Global Economic Environment

Chapter 2

Economic Integration

- 1900 - only 10 percent integration
- 2000 - 50 percent integration
  - European Union
  - NAFTA
  - ECOWAS

New realities

- Capital movements replaced trade levels
- Production "uncoupled" from employment
- World economy dominates, country economies are secondary
- End of the capitalism/socialism struggle
- E-commerce changes all models
  - Business and national

Economic Indicators

Gross Domestic Product
- Total market value of all goods and services produced within a nation's borders
- Measure of economic output

Gross Domestic Income
- GDP plus income generated from non-resident sources
  - Example: money sent to families in Home countries
  - Profits from selling goods made in another country in the home country

Economic Systems

- Type of economy
- Type of government
- Trade and capital flows
- The commanding heights
- State provided services funded by taxation
- Institutional transparency
- Free markets/entrepreneurial behavior

Economic System Structures
**Heritage Foundation**

**Economic Freedom**

- **Free**
  - 20 nations (includes US)
- **Mostly Free**
  - 52 nations
- **Mostly Unfree**
  - 73 nations
- **Repressed**
- **Unrated**

---

**Stages of Market Development**

- High-Income Countries
  - GNP > $10,166
- Upper-middle-income Countries
  - GNP ≥ $3,256 ≤ $10,005
- Lower-middle-income Countries
  - GNP ≥ $825 ≤ $3,255
- Low-Income Countries
  - GNP < $825

86% of the world’s population

---

**BOP Myths**

- Poor have NO money
- Poor are too concerned with satisfying basic needs to “waste” money on non-essential items
- Goods sold in developing markets are too inexpensive for new entrants to make a profit
- Individuals in BOP markets cannot use advanced technology
- Global companies targeting BOP countries will be criticized for exploiting the poor.

---

**True Nature of BOP market**

- There is Money at the BOP
- Ease of access to BOP markets
- BOP Markets are brand-conscious
  - Extremely value conscious
- BOP Market is connected
- BOP Customers accept advanced technology readily

---

**Kopeyia, Ghana**

- Inexpensive for new entrants to make a profit.
- Needs to “waste” money on non-essential items

---

**DISTRIBUTION OF ECONOMIC FREEDOM**

- Map showing distribution of economic freedom worldwide.
The Market Development Imperative
- Create the capacity to consume
  - Affordability
  - Single serve packaging
  - Creative purchasing plans
- Access
  - Intensity of distribution (walking distance)
  - Availability
- The Need for New Goods and Services
- Dignity and Choice
- Trust is a Prerequisite

Philosophy for Developing Products and Services for BOP market
- The basic economics of the BOP market are based on small unit packages, low margin per unit, high volume, and high return on capital employed.

Twelve Principles of Innovation
- Focus on price performance
- Innovation requires hybrid solutions
- Solutions must be transportable across countries, cultures, and languages
- Conserve resources - eliminate, reduce, recycle
- Start with understanding of functionality
- Process innovations are just as critical
- Deskilling work is critical
- Education consumers on product usage
- Products must work in hostile environments
- Research on interfaces given nature of population
- Innovations must reach the consumer
- Feature and function evolution in BOP markets can be rapid

Institutions and Groupings
- G8
- OECD
- The Triad

Balance of Payments (the other BOP)
- Record of economic transaction all over the world
- Current and capital accounts
- Just like a company balance sheet
  - Focus is on trade and cash flow expenditures

International Finance
- Foreign exchange
  - Devaluation
    - (one’s currency looses value in comparison to another)
  - Revaluation
    - Strengthening of currency value in relation to others
**PPP - Purchasing Power Parity**


---

**Currency Risk**

- **Economic Exposure**
  - Hedging
  - Forward Market
    - Put option
    - Call option

- **Reducing Exposure**

---

**BOP = Bottom of the Pyramid**

- Tier 1: PPP > $20,000
- Tier 2-3: PPP $1,500 - $20,000
- Tier 2: PPP = $1,500
- Tier 5: PPP < $1,500

---

**Currency Risk**

- Purchases aircraft from Boeing
  - 10% down payment
  - Rest upon delivery (5 years later)
- Revenues of JAL in Yen
- Payments in USD
- In 1985 - entered into 10 year forward exchange contract
  - Value of Yen surged against dollar from ¥240 to ¥99 in 1994
  - Misjudgment cost JAL 86 percent more per each aircraft
  - Admitted loss of USD 45 million or ¥45 billion