
# Chapter 3

## Appreciating the dynamics of the international economic and financial environment

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# Book Content

## *Learning objectives*

After reading this chapter you should be able to:

- identify ways of segmenting the global economic environment and appreciate the ways in which countries differ from each other in terms of global variables
- recognise that consumption patterns have an important effect on demand in international markets
- measure international markets so as to predict likely outcomes of involvement
- analyse the role of international bodies in regulating the international business environment
- determine the impact of international trade relations negotiations and agreements on international marketing
- explain how the international financial system operates
- recognise how foreign exchange variations influence the successful undertaking of international business
- understand alternative strategies when faced with recession in an international market
- identify the role of aid in creating international business opportunities.

## *Discussion Questions*

**1. Apart from those mentioned in the chapter, what are the new emerging global trends likely to influence the global economic scene in the second decade of the 21st century?**

Some of the emerging global trends that are likely to impact on the global economic scene in the 21st century include:

1. *Increased use of technology* – Technology enables the international marketer to gain faster access to information about many aspects of its existing or potential overseas markets. It may also be used to decrease the cost of conducting business overseas.

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2. *Well-informed consumers* – Consumers globally are becoming aware of products being made and sold overseas (particularly because of technology) to which they have access like never before. If a product made overseas is not sold in the domestic country (say, at a retail or wholesale level), it does not mean that it cannot be bought at all.
3. *Increase in small firms participating in export marketing* – Most forms of international marketing activity used to be the exclusive domain of relatively large, well-resourced organisations. The number of smaller firms engaging in basic exporting activity is increasing, due mainly to the advent of technology (especially the internet), the decrease of trade barriers and the issue of government-funded export grants.
4. *The increase in born globals* – Born globals are (usually small) firms that commence their operations internationally and have not operated in the domestic market. The internet, in particular, has accelerated the incidence of born global firms.

Instructors should encourage students to both advance and defend their suggestions for emerging trends. Students should also be encouraged to determine how these trends might both positively and negatively impact on Australian and New Zealand companies operating in both domestic and international markets.

**2. Classification of countries according to economic criteria is often a way of assessing their likely potential as markets. Discuss the merits of classification by economic system, by economic structure or by stage of market development.**

This question could be answered in the form of a matrix as illustrated below.

| Country | Economic System | Economic Structure | Stage of Market Development |
|---|---|---|---|
| China | | | |
| Japan | | | |
| Indonesia | | | |
| Philippines | | | |

Countries can be classified by economic system (market allocation, command allocation and mixed system), economic structure (agriculture, industry and

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services) and stage of market development (high-income, upper middle-income, lower middle-income and low-income). Such classification enables the international marketer to assess the potential economic viability of marketing its product into a country, the likely price it will have to charge for their product, the likely government involvement in the firm's marketing activity in a country, and how sophisticated (i.e. literate, informed) the consumers in that country are. The matrix illustrated above also enables the international marketing firm to compare countries on the same criteria and prioritise its investment based on the economic environment of each offshore destination.

**3. A number of criteria can be used to measure international markets. Which is <u>most relevant</u> for suppliers of:**

**a) basic consumer goods?**
**b) luxury consumer goods?**
**c) industrial products?**
**d) environmentally friendly products?**
**e) infrastructure projects?**
**f) mining equipment?**

a) Basic consumer goods – income distribution, per capita income.
b) Luxury consumer goods – consumers' discretionary income, income distribution.
c) Industrial products – economic infrastructure.
d) Environmentally friendly products – government policy on the environment.
e) Infrastructure projects – stage of economic development.
f) Mining equipment – stage of economic development.

Students should be reminded that a number of different criteria would be used for each type of product – the question asked only for the most relevant. Students should be encouraged to explain why they have selected each criterion as the most relevant.

**4. Are regional trade groupings more effective when greater national sovereignty is ceded to the group, as happens in an economic union? How would you rate the effectiveness of APEC in this context?**

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For regional trade groupings to be effective, some degree of ceding of national sovereignty needs to take place. Most governments will cede the minimal amount of national sovereignty possible in the interest of making the regional trade grouping successful. APEC's success in this matter is difficult to measure given the diverse economic, political and cultural backgrounds of its member nations. That being said, students should be encouraged to advance and defend their evaluation of effectiveness.

