Global Business 4th edition Mike Peng Solutions Manual

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CHAPTER 2

UNDERSTANDING FORMAL INSTITUTIONS: POLITICS, LAWS, AND ECONOMICS

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

1. explain the concept of institutions and their key role in reducing uncertainty.
2. articulate the two core propositions underpinning an institution-based view of global business.
3. identify the basic differences between democracy and totalitarianism.
4. outline the differences among civil law, common law, and theocratic law.
5. understand the importance of property rights and intellectual property rights.
6. appreciate the differences among market economy, command economy, and mixed economy.
7. participate in two leading debates concerning politics, laws, and economics.
8. draw implications for action.

GENERAL TEACHING SUGGESTIONS

Politics, laws, and economics are fertile ground for heated debate. The Debates and Extensions section in this chapter may give you some ideas for the development of debate teams. If you regularly read the ***Wall Street Journal***, you will likely find a current article that might be used as an effective tool to bring out some aspects of this chapter.

OPENING CASE DISCUSSION GUIDE

Emerging Markets: The Peril and Promise of Russia. This case can yield many questions for class discussion. It covers the economic growth and development since the Soviet Union dissolved and Russia became separate from the other Soviet republics. Although it mentions corruption and loss of individual freedom in covering the extent to which Russians are better off, much (not all) of the discussion focuses on economics. Ask your students whether they feel that too much focus is placed on economic betterment or not enough. Ask them if they would be willing to lose some personal freedoms if the country where they live could enable them to enjoy a better life financially.

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CHAPTER OUTLINE: KEY CONCEPTS AND TERMS
Sections I through VIII of Chapter 2

I. UNDERSTANDING INSTITUTIONS

1. Key Concept

Institutions are commonly defined as "the rules of the game." Institutions have formal and informal components, each with different supportive pillars.

2. Key Terms

- **Cognitive pillar** is the internalized (or taken-for-granted) values and beliefs that guide individual and firm behavior.
- **Formal institutions** are institutions represented by laws, regulations, and rules.
- **Informal institutions** are institutions represented by cultures, ethics, and norms.
- **Institutional framework** is formal and informal institutions that govern individual and firm behavior.
- **Institutional transitions** are fundamental and comprehensive changes introduced to the formal and informal rules of the game that affect firms as players.
- **Institution-based view** is a leading perspective in global business that suggests that the success and failure of firms are enabled and constrained by institutions.
- **Institutions** are formal and informal rules of the game.
- **Normative pillar** is the mechanism through which norms influence individual and firm behavior.
- **Norms** are the values, beliefs, and actions of relevant players that influence the focal individuals and firms.
- **Regulatory pillar** is the coercive power of governments.

II. WHAT DO INSTITUTIONS DO?

1. Key Concept

The key function of institutions is to reduce uncertainty.

2. Key Terms

- **Opportunism** is the act of seeking self-interest with guile.
- **Transaction cost** is the cost associated with economic transactions or, more broadly, the costs of doing business.
- **Transition economies** are a subset of emerging economies, particularly those moving from central planning to market competition (such as China, Poland, Russia, and Vietnam).

III. AN INSTITUTION-BASED VIEW OF GLOBAL BUSINESS

1. Key Concepts

Proposition 1: Managers and firms *rationally* pursue their interests and make choices within the formal and informal institutional constraints in a given institutional framework.

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Proposition 2: While formal and informal institutions combine to govern firm behavior, in situations where formal constraints are unclear or fail, informal constraints will play a larger role in reducing uncertainty and providing constancy to managers and firms.

2. ***Key Terms***
   - **Bounded rationality** is the necessity of making rational decisions in the absence of complete information.

