

THE IMPACT OF THE BUSINESS ENVIRONMENT ON THE SOUTH AFRICAN EMERGING MARKET ECONOMY

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Abstract

The business environment impacts on the strategic as well as the operational policies, decisions and actions of enterprises, as businesses do not operate in a vacuum. This research paper addresses the impact of the business environment on the South African emerging market economy, where emerging market economies usually have a rapid growing economy as well as government policies which embody economic liberalization and a free-market system. Secondary as well as primary data were applied to achieve the objective of this research paper, which involves the improvement of financial decision-making concerning the impact of the business environment on an emerging market economy. The empirical study of this research paper focuses on the following three aspects, viz.:

- The importance of the impact of various business environment factors on an emerging market economy,
- The problem areas within the business environment which impact on an emerging market economy and possible solutions to solve them, as well as
- The perceptions concerning the rating of various business environment factors over the past five years and the next five years in South Africa.

As this research paper focuses on an emerging market economy, the conclusions of this study should be valuable to other countries which have the same type of economy.

Keywords: Business Environment, Economic Impact, Financial Impact, Impact of Foreign Direct Investments, Impact of the Infrastructure, Political Impact

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1. Introduction

Enterprises do not operate in a vacuum, as the business environment impacts on them and influences their strategic and operational policies, decisions and actions. This research paper addresses the impact of the business environment on the South African emerging market economy, where emerging market economies usually have two characteristics according to Hoskisson *et al.* (2000:249). These two characteristics consist of a rapid growing economy as well as government policies which embody economic liberalization and a free-market system (Lim, 1983:754). Although emerging market economies have the ability to make significant contributions to the global economy, unlocking the growth potential of these economies is often difficult. Emerging market economies often share common problems and shortfalls, which mainly focus on the financial, economic and political situations as well as the availability of a proper infrastructure and adequate foreign direct investments in the particular countries.

The *objective* of this research paper involves the improvement of financial decision-making concerning the impact of the business environment on an emerging market economy. To achieve this objective, secondary as well as primary data are necessary. The secondary data will consist of a literature study focusing on the financial, economic and political impact of the business environment on an emerging market economy as well as the related impact of the infrastructure and foreign direct investments.

The primary research of this study will focus on the top companies listed on the Johannesburg Stock Exchange, as these companies are regarded as the business leaders in South Africa. The perceptions of these companies were obtained by means of an opinion survey with reference to the *importance* of the impact of various business environment factors on an emerging market economy, the *problem areas* which the respondents experienced and the suitable solutions to solve problems. The perceptions of the respondents concerning the *rating* of various business environment factors over the past five years and the

next five years in South Africa are also provided in this research paper.

2. The Impact of the Business Environment

The impact of the business environment consists of various factors which have a combined influence on an emerging market economy. The following factors are considered as those which have a major impact on an emerging market economy and they will receive attention in the next sections:

- The financial environment of an emerging market economy,
- The economic environment of an emerging market economy,
- The political environment of an emerging market economy,
- The infrastructure of an emerging market economy, and
- The foreign direct investments that occur within an emerging market economy.

2.1 The financial environment of an emerging market economy

Financial stability is vital to the efficient functioning of an emerging market economy as it provides the basis for rational decision-making concerning the allocation of resources. When proper financial decision-making takes place, capital and financial investments should lead to the improvement of the economy in the long run. Financial instability may however result in adverse effects on the economic activities of a country as the financial sector may be hesitant to conclude contracts. It must be borne in mind that the tumult of a country's financial sector may have long-term implications on the economic and political structures thereof (Crockett, 1996:531).

Financial stability may have an important impact on the growth of a country. It must however be emphasised that it is very difficult to prove the relationship between financial stability and the growth of a country, as the related growth can be negatively or positively effected by financial instability. When the instability is due to an increase of market volatilities, the flow of information may be improved which may lead to an increase of risk taking, resulting in an increase in the growth of a country (Blejer, 2006:3430). It is therefore clear that financial instability does not always lead to a negative impact on the growth of a country.