**5. Discuss the role of the International Monetary Fund in enforcing financially responsible behaviour on the nations of the world. Is there a better alternative?**

The role of the International Monetary Fund (IMF) is (amongst other things) to assist those nations that need funding for economic infrastructure development projects to assist with their economic development. The IMF's role in enforcing responsible financial behaviour is, at times, questionable. Many nations (such as Mexico and Indonesia) have defaulted on financial-aid loans provided by the IMF. However, in recent times, the IMF's funding of aid projects has been contingent on the lending nations' ability to repay – hence aid is dependent on the government undertaking certain economic measures before they receive aid funding. Students should be encouraged to advance and defend any alternative they suggest.

**6. What were the economic and financial causes of the global financial crisis of 2008? Why did the IMF receive such criticism for failing to protect the international financial system?**

A variety of factors is behind the global financial crisis of 2008 and students should be encouraged to advance and defend their own opinions. Most will likely point to the US 'credit crunch' (sub-prime mortgage liquidity crisis) as being a major contributing factor (some would suggest initiating factor). Students, however, should note how financial markets are now so inter-connected that stresses or failures in one inevitably lead to stresses or failures in others (stock market volatility, collapse of financial institutions, lack of consumer confidence, government bailouts). Students should note the current Eurozone debt crisis with countries requiring bailouts.

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The IMF was created to promote international cooperation and facilitate balanced growth of international trade. The IMF has been criticised for the conditions it places on the loans it gives to countries in distress such as Greece's austerity measures and that such measures (e.g. cut government expenditures) infringe national sovereignty.

**7. What are the most common forms of financial risk involved in doing business internationally? What ways exist of minimising this financial risk for local firms?**

The most common forms of financial risk in doing business overseas are:

1. *commercial risk* – relates to the loss resulting from the loss of a key customer, the threat of a takeover bid, or slow payment by an overseas client
2. *political risk* – relates to the risk that government policies and actions overseas threaten the financial viability of the marketing firm's investment in that country
3. *foreign exchange risk* – results from fluctuating exchange rates leading to shortfalls or windfalls in costs and profits.

Financial risk can be minimised by Australian or New Zealand firms in a number of ways. Firstly, they can negotiate a fixed exchange rate for a particular transaction. If the official exchange rate happens to change substantially during the period of the transaction, neither firm is affected because they have agreed to a rate of exchange.

Secondly, Australian or New Zealand firms can reduce the financial risk of conducting business overseas by agreeing to do business in a stable currency (often the US dollar). This currency may not be beneficial for most firms, but it does minimise the risk of financial strife.

Finally, the Australian or New Zealand firm can simply avoid doing business in those nations where the risk of conducting business is too great.

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## *Case Study Solutions*

*Coping with crises in international markets*

**Question 1**
What are the problems that can be used in international marketing due to a crisis?

**Answer**
A crisis is a crucial moment, a turning point in events. There are various types of crises and each has its own impact in one way or another. A crisis can cause many problems to an organisation.
It can cause financial loss to the organisation.
It can affect the image of the organisation in a negative way.
There can be potential loss of manpower and infrastructure due to an environmental crisis.
Crisis can also put the organisation out of business and force it to close down.

**Question 2**
What is crisis management?

**Answer**
Crisis management is the process to deal with any unpredictable event that can be a threat to the company, its shareholders or employees. Crisis management requires a proper plan in place and teamwork. Crisis management can also be defined as trying to deal with the problem after it has occurred. It is very important to have a plan in place and to train staff ahead of a crisis situation occurring. When a company is planning for a crisis, it should also have a post-crisis plan in place. This can help an organisation to avoid a similar situation in future.

**Question 3**
What can companies do to prepare themselves for a crisis that occurs in an overseas market?

**Answer**
Identify the crises that can impact on the organisation.
Have a strong business continuity plan in place.
Have an action plan in place along with a checklist.
Appoint someone as a single point of contact to communicate with the client.
Try to recover from the crisis and continue business as normal.

**Question 4**
Why is crisis management important for international companies?

**Answer**
International companies invest a lot of money when they take their business overseas. There are many reasons why a company would decide to invest in a different country – profit and success in business are just a couple to mention. If the organisation that an international company has invested in is hit by a crisis, then the parent company will suffer many losses.

Setting up crisis management is favourable for international companies as it ensures they do not suffer any kind of financial loss. This also helps both of the companies in the long run, as both firms are ready for any kind of crisis and can minimise the loss.