IV. POLITICAL SYSTEMS

1. ***Key Concepts***
   Democracy is a political system in which citizens elect representatives to govern the country. Totalitarianism is a political system in which one person or party exercises absolute political control over the population.
2. ***Key Terms***
   - **Communist totalitarianism** is a type of totalitarianism that centers on a communist party.
   - **Democracy** is a political system in which citizens elect representatives to govern the country on their behalf.
   - **Political risk** is risk associated with political changes that may negatively impact domestic and foreign firms.
   - **Political system** is the rules of the game on how a country is governed politically.
   - **Right-wing totalitarianism** is a type of totalitarianism that is characterized by its intense hatred of communism.
   - **Theocratic totalitarianism** is a type of totalitarianism that monopolizes political power in the hands of one religious party or group.
   - **Totalitarianism (dictatorship)** is a political system in which one person or party exercises absolute political control over the population.
   - **Tribal totalitarianism** is a type of totalitarianism in which one tribe or ethnic group (which may or may not be the majority of the population) is monopolizing political power and oppressing other tribes or ethnic groups.

V. LEGAL SYSTEMS

1. ***Key Concept***
   Laws in different countries are transplanted from three legal traditions. Civil law uses comprehensive statutes and codes as a primary means to form legal judgments. Common law is shaped by precedents and traditions from previous judicial decisions. Theocratic law is a legal system based on religious teachings.
2. ***Key Terms***
   - **Civil law** is a legal tradition that uses comprehensive statutes and codes as a primary means to form legal judgments.
   - **Common law** is a legal tradition that is shaped by precedents and traditions from previous judicial decisions.
   - **Copyrights** are the exclusive legal rights of authors and publishers to publish and disseminate their work.
   - **Intellectual property (IP)** is intangible property that is the result of intellectual activity.

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- **Intellectual property rights (IPRs)** are rights associated with the ownership of intellectual property. IPRs primarily include rights associated with (1) patents, (2) copyrights, and (3) trademarks.
- **Legal system** is the rules of the game on how a country's laws are enacted and enforced.
- **Patents** are exclusive legal rights of inventors of new products or processes to derive income from such inventions.
- **Piracy** is the unauthorized use of intellectual property.
- **Property right** is the legal right to use an economic property (resource) and to derive income and benefits from it.
- **Theocratic law** is a legal system based on religious teachings.
- **Trademarks** are the exclusive legal rights of firms to use specific names, brands, and designs to differentiate their products from others.

VI. ECONOMIC SYSTEMS

1. ***Key Concept***

   An economic system refers to the rules of the game on how a country is governed economically. A pure market economy is characterized by *laissez faire* and total control by market forces. A pure command economy is defined by government ownership and control of all means of production. Most countries operate mixed economies with a different emphasis on market versus command forces.

2. ***Key Terms***
   - **Command economy** is an economy characterized by government ownership and control of factors of production.
   - **Economic system** is the rules of the game on how a country is governed economically.
   - **Market economy** is an economy characterized by the "invisible hand" of market forces. The government takes a hands-off approach known as *laissez faire*.
   - **Mixed economy** is an economy that has elements of both a market economy and a command economy.
   - **State-owned enterprises** (**SOEs**) are firms that are owned and controlled by the state.

VII. DEBATES AND EXTENSIONS

1. ***Key Concept***

   Two leading debates are (1) drivers of economic development and (2) private ownership versus state ownership.

2. ***Key Terms***
   - **Beijing Consensus** is a view that questions Washington Consensus's belief in the superiority of private ownership over state ownership in economic policymaking, which is often associated with the position held by the Chinese government.
   - **Moral hazard** is recklessness when people and organizations (including firms and governments) do not have to face the full consequences of their actions.

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- **Washington Consensus** is a view centered on the unquestioned belief in the superiority of private ownership over state ownership in economic policymaking, which is often spearheaded by the US government and two Washington-based international organizations: the International Monetary Fund and the World Bank.

VIII. MANAGEMENT SAVVY

1. Key Concept

Managers considering working abroad should have a thorough understanding of the formal institutions before entering a country. In situations where formal constraints are unclear, managers can reduce uncertainty by relying on informal constraints, such as relationship norms.

