

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: Google's China Gamble

1. Summary:

This vignette discusses some of the problems associated with globalization within the context of political, legal, and technological environments. Google faced many challenges while attempting to capitalize on the market growth opportunities in China, while at the same time acknowledging the requests of the Chinese government. China's government demanded that Google censor its content for Chinese Internet users. While Google initially complied with the request, it became increasingly frustrated by the limitations. Google made the decision to redirect Chinese users to its unfiltered Hong Kong search engine after an alleged attack by China on its corporate infrastructure.

2. Suggested Class Discussion:

1. Students should be able to discuss how differing political and legal environments might affect a company and how globalization influences these environments.
2. Students should be encouraged to consider strategies to adapt to and overcome obstacles while engaging in growth initiatives in international markets.

3. Related Internet Sites:

- Google China: { <http://www.google.cn/> }.
- 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}.

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 is law 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 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 inappropriate in the United States.
- 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 of 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.

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) 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.

The World of International Management - Revisited

Questions & Suggested Answers

1. How will changes in the political and legal environment in China affect U.S. MNCs conducting business there?

Answer: Changes in the political and legal environment in China will pose a myriad of obstacles for U.S. MNCs. The political environment in China is very complex because of the government's desire to balance national and immediate needs with the challenge of a free-market economy and globalization. Government regulations severely hamper multinational activity and favor domestic companies, which usually results in questionable treatment. The biggest problem may well be that the government does not know what it wants from multinational investors, and this is what accounts for the mixed signals and changes in direction it continually sends.

2. How might rules governing data privacy and free speech affect future investment by Internet companies such as Yahoo?

Answer: Data privacy and free speech are of great concern to Internet companies investing in countries such as China. Yahoo cooperated with the Chinese authorities to arrest a nonconformist who had a Yahoo account. In order to stay on good terms with the Chinese government, Yahoo abided by its wishes. This action brought negative attention to the company and is a good example of how political and legal barriers should be considered prior to engaging in growth strategies internationally.

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

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
Biotechnology
Civil or code law
Collectivism
Common Law
Democracy
Doctrine of comity
Foreign Corrupt Practices Act (FCPA)
Individualism
Islamic law
Nationality principle
Principle of sovereignty
Protective principle
Socialism
Socialist law

Territoriality principle
Totalitarianism

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 control over many industries. Hence, the political risk is much higher for MNCs wishing to do business in these countries than, say, Europe (also point out that China is still Communist). 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.

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, Cable & Wireless of Great Britain has opened an office in Hanoi. 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, 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, ask students to write a brief assessment of Hitachi's operations in 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. On the other hand, the government still closely controls the economy and U.S. firms may find that their opportunities are limited and that the government will try to play one multinational off against another in order to gain a better position for itself.

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 80 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. Examples include consumer goods such as televisions, radios, washers, dryers, and ovens, as well as computer and industrial equipment that can help increase the nation's productivity. 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. Would 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 and pagers 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. 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.

You Be the International Consultant: A Chinese Venture

Questions & Suggested Answers

1. How important is the political environment in China for the Darby Company? Explain.

Answer: The political environment is very important but only moderately conducive to doing business there. Certainly the government is interested in doing business with Darby, but whether or not there are going to be any long-term profits is still a matter of debate. Additionally, given that both sides have agreed to a rather detailed approach concerning how disputes are to be handled (the World Court), one is left to wonder if the Darby management really believes that it will be treated fairly by the Chinese. To the extent that these concerns are influencing management's decisions, it would seem that Darby is unsure of its welcome in China.

2. If a disagreement arises between the two joint-venture partners and the government of China reneges on its promises, how well protected is Darby's position? Explain.

Answer: Darby is protected in that it can bring its case to the World Court. On the other hand, each side is responsible for its own legal fees, so the company will not pursue this course of action unless the amount to be recovered is greater than the legal costs. This means that on petty disagreements, the company will probably end up negotiating a settlement with the Chinese or letting the matter drop.

Overall, the company is well protected only in the case of major disagreements that involve large sums of money. Additionally, it is important to remember that if the Chinese can make the cost of going to the Hague (the World Court) very expensive to Darby, this approach is going to become even less attractive as an alternative to negotiating with them, and working out the best deal without legal action.

3. Are the economic and technological environments in China favorable for Darby? Why, or why not?

Answer: The economic and technological environments are favorable for Darby at the present time. However, if the Chinese can duplicate Darby's technology, or if a competitor is able to develop a superior product at an attractive price, the company's position may deteriorate rapidly. Most importantly, while the economic and technological environments are important, it is the political and social interrelationships that Darby has with those who are in decision-making positions that will be of greatest importance. If the Chinese decide to stay with Darby regardless of competitive offerings, the company will do very well. If the Chinese decide to play the company off against the competition, Darby will find its China venture a major disappointment.