Paper E1
Enterprise Operations

The balance of economic power has shifted dramatically towards the world's emerging markets in recent years, but their imminent supremacy over the developed Western nations is far from assured.

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Globalisation has meant that all but the smallest and most local of businesses are subjected to a plethora of international factors, making it nigh on impossible to survive by staying local. Enterprises either have to go global or accept the risk that they may lose business to international competition.

E1 students need to develop a broad understanding of the global business environment and how it relates to the syllabus. The table on the opposite page lists key topics in the syllabus and gives relevant industry examples and reference points.

For many organisations in the developed world, their expansion plans in the past ten to 20 years have usually taken them towards Asia. China and India have offered them promising opportunities, as have the so-called tiger economies of Hong Kong, Taiwan, South Korea and Taiwan, and, latterly, Indonesia, Malaysia, the Philippines and Thailand.

There are also opportunities in Africa – some authors even bracket the continent’s largest economy, South Africa, in among the Brics. Latin America, too, has shown promise as an emerging market. Its proximity to the US, the world’s largest consumer, makes the region attractive, although the relatively high labour costs there and government policies such as deliberate currency devaluations have helped Asia to remain the more popular destination for investments, especially in manufacturing. These investments increased when even white-collar functions such as R&D shifted to Asia.

Asia has become the go-to market for many businesses, therefore. The turning point for the global economy and a key factor in the shifting balance of power from West to East was when, having been the factories of the world for decades, China and India began spending the fortunes they amassed in their years of rapid industrialisation. In contrast with the recession suffered by most Western economies, we find two nations, each with populations of over two billion, with huge economic growth and a growing appetite for consumption.

In 2011 the economies of the Brics grew at an average of 7 per cent compared with global economic growth of 2 per cent. Little wonder, then, that multinationals from these nations are investing in the West. In a reversal of the old economic order, Western brands such as Harley-Davidson and Burberry are thriving on the growth of emerging markets, while the survival of Caterpillar, threatened by a decline in the US building industry, was secured as the result of China’s construction boom.

Growth of Western economies versus that of non-OECD economies (including the Brics)

Despite remaining the largest economy in the world on paper, the US lost status after the 2007-08 financial crisis triggered by sub-prime mortgage lending, which caused ripples to spread through other Western markets. Debt is the biggest problem facing the Obama administration. Despite an improvement in GDP, the trade balance in March 2012 indicated a deficit of $51.8bn. In addition, unemployment reached 8.1 per cent in April 2012 from a low in May 2007 of 4.4 per cent. Such changes led indirectly to a reduction in consumer confidence and spending, which in turn created a vicious circle of reduced investment, depressed demand and further job losses.

When considering the EU, Greece’s potential exit from the eurozone, the lack of liquidity in Spain’s banking system, political instability in Italy and the public’s lack of appetite for further austerity throughout the continent all send worrying messages. The combined GDP of the 27 member states trading, by agreement, mostly without barriers such as tariffs, is projected to have grown by a mere 0.3 per cent last year.

It’s clear, then, that the mature economies of the West are still faring relatively poorly, but a total shift in power from West to East in terms of trade, investment, GDP and income are yet to occur. There are numerous reasons for this.

Some Western organisations feel that doing business in China does not take place on a level playing field, believing that domestic firms have an unfair advantage. Some think that corporate political activity is a key requirement for trading there. In 2011, for example, General Motors (through a joint venture, Shanghai GM) made a financial contribution to the Chinese Communist Party’s 90th-birthday celebrations. Commentators have suggested a link between this sponsorship and the fact that GM’s luxury model, the Cadillac, is aimed at high-ranking party members.

There are implications for corporate social responsibility, too, as there have been labour-rights violations in some emerging economies. Spanish clothing giant Zara, for instance, was recently criticised for contracting with Bangladeshi factories with fatally poor safety standards. And Apple attracted negative publicity for its use of Foxconn, a Chinese manufacturer whose poor conditions,

Real GDP growth (% change year on year)

Source: Economist Intelligence Unit.