Not only the financial stability, but also the efficiency of the financial sector should be taken into account where the efficiency focuses on the transformation of resources into capital (Blejer, 2006:3431). An efficient financial system should lead to a smaller currency crisis risk, may give rise to a smaller loss when a financial crisis occurs, as well as

should provide more rapid growth to a country (Blejer, 2006:3432).

The financial environment manifests itself amongst others in the financial climate and the financial services available in an emerging market economy. The smoothening of the related business cycle fluctuations by applying proper government policies also plays an important role in this regard. The extent as well as the volatility of the applicable foreign exchange rates, interest rates and inflation rates should furthermore be taken into account when the financial environment of an emerging market economy is considered. It must be emphasised that the applicable tax regulations will contribute significantly to the related impact of the financial environment, although it originates from the fiscal policies which is part of the economic environment.

2.2 The economic environment of an emerging market economy

Economic stability is of prime importance to any country. When the government of a country fails to apply proper policies, major economic problems may be caused (Kazmi, 2012:1). It is general knowledge that the monetary and fiscal policies of a country fulfil an important role in any country. As the monetary policies influence the supply of and demand for money, it is expected that when the purchasing power of money is reasonably steady, a particular country should achieve the maximum output while the highest living standards should prevail (Jordan, 2006:507). The fiscal policies of a country focus, amongst others, on the level of taxation in order to finance the government expenditure. The tax regulations play an important role when the financial impact of the business environment on an emerging market economy is considered.

Dissart (2003:424) suggested that one way to achieve economic stability can be through the application of economic diversity. A greater variety of industries in a country should lead to a better spreading of the labour force amongst the industries and/or the regions of that country during the seasonal and/or cyclical phases. Before focusing on a policy of economic diversification, emerging market economies should however ensure that they have skilled labour as required by the various industries. It is interesting to note that Sherwood-Call (1990:24) recommended that when a particular region has an abundant supply of a natural resource or resources and/or a group of enterprises in a particular industry which create a comparative advantage for that region, that particular opportunity may be employed over and above economic diversification of an emerging market economy. The political impact of the business environment receives due attention in the next section.

2.3 The political environment of an emerging market economy

A sound business environment depends to a large extent on the political situation of a country. An increasing number of developing countries are apparently opting for democracy which usually brings a participatory government (Rodrik, 2000:144). Democracy usually creates economic value, especially in countries where different cultures and languages may lead to detrimental social results (Rodrik, 2000:144).

It is not clear whether there is a link between democracy and long-term economic growth rates according to Rodrik (2000:140). While Rodrik (2000:140) could not determine a link between these two variables, he found a negative relationship which is statistically significant between democracy and the *volatility* concerning economic performance. This conclusion implies that an increase in democracy should decrease the possibility of economic volatility. It is interesting to note that Quinn and Woolley (2001:653) found that democracy should lead to *lower rates* of economic *volatility*. Their conclusion therefore supports the finding of Rodrik.

The conclusions of the research done by Feng are in line with the findings of Rodrik as well as that of Quinn and Woolley. Feng (1997:414) concluded that democracy should have a positive impact on economic *growth* as democracy reduces the possibility of the unconstitutional change of a government. The constitutional political changes which are possible through a democratic dispensation should favour the business environment which may lead to economic growth and development. Although it is suggested by Feng that democratic governance holds the possibility to further economic growth, it should be clear that the relationship between democracy and economic growth is not necessary a given fact. An efficient democratic government has the responsibility to positively influence the business environment of a country by promoting ethical practices, fair competition and the enforcement of legal action against any corruption and malpractice in the public as well as the private sectors. The impact of the infrastructure in this regard is discussed in the following section.

2.4 The infrastructure of an emerging market economy

The infrastructure that exists within a country plays a major role in its emerging market economy. A lack of infrastructure and associated public services do not make a country attractive to investors. According to the Africa Infrastructure Knowledge Program (2011:4) the term infrastructure refers to the comprehensive network of public services which are necessary for the economic and social activities of a country. It includes amongst others the following

(Africa Infrastructure Knowledge Program, 2011:4-5; Collier, 2011:18-21):

- Road, railway, maritime and air transport ,
- The supply of water, sanitation, electricity, gas and gasoline, as well as
- The availability of administration, construction and maintenance services.

