Chapter 2: The Political, Legal, and Technological Environment

Learning Objectives and Chapter Summary

1. INTRODUCE the basic political systems that characterize regions and countries around the world and offer brief examples of each and their implications for international management.

   The global political environment can be understood via an appreciation of ideologies and political systems. Ideologies, including individualism and collectivism, reflect underlying tendencies in society. Political systems, including democracy and totalitarianism, incorporate the ideologies into political structures. There are fewer and fewer purely collectivist or socialist societies, although totalitarianism still exists in several countries and regions. Many countries are experiencing transitions from more socialist to democratic systems, reflecting related trends discussed in Chapter 1 toward more market-oriented economic systems.

2. PRESENT an overview of the legal and regulatory environment in which MNCs operate worldwide, and highlight differences in approach to different legal and regulatory issues in different jurisdictions.

   The current legal and regulatory environment is both complex and confusing. There are many different laws and regulations to which MNCs doing business internationally must conform, and each nation is unique. Also, MNCs must abide by the laws of their own country. For example, U.S. MNCs must obey the rules set down by the Foreign Corrupt Practices Act. Privatization and regulation also affect the legal and regulatory environment in a specific country.

3. REVIEW key technological developments, including the growth of e-commerce, and discuss their impact on MNCs now and in the future.

   The technological environment is changing quickly and is having a major impact on international business. This will continue in the future. For example, digitization, higher-speed telecommunication, and advancements in biotechnology offer developing countries new opportunities to leapfrog into the 21st century. New markets are being created for high-tech MNCs that are eager to provide telecommunications service. Technological developments also impact both the nature and the structure toward a more high-tech, knowledge-based economy. MNCs that understand and take advantage of this high-tech environment should prosper, but they must also keep up, or move ahead, to survive.

The World of International Management: Social Media and the Pace of Change

1. Summary:

   This vignette discusses the ability of social media to influence world events. The Arab Spring led to real reforms at a pace never before seen in Northern Africa and the Middle East. Unlike previous revolutions, which lacked any widespread, immediate communication tools, the Arab spring protestors were equipped with smartphones and social media. Twitter and Facebook morphed from informal, friendly networking sites to powerful weapons. Groups used Facebook to announce events, garner online support, and encourage people to participate. Attempts to block social media backfired and increased the number of protestors. In addition, protestors became journalists to the international community, with no lag time in broadcasting the news. As a result, governments such as the United States were pressured to take a stand and to lend assistance.

   From a business standpoint, production and GDP were negatively affected almost overnight. One silver lining from the rapid regime changes is the potential for equally as fast transitions to more open trade and business dealings. Managing the political and legal environment will continue to be an important challenge for international managers, as will the rapid changes in the technological environment of global business.

2. Suggested Class Discussion:

   1. Students should be able to discuss how social media influences the political and business environments in countries seeking to transition into democracies—without the blessing of the government.

   2. Students should be encouraged to consider strategies to use social media to the advantage of international markets in unstable political environments.

3. Related Internet Sites:

   - Google Arab Spring, Tunisia, Egypt, Yemen, Libya: {http://www.google.cn/}
   - Facebook—Arab Spring: {http://www.facebook.com}
   - Wikipedia: {http://en.wikipedia.org/wiki/Arab_Spring}
   - Business Week: {www.businessweek.com}

Chapter Outline with Lecture Notes and Teaching Tips

Ideologies

Individualism

1) *Individualism* – adopters of individualism adhere to the philosophy that people should be free to pursue economic and political endeavors without constraint. This means that government interest should not solely influence individual behavior.

Collectivism

1) *Collectivism* – the political philosophy that views the needs or goals of society as a whole as more important than individual desires.

Socialism

1) *Socialism* –a moderate form of collectivism in which there is government ownership of institutions, and profit is not the ultimate goal.

   a) Communism is an extreme form of socialist thought which was realized through violent revolution and committed to the idea of a worldwide communist state.
   b) Social democracy is a social movement that achieved its goals through nonviolent revolution.

Political Environment

1) The domestic and international political environment has a major impact on MNCs. As government policies change, MNCs must adjust their strategies and practices to accommodate the new perspectives and actual requirements. Moreover, in a growing number of geographic regions and countries, governments appear to be less stable; therefore, these areas carry more risk than they have in the past.