Non-OECD nations (including Brics)

OECD nations (Western economies)
The global business environment as it relates to E1

Syllabus topic | Industry example
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The effects on business of globalisation, both in general and in specific areas – eg, trade. | Apple’s sales from outside the US have soared over the past few years. They increased from $14bn in 2005 to $64bn in 2010. In 2010, 56 per cent of the company’s sales revenue came from international markets. 1
Risks to globalisation – eg, protectionism. | US telecom equipment providers lobbied the government to prevent Chinese firm Huawei from acquiring 3com.
The development of emerging economies. | The Brics’ emergence is one of the most dominant trends of globalisation. China, for instance, has become the largest market for cars and luxury goods.
The development of multinational companies. | These include organisations from the developed world – eg, Toyota and Coca-Cola – and, more recently, ones based in emerging markets, such as Tata and Geely.
The growth in outsourcing and offshoring, and their impact on decision-making. | Nike controversially offshored production in a bid to reduce its labour costs and gain access to developing Asian markets, while keeping its design function in-house.
Cultural differences. | US executives are surprised by their Brazilian counterparts’ propensity for arriving late at meetings and starting them by discussing the previous night’s football match.
Corporate social responsibility and corporate governance. | Measures such as the UK combined code on corporate governance and the Sarbames-Oxley Act 2002 have been designed to prevent scandals such as Enron, which shook confidence in the capital markets in 2001.
Government regulations on business and corporate political activities. | In 2012 an aviation show in China was sponsored by European aircraft manufacturers in a bid to ease tensions between China and EU governments concerning air access for commercial flights. This prevented the loss of access to one of the world’s most important aerospace markets.
The effects of NGOs on business and perceptions of NGOs as strategic partners. | Facebook entered a partnership with environmentalist lobby group Greenpeace aimed at reducing the ecological impact of its systems.

References and further reading

including excessive working hours, have led to a spate of suicides among workers. Furthermore, the mature economies of the West cannot simply be written off. During the last quarter of 2011 there were signs of increased consumer spending in the US and, since this fuels 70 per cent of the nation’s economy, it came as heartening news for Obama. Much of the growth was powered by a 15 per cent surge in sales of cars (considered a key economic indicator in the US) and of other long-lasting manufactured goods. The Economist Intelligence Unit has forecast that real GDP growth in the US for 2013-16 will remain fairly stable at just over 2 per cent a year.

Many of the Brics depend on the US and EU for their growth. Whenever these mature markets cool down and/or their governments tighten expenditure, the emerging economies feel the effects – we have already seen a deceleration in China’s manufacturing sector and lower-than-predicted growth in Brazil.

In emerging markets, fast GDP growth may also have negative implications for social cohesion: where the increased wealth is held by a relatively small number of people, this can lead to unrest. India has been plagued with political turmoil and corruption for decades, while Russia depends heavily on oil exports, so any decline in the price could put the government in jeopardy, since it needs oil prices to remain high to support its fiscal spending projects. Brazil, despite its best efforts, is still struggling to maintain law and order, while its infrastructure has not been modernized to reflect the wave of investment heading towards the country. (China scores well in this area compared with the other Brics.) Declining demand from the West has created further threats. The outsourcing and offshoring of manufacturing and service provision to emerging economies has slowed considerably owing to concerns in the developed world about rising costs in China and other offshoring destinations. There is also a growing recognition among Western firms that there are more subtle challenges – for example, in finding outsourcing partners with the right strategic fit or the need for better quality control. These are linked with Oliver Williamson’s transaction cost theory, which identified the hidden costs of outsourcing.

There has been an obvious shift in economic power towards the emerging markets, but the Brics’ success brings with it political challenges and is also tempered by a dependence on demand from the more mature Western economies, which clearly have several problems of their own. While the US and EU have seen increased competition from imports and are still suffering the effects of recession and austerity, they cannot be written off just yet, because slight, but reliable, signs of growth remain.

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