It is interesting to note that most of the countries in Sub-Saharan Africa are spending between 6% and 12% of their annual gross domestic product on their infrastructure, while China spent more than 14% of their gross domestic product in 2006 on capital infrastructure investment (Africa Infrastructure Knowledge Program, 2011:52). The spending of a country on their infrastructure is very important to private enterprises, as an efficient and effective infrastructure should lower the enterprises' operating costs, increase their net profits and enhance their competitiveness. It is generally accepted that an excellent infrastructure will improve the business environment of a country which should lead to more foreign direct investments.

2.5 The foreign direct investments that occur within an emerging market economy

Foreign direct investments are very important to a host country, as it should amongst others impact on the economic growth, the imports and exports, the production, the balance of payments and the general development of that particular country. It is interesting to note that 33% of the total foreign direct investments were undertaken during 1996 in developing countries, which emphasises the importance of these countries in the global economy (Arnold & Quelch, 1998:7-20). Quazi (2007:329) referred to the three development gaps which foreign direct investments can fill in a developing country, which are as follows:

- The investment gap by supplying cash inflow for the required capital investments in the country,
- The foreign exchange gap with reference to foreign currency linked to the initial investments and the foreign earnings when the country's production is exported, as well as
- The tax revenue gap as the additional economic activities should lead to more taxable income in the country which the particular government can tax.

The determinants of foreign direct investments in a country may include a variety of variables, such as the inflation, interest and foreign exchange rates, the market size, the current and expected wage levels and the availability of a trained workforce, the quality and extent of the infrastructure, the return on investment which the private enterprises can achieve, the current and expected political stability, as well as the financial and trade liberalization (Quazi, 2007:330). Farrell *et al.* (2004:30) also mentioned the

regulatory environment of a country, the accessibility by air and the financial incentives which are available. It is significant that Borensztein *et al.* (1998:134) found that a strong positive relationship existed between foreign direct investments and the level of educational attainment in a country, emphasising the importance of a country's educational system.

Although enterprises from abroad which carry out the foreign direct investments may obtain satisfactory financial returns on their investments, the local population should also benefit by the investments. Gohou and Soumaré (2012:93) found a strong positive relationship between foreign direct investments and the improvement in the level of welfare concerning the entire African continent. They also suggested that the impact of foreign direct investments should be bigger when the particular country is poorer and less developed.

Foreign direct investments hold the ability to improve the standard of living in a particular country in more than one way. New markets may be developed due to the new and/or additional production of various types of goods, new technologies may be available to and be applied by the local population, and the skills of the local population may be developed (Khan *et al.*, 2009:482). Furthermore, the new employment opportunities should benefit the local population by providing more disposable income for various personal needs. It can be concluded that foreign direct investments should improve the business environment in general.

3. Research Methodology

Table 1. The weights assigned to the answers of the respondents

Answers of the respondents:		Weights assigned:
Extremely important	Excellent	5
Highly important	Between excellent and average	4
Moderately important	Average	3
Little important	Between average and poor	2
Not important	Poor	1

The primary data obtained by the empirical study appears in the following sections.

4. Empirical Results

The empirical results are discussed in the subsequent sections and the description thereof will pay due attention to the following aspects:

- The importance of the impact of various business environment factors on an emerging market economy,
- The problem areas within the business environment which impact on an emerging market

The *objective* of this research paper has already been stated, namely the improvement of financial decision-making concerning the impact of the business environment on an emerging market economy. Both secondary data and primary data were necessary to accomplish the objective. The preceding sections of this research provided the results of the secondary research to enable the compilation of a relevant questionnaire for the primary research.