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**Question 5**
Do you consider that firms with operations in a number of countries are in a better position to cope with crises than firms that operate in a single location and/or a single country?

**Answer**
*Please note:* This question requires personal reflection and justification.

## *International Marketing Edge (IMEDGE)*

**Concept**

The IMEDGE section draws on materials covered in each chapter to give students an opportunity to undertake a practical and hands-on exercise which covers a specific international marketing topic. Using information from the chapter and other extra sources, IMEDGE tasks can be done either as group or individual activities.

*What are the potential benefits of IMEDGE?*

**Students**

- It requires students to apply theory to a real life scenario using information from the sources identified in the chapter.
- It consolidates students' understanding of key concepts covered beyond the basic theory.
- Unlike case studies, the task involves collecting current on-going data and applying it to concepts covered.

**Instructors**

- It is a very useful teaching aid since it asks students to complete a task which involves looking for current information and applying principles covered.
- It encourages students to keep abreast of current international marketing activities
- It can complement other blended teaching and learning activities applied by instructors. For example, discussion questions and research assignments.

## Model Answer - IMEDGE - Chapter 3

### General country fact sheet which details the two countries' economic situation

Students are required to undertake a real time evaluation of the Italian and Spanish economic environments in the context of the economic crisis they have faced. The key challenge is for the students to identify relevant economic indicators that are likely to impact on how a diversified beverages company can explore marketing opportunities in these countries. Thus, emphasis should not be just on presentation of economic indicators but on indicating their relevance.

### An assessment of opportunities to expand into this market in view of the economic fact sheet that you have prepared.

Identification of marketing opportunities should follow from the economic situation analysis. Students could use the IMF country reports to identify opportunities for diversifying into products that are likely to be deemed necessary in the tough economic environment in which the two countries find themselves. There are various source documents available from the International Monetary Fund and World Bank which students can access. Country fact sheets from DFAT, Austrade and NZTE can also be used to identify some of the opportunities that Australian firms are exploring in these countries. Austrade and NZTE export reports clearly identify opportunities for local companies overseas.

**Examples of product innovation include**:

- Modified cheaper fast moving consumer goods.

### Key Information Sources


**SPAIN**

1. **Department of Foreign Affairs and Trade (2011),** www.dfat.gov.au/geo/fs/ital.pdf
2. **International Monetary Fund (2012). *CountryInformation. www.imf.org/external/country/ESP/index.htm***
3. **World Bank (2012),"*Countries and economies". http://data.worldbank.org/country/spain***
4. **Central Intelligence Organisation (2012) *The World Factbook*. https://www.cia.gov/library/publications/the-world-factbook/geos/sp.html**
5. **Organisation for Economic Co-operation and Development (2012). *Countries*. http://www.oecd.org/spain/**
6. **Austrade (2012), *Spain Profile*. http://www.austrade.gov.au/Spain-profile/default.aspx**

**ITALY**

1. ***Department of Foreign Affairs and Trade (2011)*** **www.dfat.gov.au/geo/fs/ital.pdf**
2. ***International Monetary Fund (2012). Country Information. www.imf.org/external/country/ITA/index.htm***
3. ***World Bank (2012),"Countries and economies". http://data.worldbank.org/country/italy***
4. **Central Intelligence Organisation (2012) The World Factbook. https://www.cia.gov/library/publications/the-world-factbook/geos/it.html**
5. **Organisation for Economic Co-operation and Development (2012). Countries. http://www.oecd.org/italy/**
6. **Austrade (2012), *Italy Profile*. http://www.austrade.gov.au/Italy-profile/default.aspx**


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# Teaching Notes

## *Tutorials*

1. Have students bring in one article from an Australian or New Zealand newspaper (hard copy or online) and one article from an international newspaper or business publication (online) that illustrates the impact of global economic conditions on a specific company. The purpose is to ensure students realise that international economic events and conditions can and do have significant impact on the activities and fortunes of individual companies. For example, a company currently exporting products considered by most consumers as discretionary purchases might be experiencing difficulty in European markets struggling under crippling debt and imposed austerity measures.

2. Have students explore the websites of the International Monetary Fund (www.imf.org) and the World Bank (www.worldbank.org) and discuss how each organisation might positively affect international marketing efforts for a specific country. The purpose is to ensure students are familiar with the range of activities of each organisation and the data available on their websites.

