

**Subject: Management**

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**Paper: 08, International Business Operations**

**Module: 05, International Business Environment: External Environment #2**



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Items	Description of Module
<b>Subject Name</b>	Management
<b>Paper Name</b>	International Business Operations
<b>Module Title</b>	International Business Environment: External Environment -2
<b>Module Id</b>	Module no.-05
<b>Pre- Requisites</b>	Cultural, Political, Legal & Regulatory factors
<b>Objectives</b>	To study the basic concepts of external Factors effecting International Business
<b>Keywords</b>	Cultural, Political, Legal Environment

## QUADRANT-I

<b>Module 05: International Business Environment: External Environment -2</b>
1. Learning Outcome
2. Introduction
3. Cultural environment
4. Impact of culture on business and individual Decision making
5. Political factors
6. Legal Environment
7. Summary

### Learning Outcome:

After completing this module the students will be able to:

- To understand various components of external business environment faced by global companies and how they impact the business.
- To know about cultural, political, legal and regulatory components of the environment.

### Introduction

In the previous module, we had explained some of the components of the international business environment. There are some more components of the same, which have lot of influence on the success and operations of businesses in the overseas markets. The important components are the socio-cultural, political and legal environments. While there is lot of intermingling between these components, these are distinct in nature. They have an overt influence on the business operations and the businesses need to understand them and adapt according to the overt influences of these environmental components.

### Cultural environment

The term culture originated in 18<sup>th</sup> and 19<sup>th</sup> centuries in Europe and has been acquiring different connotations, each representing a different perspective, viz. agriculture, anthropology, sociology, philosophy, psychology, etc. Etymologically, it

refers to the cultivation of the soul. As the philosophers accommodated a wider and practical perspective to life, accommodating other existential aspects, culture acquired a different meaning and is used to refer to all the ways in which the humans overcome their original barbarism through artifice and become fully human. Thus, it is the set of shared values of a society. It encompasses religion, language, customs, traditions and beliefs, tastes and preferences, social stratification, social institutions, buying and consumption habits etc.

The study of culture is the study of all aspects of a society. It is the language, knowledge, laws, and customs that give society its distinctive character and personality. In the context of consumer behavior, culture is defined as the sum total of learned beliefs, values, and customs that serve to regulate the consumer behavior of members of a particular society. Beliefs and values are guides for consumer behavior; customs are unusual and accepted ways of behaving.

The impact of culture is so natural and ingrained that its influence on behavior is rarely noted. Yet, culture offers order, direction, and guidance to members of society in all phases of human problem solving. Culture is dynamic, and gradually and continually evolves to meet the needs of society.

Culture is learned as part of social experience. Children acquire from their environment a set of beliefs, values, and customs that constitute culture (i.e., they are cultured). These are acquired through formal learning, informal learning, and technical learning. Advertising enhances formal learning by reinforcing desired modes of behavior and expectations; it enhances informal learning by providing models for behavior.

Culture is communicated to members of the society through a common language and through commonly shared symbols. Because the human mind has the ability to absorb and process symbolic communication, marketers can successfully promote both tangible and intangible products and product concepts to consumers through mass media.

### **Impact of Culture on business and individual decision making**

Culture has several interfaces where it influences the business and has an impact at the macro level as at the individual level. Some of the macro level impacts of culture are:

- (i) Decision-making: In some societies, all-important organizational

decisions are made by the top management, while in others, the decisions are diffused throughout the organization. For example, the decision making is highly decentralized in Japanese firms, while it is highly centralized in American firms. There are cultural reasons behind this.

(ii) Risk evasiveness: The decision-makers in some organizations are averse to risk, while some take risk and thus make higher gains. The risk bearing behaviour of groups is also a cultural phenomenon. This influences investment decisions at the organizational levels and at the micro level of the consumers, it has its impact on the buying habits. People who take risk buy new and innovative products, while others prefer to stick to tested products.

(iii) Individual vs group reward: In some societies, such as the Japanese, the group reward is valued more than the individual reward, which is the order in the American firms.

(iv) Organizational loyalty: Extrapolating the above point, the societies with strong inter-personal ties have a high degree of organizational loyalty, while those who value individual achievements have low organizational loyalty.

(v) Culture and perception: Culture has a great bearing on how people view themselves and their surroundings, which influences their behaviour. The cultural impact of perception influences the sense of self gratification, empathy and organizational commitment.

(vi) Individual impacts: Besides the macro level impacts, culture has an impact at the level of the individuals as well. Culture influences the sense of self and space, communication and language, dress and appearance, food and feeding habits, time consciousness, beliefs and norms, customs and rituals, mannerisms and etiquettes, etc.

