Political and Economic Factors, and Legal Systems which impact Global Business Operations

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What do we need to know

- Here are all the topics this PowerPoint aims to cover from the BME Y12 Syllabus.
- This PowerPoint covers a lot. Be sure to take some breaks!

- economic factors which impact on business operations in the global market, including:
  - economic activity
  - discretionary spending
  - interest rates
  - currency fluctuations
- political factors which impact on business operation in global markets, including:
  - stability of foreign governments
  - relationship of foreign governments with the Australian Government
- impact of legal systems on business operation in global markets
  - differences regarding competition regulation
    - patent registrations
    - product liability

The Economic Factors

- ❑ economic activity
- ❑ discretionary spending
- ❑ interest rates
- ❑ currency fluctuation

Economic Activity

When we discuss how economic activity affects global businesses, we're looking at 'macro-economic' forces. These forces refer to the factors or influences which determine the competitiveness in an economic environment (markets, whole nation economies, etc).

The three main factors that come under Economic Activity are: economic growth, inflation, and unemployment.

- **Economic Growth** – this is defined as an increase in the amount of goods and services produced per person of the population over a period. There are two main ways Governments encourage economic growth:
  - Supply side (indirect) – where Government tries to increase the productivity of the labour force by offering innovation grants or subsidising education and training
  - Demand side (direct) - expansionary fiscal policy is used by the Government (typically more targeted funding), taxation is cut and spending overall increases.
  - High growth decreases unemployment (as firms hire more to increase output), increases consumer expenditure (more people earning higher incomes) and increases business confidence.
  - Increased business confidence leads itself to increased investment and exports to match increased consumer demand

Economic Activity (Continued)

- **Inflation** – defined as a rise in prices which can be translated to a decline in purchasing power over time. There are two main types of inflation:
  - **Demand pull** – this is where consumers spend too much. There is an excess of money flow available for too little goods, so firms price their goods and services higher to counter a lack in supply
  - **Cost push** – this is when there are high costs associated with manufacturing and other firm operations, which increases prices so firms can protect profit margins
  - **Opportunities from low inflation include:**
    - Low interest rates, enables firms to finance new expansion plans and business activities at a cheaper rate
    - Reduced cost of servicing debt, this refers to the principal and interest on outstanding debt that a business must pay being reduced
    - Reduced costs of raw materials
  - **Threats from low inflation include:**
    - Decreased revenue, as consumers postpone their purchases in anticipation of lower prices in the future
    - Firms may feel the need to reduce prices in order to remain competitive
  - **High inflation** has the **exact opposite** threats and opportunities (i.e. increased costs of raw materials – threat)

Economic (Continued again)

- **Unemployment** is defined by the OECD as people above a specific age (15 in Australia) who is not in paid employment or self-employment but is currently available for work during the reference period. There are three main causes for unemployment:
  - Cyclical – this occurs when there is a change in economic activity over a business cycle. i.e., during a recession, unemployment increases, and this decreases during an expansion. This can cause labour excess or shortages respectively for a firm
  - Structural – where there is a mismatch between the skills of workers and the requirements of their jobs. This can cause labour shortages for a firm, and can be caused by new technology, automation or changes in processes
  - Frictional – this is voluntary unemployment caused by workers moving between jobs in the labour market and transitioning in/out of the labour force. This can create opportunities for businesses to acquire new employees or replace existing ones depending on the competitiveness of the labour market
- Low unemployment can present the following **opportunities**:
  - Increased consumer demand (as more people have disposable income from employment)
  - Increased consumer expenditure (see last bullet point), generates economic growth which leads to increased business confidence and greater investments, imports and exports
- Low unemployment can also present the following **threats**:
  - Increase in labour costs (associated with higher salaries/wages to retain staff)
  - Harder to recruit new employees, which can affect production capacities

Discretionary Spending

Costs that businesses and households **can survive without, if necessary**, is defined as discretionary spending. This links to disposable (or discretionary) income which is income that is left for spending, investment or saving after necessities and taxes are paid for.

The amount of discretionary spending firms and households engage in depends on economic indicators such as disposable income, interest rates, opportunity cost of holding cash, inflation, consumer confidence etc.

A concept that links closely to discretionary spending is consumption expenditure, which is the general purchase of goods and services. There are three types of this:

- **Non-durable goods**, these are single-use goods consumed for a short period of time (food, cosmetics)
- **Durable goods**, these are expected to last or provide utility for three or more years (cars, furniture)
- **Service**, any non-commodity items (things that are not economic goods), such as online subscriptions

Spending on durable goods tend to be discretionary, as they can be delayed or brought forward dependant on economic conditions. Firms' bottom line can be adversely affected if households' marginal propensity to consume is low.