## *Lectures*

1. When discussing economic integration (**Chapter 3: Regional trade groupings**) students should be encouraged to critically evaluate the benefits and disadvantages presented to Australian or New Zealand international marketers by the different categories. For example, initial thoughts that the European Union would result in 'Fortress Europe' with access cut off to marketers from non-EU countries has not eventuated; however, trade between EU member nations has been made significantly easier. One of the benefits has been standardisation in a range of aspects of significance to marketers, not the least of which being the majority adoption of the Euro – a single currency simplifies pricing across European markets.

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2. When discussing free-trade areas (**Chapter 3: Regional trade groupings**) students should be reminded that there are winners and losers with every agreement. For example, the China-New Zealand Free-trade Agreement was extremely beneficial to New Zealand's agricultural sector (eventual reduction/elimination of tariffs on NZ dairy etc) but has had quite negative effects on New Zealand's domestic shoe manufacturing industry (eventual elimination of tariffs on Chinese textiles and shoes), with many producers forced to go offshore.

## *Assignments*

1. Select two countries with dynamic and volatile environments (e.g. Argentina, China) and two different products. Using the political factors identified in the chapter, discuss the possible challenges to the international marketer of your selected product or industry in each country.

This assignment requires students to research the factors identified in the text (**Chapter 3: Political factors**) such as the philosophy of the party in power as they apply to their selected country. Once students have an understanding of these political factors they need to then determine the challenges these might present to the marketers of their selected products. The answers will vary depending on the products or industries selected.

2. Select one country and one product. Using the criteria for measuring markets identified in the chapter, critically evaluate whether the company producing your selected product should enter your selected country.

This assignment requires students to conduct research into their selected country, identifying aspects such as per capita income, purchasing power parity (e.g. Big Mac index), age/location of population, infrastructure etc. (**Chapter 3: Measuring markets**). Students then have to determine whether or not the selected country represents an attractive market for their selected product. The assignment asks for critical evaluation, requiring students to consider both positive and negative aspects.

## *Additional Questions*

**1. Explain the philosophy of Engel's law and discuss how an understanding of Engel's law can assist the international marketing manager.**

Engel's law states that, as income rises above a certain minimum, expenditure on food as a percentage of total income decreases. The share of income spent on necessities provides an indication as to how much consumers are likely to spend on other purchases. Thus, the average income level of a nation influences heavily what will be produced and consumed. For example, the lower the per capita income of people in a nation, the more they will spend on basic necessities such as food and clothing. As their discretionary income rises, they will tend to spend more on other items such as white goods, holidays and so on. Being aware of such issues allows the international marketing manager to identify potential markets.

**2. The economic environment of any nation is beyond the control of the international marketing manager. Briefly describe the strategies a firm can employ to cope with an economic recession in an international market, and discuss the relevant factors that would influence the choice of strategy.**

Kotabe and Helsen (2000) identify eight possible strategies (**Chapter 3: Coping with recession**):

1. pulling out
2. emphasising a product's value
3. changing the product mix
4. repackaging the goods
5. maintaining stricter inventory
6. looking for expansion opportunities outside the region
7. increasing advertising
8. increasing local procurement.

Which of these strategies (or combination of these strategies) the firm decides to use will depend heavily on the product and the industry. For example, when the Asian crisis occurred in the late 1990s, the live beef trade to Indonesia ceased.

Australian livestock exporters could not afford to export stock at the level at which the Indonesians could afford to pay. Thus, the first of the eight strategies, an exit from the market (either short-term or permanently), was a viable option. The choice of the other seven options will depend on the firm's strength and position in the market, the firm's own internal resources in terms of being able to 'ride the storm', and also the anticipated severity and time frame of the recession.

**3. Based on the factors outlined for measuring markets listed in the textbook, which would you consider to be most important for a) food exports, b) high-technology exports and c) fashion goods?**

This answer will require students to address the economic and non-economic factors that need to be considered, including income, population, quality of life, infrastructure, geography, debt and resources (**Chapter 3: Measuring markets**). For a basic product like food, the main issues will relate to income, population, geography, resources and infrastructure. In particular, students will need to address issues such as how the product will get to the appropriate country and its regions, how it will be distributed, and whether or not the resources of the country will mean that the product can be easily produced locally. High-tech products will be particularly influenced by income and infrastructure, while non-essentials such as fashion items are most likely to be influenced by income, population (especially distribution of age) and geography, with a greater emphasis on markets contained in the urban centres that are more outward looking in terms of fashion and new products.

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