax collection, import tariffs and so on. And then, the government also do also gets into direct market operations. That is getting into the market directly, on its own.

So, that can be money creation, 1; fiscal is the government purchases; and the trade instrument available through direct market operation is government imports. Then government can set up joint ventures, then what are the minimum wages that the government has set. And then, you can have state owned enterprises.

(Refer Slide Time: 18:35)

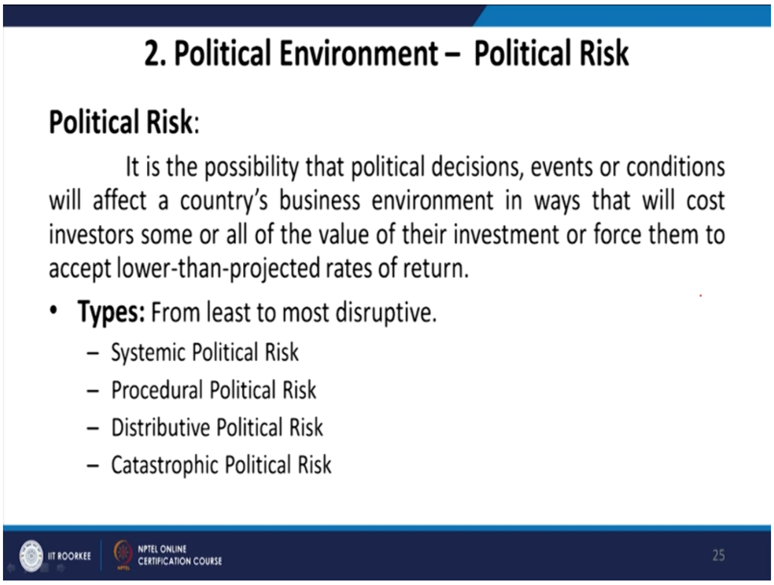


On the basis of all this, how to decide which country is better to enter and which country is not so good to enter. And for that, what companies do is to assess the risk and this is the country risk assessment criteria. Obviously the riskier the country is, the company would not like to enter that kind of country. So, the lesser risk, the more important it is for the company to enter. So, how to go about assessing the risk.

So, there are 3 types of risks. 1 is the economic risk, another is the financial risk and the third is the political risk. So, on the basis of these factors, a index is made on the basis of which the company is able to understand which country is riskier, which is less riskier. Where economic risk is more, where political risk is more and where financial risk is more. So, when we are talking of economic risk, that includes GDP per capita, annual growth annual GDP growth, annual inflation rate, budget balance as percent of GDP and the current account as percent of GDP.

So, on the basis of this, a index is made. A index is a weighted average and on the basis of which it becomes easier for companies to decide in which country, which countries are riskier and which are not riskier.

(Refer Slide Time: 20:10)

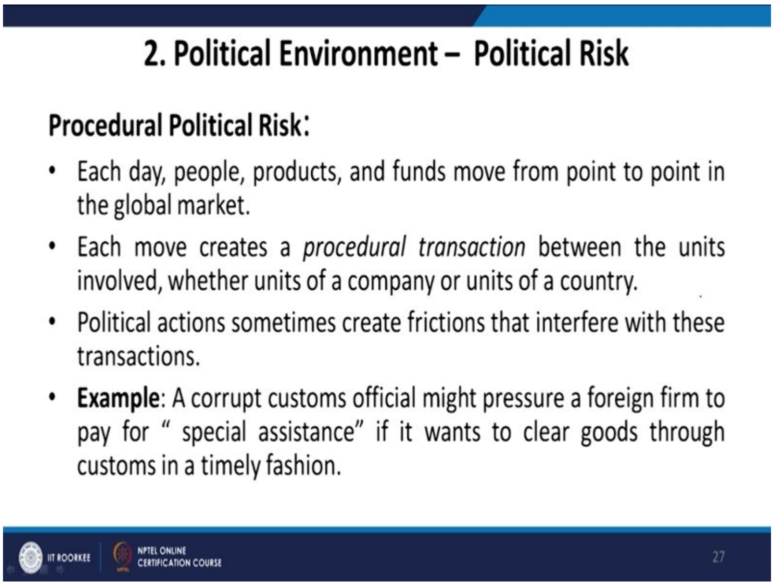


Then, there are certain kind of political risk. So, it is the possibility that the political decisions, events or conditions will affect the country's business environment in ways that will cost investors some or all of the value of their investment or force them to accept lower than projected rate of returns. And the type of the political risk are: systematic political risk, procedural, distributive and catastrophic.