Marginal propensity refers to a proportion of an increase in an individual's income which is spent on consumption.

Discretionary spending heavily relies on overall income and economic prosperity/growth. Firms can expect that when consumers are doubtful about the current state of the economy, they are more likely to save, and must adjust operations accordingly. A good firm will always anticipate the seasonal and volatile nature of discretionary spending.

Interest Rates

The proportion of a loan/borrowed money that is charged as interest to the borrower are known as interest rates. They are typically expressed as an annual percentage of the loan outstanding. As interest rates change, so does the cost of borrowing money. The trend of interest rates typically indicates the strength/health of an economy.

When interest rates are being raised, they are usually a corrective measure for inflation and encourage people to spend less, save more. The inverse applies when interest rates are being lowered.

Why they change

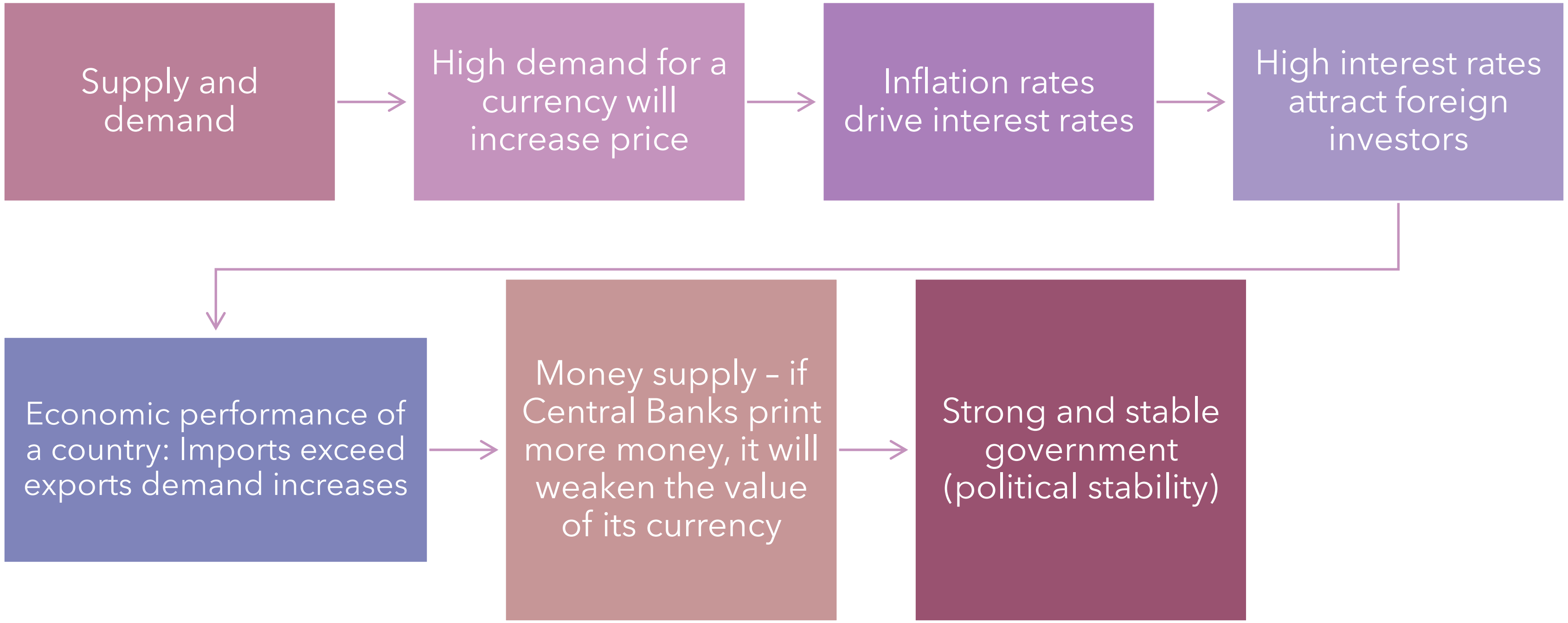
- Monetary policy, which are policies that involve the manipulation of the cash rate (the interest rate paid between banks on unsecured overnight loans). These policies are designed to bring desired change in the level of economic activity
- The Reserve Bank of Australia (RBA), which is autonomous from the Government, is tasked with the goal of 2-3% inflation