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END-OF-CHAPTER GUIDE

*Review Questions and Answers
*Critical Discussion Questions and Answers
*Global Action
*Closing Case

REVIEW QUESTIONS AND ANSWERS

1. ***ON CULTURE:*** Is there any relationship between the culture of a given country and the extent to which it will likely have a dynamic, growing economy? Are there cultures that would be more likely to limit economic growth and even result in poverty? Defend your answer.
   Usually, multiple forces affect a given economy during a given period of time. It could be argued that if one culture values competitive hard work and change but another country's culture looks down upon such things, values could affect the economy to some degree. Some will disagree and may point out that even if culture affects the economy, economic impact is not the only issue in life.

2. Compare PengAtlas Maps 1.1 (Developed Economies and Emerging Economies) and Map 1.2 (Political Freedom Around the World). To what extent do developed economies tend to have a high level of political freedom–or is there any relationship? If there is any relationship, is it causal or coincidental? Explain.
   Map 1.1 lists 33 developed nations. Map 1.2 lists countries as Free, Partly Free or Not Free. Of the 33 developed nations, 32 are on the Free list and the remaining nation (Singapore) is on the Partly Free list. Most students will find it difficult to believe that there in no relationship between being free and being developed. However, China is listed as Not Free but is likely to eventually be listed as developed – whether it will also eventually be on the Free or Partly Free list remains to be seen.

3. Compare PengAtlas Map 1.3 (Legal Systems Around the World) and Map 1.1. In your opinion, what stands out to you regarding each category of legal system? Are there any relationships? If so, are they causal or coincidental? Defend your answer.
   Of the 20 countries with civil law, a majority (12 or 80%) are developed. Of the 16 countries that have common law, a majority (9 or 56%) are developed. The three countries with theocratic law are not listed as developed. Since there were far fewer theocratic law countries as compared to the other two categories, it cannot be stated with certainty that there is or is not a relationship between development and theocratic law. Furthermore, the numbers 20 and 16 are not large numbers. However, it does appear that a larger listing of countries might indicate a relationship.

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4. How can the "rules of the game" reduce uncertainty?
   The very word "rules" suggests the answer to that question. When there is nothing involving formal or informal rules to serve as a guideline, there is obviously going to be uncertainty.

5. Do "rules of the game" promote or prevent opportunism?
   Students will probably argue that much depends on the rules.

6. Do you agree that managers and firms really pursue their interests? Why or why not?
   It probably could be argued that they pursue their interests but their idea of what constitutes their interest may not be in agreement with what others would regard as their interest. A firm or person may wish to be respected and admired by society – that may be what the firm or individual feels is in one's best interest. However, that might involve not taking advantage of an opportunity for increased profits or a raise in compensation.

7. What are examples of informal constraints that affect global business firms?
   Students should be able to list a variety of constraints such as the negative reactions of various stakeholders to actions that may be legal but viewed as unacceptable.

8. What are the pros and cons of expanding into a democratic country?
   Various responses may include less threat from an arbitrary dictator but there is the risk that if the democracy does not have any constraints on what the majority can do, a minority could be exploited by the majority – e.g. four foxes and one chicken voting on what to have for supper.

9. What are the pros and cons of expanding into a totalitarian country?
   At first such a country might seem to offer stability. However, the pros or cons of such an expansion could be affected by opposition to the government in that nation and whether that could lead to an overthrow of the government and confiscation of your property. Another factor is groups who might boycott your products if you do business in that country.

10. Would you rather do business in a country that uses civil law or common law? Why?
    Opinions may vary depending on the extent to which one prefers flexibility versus certainty. Some may prefer the type of law used in the country in which they live.

11. What are some of the issues to consider before doing business in a theocracy?
    Cultural sensitivity would be especially important in such a country. Familiarization with beliefs and the application of those beliefs to all aspects of business would be essential.

12. What is the relationship between property rights and economic development?
    According to de Soto, there is a significant relationship between the two: The legal protection of property rights allows economic growth. For example, when property rights are in place, an entrepreneur can use his or her title to a piece of land as collateral for a small business loan.