The primary research focused on the top 20 companies listed on the Johannesburg Stock Exchange. These companies were identified as the sample of the empirical study as they are perceived to be the South African business leaders (Financial Mail, 2012). A cover letter and the questionnaire were sent to the intended respondents via post. Two of these companies were unable to reply because their company's policy did not allow their employees to provide information to outsiders. The sample was therefore decrease to 18 companies. After following up, 13 completed questionnaires were available for the primary research, which represents a response rate of more than 72%.

Some of the questions of the questionnaire used a five point Likert interval scale. It was explicitly stated on the questionnaire that the five point Likert interval scale forms a continuum which enabled the weighting of the answers (Albright *et al.*, 2002:224-229 & 245). The answers of the respondents, which appear in Section 4, were weighted by assigning the weights shown in Table 1.

economy and possible solutions to solve them, as well as

- The perceptions concerning the rating of various business environment factors over the past five years and the next five years in South Africa.

4.1 *The importance of the impact of various business environment factors on an emerging market economy*

The perceptions of the respondents relating to the importance of the impact of various business environment factors on an emerging market economy are depicted in the following table.

Table 2. The importance of the impact of various business environment factors on an emerging market economy, as perceived by the respondents

Business environment factors	Extremely important	Highly important	Moderately important	Little important	Not important
The <i>financial climate</i> in which an enterprise operates and the stability thereof.	12	1			
The provision of <i>financial services</i> (banking, insurance, investment, asset management etc.)	7	5	1		
The <i>smoothing</i> of business cycle fluctuations by authorities.	1	5	5	2	
The extent and volatility of the <i>foreign exchange rate</i> .	5	7	1		
The extent and volatility of the <i>interest rate</i> .	1	9	3		
The extent and volatility of the <i>inflation rate</i> .	4	7	2		
The applicable <i>fiscal policy</i> and <i>tax regulations</i> .	8	5			
The <i>economic</i> environment of the emerging market economy and the stability thereof.	7	6			
The <i>political</i> environment of the emerging market economy and the stability thereof.	5	8			
The <i>infrastructure</i> of the emerging market economy.	4	8	1		
The extent of and the incentives for <i>foreign direct investments</i> that occur within the emerging market economy.	6	6	1		

The perceptions of the respondents which are shown in the preceding table were weighted by applying the weights discussed in Section 3 of this research paper. The weighted responses on the

importance of the impact of various business environment factors on an emerging market economy appear in Table 3.

Table 3. The weighted responses on the importance of the impact of various business environment factors on an emerging market economy, in a declining order of importance

Total weighted scores calculated	Declining order of importance	Business environment factors
64	1	The financial climate in which an enterprise operates and the stability thereof.
60	2	The applicable fiscal policy and tax regulations.
59	3	The economic environment of the emerging market economy and the stability thereof.
58	4	The provision of financial services (banking, insurance, investment, asset management etc.)
57	5	The political environment of the emerging market economy and the stability thereof.
57	5	The extent of and the incentives for foreign direct investments that occur within the emerging market economy.
56	7	The extent and volatility of the foreign exchange rate.
55	8	The infrastructure of the emerging market economy.
54	9	The extent and volatility of the inflation rate.
50	10	The extent and volatility of the interest rate.
44	11	The smoothing of business cycle fluctuations by authorities.

The preceding table points out that the financial climate in which an enterprise operates as well as the stability thereof is regarded as the business environment factor which has the *most* important impact on an emerging market economy. It seems quite rational as the financial climate should set the scene for the strategic decisions which an enterprise usually makes. It is interesting to note that the economic environment and the stability thereof, as well as the political environment and the stability thereof, are respectively the *third* and (one of the) *fifth* most important business environment factors according to the perceptions of the respondents. It must be emphasised that the economic and political environments also contribute to the setting of the business scene for strategic decision-making.

The business environment factors which respectively have the *second*, *fourth* and (the other) *fifth* highest total weighted scores calculated according to Table 3, address very specific issues. These topics are as follows:

- The applicable fiscal policy and tax regulations,
- The provision of financial services, such as banking, insurance, investment and asset management, as well as
- The extent of and the incentives for foreign direct investments that occur within the emerging market economy.