(Refer Slide Time: 20:41)

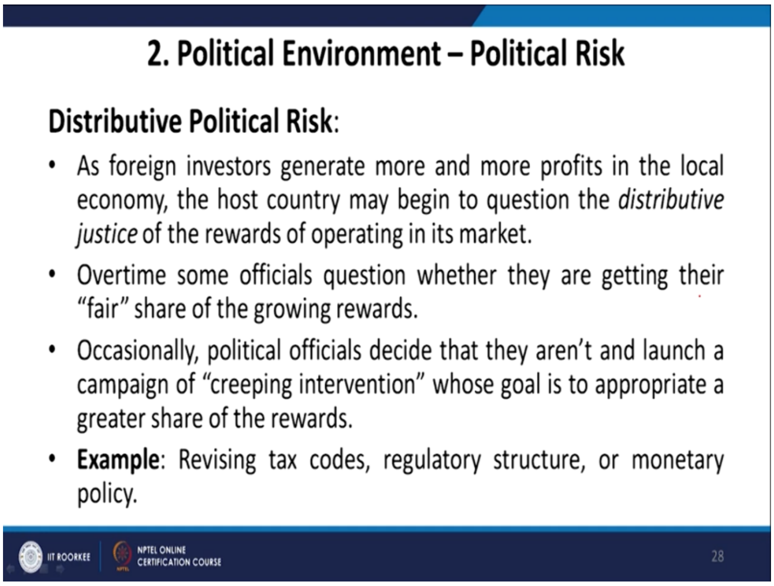
The systematic risk means the risk that impact all firms whose activities are affected by the political system. But systematic changes do not necessarily create political risk that reduce profit potential. For example, in 1990s Argentinean government initiated a radical program to deregulate and privatize the government, the country's state-centered economy. Investors who accepted the risk and persuade the resulting opportunities prospered as the country became more democratic.

(Refer Slide Time: 21:15)



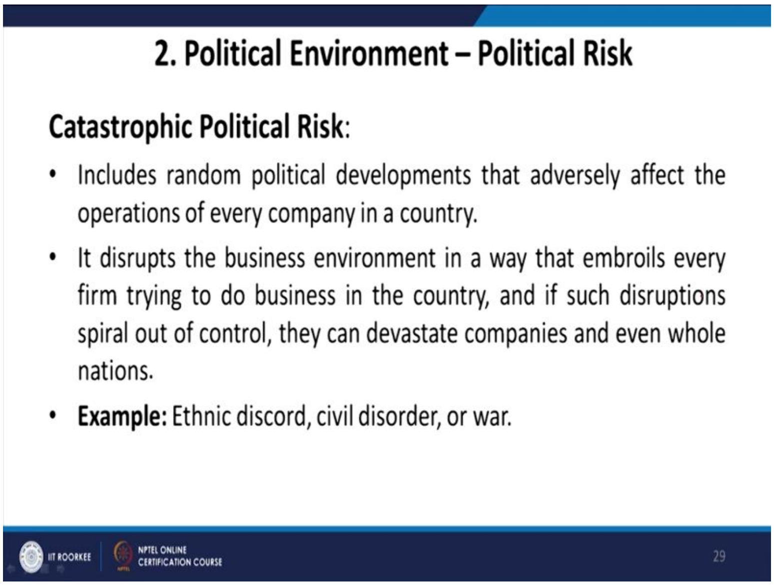
Procedural risk: each day, people, product and funds move from point to point in the global market. Each move creates a procedural transaction between the units involved whether the units of a company or units of a country. Political actions sometimes create friction that interfere with these transactions. For example, in recent times, the crisis of separated families in the U.S. Another example is a corrupt custom official might pressure a foreign firm to pay for special assistance, if it wants to clear goods through customs in a timely fashion.