**Subculture:** Within the broadly defined culture, there are several sub-cultures, which assert a similar influence on the business. A subculture is a variant of the culture. While it shares values and beliefs with the culture, it does modify it according to the specific requirements of the group. For example, although the people all over India share common values, celebrate common festivals and profess similar religious beliefs, there are several variations at local levels. Hindus of northern India would follow different rituals from those in eastern India or southern India. The marketer must understand the subculture as well while adapting to the local conditions.

To sum up, understanding of culture is very important for success in overseas marketing. Although, the world is becoming global and there is a high degree of cultural diffusion, still, there is a need to adapt to the local environment, of which culture is an important constituent.

### **Culture and International Marketing**

Culture has lot of impact on international as the marketing mix has to be designed according to the cultural characteristics of the population of the host country. For example, when McDonalds launched their burger into the Indian markets, they introduced the products which had stronger and pricier tastes to suit the taste buds of the Indian consumers. They did not introduce any varieties of burger, which used beef as it would have hurt the sentiments of a majority of the Indian population.

Similarly, culture influences the communication patterns and styles and the marketing communication campaigns have to be designed accordingly. For example, Pepsi has a very popular slogan – Come alive with Pepsi generation. When Pepsi used the same slogan in China, it translated as – Pepsi will bring your ancestors from the dead. This slogan created lot of negative publicity and it had to be withdrawn. Similarly, a baby food manufacturer had to change its brand name from 'Gerber' because in French it means – to vomit.

Kellogg could not succeed into the Indian market to the extent to which it had anticipated because cereals are not the preferred breakfast food. So, they had to target specific consumer segments such as children, women, etc.

The above examples show how firms can make big mistakes when they do not understand the local culture and introduce their products. So, the new mantra for success into the overseas markets is – 'Think Global, Act Local.' It means that while firms must have a vision to grow into a global company, they must act according to the culture, tastes and preferences of the local markets. Such an understanding will help them to be successful into the international markets.

### **Political environment**

As a firm ventures abroad, it has to deal with various countries, each having its own political set up. Some of the components of the political environment are:

Political Systems:

After the disintegration of USSR, the communist or the socialist form of government

is not working in many countries, but the impact of socialism on the thinking of the people and political class is still discernible. There are countries like Pakistan, which follow dictatorship style of government, while most countries in Europe and North America follow democracy. Even the democracy has various forms such as the presidential form, as prevalent in USA, or the parliamentary form of government, as in UK and India. Some countries in the Middle East have a typical theist –political set-up, while others are secular countries. There have been lots of changes in the Arab world, where people have come forward and asserted themselves to switch over to democracy.

The form of government has a direct impact on business because each form of government has its own typical set of policies, programmes and priorities. These have an impact on the regulatory mechanism of the countries and the business has to comply with the laws of the land.

#### Political instability

Despite diverse political systems, no system is bad if it works in a stable manner. The biggest problem arises when there is political instability. Some of the examples of political instability are:

- Widespread public protests have changed the dictatorial forms of government in Egypt and Libya
- There is a bloody battle going on in Syria for the change of government
- Pakistan had a military coup and then a democracy, controlled by the military dictator
- Afghanistan was under the rule of fundamentalist Taliban and there is elected government now. Situation will drastically change if US withdraws its army from there
- Iraq had seen a change in regime, enforced by America
- There were coups and genocides in Sierra Leone, Ethiopia, Eritrea, Congo and many other African countries

In each of the examples quoted above, we find an element of uncertainty. The forms of government change and so do the nature of doing business with that country. For a firm aspiring to market its products abroad, it has to carefully study the type of the political system and the stability. In countries, which are politically instable, the business takes extra protective measures and restricts its operations to exporting or joint ventures. However, in the countries with high political stability, the business

makes direct investments.

China has attracted maximum foreign direct investment because of a stable pro-business attitude of the government. Despite being a socialist state, China has transformed itself to the needs of time and has opened up its economy at a fast rate. On the other hand, the ghost of regulatory set-up of the yesteryears continues to haunt India and we see less investment here. Even within India, we see lesser investment in the states such as Kerala and West-Bengal because of the leftist parties have been in power.

Political risk:

Although, often correlated, political instability and political risk do not go together always. In the examples of political instability mentioned above, we find that although the governments have changed in Italy, Japan and India, the basic national character did not undergo any major change, nor was a change in the policies and business had a sense of continuity and security while doing business in these countries. However, the war in Afghanistan and Iraq has had a tremendous impact on the business. Not many companies are taking the initiative of doing business in these countries. They would prefer to wait till normalcy returns.

Political risk is more associated with the uncertainty and unpredictability of the political parties in power in a country. Basically, political risk depends on two factors - the willingness and the ability of a government to keep the situation under control.