It is interesting to note that the importance of the impact of the foreign exchange rate, the inflation rate, the interest rate, the infrastructure and the smoothening of business cycle fluctuations were not amongst the six business environment factors which have the most important impact on an emerging market economy. It can therefore be concluded that although the impact of the foreign exchange rate, the inflation rate and the interest rate, as well as the impact of the infrastructure of an emerging market economy and the smoothening of the business cycle fluctuations by authorities, are important according to the perceptions of the respondents, the total weighted scores calculated in Table 3 indicate that the other six business environment factors mentioned previously in this section have a more important impact on an emerging market economy than these five factors. The next section will address the problem areas within the business environment which impact on an emerging market economy.

4.2 The problem areas within the business environment which impact on an emerging market economy and possible solutions to solve them

The respondents were requested to mention the three most important problem areas within the business environment which impact on an emerging market economy. The perceptions of the respondents are depicted in Table 4.

Table 4. Problem areas within the business environment which impact on an emerging market economy, as perceived by the respondents

Problem areas	Number of respondents who mentioned the problem area
The <i>financial climate</i> in which an enterprise operates and the stability thereof.	6
The <i>economic</i> environment and the stability thereof.	6
The applicable <i>fiscal policy</i> and <i>tax regulations</i> .	6
The extent and volatility of the <i>foreign exchange rate</i> .	4
The <i>political</i> environment and the stability thereof.	3
The <i>infrastructure</i> of the emerging market economy.	3
The extent and volatility of the <i>inflation rate</i> .	3
The extent of and the incentives for <i>foreign direct investments</i> that occur within the emerging market economy.	3
The provision of <i>financial services</i> (banking, insurance, investment, asset management etc.)	2
The <i>smoothening</i> of business cycle fluctuations by authorities.	1
The extent and volatility of the <i>interest rate</i> .	1
The <i>public services</i> available in the emerging market economy.	1

A variety of 12 problem areas were identified by the respondents according to the preceding table. The three problem areas mentioned by the highest number of respondents, as well as the solutions available to solve them, are as follows:

- The financial climate in which an enterprise operates and the stability thereof seem to represent a

problem area in this regard. To solve this problem area, governments need to create consumer confidence and long-term financial stability through their policies, decisions and actions to enable enterprises to improve their strategic and operational planning. The efficiency of the money and capital market should also play a major role in this regard.

- Another problem area which was indicated by the respondents was the economic environment and the stability thereof. It appears that governments should formulate and apply transparent economic policies which have to focus on prudent monetary and fiscal policies. The economic policies should also address, amongst others, inflation targeting, budget deficits, creation of employment and obtaining foreign direct investments.

- The applicable fiscal policy and tax regulations were also identified in Table 4 as a problem area. Solutions to solve this problem area embody that the fiscal policy and tax regulations should be clearly communicated by government and that it should be directed at economic and social development by employing tax revenues efficiently. Misappropriation of funds should be avoided by governments at all times. A government should also

abstain from unnecessary changes of the fiscal policy and tax regulations as it may increase the risk level of the business sector. The following section will pay attention to the perceptions of the South African respondents concerning the rating of various business environment factors over the past five years and the next five years.

4.3 The perceptions concerning the rating of various business environment factors over the past five years and the next five years in South Africa

The perceptions of the respondents concerning the rating of various business environment factors over the past five years and the next five year in South Africa are respectively depicted in Tables 5 and 6.

Table 5. The respondents' perceptions concerning the rating of various business environment factors over the *past* five years

Aspects of the business environment	Excellent	Between excellent and average	Average	Between average and poor	Poor
Financial environment	2	4	6	1	
Political environment			7	3	3
Economic environment			8	5	
The infrastructural environment		4	2	7	
The fiscal policy and tax regulations	1	4	8		

Table 6. The respondents' perceptions concerning the rating of various business environment factors over the *next* five years

Aspects of the business environment	Excellent	Between excellent and average	Average	Between average and poor	Poor
Financial environment	3	3	6	1	
Political environment			8	3	2
Economic environment			11	2	
The infrastructural environment		3	6	3	1
The fiscal policy and tax regulations	2	4	6	1	

The respondents' perceptions which appear in Tables 5 and 6 were weighted by means of the weights that were discussed in Section 3 of this research paper. The *average* weighted scores were thereafter calculated for the various business

environment factors over the past five years and the next five years. The average weighted scores calculated as well as the improvement in the average weighted scores calculated are depicted in the following table.