(Refer Slide Time: 21:58)



The distributed political risk means, for example, a foreign investor generates more and more profit in the local economy. The host country may begin to question the distributive justice of the rewards of operating in that market. Sometime or overtime, some official questions whether they are getting their fair share of the growing rewards. Occasionally political officials decide that they are not and launch a campaign for creeping intervention whose goals is to appropriate a greater share of the rewards. For example, revising tax code, regulatory structure or monetary policy.

(Refer Slide Time: 22:39)



Catastrophic political risk includes random political developments that adversely affect the operations of each company in a country. It disrupts the business environments in a way that embroils every firms trying to do business in the country. And if such disruptions spiral out of control, they can devastate companies and even whole nations. For example, ethnic discord, civil disorder or war.

(Refer Slide Time: 23:10)

The last component of this module is the terrorism; how terrorism affects the world economy. So, terrorist activities, they interpret international movement of supplies and merchandise and financial flows. Every year, terrorist attacks make a considerable impact on the world economy. So, according to 2017 global terrorism index, the impact fell by 7% in 2016, the second year in succession that it declined. Despite the decline, cost still bridged reached $84 billion last year.

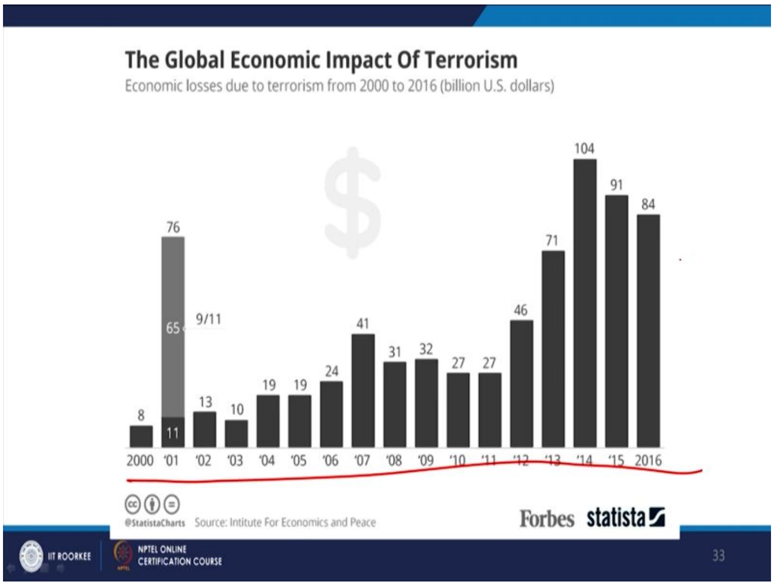
(Refer Slide Time: 23:57)

According to an IMF study, the September 11, 2001 terrorist attack in New York and Washington DC resulted in major losses for the U.S. economy. The short-term lost economic output was estimated as $47 billion. The stock market lost $1.7 trillion in addition to 125,000 workers were laid off for 30 days. Since the attack on 9/11, economic losses from terrorism generally fluctuated before reaching $41 billion in 2007, primarily as a result of violence in Iraq. And with the rise of ISIS, there was a further surge in losses since 2012. And they reached the peak of $104 billion in 2014.

(Refer Slide Time: 24:52)

Countries embroiled in conflicts, tend to suffer the highest economic impact of terrorism. Most of them are situated in the Middle East, North Africa, Sub-Saharan Africa and South Asia. Last year, Iraq had the highest economic impact of terrorism as a share of GDP at 24%. Afghanistan was also ravaged by terrorism with losses coming to 13% of GDP, while South Sudan had the third highest impact at 9%.

(Refer Slide Time: 25:24)



Now, this shows the economic impact of terrorism. These bar charts, they come from Forbes. So, on this axis we have the years and this is what how much losses were made. So, with this we end this module, the ninth module. And in this module we have talked about the political how to go about analyzing the political environment of a country. And to further understand the political environment of the country;

(Refer Slide Time: 25:58)

These can be the sources from where you can understand these things further. Thank you.