INTERNATIONAL ECONOMIC ENVIRONMENT

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- Economic environment is the most important factor which affects the international business firm. An analysis of economic environment enables a firm to know –

  how big is the market….?

  what its nature is …….?

- Through this analysis, a firm can determine whether it should enter a particular foreign market or not .
- If yes, then what specific strategies should it adopt to become successful…….

WHAT IS ECONOMIC….??

Economic means " the study of the production and consumption of goods and the transfer of wealth to produce and obtain those goods. Economics explains how people interact within markets to get what they want or accomplish certain goals."

WHAT IS ENVIRONMENT….??

Circumstances, influences, stresses, and competitive, cultural, demographic, economic, natural, political, regulatory, and technological factors (called environmental factors) that effect the survival, operations, and growth of an organization.

ECONOMIC ENVIRONMENT

- Those Economic factors which have their affect on the working of the business is known as economic environment.
- It includes system, policies and nature of an economy, trade cycles, economic resources, level of income, distribution of income and wealth etc.
- The economic environment represents the economic conditions in the country where the international organization operates.

- Economic environment is very dynamic and complex in nature. It does not remain the same. It keeps on changing from time to time with the changes in an economy like change in Govt. policies, political situations.

Global/International Economic Environment

If any business enterprise is involved in foreign trade, then it is influenced by not only its own country economic environment but also the economic environment of the country from/to which it is importing or exporting goods.

- There are various rules and guidelines for these trades which are issued by many organizations like World Bank, WTO, United Nations etc.

Elements of Economic Environment

It has mainly five main components:-

- Economic Conditions
- Economic System
- Economic Policies
- Economic Legislations
- Economic Development

Economic Condition

- Economic Policies of a business unit are largely affected by the economic conditions of an economy. Any improvement in the economic conditions such as standard of living, purchasing power of public, demand and supply, distribution of income etc. largely affects the size of the market.
- Business cycle is another economic condition that is very important for a business unit. Business Cycle has 5 different stages:-

1. Prosperity
2. Boom
3. Decline
4. Depression
5. Recovery

Following are mainly included in Economic Conditions of a country:-

I. Stages of Business Cycle

II. National Income, Per Capita Income and Distribution of Income

III. Rate of Capital Formation

IV. Demand and Supply Trends

V. Inflation Rate in the Economy

VI. Industrial Growth Rate, Exports Growth Rate

VII. Interest Rate prevailing in the Economy

VIII. Trends in Industrial Sickness

IX. Efficiency of Public and Private Sectors

X. Growth of Primary and Secondary Capital Markets

XI. Size of Market

Hence, if the economic condition of a country is good, then business units may have better opportunities in that country.

On the contrary, a depressed economic condition discourage the business activities.

Economic System

- An Economic System of a nation or a country may be defined as a framework of rules, goals and incentives that controls economic relations among people in a society.
- Different countries of a world have different economic systems and the prevailing economic system in a country affect the business units to a large extent.

Economic system of a nation can be of any one of the following type:-

- Capitalist Economy / Market Based Economy.
- Socialist Economy / Centrally Planned Economy. (CPE)
- Mixed Economy.

Capitalist Economy

- The economic system in which business units or factors of production are privately owned and governed is called Capitalism.
- The decision to produce and distribute goods is taken by individual firms based on the forces of demand and supply.
- The profit earning is the sole aim of the business units.
- Government of that country does not interfere in the economic activities of the country. It is also known as free market economy. All the decisions relating to the economic activities are privately taken.
- Examples of Capitalistic Economy:- England, Japan, America etc.

Socialist Economy

- Under socialism economic system, all the economic activities of the country are controlled and regulated by the Government in the interest of the public.
- The first country to adopt this concept was Soviet Russia.
- Example- China
- The two main forms of Socialism are:-

(a) **Democratic Socialism**:- All the economic activities are controlled and regulated by the government but the people have the freedom of choice of occupation and consumption.
(b) **Totalitarian Socialism**:- This form is also known as Communism. Under this, people are obliged to work under the directions of Government.

Mixed Economy

- The economic system in which both public and private sectors co-exist is known as Mixed Economy.
- Some factors of production are privately owned and some are owned by Government.
- There exists freedom of choice of occupation and consumption. Both private and public sectors play key roles in the development of the country.
- Example – the Indian economy represents a mixed economic system.

Economic Policies

- Economic policies are formed by the government and the activities of every business unit are affected by these policies.
- Important economic policies of a country are as follows:-

  1. **Monetary Policy:-** The policy formulated by the central bank of a country to control the supply and the cost of money (rate of interest), in order to attain some specified objectives is known as Monetary Policy.

2. **Fiscal Policy:-** It may be termed as budgetary policy. It is related with the income and expenditure of a country. Fiscal Policy works as an instrument in economic and social growth of a country. It is framed by the government of a country and it deals with taxation, government expenditure, borrowings, deficit financing and management of public debts in an economy.

3. **Foreign Trade Policy:-** It also affects the different business units differently. E.g. if restrictive import policy has been adopted by the government then it will prevent the domestic business units from foreign competition and if the liberal import policy has been adopted by the government then it will affect the domestic products in other way.

4. **Foreign Investment Policy**:- The policy related to the investment by the foreigners in a country is known as Foreign Investment Policy. If the government has adopted liberal investment policy then it will lead to more inflow of foreign capital in the country which ultimately results in more industrialization and growth in the country.
5. **Industrial Policy**:- Industrial policy of a country promotes and regulates the industrialization in the country. It is framed by government. The government from time to time issues principals and guidelines under the industrial policy of the country.

Economic Legislations

Governments of different countries frame various legislations which regulates and control the business.

Economic Development

- Economic Development means improvement in the level of living of the people of a country. Therefore, it means increase in national income as well as per capita income.
- The economic growth and economic development are the two sides of the same coin.
- The different countries can be divided into different segments based on GNP per capita.

- These segments can be :-
  1) Low-Income Countries (US$ 1025 or less)
  2) Lower-Middle-Income Countries (US$ 1026 to $ 4035)
  3) Upper-Middle-Income Countries (US$ 4036 to $12475)
  4) High-Income Countries(above US$ 14276)

Classification of Countries is from the World Bank, July 2012, on the basis of 2011 GNI per capita.

World Bank list of economies (July 2012)

Google Docs

1 - Low income: $1,025 or less

2 - Lower middle income: $1,026 to $4,035

3 - Upper middle income: $4,036 to $12,475

4 - High income: $12,476 or more

Preliminary Economic Indicators

- Whenever a firm moves abroad for international business, it takes into account some preliminary economic indicators of the host country at a particular point of time, as well as over a particular period.
- These economic indicators help the firm know, among other things,

  1) The size of demand for its product.

  2) The expected cost of production and the net earnings, so as to ascertain its competitive edge.

  3)Whether it will be able to smoothly repatriate its earnings back to its home country.

Important economic indicators are:

- Inflation
- Level of Income and its Distribution
- Consumption Behavior
- Availability of Human and Physical Resources
- Network of Infrastructure
- Fiscal, Monetary and Industrial Policies