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13. Why is it important to protect IPR?
    IP is normally intangible and can thus be easily duplicated. The incentive to invent or create music, for example, could be reduced if innovators had no assurance of reaping rewards from their efforts.

14. Under what circumstances would it be easier to do business in a command economy than a market economy?
    In a market economy, one may need to convince many buyers but in a command economy in which the government is the buyer, the persuasion needs to be directed toward only those in control of the government. Also, buyers in a market economy may be fickle and change their mind over time but in a command economy, there is stability unless those in the government change what they want.

15. Many view the United States as a mixed economy. In your opinion, is the mix changing? If so, how? Is it shifting more to a command economy or a market economy?
    The U.S. economy is constantly changing but the direction may depend on the political and economic tilt of those answering the question. Those who want more government involvement may not feel that a specific increase in government is sufficient and may take a much different view of the direction of the economy than those who feel that the country is moving toward a command economy.

16. In your opinion, which is most important to economic development—culture, geography, or institutions?
    This is a question in which the answer is not as important as the reasoning and the ability to defend that reasoning.

17. Given whatever plans you have for the future, do you feel you would have the greatest likelihood of success under private ownership or under state ownership? Why?
    The answer to this question may depend on the specific individual's career plans (perhaps it involves some type of government activity, for example) and the person's social, political, and economic tilt.

18. Why is it important to understand formal institutions before entering a country? Explain by using an example.
    This is true for both firms and individuals who wish to avoid being fined or imprisoned. Students should be able to use their own country to create examples that could get a person or firm into trouble if there was no awareness of formal institutional requirements.

19. ***ON CULTURE:*** Why is understanding of human relations within a culture sometimes more important than legal expertise?
    In some societies there will be no need for legal expertise (for example, to prepare a contract) until the relationship has been established so that one is trusted.

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CRITICAL DISCUSSION QUESTIONS AND ANSWERS

1. How do you explain your country's economic success (or failure)?
   Encourage students to answer this question by focusing on concepts brought forth in this chapter (political, legal, and economic systems) and avoid using the question to expound favor or opposition to a politician or ideology. However, this is a question in which the answer is not as important as the thought process and the ability to clearly articulate.

2. What is your view on the debate between private ownership and state ownership?
   The response will likely be the result of ideology but this is a question in which the answer is not as important as the thought process and the ability to clearly articulate.

3. ***ON ETHICS**:* As manager, you discover that your firm's products are counterfeited by small family firms that employ child labor in rural Bangladesh. You are aware of the corporate plan to phase out the products soon. You also realize that once you report to the authorities, these firms will be shut down, employees will be out of work, and families and children will be starving. How do you proceed?
   This is a question in which the answer is not as important as the thought process and the ability to clearly articulate. However, because you plan to phase out the product, you may choose to ignore the counterfeiting. Even though child labor is involved, because child starvation is worse, you might offer advice to the family firms as to how to be more successful.

4. ***ON ETHICS**:* Your multinational is the largest foreign investor and enjoys good profits in (1) Sudan, where government forces are reportedly cracking down on rebels and killing civilians; and (2) Vietnam, where religious leaders are reportedly being prosecuted. As country manager, you understand that your firm is pressured by activists to exit these countries. The alleged government actions, which you personally find distasteful, are not directly related to your operations. How would you proceed?
   Although this is also a question in which the answer is not as important as the thought process and the ability to clearly articulate, there are some things that should be considered even by students who really do not care about social/humanitarian issues and are only concerned about the bottom line. In a global economy with instant global communication of news, the policies of a given country might not affect a firm's operations in that country but it might affect the firm's sales and problems with legislative initiatives in other countries.

GLOBAL ACTION

1. Evaluating political risk is an important element of country risk analysis. In fact, your personal interest relates to countries in the Middle East and North Africa region that have a high political risk. Provide a brief overview of the region and the reasoning behind assessing these countries that have been assessed with high political risk. From this list, which country has the highest overall country risk?