   Teaching Tip: The U.S. State Department produces a series of annual "Country Reports" to acquaint American businesses with other countries. Each report contains nine sections: (1) Key Economic Indicators; (2) General Policy Framework; (3) Exchange Rate Policies; (4) Structural Policies; (5) Debt Management Policies; (6) Significant Barriers to U.S. Exports and Investments; (7) Export Subsidies Policies; (8) Protection of U.S. Intellectual Property; and (9) Worker Rights. The site is available at {http://www.state.gov/www/issues/economic/trade_reports/99_toc.html}. Another source of information in other countries is the CIA's "The World Factbook" available at {https://www.cia.gov/library/publications/the-world-factbook/}.

Political Systems

1) *Democracy* –a political system in which the government is controlled by the citizens either directly or through elections. A democratic society cannot exist without at least a two-party system.

2) *Totalitarianism* –a political system in which there is only one representative party which exhibits control over every facet of political and human life. Power is often maintained by suppression and opposition.

Legal and Regulatory Environment

1) There are four foundations on which laws are based around the world.

   a) *Islamic Law* - This law is derived from interpretation of the *Qur'an* and the teachings of the Prophet Mohammed. It is found in most Islamic countries in the Middle East and Central Asia.
   b) *Socialist Law* - This law comes from the Marxist socialist system and continues to influence regulations in former communist countries.
   c) *Common Law* - This law comes from English law, and is the foundation of the legal system in the United States, Canada, England, Australia, New Zealand, and other nations.
   d) *Civil or Code Law* - This law is derived from Roman law and is found in the non-Islamic and nonsocialist countries such as France, some countries in Latin America, and even Louisiana in the United States.

Basic Principles of International Law

1) **Sovereignty and Sovereign Immunity** - The *principle of sovereignty* holds that governments have the right to rule themselves as they see fit.
2) **International Jurisdiction** - International law provides for three types of jurisdictional principles:
   i) Nationality Principle
   ii) Territoriality Principle
   iii) Protective Principle
3) **Doctrine of Comity** – The *doctrine of comity* holds that there must be mutual respect for the laws, institutions, and government of other countries in the matter of jurisdiction over their own citizens.
4) **Act of State Doctrine** - Under the *act of state doctrine*, all acts of other governments are considered to be valid by U.S. courts, even though such acts are illegal or inappropriate under U.S. law.
5) **Treatment and Rights of Aliens** - Countries have the legal right to refuse admission of foreign citizens and to impose special restrictions on their conduct, right of travel, where they can stay, and what business they may conduct.
6) **Forum for Hearing and Settling Disputes** - This is a principle of U.S. justice as it applies to international law.

Examples of Legal and Regulatory Issues

1) **Financial Services Regulation** – The global financial crisis of 2008–2010 prompted regulators around the world to establish new regulations designed to reduce the risk of associated with certain types of financial instruments.
2) **Foreign Corrupt Practices Act** – The *Foreign Corrupt Practices Act* makes it illegal to influence foreign officials through personal payment or political contributions.

   Teaching Tip: The U.S. Department of Justice maintains an updated website on the Foreign Corrupt Practices Act, including a "lay person's" simplified interpretation of the Act. The website is {http://www.usdoj.gov/criminal/fraud/fcpa/}.

3) **Bureaucratization** - Very restrictive foreign bureaucracies are one of the biggest problems facing MNCs. Table 2-1 in the text ranks the overall ease of doing business in countries around the world.
4) **Privatization** - Another example of the changing international regulatory environment is the current move toward privatization by an increasing number of countries.

Regulation of Trade and Investment

1) The regulation of international trade and investment is another area in which individual countries use their legal and regulatory policies to affect the international management environment. The rapid increase in trade and investment has raised concerns among countries that others are not engaging in fair trade, based on the fundamental principles of international trade as specified in the WTO and other trade and investment agreements.

Technological Environment and Global Shifts in Production

1) Technological advancements not only connect the world at lightning speed but also aid in the increased quality of products, information gathering, and R&D.

Trends in Technology, Communication, and Innovation

1) The innovation of the microprocessor is the foundation for most technological and computing advances in the world today.
2) One Laptop Per Child (OLPC) is a U.S. nonprofit organization aimed at putting an affordable educational device in the hands of the world's poorest children.
3) World connectivity is threatened by possible disruptions to the underground and underwater cables that powers the network.

Biotechnology

1) *Biotechnology* is the integration of science and technology to create agricultural or medical products through industrial use and manipulation of living organisms.

E-Business

1) As the Internet becomes increasingly common, it is having a dramatic effect on international commerce. Internet penetration rates for major world regions are shown in Table 2-2 in the text.

   Teaching Tip: An interesting website to show your students is the Internet Traffic Report {http://www.internettrafficreport.com/}. This site monitors the flow of Internet traffic around the world. It then displays a value between zero and 100 for different regions of the world. Higher values indicate faster and more reliable connections.

