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A study on Political Environment in International Business

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ABSTRACT:

The political environment in international business consists of a set of political factors and government activities in foreign market that can either facilitate or hinder a business ability to conduct business activities in a foreign market. This article will focus on business practices in the global political environment. It will discuss the political risk and political challenges in international political as well as economic system. It will provide the different types of political risk and measures to identify them and also will provide necessary suggestions to make strategies to handle with these political changes. It will also focus on cross-border alliances and political challenges in these alliances and its business. Some suitable examples will also be added to further elaborate the political environment.

Keywords: Political Risk, Globalization, Investment, Trade Relations

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Introduction

Business practices ad operations in the international political environment are influenced by the forces and processes of globalization and the impact of political risks. Political risks refer to the potential effects of a change in government on a business. The process of globalization refers to the increasingly free flow of ideas, people, goods, services and capital that is leading to the integration of economies and societies. Businesses have adapted to the changing global political environment by identifying political risks prior to investment in foreign business activities and investments. Global political environment has a significant effect on the working as well as the policies of the international business.

Global Political Environment

A political environment is characterized by the regulatory environment, local attitudes towards corporate governance, reaction to international competition, and labor laws. Political environment around the world are changing due to the forces of globalization.Globalisation is characterized by the permeability of traditional boundaries of nations, cultures and economic markets. According to Thruow (1995),the fundamental economic forces and events influencing globalization and political turmoil around the world include:

- The end of communism

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- The shift from an economy based on natural resources to one based on knowledge industries.
- Demographic shifts
- The development of a global economy.
- Increased trade liberalization
- Advances in communication technology
- Increased threat of global terrorism
- An era without a dominant economic, political or military power

Globalization creates a turbulent global socio-political environment characterized by competing political actors, shifting power relations, and politically-driven changes in national economics around the world. Businesses work to find opportunity and profit to be had from political and economic changes. The political turbulence and upheaval has resulted in a move from centralized economies to a decentralized global economy and has created numerous emerging markets. These emerging markets refer to the capital markets of developing countries that have liberalized their financial systems to promote capital flows with non residents and have become broadly accessible to foreign investors.

Business opportunities, including international investments and joint ventures, in the global economy are increasingly tied to trade pacts such as the north American Free trade Agreement(NAFTA) between united states, Canada and Mexico, the Mercosur trade pact between Argentina,Uruguay,Brail,and Paraguay and the Asia Pacific Economic Cooperation(APEC) trade zone. In addition, business opportunities are resulting from privatization worldwide. Countries are privatizing many state-owned industries and allowing foreign investors to purchase pieces of them through joint ventures or allowing local operations to participate in these projects.

Emerging markets, often occurring in countries experiencing political upheaval, will continue to increase in the expanding global market, businesses, participating in the new global economy, will continue to seek out new manufacturing and sales opportunities and new risks. Political risks are one of the major problems and considerations for businesses in the global political environment. Opportunities and liabilities are growing proportionately in the new global economy. The following section describes and analyses the influence of political risk on business activities and operations.

Political Risk

Political risk is generally defined as the risk to business interests resulting from political instability or political change. Political risk exists in every country around the globe and varies in magnitude and type from country to country. Political risks may arise from policy changes by governments to change controls imposed on exchange rates and interest rates. Moreover, political risk may be caused by actions of legitimate governments such as controls on prices, outputs, activities, and currency and remittance restrictions. Political risk may also result from events outside of government controls such as war, revolution, terrorism, labor strikes, and extortion.

Political risk can adversely affect all aspects of international business from the right to export or import goods to the right to own or operate a business. For example, categorizes risk based on economic; exchange transfer; strike, riot, or civil commotion; war; terrorism; sovereign non-payment; legal and regulatory; political interference; and supply chain vulnerability.

Evaluation of level of political risk

Forms of investment and risk

For a firm considering a new foreign market, there are three broad categories of international business: trade, international licensing of technology and intellectual property, and foreign direct investment. A company developing a business plan may have different elements of all three categories depending on the type of product or service.

The choice of entry depends on the firm's experience, the nature of its product or services, capital resources, and the amount of risk it's willing to consider (Schaffer et al, 2005). The risk between these three categories of market entry varies significantly with trade ranked the least risky if the company does not have offices overseas and does not keep inventories there. On the other side of the spectrum is direct foreign investment, which generally brings the greatest economic exposure and thus the greatest risk to the company.

Protection from political risk

Companies can reduce their exposure to political risk by careful planning and monitoring political developments. The company should have a deep understanding of domestic and international affairs for the country they are considering entering. The company should know how politically stable the country is, strength of its institutions, and existence of any political or religious conflicts, ethnic composition, and minority rights. The country's standing in the international arena should also be part of the consideration; this includes its relations with neighbors, border disputes, membership in international organizations, and recognition of international law. If the company does not have the resources to conduct such research and analysis, it may find such information at their foreign embassies, international chambers of commerce, political risk consulting firms, insurance companies, and from international businessmen familiar with a particular region. In some countries, the governments will establish agencies to help private businesses grow overseas. Governments may also offer political risk insurance to promote exports or economic development. Private businesses may also purchase political risk insurance from insurance companies specialized in international business. Insurance companies offering political risk insurance will generally provide coverage against inconvertibility, expropriation and political violence, including civil strife (US Small Business Administration). Careful planning and vigilance should be part of any company's preparation for developing an international presence.

Government policy changes and trade relations

A government makes changes in policies that have an impact on international business. Many reasons may cause governments to change their policies toward foreign enterprises. High unemployment, widespread poverty, nationalistic pressure, and political unrest are just a few of the reasons that can lead to changes in policy. Changes in policies can impose more restrictions on foreign companies to operate or limit their access to financing and trade. In some cases, changes in policy may be favorable to foreign businesses as well.

To solve domestic problems, governments often use trade relations. Trade as a political tool may cause an international business to be caught in a trade war or embargo (Schaffer et al, 2005). As a result, international business can experience frequent change in regulations and policies, which can add additional costs of doing business overseas.

Example:

The current example of political risk is the policy of Donald Trump, President of United States of America. His political policies are making great impact on overall business of other countries, after only 4th day of his oath. His initial speech has the words 'buy American, hire American' which states that buy products made only in America and hire the services of American companies. It has made worst impact on the business of Indian companies especially the IT industry.75$ of our IT business is dependent on exports out of which 60% on America. It has made these IT companies to cut short its recruitment from B-schools.it has lead to 30% less recruitment this year. At one business school, Infosys took on 13 people compared with 40 last year, while dell hired three against five and Wipro recruited 5 compared with 9 last times. Another statement regarding 'border-tax' will have also its impact on the business across the countries. As 'border-tax' will be imposed on those American companies, who will manufacture products in another countries and try to sell them in US. It can adversely affect the business developing countries

Conclusion

Political risk assessment is today a task of paramount importance for the international investor. While in the past political risk was often conceptualized in terms of hostile action by host countries' governments, with the quick pace of globalization its nature and sources have considerably changed, raising the interest of scholars belonging to different fields, from international economics to international relations, from empirical political science to psychology and decision theory. In an era in which global equilibrium have changed and once clear-cut distinctions such as "developing" vs. "developed" countries have become blurred, intelligence and risk management has become a major source of concern. The issue of the relationship between politics and the activity of international investors has become even more burning in light of the ongoing economic and financial crisis, a crisis whose causes are – at least partially – ascribable to questionable policy choices.

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