International Business

Foundations of International Economy and Trade: Culture, Politics, Law and Ethics

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The Significance of Culture in IB

In international business, culture is not, as often would be as first thought, defined as it is in civil life, in which you will think of museums, concerts, churches. These are elements of culture, in fact, expressions of it. You will become familiar with culture as:

> “the acquired knowledge that people use to interpret experience and to generate social behaviour.”
>
> (James Spradley)
>
> “Culture is the collective programming of the human mind that distinguishes the members of one human group from those of another. Culture in this sense is a system of collectively held values.”
>
> (Geert Hofstede)
>
> “Culture is the deeper level of basic assumptions and beliefs that are shared by members of an organization, that operate unconsciously and define in a basic ‘taken for granted’ fashion an organization's view of its self and its environment.”
>
> (Edgar Schein)

Culture is hence the manner in which groups tend to differentiate themselves from one another, also referred to as the in- and the out-group, defined by the shared evolved knowledge of this group, defining behaviors, possessions, manners, beliefs, and communicating these amongst each other. It determines the way in which we see matters as right or wrong, normal or strange, valuable or worthless.

These cultures can be seen within nations, organizations, religions, professions, sectors and industries, and many other determined groups that conceive of a certain way of doing and thinking as the most relevant in the given scenario, relative to other groups. Culture is most easily observed on the:

- national level: the nation in its collectivism, possibly with sub-groups
- regional level: ethnic, linguistic, or religious differences in a region
- gender level: gender differences (female vs. male)
- generation level: differences between grandparents and parents, parents and children, the older and younger workforce
- social class level: educational opportunities and differences in occupation, wealth and education
- corporate level: the *corporate culture* of an organization, industry or sector culture, or profession.

Taking it *Further*

An estimated 53 million people globally work for companies foreign to their original culture. This globalization effect leads us to the need for understanding of how people's preferences, beliefs and values differ. Why should we? Because if one is not aware of these differences, the organization will be most likely to fail in international marketing efforts, internationalization strategies, international negotiations, merger and acquisitions, and simply making multiculturalism a positive value.

Working with different cultures is part of the day-to-day realities of international business. In the best case, multiculturalism becomes a value and a comparative advantage. In the worst case, however, cross-cultural miscomprehensions hinder business opportunities through *ethnocentrism*, i.e. one believes one's culture to be superior to others.

Some lecturers teach multicultural issues limiting the focus upon human resources and negotiations. Others go further, and add processes and methodologies that move from 'looking at the differences' to 'creating value'. The latter will also examine the international subsidiary management, for example, and organization, leadership and communication. One quiz question may ask about the need for autonomy or control of subsidiaries in different cultures.

Weaknesses and failures in communication are part of the most apparent problems in multicultural management. In the company-to-company context, contracts, alliances, joint ventures and mergers and acquisitions can fail or become complicated if cultural aspects have not been taken into consideration.

Consider the cultural difficulties of Pharmacia and Upjohn, or Daimler Chrysler. In the customer relation, the different consumer preferences, cultures and habits require adaptations. They may result in costs but can open new markets and specialization. Some leading international corporations (such as Ford, Palmolive and Parker Pen) encountered some marketing mistakes in advertising campaigns, and had to learn the hard way. These mistakes are always due to a lack of knowledge about cultural difference or *ethnocentrism.* They result in significant inefficiencies.

> "Culture is more often a source of conflict than of synergy. Cultural differences are a nuisance at best and often a disaster."
>
> (Hofstede)

> "Misunderstanding of national cultural differences have been cited as the most important factors behind the high failure rate of global JVs and alliances."
>
> (Piero Morosini, author of *Managing Cultural Differences*, 2003)

Business negotiations are often used to illustrate cultural difference. A negotiation in Western countries will aim for mutual agreement and handshakes when that agreement is reached, i.e. the end of negotiations starting a partnership of some sort. In Middle Eastern countries, agreement leads to handshaking, indicating that now further details can be explored through further negotiation. Germans and North-Americans prefer the paper-based agreements while Spaniards and Italians will be satisfied with the verbal promise.

Pitfall

In Multiple Choice Questions (MCQ), it is important to remember your professor's culture. It is rather common to see students misinterpret potential answers becausethey read with their own cultural background in mind. Never hesitate to ask for help on terms that could be misunderstood.