Telecommunications

1) One of the most obvious dimension of the technological environment facing international management today is telecommunications. Developing countries are especially interested in attracting telecommunications firms.

Technological Advancements, Outsourcing, and Offshoring

1) As MNCs use advanced technology to help them communicate, produce, and deliver their goods and services internationally, they face a new challenge: how technology will affect the nature and number of their employees.
2) In the future technology has the potential to displace employees in all industries, from low-skill jobs to knowledge work.
3) The new technological environment has both positive and negatives for MNSs and societies as a whole.

The World of International Management - Revisited

Questions & Suggested Answers

1. How will changes in the political and legal environment in the Middle East and North Africa affect U.S. MNCs conducting business there?

   Answer: Political uncertainty and instability is a challenge. MNCs need to assess the political risk and strategies to cope with the situations. The Arab Spring has highlighted some of the issues: supply chain disruptions, longer shipping times, and spikes in oil prices. MNCs must collaboratively work with new governments as laws, policies, and regulations are introduces and altered.

2. How might evolving political interests and legal systems affect future investment in the region?

   Answer: With changing political and legal systems, the environment for investment may result in more caution. Regulations can change quickly, protection may disappear, unfavorable subsidies may come into being, and so on. On the other hand, new markets and new offshoring options may open up.

3. How does technology result in greater integration and dependencies among economies, political systems, and financial markets, but also greater fragility?

   Answer: These changes have been manifested in terms of increased e-commerce and telecommunications, as well as their implications in terms of outsourcing, offshoring, transparency, and financial market integration in general. On the positive side, technology allows organizations to capitalize on their core competencies and create sustainable competitive advantage through networking, outsourcing and other globally flexible arrangements. Moreover, integration of and mobility in financial and labor markets allows for drawing on more competitive sources of capital and labor. Increasingly, technology is also facilitating open communication and transparency, and eliminating much of the opaqueness that existed in many regions. On the other hand, various challenges are presented by technology. Jobs and investments have been dislocated in many developed countries. Political and economic crises in one region now have further reach and stronger ramifications on the rest of the world.

Key Terms

Act of state doctrine―A jurisdictional principle of international law which holds that all acts of other governments are considered to be valid by U.S. courts, even if such acts are illegal or inappropriate under U.S. law

Biotechnology―The integration of science and technology to create agricultural or medical products through industrial use and manipulation of living organisms

Civil or code law―Law that is derived from Roman law and is found in the non-Islamic and nonsocialist countries

Collectivism―The political philosophy that views the needs or goals of society as a whole as more important than individual desires

Common law―Law that derives from English law and is the foundation of legislation in the United States, Canada, and England, among other nations

Democracy―A political system in which the government is controlled by the citizens either directly or through elections

Doctrine of comity―A jurisdictional principle of international law which holds that there must be mutual respect for the laws, institutions, and governments of other countries in the matter of jurisdiction over their own citizens

Foreign Corrupt Practices Act (FCPA)—An act that makes it illegal to influence foreign officials through personal payment or political contributions; became U.S. law in 1977 because of concerns over bribes in the international business arena
Individualism—The political philosophy that people should be free to pursue economic and political endeavors without constraint
Islamic law—Law that is derived from interpretation of the Qur'an and the teachings of the Prophet Muhammad and is found in most Islamic countries
Nationality principle—A jurisdictional principle of international law which holds that every country has jurisdiction over its citizens no matter where they are located
Principle of sovereignty—An international principle of law which holds that governments have the right to rule themselves as they see fit
Protective principle—A jurisdictional principle of international law which holds that every country has jurisdiction over behavior that adversely affects its national security, even if the conduct occurred outside that country
Socialism—A moderate form of collectivism in which there is government ownership of institutions, and profit is not the ultimate goal
Socialist law—Law that comes from the Marxist socialist system and continues to influence regulations in countries formerly associated with the Soviet Union as well as China
Territoriality principle—A jurisdictional principle of international law which holds that every nation has the right of jurisdiction within its legal territory
Totalitarianism—A political system in which there is only one representative party which exhibits control over every facet of political and human life

Review and Discussion Questions

1. In what way do different ideologies and political systems influence the environment in which MNCs operate? Would these challenges be less for those operating in the EU than for those in Russia or China? Why, or why not?