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Exercise 1 Answers
One resource which can be used is "*A.M. Best Country Risk Ratings*". This website can be found by entering the search term "country risk analysis" at the globalEDGE™ Resource Desk search box located at http://globaledge.msu.edu/resourceDesk/. At the A.M. Best Ratings & Criteria Center website, click a tier. View each country in the tier to assess which country has the highest overall country risk.
Search Term: "country risk analysis"
Resource Name: *A.M. Best Country Risk Ratings*
Website: http://www3.ambest.com/ratings/cr/crisk.aspx
globalEDGE™ Tag: Country Level

2. Since you work for a diversified multinational corporation, economic risk across different sectors of the world economy is an integral part of analysis as it indicates the future business prospects for specific industries. Evaluate the risk assessment of three industry sectors that are available to analyze. Prepare a report and provide a recommendation concerning which industry and region would be most beneficial to your company.
Exercise 2 Answers
One resource which can be used is Coface. This website can be found by entering the search term "country risk assessments" at the globalEDGE™ Resource Desk search box located at http://globaledge.msu.edu/resourceDesk/. At the Coface website, select a country and view the risk information. Students can use this information to evaluate the risk for specific industries. This may lead to a discussion concerning the ideal regions for their company.
Search Term: "country risk assessments"
Resource Name: Coface
Website: http://www.coface.com/Economic-Studies-and-Country-Risks
globalEDGE™ Tag: Country Level

CLOSING CASE DISCUSSION GUIDE AND ANSWERS

Emerging Markets: Is Democracy Good for Economic Development? points out problems faced by many fledgling democracies and compares their progress to developments in countries ruled by totalitarian governments. In several cases, the democracy does not win the comparison.

1. Why does democracy have such broad appeal as a political system around the world?
As the text says, Compared with dictatorships, on average, democracies are richer, less corrupt, and less likely to go to war. Democracies allow people to make their own political choices. This is a powerful attracton.

2. How does democracy suffer from severe setbacks in some countries lately?
Ask students for examples from current events.

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3. How does the Chinese experience answer the question: "Is democracy good for economic development?"
   The text provides examples of massive changes that were made quickly. Ask students why such changes can be done so quickly in a totalitarian government. Having a single person or group in charge enables them to act quickly without having to consider any opposing arguments.

4. ON ETHICS: The military governments in Egypt and Thailand have invited your firm to do business there. As CEO, you appreciate the lucrative offers. But you are also concerned that your firm may be labeled "devil's advocate" or "accomplice" by democracy activists around the world. How would you proceed?
   This is a question in which the answer is not as important as the reasoning and the ability to defend that reasoning.

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GLOBAL BUSINESS

FOURTH EDITION

Chapter 2

Understanding Formal Institutions: Politics, Laws, and Economics

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LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- **2-1** explain the concept of institutions and their key role in reducing uncertainty.
- **2-2** articulate the two core propositions underpinning an institution-based view of global business.
- **2-3** identify the basic differences between democracy and totalitarianism.
- **2-4** outline the differences among civil law, common law, and theocratic law.
- **2-5** understand the importance of property rights and intellectual property rights.
- **2-6** appreciate the differences among market economy, command economy, and mixed economy.
- **2-7** participate in two leading debates concerning politics, laws, and economics.
- **2-8** draw implications for action.

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UNDERSTANDING INSTITUTIONS

institutional transitions – fundamental and comprehensive changes introduced to the formal and informal rules of the game that affect firms as players

institution-based view – a leading perspective in global business that suggests the success and failure of firms are enabled and constrained by institutions

institution – formal and informal rules of the game

institutional framework – formal and informal institutions that govern individual and firm behavior

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Table 2.1
Dimensions of Institutions

Table 2.1 Dimensions of Institutions

Degree of formality	Examples	Supportive pillars
Formal institutions	• Laws • Regulations • Rules	• Regulatory (coercive)
Informal institutions	• Norms • Cultures • Ethics	• Normative • Cognitive