Interest Rates (Continued)

Changing interest rates (impact on firms)		Monetary policy stances	
Rising Interest Rates	Falling Interest Rates	Contracting stance (rising interest rates)	Expansionary stance (cutting interest rates)
- Increases cost of funding, which decreases profitability as costs increase	- Reduces interest expenses and funding costs for firms - Improves liquidity and profitability for firms	- Less people borrowing, reduces in consumer expenditure	- More people borrowing, increases consumer expenditure
- Increases mortgage/other debt repayments for consumers, therefore household disposable income decreases - Decreases consumption, sales and profitability for firms - Incentive for households to save	- Decreases risk for firms, improves consumer and business confidence leading to greater sales - Increases marginal propensity to consume (explained earlier)	- Less money flowing in the economy	- More money following through the economy
- Less certainty means a decrease in investments	- Reduces mortgage/other debt payments, increases household spending as a result	- Slows the economy at the added benefit of less inflation	- Stimulates economy with the downside of increased inflation

Currency Fluctuation

- See previous PowerPoint called "14. Sources of Risk in Financial Markets and Minimisation Strategies"
- Slides 3 & 4 (Currency Fluctuation and Appreciation and Depreciation of Currencies). Following diagram by Gabrielle Jolliffe may be helpful as an additional resource -



How this all relates to Global Business Operations

- All these factors happen both worldwide and on an individual nation basis
- This means businesses are continually having to adapt, account for, and forecast challenges that arise with regards to economic factors
- Good businesses will modify business operations to mitigate/minimise the impact of unfavourable economic conditions and take advantage of favourable conditions
- These factors are all very easy to link to foreign market expansion, loss mitigation in foreign markets and risks/factors to consider when expanding globally

The Political Factors

- Stability of foreign governments
- Relationship of foreign governments with the Australian Government

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Stability of Foreign Governments

Political stability refers to the ability of Governments to operate effectively, efficiently, and deliver their elected mandate. Democratic governments are dominant in western countries and can cause political instability should there be a change in powers (a new Government elected over an existing one).

Examples of instability include:

- Coalitions (two or more parties forming Government) restricting the ability to deal with major reforms and/or changes. This can erode public confidence which in turn affects business/consumer confidence and can provide a negative outlook on the economy
- Taxation and spending levels being fragile/weak
- Protectionism decisions, where governments intervene to restrict international trade to help domestic industries. Usually implemented to bolster domestic industries but also mitigate safety or quality concerns
- Intervention into domestically (i.e., Australian) owned assets such as nationalisation of industries, in which assets are no longer privately owned rather become the property of the state

Stability of Foreign Governments (Continued)

Impact of political instability (increases risk!):

- Higher interest rates as a reactionary measure due to a higher chance of defaulting on payments (failing to fulfil an obligation, in this case repayment)
- Gearing (the relationship of debt to equity), liquidity increasing, and increase payback period for borrowing (due to increased risk)
- Higher insurance premiums for firms
- Lower business and consumer confidence, reduces sales and profitability
- Retaliation by nations against foreign trade creates barriers for firms to trade globally
- Tariffs, embargos (bans on trade with another country), quotas on trade
- Breakdown in diplomatic relationships between countries, which causes withdrawals from trade talks and agreements

Relationship of Foreign Governments with the Australian Government

Benefits of Closer Economic/Political Relationships include:

- **Increased access to global markets**, as free trade agreements are likely to be signed resulting in a reduction of barriers in entering foreign markets
- **Lower levels of protectionist policies** which lowers the cost of borrowing/financing expansion policies for firms abroad
- **Decreases risk** which means reduced insurance premiums for businesses and reduced funding costs
- **Increases investment opportunities** both domestically in Australia from foreign firms, and internationally

Why invest in Australia (Department of Foreign Affairs and Trade)	How to improve foreign relations
- Australia has experienced 29 years of uninterrupted annual growth (1990-91 to 2018-19) which has not been matched by any other developed economies - Highly skilled and educated workforce, with ~47% (approx.) of the workforce having a tertiary qualification - Strategic location, with strong trade links to the Indo-Pacific region which is growing rapidly, and 24-hour connectivity between time zones in Europe, Asia and Americas - Strong Governance, 14th in 2020 in the World Bank's Worldwide Governance Indicators (2021) - A lot of infrastructure made available, in the form of ports, rails, road transportation networks etc for businesses to use	- Government should engage in closer diplomatic ties - Co membership in regional trade bodies such as OPEC, ASEAN, APEC - Signing Free Trade Agreements - Providing foreign aid and/or support - Passing non-discriminatory, pro international trade legislation

The Legal Systems

- Patent registrations
- Product Liability
- Differences regarding competition regulation

Patent Registrations

Patents are the most common form of intellectual property protection, providing users the legal right to commercially exploit a unique and innovative product, method, substance, process or design.