In any structure, knowledge and work, the collection and the spread of information, the measurement of results, and the creation of forecasts rely on an efficient organizational structure. A multinational needs to be well adapted to the cultural specificities of each region, i.e. the way in which management, delegation, personnel and human resource issues and operational issues are most efficiently implemented. The different types of business are organized:

- along their *corporate culture*, or
- along that of their owners or
- along that of the headquarters,

on a local as well as a global level.

For example, a family business is normally rather organic, directive and individually oriented, while entrepreneurial businesses tend to be unsystematic and group-focused. Professional service firms (for example, consulting companies) have an individualist focus and are mechanistic, but they can also be group-oriented. MNEs are mainly characterized as mechanistic and autocratic. Leadership styles and leaders' performance are culturally determined. Leadership differs among managers of different cultures; its acceptance is defined by the convergence with employees' own culture.

The better you understand the verbal and non-verbal communication tools of the corporate leader, the better you can understand the message, share it, feel close to it and engage in the objectives that need to be reached.

Theories of Cultural Dimensions

Different theorists have defined a variety of dimensions to understand cultures. The table below summarizes three of them, which are analysed in all major IB books.

> ‘It's good to know what to look out for, if I want to understand other cultures. But how can I help my company adapt better, and make a value out of differences?’

The main tools taught to counteract culture clashes are:

1. awareness of the cultural differences in the company's environment and structure
2. adaptation (training programmes, job rotation, expatriation)
3. leverage of the diversity of cultures (*corporate culture* makes diversity a value).

The more complex the organization gets, the more the company needs to focus on these tools. This is the case:

- in any new internationalization phase
- in particular, in the creation of a joint-venture, a merger or an acquisition taking place.

Table 2.1 Useful cross-cultural management dimensions

Theorist name	Hofstede (p. 134 in Rugman)	Trompenaars (p. 135)	GLOBE (p. 137)
Number of cultural dimensions	4	7	9
Dimensions	1) *power distance* (acceptance of power between instances)	1) universalism vs. particularism	1) assertiveness
	2) uncertainty avoidance	2) individualism vs. collectivism	2) future orientation
	3) individualism	3) neutral vs. emotional	3) gender differentiation
	4) masculinity	4) specific vs. diffuse	4) uncertainty avoidance
		5) achievement vs. ascription	5) *power distance*
		6) sequential vs. synchronic	6) institutional collectivism
		7) internal vs. external	7) in group/family collectivism

			8) performance orientation
			9) humane orientation

The Significance of Politics in IB

The economic system in which companies operate is determined by the political structure of the country

'What is This: The Political Economy?'

A study of political economy examines the way in which political factors influence the functioning of economic systems.

The study of political risk, which we will refer to once again in section 2.9, examines the probability in which politics may be, now and in the future, disadvantageous to business objectives.

Hill compares two dimensions: one, the emphasis of individualism or collectivism of a government, and two, the tendency towards democracy or totalitarianism.

Democracies tend to promote *market-driven* economies (e.g. the USA) while totalitarian regimes are often characterized by a *centrally determined* market structure (e.g. the former USSR), as a command or state-directed economy.

In your exam, do remember nonetheless that nowadays, most economies include aspects of both economic structures and are therefore mixed economies.

A typical exam question: Is a democratic system essential for sustained economic development? You may want to answer this with an analysis of political vs. economic systems, with examples, and point out the pros and cons of these systems (for example, stability but lack of competitive forces in command economy; high degrees of liberalism in market economies), before you come to your conclusion.

There are essentially two ways in which the political authorities interact with business:

1. through *privatization* or *nationalization*, government control of assets, embargoes and sanctions, export controls, and the regulation of International Business behaviour
2. through government-business cooperation, trade and industrial policy, support and assistance.

Privatization can happen in the form of *contract management* (the government keeps ownership of assets but gives operational responsibility to the private company) or *divestiture* (selling of assets). The latter option is the more common one.

'Do Governments Typically Interfere in Import or Export Activities?'