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FORMAL INSTITUTIONS

formal institution – institution represented by laws, regulations, and rules

regulatory pillar – the coercive power of governments

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INFORMAL INSTITUTIONS

informal institution – institution represented by cultures, ethics, and norms

normative pillar – the mechanism through which norms influence individual and firm behavior

norms – values, beliefs, and actions of relevant players that influence the focal individuals and firms

cognitive pillar – the internalized (or taken for-granted) values and beliefs that guide individual and firm behavior

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WHAT DO INSTITUTIONS DO?

transaction cost – the cost associated with economic transactions or, more broadly, the costs of doing business

opportunism – the act of seeking self-interest with guile

transition economies – a subset of emerging economies, particularly those moving from central planning to market competition (such as China, Poland, Russia, and Vietnam)

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Figure 2.1
Institutions, Firms, and Firm Behavior

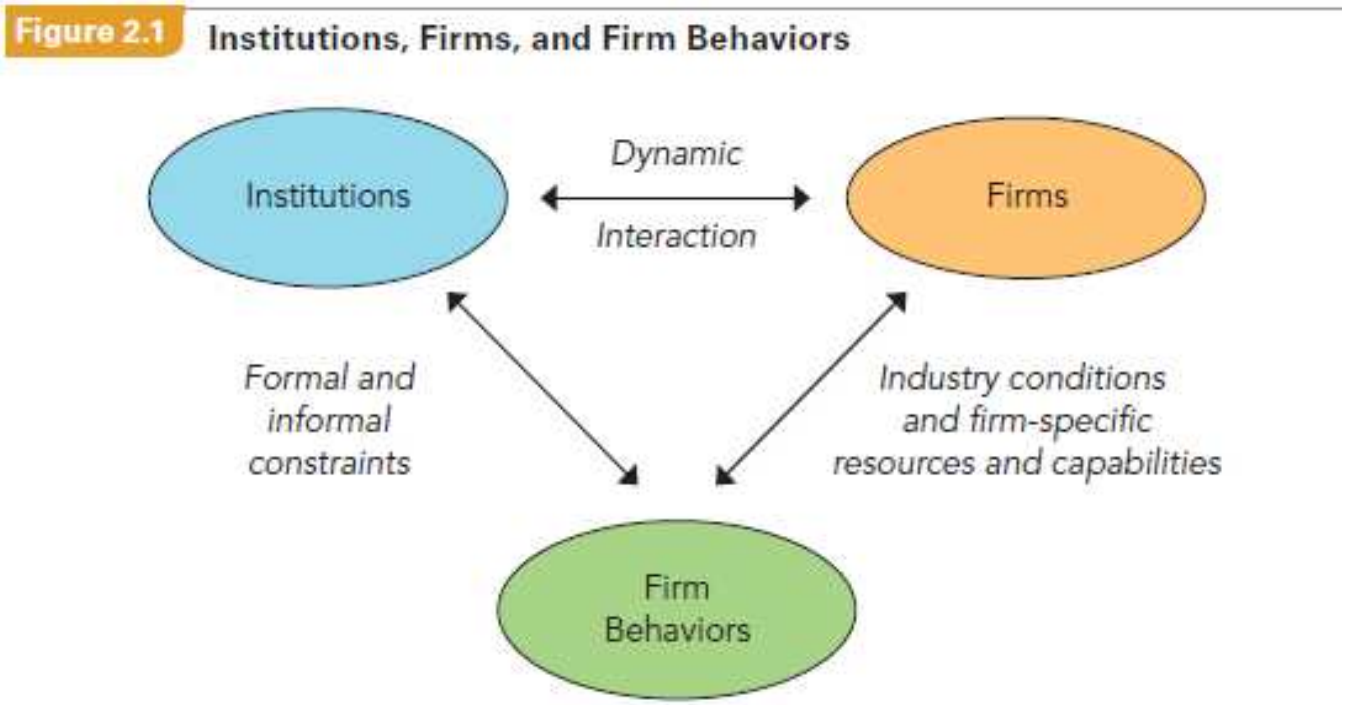

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Table 2.3
Two Core Propositions of the Institution-Based View