- Standard patents last 20 years
- Innovative patents last 8 years, however these have now begun the process of being phased out. All innovative patents will expire on 26 August 2029, **however** they are still considered valid in this course to discuss

Why apply for patents?

- **Competitive advantage**, as if innovative and/or unique items are protected, competitors cannot directly compete with your goods and services by marketing your product. A notable distinction must be present
- **Innovation**, new innovative ideas attract greater market share as consumers look for differentiation in products
- **Research and development is encouraged** which can be leveraged for tax offsets/minimisation, allow firms to exploit new technology, and contribute to economic prosperity
- **Marketing opportunity**, which lends itself as a source of finance if done correctly

International Intellectual Property (IP) Registration

The World Intellectual Property Organisation (WIPO) is a separate specialised body of the United Nations which is responsible for the promotion of intellectual property (IP) throughout the world through its member nations.

WIPO facilitates international IP protection in the following ways:

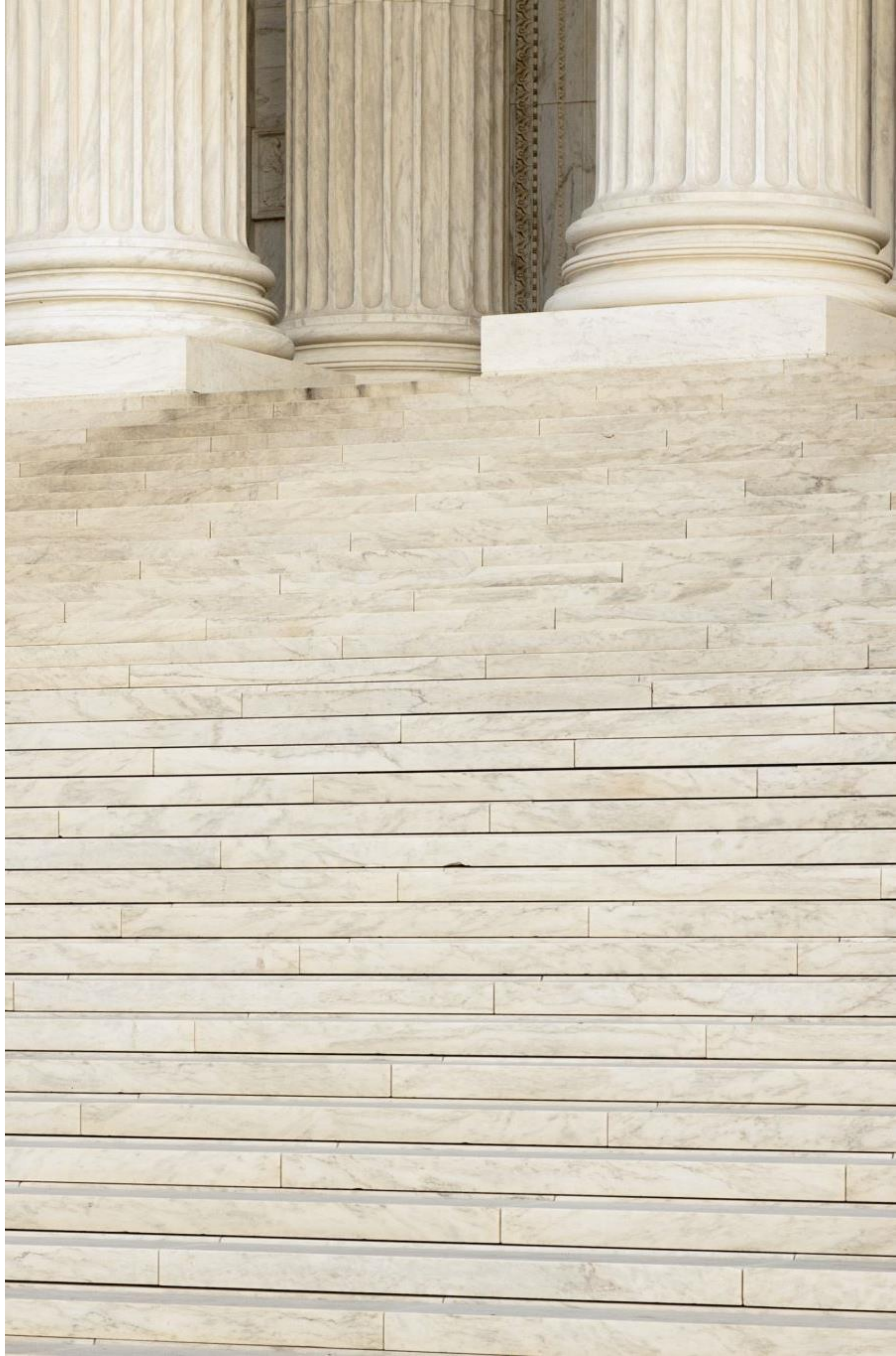
- Madrid protocol, a treaty that facilitates the international registration of a trademark by filing trademark application for numerous countries in one application
    - Trademarks must be registered domestically before businesses apply internationally
    - This treaty can be very expensive and, in some instances, it's cheaper to apply to each individual jurisdiction
    - Does not have a notification system for potential breaches, it's up to businesses to act against infringements
- Patent Cooperation Treaty (PCT), a treaty ratified in 1970 for international patent law
    - Provides a unified process for filing patents to protect innovation in all member nations
    - More than 140 countries are signatory
    - Protects intellectual property in all prior mentioned countries
    - Has application fees and various national fees