Table 7. The average weighted scores calculated for various business environment factors over the *past* five years and the average weighted scores calculated for these business environment actors for the *next* five years

Business environment factors	Average weighted score calculated for the past five years	Average weighted score calculated for the next five years	Improvement in the average weighted scores calculated
Financial environment	3.54	3.62	0.08
Political environment	2.31	2.46	0.15
Economic environment	2.62	2.85	0.23
The infrastructural environment	2.77	2.85	0.08
The fiscal policy and tax regulations	3.46	3.54	0.08

The average weighted scores calculated for the past five years as well as for the next five years indicate that the ratings by the respondents were the *highest* for the financial environment as well as for the fiscal policy and tax regulations according to Table 7. It must however be emphasised that the ratings of these two business environment factors were above “average” but still not on the level of “between excellent and average” (as the ratings were above 3 but below 4 according to Table 1).

The *remaining* three business environment factors of Table 7, viz. the political environment, the economic environment and the infrastructural environment, have average weighted scores calculated for the past five years as well as for the next five years which represent ratings by the respondents of below “average” (as the ratings were smaller than 3 according to Table 1).

It is interesting to note that the average weighted scores calculated for the *next* five years concerning *each* of the five business environment factors mentioned in Table 7 are higher than the average weighted scores calculated for each corresponding business environment factor for the *past* five years. It can therefore be concluded that the respondents were expecting an improvement in the ratings of *each* of these five business environment factors during the next five years compared with the past five years.

5. Conclusions

It was already stated in this research paper that the *objective* of this research embodies the improvement of financial decision-making concerning the impact of the business environment on an emerging market economy. The conclusions made are based on the secondary data as well as the primary data which were obtained. As the topic of this research paper focuses on the impact of the business environment on an emerging market economy, the following conclusions should be valuable to other countries which have the same type of economy:

(1) It was concluded that the six business environment factors which have the most important impact on an emerging market economy are as follows (in a declining order of importance):

- The financial climate in which an enterprise operates and the stability thereof,
- The applicable fiscal policy and tax regulations,
- The economic environment of the emerging market economy and the stability thereof,
- The provision of financial services (banking, insurance, investment, asset management etc.),
- The political environment of the emerging market economy and the stability thereof, *as well as* the extent of and the incentives for foreign direct investments that occur within the emerging market economy. (These two factors have the same total weighted score calculated.)

It should be emphasised that the six business environment factors mentioned above have to receive special attention when the impact of business environment factors on an emerging market economy is considered by enterprises and governments.

(2) The three problem areas mentioned by the highest number of respondents are as follows:

- The financial climate in which an enterprise operates and the stability thereof,
- The economic environment and the stability thereof, as well as
- The applicable fiscal policy and tax regulations.

The solutions to solve these problem areas focus on the *policies, decisions and actions* of the particular *government*, which should, amongst others, create consumer confidence and long-term financial stability, should provide an efficient money and capital market, should formulate and apply transparent economic policies while focusing on prudent monetary and fiscal policies, should communicate the fiscal policy and tax regulations that are directed at economic and social development of the country, should abstain from the misappropriation of funds and should avoid unnecessary changes of the fiscal policy and tax regulations to lower the risk level of the business sector.

(3) The financial environment as well as the fiscal policy and tax regulations in South Africa are the two business environment factors which have the highest ratings according to the perceptions of the respondents. Their ratings for the past five years and the next five years are above “average” but the ratings are still not on the level of “between excellent and average”.

The political environment, the economic environment and the infrastructural environment in South Africa have received ratings by the respondents of below “average”. It was however concluded that the respondents were expecting an improvement in the ratings of *each* of these five business environment factors in South Africa during the next five years compared with the past five years.

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