Table 2.3 Two Core Propositions of the Institution-Based View

Proposition 1	Managers and firms *rationally* pursue their interests and make choices within the formal and informal constraints in a given institutional framework
Proposition 2	While formal and informal institutions combine to govern firm behavior, in situations where formal constraints are unclear or fail, informal constraints will play a *larger* role in reducing uncertainty and providing constancy to managers and firms

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AN INSTITUTION-BASED VIEW OF GLOBAL BUSINESS

bounded rationality – the necessity of making rational decisions in the absence of complete information

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POLITICAL SYSTEMS

political system – the rules of the game on how a country is governed politically

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TYPES OF POLITICAL SYSTEMS

democracy – a political system in which citizens elect representatives to govern the country on their behalf

totalitarianism (dictatorship) – a political system in which one person or party exercises absolute political control over the population

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TYPES OF TOTALITARIANISM

communist totalitarianism – centers on a communist party

right-wing totalitarianism – is characterized by its intense hatred against communism

theocratic totalitarianism – refers to the monopolization of political power in the hands of one religious party or group

tribal totalitarianism – refers to one tribe or ethnic group (which may or may not be the majority of the population) monopolizing political power and oppressing other tribes or ethnic groups

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POLITICAL RISK

political risk – risk associated with political changes that may negatively impact domestic and foreign firms

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LEGAL SYSTEMS

legal system – the rules of the game on how a country's laws are enacted and enforced

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LEGAL TRADITIONS

civil law – a legal tradition that uses comprehensive statutes and codes as a primary means to form legal judgments

common law – a legal tradition that is shaped by precedents and traditions from previous judicial decisions

theocratic law – a legal system based on religious teachings

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Table 2.5
Three Legal Traditions

Table 2.5 Three Legal Traditions[1]

Civil law countries	Common law countries	Theocratic law countries
Argentina, Austria, Belgium, Brazil, Chile, China, Egypt, France, Germany, Greece, Indonesia, Italy, Japan, Mexico, Netherlands, Russia, South Korea, Sweden, Switzerland, Taiwan	Australia, Canada, Hong Kong, India, Ireland, Israel, Kenya, Malaysia, New Zealand, Nigeria, Singapore, South Africa, Sri Lanka, United Kingdom, United States, Zimbabwe	Iran, Saudi Arabia, United Arab Emirates[2]

[1] The countries are examples and do not exhaustively represent all countries practicing a particular legal system.
[2] Certain parts of Dubai (an emirate within the UAE), such as the Dubai International Finance Center, practice common law.

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PROPERTY RIGHTS

property right – the legal right to use an economic property (resource) and to derive income and benefits from it

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INTELLECTUAL PROPERTY RIGHTS

intellectual property (IP) – intangible property that is the result of intellectual activity

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INTELLECTUAL PROPERTY RIGHTS (cont'd)

intellectual property right (IPR) – right associated with ownership of intellectual property

- **patent** – exclusive legal rights of inventors of new products or processes to derive income from such inventions
- **copyright** – exclusive legal rights of authors and publishers to publish and disseminate their work
- **trademark** – exclusive legal rights of firms to use specific names, brands, and designs to differentiate their products from others

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INTELLECTUAL PROPERTY RIGHTS (cont'd)

piracy – unauthorized use of intellectual property

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ECONOMIC SYSTEMS

economic system – rules of the game on how a country is governed economically

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TYPES OF ECONOMIC SYSTEMS

market economy – an economy characterized by the "invisible hand" of market forces; the government takes a hands-off approach known as *laissez faire*

command economy – an economy characterized by government ownership and control of factors of production

mixed economy – an economy that has elements of both a market economy and a command economy

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STATE-OWNED ENTERPRISES

state-owned enterprise (SOE) – a firm owned and controlled by the state (government)

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DRIVERS OF ECONOMIC DEVELOPMENT

What drives economic development in different countries?