Individual Countries IP Registration and Challenges for International IP Registration

Individual countries have their own IP legislated frameworks to protect innovation within their jurisdictions. It can be complicated and expensive for firms to understand individual legal frameworks, which is why WIPO treaties are utilised.

Challenges to International IP registration include:

- **Not all countries are members of WIPO**, with different laws regarding the protection and recognition of foreign IP
- **No worldwide patenting system exists**, either individual applications to nations must be submitted, or a PCT application to all treaty members
- **Can be lengthy and drawn out** depending on efficiency of the office in which you submit your application(s) to
- **Need to pay several national fees per country**, which can include filing, examination and maintenance fees (Australia)



Product Liability

Product Liability refers to an area of business law that allows consumers injured by a purchased product to sue its manufacturer, retailer and distributor for liability. These entities are all responsible for injuries that their products cause.

Businesses need to be aware of differences in product liability laws in different countries to:

- **Avoid fines, loss of sales and market share, penalties, negative public image, product recalls and litigation costs**
- **Mitigate the need for product liability insurance** which can be costly. Product liability insurance however reduces risk in liability as it helps pay out legal and operational costs when managing problems relating to liability.

Consumer and Business Rights and Obligations

Consumer Rights	Business Obligations
Australian Consumer Law 2011 – Australia's national law for fair-trading and consumer protection - Under the ACL, your seller automatically provides consumer with consumer guarantees, which legally binds consumer rights - ACCC – administers ACL, promotes fair trade and competition, strengthening the economy and encouraging innovation **Consumers are eligible for remedy if product does not meet consumer obligations**. See 'Business Obligations'.	**Consumer Guarantees** - they must come with clear title and undisturbed possession and be free from any undisclosed securities - product must be of acceptable quality and fit for any disclosed purpose - product must match their description, sample or demonstration model Free from **bait advertising**, **scientific claims** and **misleading country of origin claims**
Consumer Obligations	**Business Rights**
- Consumers have 3 years to bring an action from the time they become aware of the loss, the defect and the identity of the Manufacturer	**Consumer is ineligible for a remedy if:** - Simply changes their mind, decides they do not like the purchase or decides they have no use for it or discovers they can buy the good or service cheaper elsewhere - Damages the goods by using them in an unreasonable way **Statutory (legal) defenses against product liability litigation include:** - Safety defect did not exist at the time of supply by manufacture - Safety defect was not discoverable at the time the manufacturer supplied the good (insufficient scientific/technical knowledge at the time)

International Consumer Protection Network (ICPEN)

- ICPEN is a global organisation formed under the United Nations, comprised of over 70 nations' consumer protection authorities.
- Many members of this organisation are members of OECD
- Engages in dispute resolution and cooperation between law enforcement agencies regarding consumer protection matters
  Follows UN guidelines regarding declaration of best practises, guidelines are not binding, providing basic set of consumer protection objectives
- These areas along with the areas under ACCC/ACL are very subjective and depend on each unique nation