International Business Operations and the Impact of Political Environment: A Conceptual Frame Work Based on a Four-Industry Study

by

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To the ever living memory of
my mother

Valentine Saber
(Um-Rashid)

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Early in this project, when I took a preliminary steps towards my dissertation, I did not foresee how many individuals would contribute to its completion. In this section I would like to express my gratitude and indebtedness to colleagues, business associates, friends, and family members who have helped me successfully fulfill this endeavor.

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Introduction

Due to the large number of variables involved and the high level of dynamics and uncertainty, international business is a complex system of human enterprise. Practitioners in international business may perceive the following factors as uncertain: (1) the general environment, (2) the specific industry, and (3) organization-specific variables. General environmental uncertainties include political and government policy instability, and macroeconomic uncertainty. These complex and interconnected factors mean that both the entrepreneur and government official must navigate through a sea of information and a variety of data before finding solutions to international business operations issues.

International business researchers are interested in country risk analysis because of uncertainties in the areas of politics, government policy, and macroeconomics. Since unforeseen restrictions on business activity can have a detrimental effect on the efficiency and profitability of firms business, political risk analysis and forecast gives the firms a chance to incorporate the requisite changes in its operations and planning.

The conceptual framework in this research, will integrate a large scale of financial data to construct a model, to test a hypothesis, and to develop a measure of financial performance, in order to produce a set of tools which can have a practical application in the field of international business.

Background of the problem

Research concerning international operations and management has been segmented into varied topics and disciplinary perspectives.

Between the 1960's and the 1990's, there were attempts to develop theories to deal with the expansion and complexity of international business (e.g., Buckley & Casson, l976; Dunning l981; Linder, l961; Porter, 1990; Sharpe, 1964; Toyne, 1989; Vernon, 1966). However, those theories dealt with particular segments or sectors of international business operations, e .g., product-life cycle, technology transfer, external market development, and foreign direct investment.

Vernon's (1966) explanation of international expansion described a simple demand driven, geographic diversification strategy. Vernon assumed that markets were similar worldwide, and that a firm's operation strategy was easily replicated in multiple national markets.

Some countries, e.g., Japan and France, have formal international policies and plans to pursue excellence in the global economy, while many other countries are having difficulty in reacting to the uncertainty and risks resulting from rapid change in the global economy.

In the past decade, the growing body of study on the global economy, multinational enterprises, and international business covered a variety of aspects and segments of international business, e.g., marketing in the global economy (O'Conner, 1988), import impact and strategic response (Palia, 1990), human resource management in international operation (Brown, 1990). This growing body of knowledge in international business and related areas is sufficient to provide an integrated view from which a comprehensive model can be developed for both research and business practices.

Statement of the Problem.

Predicting financial performance of a business venture in foreign environment is one of the major concerns in international business operations.

This research attempts to develop a conceptual framework to construct a model, develop a measure of financial performance in foreign business environments, to test a hypotheses and to demonstrate the versatility and applicability of the newly introduced measure.

The proposed model of international business operations suggest that *the level of financial performance of a global company in foreign business environment is linearly related to the political conditions in the host country.* The second and peripheral hypothesis is that *the relationship between financial performance and the political conditions is country specific.* These hypotheses were tested in the present study.

Purpose of the Study

The central purpose of this study will be four fold, namely:

1. To develop a measure of business financial performance by employing empirical data from global companies.

2. To identify and develop a measure for host country political risk variables which influence performance in the international business environment.

3. To test the main hypothesis that there is a linear relationship

between global companies' financial performance in foreign business environments and the political conditions in the host country.

4. To provide a foundation for decision making in international business operations for global companies and to assist business practitioners in their planning and policy making.

Research Questions

Following are the research questions guiding this study:

1. Employing the factor analysis method to extract a common factor from three financial performance ratios, what measure can be developed to assess a company's business performance?

2. Is there a relationship between the company's financial performance in the global business arena and its performance in its parent country, and how does this relationship compare across four selected industries?

3. Utilizing the regression analysis method, what are the identifiable political risk variables influencing the company's financial performance in foreign business environment?

Scope of the Study

This research study will focus on developing a model for international business operations by employing data listed in publications by the World Bank, Morgan Stanley Capital, Political Risk Services, and independent research organizations. It is intended to develop a financial performance formula based on data published on 630 Companies ranked in Business Week's Global 1000, between 1994-1997.

The scope of this study will be confined to variables pertaining to the political uncertainties found in the parent and the host country.

The financial performance of four selected major industries (automotive, pharmaceutical, banking, and electric and electronic equipment) in four parent countries (France, Germany, Japan and the United States) will be measured against twelve political uncertainties (independent variables) in thirteen host countries.

Importance of the Study

This study intended to contribute to the integration of the growing body of research findings in international business. The attempt was to develop a new conceptual frame work to deal effectively with the enormous amount of data and information in international business operations.

With the introduction of new measure, the study was designed to investigate the levels of performance of global companies conducting international business, as compared among countries and across four selected industries.

It was hoped that the methods and the findings in this study would stimulate further attempts to refine and establish a grand model and a unified theory. These may provide a foundation for decision making in international business operations for multinational enterprises, on the one hand, and for planning and policy-making for governments, on the other.

Theoretical Background

Mercantilism

The economic philosophy put forward by a number of writers from approximately the fifteenth century to the eighteenth century was mercantilism. It premised that a country's wealth was dependent on its holdings, usually in the form of gold.

Trade was an integral part of this economic philosophy. Mercantilism was the first theory that espoused trade (Daniels and Radebaugh, 1986). Later on, neomercantilism was developed to explain the phenomenon that some countries apparently tried to run favorable balances of trade not to seek an influx of gold, but rather to achieve social or political objectives.

Theory of Comparative Advantage

Ricardo (1817) developed the theory of comparative advantage, which holds that there may still be gains from trade if a country specializes in those products that it produces more efficiently than other products, without regard to whether or not the country has an absolute advantage.

The principle of comparative advantage states that it is beneficial for a country to specialize in production of the good in which it has a comparative advantage and to trade for the good in which it has a comparative disadvantage.

Overview of Internationalization

Theories explaining why firms internationalize flow from two streams of international business literature. The first stream is based on organizational behavior theories suggesting that firms internationalize when they have established a track record of operations and thereby have gained sufficient experience (Aharoni, 1966; Johanson & Vahlne, 1977).

The second stream is based on industrial economics. These theories suggest that firms seek international exchanges after they have established a domestic market position. (Kindleberger, l969) or when they have achieved a competitive advantage. (Buckley, 1983).

While these general theories do not distinguish between businesses by size, they do explain why established large businesses invest abroad. Similarly, theories of entrepreneurship explain dimensions of venture creation but do not address reasons for internationalization. Integration of these theories from the international business and entrepreneurship perspectives is proposed to further understand the internationalization of business.

Behavioral Theories of Internationalization

Behavioral theories assume that internationalization is an outcome of a sequential process of incremental adjustments to the changing conditions of the firm and its environment (Aharoni, 1966). (See Figure 1.1) The internationalization process describing the decision-making behavior of the organization is rooted in work by Cyert