- Culture
- Geography
- Institutions

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Table 2.6
Private Ownership versus State Ownership

Table 2.6 **Private Ownership versus State Ownership**

	Private ownership	State ownership
Objective of the firm	Maximize profits for private owners who are capitalists (and maximize shareholder value for public shareholders if the firm is publicly listed).	Optimal balance for a "fair" deal for all stakeholders. Maximizing profits is not the sole objective of the firm. Protecting jobs and minimizing social unrest are legitimate goals.
Establishment of the firm	Entry is determined by entrepreneurs, owners, and investors.	Entry is determined by government officials and bureaucrats.
Financing of the firm	Financing is from private sources (and public shareholders if the firm is publicly traded).	Financing is from state sources (such as direct subsidiaries or banks owned or controlled by governments).
Liquidation of the firm	Exit is forced by competition. A firm has to declare bankruptcy or be acquired if it becomes financially insolvent.	Exit is determined by government officials and bureaucrats. Firms deemed "too big to fail" may be supported by taxpayer dollars indefinitely.
Appointment and dismissal of management	Management appointments are made by owners and investors, largely based on merit.	Management appointments are made by government officials and bureaucrats who may also use non-economic criteria.
Compensation of management	Managers' compensation is determined by competitive market forces. Managers tend to be paid more under private ownership.	Managers' compensation is determined politically with some consideration given to a sense of fairness and legitimacy in the eyes of the public. Managers tend to be paid less under state ownership.

Sources: Extracted from text in (1) M. W. Peng, 2000, *Business Strategies in Transition Economies* (p. 19), Thousand Oaks, CA: Sage; (2) M. W. Peng, G. Bruton, & C. Stan, 2014, Theories of the (state-owned) firm, Working paper, Jindal School of Management, University of Texas at Dallas.

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PRIVATE OWNERSHIP VERSUS STATE OWNERSHIP

Washington Consensus – a view centered on the unquestioned belief in the superiority of private ownership over state ownership in economic policy making, which is often spearheaded by the US government and two Washington-based international organizations: the International Monetary Fund and the World Bank

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PRIVATE OWNERSHIP VERSUS STATE OWNERSHIP (cont'd)

moral hazard – recklessness when people and organizations (including firms and governments) do not have to face the full consequences of their actions

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PRIVATE OWNERSHIP VERSUS STATE OWNERSHIP (cont'd)

Beijing Consensus – a view that questions Washington Consensus's belief in the superiority of private ownership over state ownership in economic policy making, which is often associated with the position held by the Chinese government

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Table 2.7
How Many of the Top Ten Largest and Top Ten Most Profitable Firms in the World Are SOEs?

Table 2.7 How Many of the Top Ten Largest and Top Ten Most Profitable Firms in the World Are SOEs?

	Top ten largest firms measured by sales		Top ten firms with the largest profits
1	Wal-Mart Stores (USA)	1	Vodafone Group (UK)
2	Royal Dutch Shell (Netherlands)	2	Fannie Mae (USA)—SOE
3	SINOPEC Group (China)—SOE	3	Freddie Mac (USA)—SOE
4	China National Petroleum Corporation (China)—SOE	4	Industrial & Commercial Bank of China (China)—SOE
5	ExxonMobil (USA)	5	Apple (USA)
6	BP (UK)	6	Gazprom (Russia)—SOE
7	State Grid (China)—SOE	7	China Construction Bank (China)—SOE
8	Volkswagen (Germany)—SOE	8	ExxonMobil (USA)
9	Toyota Motor (Japan)	9	Samsung Electronics (South Korea)
10	Glencore (Switzerland)	10	Agricultural Bank of China (China)—SOE

Source: Adapted from Fortune, 2014, Global 500, July 21: F-1 and F-13.

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Table 2.8
Implications for Actions

Table 2.8 Implications for Action
• When entering a new country, do your homework by having a thorough understanding of the formal institutions governing firm behavior.
• When doing business in countries with a strong propensity for informal relational exchanges, insisting on formalizing the contract right away may backfire.

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