   Answer: The international political climate on the whole is improving. Former communist nations are seeing the benefits of free market systems. While this presents obvious opportunities in new markets for MNCs, the risks of doing business in many of these countries are still high. Also, in countries like Russia and China, the government still has some control over many industries. Hence, the political risk is much higher for MNCs wishing to do business in these countries than, say, Europe. Why China is still communist, free market principles are encouraged. Another consideration for MNCs is the stability of the currency. Wide fluctuations in the value of money are still occurring in emerging nations such as in Eastern Europe or Southeast Asia, as well as in Northern Africa and the Middle East.

2. How do the following legal principles impact on MNC operations: the principle of sovereignty, the nationality principle, the territoriality principle, the protective principle, and the principle of comity?

Answer: The legal environment in the international marketplace can be quite complex. This is due to law developing from individual countries, treaties, and such items as the Geneva Convention. Further complicating matters are that many principles of law are unwritten understandings between nations. Fortunately, most of what MNCs need to know can be found in several broad principles that govern the conduct of international law.

The principle of sovereignty holds that governments have the right to rule themselves as they see fit. Therefore, MNCs must understand the laws of other countries when operating there and abide by them. In the United States, for example, we have many safety rules and regulations governing the workplace. A Japanese-owned company opening a production operation in the U.S. must follow U.S. law. Should violations occur, the territoriality principle allows the dispute to be handled in the U.S. court system, regardless of where the MNC’s headquarters is located.

However, the nationality principle holds that every country has jurisdiction over its own citizens, regardless of where they are located. Therefore, a Japanese citizen doing business in the U.S. is not exempt from the laws of his or her own country just because he or she is outside the borders.

The protective principle holds that every country has jurisdiction over behavior that adversely affects its national security, regardless of where the conduct took place. Therefore, if an MNC is engaging in conduct that threatens another country, international law allows the violator to be subject to the host country's legal system, regardless of where the violations are taking place.

The doctrine of comity holds that there must be mutual respect for the laws, institutions, and governments of other countries in the matter of jurisdiction over their own citizens. This common-sense principle will foster better relations between MNCs doing business in foreign countries.

3. How will advances in technology and telecommunications affect developing countries? Give some specific examples.

Answer: Technological advancements are connecting the world at a lightning speed while increasing quality of products, information gathering, and R&D. The world can be seen as becoming increasingly more flat, which will allow developing countries to more easily enter the international market. Developing countries are eager to attract telecommunication firms and offer liberal terms. For example, General Electric has opened a trade office in Vietnam. Increased competition and expansion is expected to continue across the world, even in developing countries.

4. Why are developing countries interested in privatizing their state-owned industries? What opportunities does this privatization have for telecommunication MNCs?

Answer: Many developing countries are recognizing the benefits of advanced communication technology. For example, using cellular phones in many developing countries is cheaper than landline phones, as phone lines do not have to be installed. To facilitate this quickly and efficiently, many countries are turning to the private sector. In addition to the obvious benefits for international firms that provide these products, this will allow the developing countries to rapidly get up to speed with the rest of the world.

Internet Exercise: Hitachi Goes Worldwide

Suggestions for Using the Exercise

1. This exercise provides an excellent opportunity to conduct an "in-depth" analysis of the business activities of one international firm―Hitachi. As an exercise in using the Internet, ask your students to find at least five additional sites that provide information on Hitachi.

2. As suggested in the exercise, after doing their research, ask students to write a brief assessment of Hitachi's operations in Asia (specifically Hong Kong and Singapore), North America, or Europe.

In the International Spotlight: Vietnam

Questions & Suggested Answers

1. In what way does the political environment in Vietnam pose both an opportunity and a threat for American MNCs seeking to do business there?

   Answer: The political environment poses an opportunity for American firms because the government is now working hard to attract U.S. investment. American companies have the chance to gain a favorable position by striking while the political opportunities are good. In 2007 Vietnam became a member of the World Trade Organization. While uneven regulations still exist, Vietnam’s membership in the WTO has attracted a great deal of foreign investment from China, Singapore, Taiwan, Japan, South Korea, Hong Kong, and the United States.

2. Why are U.S. multinationals so interested in going into Vietnam? How much potential does the country offer? How might Vietnam compare to China as a place to do business?

   Answer: Vietnam has a population of 90 million. This makes it an attractive market for many firms, in particular because growth of this economy will spawn the need for a variety of goods and services, many of which are currently not widely available. The increased productivity, in particular, will help Vietnam improve the standard of living of its people as well as provide the basis for developing an export economy that can help the country grow and pay for its international purchases.