Assessment of political risk:

Marketers need to understand and assess the political risks. While there are several approaches to do so, Sundaram and Black have summarized the analysis of political risk in the form of the following points:

**Step 1**

Determine the critical economic/business issues relevant to the firm.

Assess the relative importance of these issues.

**Step 2**

Determine the relevant political events.

Determine the probability of occurring.

Determine the cause and effect relationship.

Determine the government's ability and willingness to respond.

**Step 3**

Determine the initial impact of the probable scenarios. Determine the

possible responses to the initial impacts. Determine the initial and ultimate political risk.

### **Legal and regulatory environment**

The marketers must carefully study the legal and regulatory system prevalent in the countries to avoid the situations that might result in conflict, misunderstanding or outright violation of the laws of the foreign country. Some of the important aspects, worth consideration, in the legal and regulatory environment are:

#### *International Law:*

International law has existed since the sixteenth century, although, it has undergone a change in the form over the years. The international bodies such as UN, WTO and the regional groupings have been instrumental in developing the international rules and regulations. These international laws are ratified by the participating countries and are binding in nature. Hence, the business must understand them correctly to ensure compliance.

#### *Conflict of laws:*

While doing business across nations, there can arise situations when the laws of two or more countries can be conflicting. The businessmen must study these laws and take measures to avoid being caught in such a situation. For example, most of the countries of Middle East want that the goods should be dispatched to them only in those ships, which do not go to Israeli ports. They ask for a certificate from the shipping line in this regard. If an exporter ignores this law, he can be in a very difficult situation and can incur heavy losses.

#### *Freedom of contracts:*

In developed countries and those which have a very sound legal system, the principles of contract are taken for granted and are strictly enforced by law. However, in some countries, government interferes with these principles and can cause a loss to the businessman. One should be vigilant especially while participating in global tenders or the projects of long gestation periods.

#### *Patents and Trademarks:*

Another important issue for a multinational corporation is the protection of its patents, trademarks and the intellectual property. Most companies invest heavily in research and development. However, unscrupulous manufacturers of some developing countries take the advantage of the difference in the patent laws and manufacture a

duplicate of the product, causing a heavy loss to the original manufacturer. The companies, which has invested heavily in R&D must analyse these situations and take protective measures. The issue has been addressed by WTO, which has instituted TRIPS (Trade Related Intellectual Property Rights) mechanism to avoid loss to the original manufacturers.

*Conflict resolution:*

It is very difficult to achieve an ideal situation when there is no conflict between the trading partners. Conflicts do happen, but there has to be a sound system of resolution of the conflicts. There are sets of principles laid down for international arbitration. The businessmen must be aware of these and carefully analyse the devotion of the partners towards implementing them.

Besides arbitration, there are alternative mechanisms of dispute resolution developed by international bodies. Some of the international bodies, which have instituted mechanisms for international arbitration, are:

- (ICC) International Chamber of Commerce (AAA)
- American Arbitration Association
- (IACAC) Inter-American Commercial Arbitration Commission
- (ICSID) International Centre of Settlement of Investment Disputes
- Swedish Arbitration Institute
- (UNCITRAL) United Nations Conference on International Trade Law

*Recourse:*

In case of a legal action, the operation of law can be very lengthy and costly procedure in many countries. If a country engages in long legal disputes in a country, it tarnishes its images, besides incurring losses of time, money and efforts.

*Tariff mechanism:*

The tariff and taxation structure of the foreign countries must be clear to the business to avoid complications at a later stage. Although, the tariff structures are being standardized across nations, still there exist differences and these must be carefully studied.

*Equity control:*

Different countries have different laws regarding equity participation of the foreign partner. Some might allow 100% FDI in some sectors, while there might be limits on investment. Some countries make the participation of a domestic partner obligatory.

Such different situations must be carefully studied before taking any investment decision.

*Documentation and formalities:*

While most countries are dismantling the tariff barriers, they are yet to make the procedures more easy and user friendly. It is notable that China's economic success story has a lot to do with the ease of doing business there. There is little red-tapism and most of the regulatory requirements are cleared speedily. On the other hand, business has to run from pillar to post to get approvals and the essential registrations for doing business in India. A thorough knowledge of the prevailing system is essential for success in a foreign country.

**Summary**

The business is a part and parcel of the social system and is influenced by several forces. In order to be successful, an understanding of the culture is essential, particularly if a marketer wants to venture out of his national boundaries. There is a sea change in the degree of risk and uncertainty in international business, which is driven primarily by the environmental forces. The business managers must be able to scan the opportunities and identify the threats posed by the environment and make a way for their success. It is noteworthy that there are several tools and techniques for analysing the environment and the student is advised to refer to standard textbooks for the same.