Students might compare Vietnam to the China of a few years ago. Vietnam is rapidly staking its claim as a player in the global economy by signing trade agreements with other countries, participating in the World Trade Organization, and opening its borders to foreign direct investment. In addition, Vietnam is implementing structural reforms designed to modernize its economy. Together, these changes are creating a more stable and predictable environment for companies.

3. Will there be any opportunities in Vietnam for high-tech American firms? Why or why not?

Answer: There certainly would be opportunities in Vietnam for high-tech American firms. Telecommunications is a good example. Firms that can offer cellular telephone technology will find Vietnam to be an excellent, still largely untapped market. One reason is that cellular technology bypasses the need to install expensive overhead (or underground) lines. This means that a telephone system can be created that connects all parts of the country, as well as providing international service, at a fraction of what it could cost to wire the nation for landlines. Other good examples of high-tech opportunities for U.S. firms are provided by computer and electronics companies that install state-of-the-art technology that can help increase Vietnam's productivity and economic growth.

A Closer Look: Comparing European Union (EU) and U.S. Financial Reform

Summary

1. The G20 wants to end the belief that banks are "too big to fail" by requiring resolution mechanisms and "living wills" for speedy windups that don't destabilize markets.
   - U.S. Senate set up an "orderly liquidation" process.
   - EU published a policy outline on resolution funds so that banks pay for future bailouts.
   - *Winners/Losers:* Banks face an extra levy on top of higher capital and liquidity requirements. Taxpayers should be better shielded.
2. Derivatives should be standardized.
   - U.S. Senate: Dodd-Frank Act requires banks to spin off their swaps desk.
   - EU: mandatory clearing of contracts.
   - *Winners/Losers:* Global banks will shift some trading. Corporations face higher costs.
3. Bonuses.
   - U.S. and EU are applying the G20 principles to curb pay and bonuses.
   - Winners/Losers: Harder to justify big bonuses in the future.
4. Credit Ratings Agencies.
   - U.S. and EU: Stricter requirements to register, report to supervisors, and show how they manage internal conflicts of interest; increased liability.

   Winners/Losers: Ratings agencies must justify what they do. There will be more competition in the EU for the "Big Three."
5. Hedge Funds/Private Equity.
   - U.S. and EU are introducing a G20 pledge to require hedge fund managers to register and report a range of data on their positions.
   - Winners/Losers: It will be harder for U.S. hedge fund managers to do business in the EU. EU: less choice, better data.
6. Banks Trading.
   - U.S. Senate: Volcker rule" bans risky trading rule" which would ban risky trading unrelated.
   - EU: Key states disagree with the rule; as they want to preserve their universal banking model.
   - Winners/Losers: Some trading could switch to the EU from the United States inside global banks.
7. Systemic Risk.
   - U.S. Senate set up a council of regulators; the House wants a bigger role for the Fed.
   - EU: approving a reform that will make the European Central Bank the hub of a pan-EU systemic risk board.
   - Winners/Losers: ECB has an enhanced role. More oversight on banks.

8. Bank Capital Requirements.
    - U.S. bill directs regulators to increase capital requirements on large financial firms as they grow in size or engage in riskier activities.
    - EU is approving new rules on requirements to discourage risky behavior.
    - Winners/Losers: Squeeze on return on equity for banks, more tools for regulators, higher costs for investors, timing issues.
9. Fixing Securitization.
    - U.S. Senate: Baseline 5 percent of credit risk on securitized assets.
    - EU already approved a similar bill.
    - Winners/Losers: Banks believe 5% is not enough and key problem is investor confidence.
10. *Source:* "Factbox: Comparing EU and U.S. Financial Reform," Reuters, May 19, 2010. Additional research by authors.

International Management in Action: The United States Goes to the Mat

Summary

1. The trade relationship between the United States and China is unbalanced, with the U.S. deficit with China reaching $319 billion in 2012. Many blame China with its undervalued yuan and government subsidies and regulations that favor Chinese MNCs. One U.S. strategy to level the playing field is to threaten to impose tariffs and then to focus on specific industries.

    In 2006, the United States and China announced a "strategic economic dialogue" to provide an overarching framework for bilateral economic dialogue and future economic relations. Issues include exchange rates, intellectual property rights, and market access. The future of U.S. claims and disagreements between the countries is uncertain. The EU and the United States would like to break down trade walls and be a part of the lucrative Chinese market, but they may need the added support of the WTO for effective negotiations.

2. Articles on this issue are multiple. See, for example: {http://www.forbes.com}, {http://www.usa.chinalaily.com}, {http://www.cnbc.com}, as well as {http://www.china-embassy.org} and {http://www.census.gov/foreign-trade/balance/c5700.html}.