When speaking about government-business cooperation, we should keep in mind that in many cases they refer to governmental support in high-technology R&D. In the same way, cooperation between public research institutes and companies is part of this. In international affairs, countries may establish trade barriers to protect home industry and boost cross-border trade of its own firms, to raise revenue for the government.

- These barriers mainly take the shape of *tariffs* (a tax levied on imports) or *quotas* (limiting supply from foreign producers)
- other forms of protection or obstacles to trade in national laws may concern health or packaging requirements, and language translations on packages
- also, *voluntary export restraints* (VERs) can be obtained when importers fear restrictions. The importer here proposes or agrees to limit shipping to a specific country (or regions, e.g. the EU) – this is self-imposed and not taking the shape of tariffs or quotas that are imposed by the governmental authority.

Another main part of the teaching of politics for international business is that of economic integration. We will review this in more detail in a section on its own (2.4), for its importance in regard to trade relations. Nonetheless, be aware of two different effects of integration, i.e. trade creation and trade diversion that is created through politics:

- *Trade creation* is the beneficial result of companies trading more extensively with each other within the trade union (remember the theory of comparative advantage!).
- *Trade diversion* describes the reduction of trade with companies outside the union (similar to barriers of trade, i.e. policy or regulation that restricts international trade – see above!).

Taking it *Further*

Economic integration enhances international trade only if:

trade creation > trade diversion

Two important cost-reducing effects on companies operating in an integrated economic environment shouldn't be forgotten. Companies benefit from internal and external economies of scale.

- Internal economies of scale means that companies are able to produce at lower unit costs in larger numbers as they have to supply a bigger market; in particular, services and networks allow for strong network economies of scale.
- External economies of scale implies that companies have access to lower unit costs as a

result of the industry growing in size.

Distinguish economies of scale from scope, which arise when it is cheaper to produce two goods together (joint production) than to produce them separately, when we deal with product range and brand value.

The Significance of Law to IB

'Why is it Important for a Manager to Know about International Law?'

Some IB books cover law barely or not at all (Rugman et al., 2006), while others deal with this topic in great detail, making a point that corporations need not only be familiar with different legal obligations, but are subject to them.

This being said, globalization causes a great boom in corporate law, in particular for merger and acquisitions activity. Indeed, many law firms have recently merged on an international scale, and deal with IB corporate law and international law all over the world. The challenge is to bridge differences in culture, mentality, business and legal practices.

First, one has to distinguish *common law* from *civil law.*

- In regions in which *common law* is applied, courts make law as they decide individual cases. Judges in a common law jurisdiction have the power to interpret the law.
- *Civil law* originates from historical writings, was defined by kings, princes, or legislatures issuing decrees or passing bills. Judges in a civil law jurisdiction have the power only to apply the law.

Taking It *Further*

On an international level, various organizations work towards worldwide legal standards: the Incoterms of the International Chamber of Commerce (explained in section 2.8), The UN Commission on International Trade Law, The International Institute for the Unification of Private Law, and The Hague-Vishy Rules on Bills of Lading sponsored by the International Law Association are crucial parts of this.

International law in general can be divided into two types:

- Public International Law includes legal relations between governments, including all matters involving the rights and obligations of sovereign nations.
- Private International Law includes laws governing the transaction of individuals and

companies crossing international borders.

Sources of this international law are bilateral and multilateral treaties between nations. Treaties are here defined as agreements between countries and may also be called conventions, covenants, compacts, or protocols.

'What Kind of Institution can Help Standardize Legal Obligations, For Example When it Comes to a Firm's International Contracts?'

The United Nations, for example, propose solutions that many countries, among them the USA, are ratified to apply, in the shape of the UN Convention on Contracts for International Sales of Goods. The law applicable to contracts between EU residents is determined by an amendment to the Rome Convention, which came into effect in 1991.

In a company or corporation liability issue, business divisions are divided into shares, i.e. stocks. The limited liability company holds that a liability in law of each shareholder to the company's creditors is limited to the amount to which the shareholder has agreed to invest in the company (i.e. to the value of the shares held). In the USA, for companies' partnerships, one needs to be familiar with the Partnership Act 1890. This legal text states that, in a relationship between persons carrying on business in common with a view of profit, all persons are equally liable (with the exception of Act 1970 on general/limited partners).

Taking it *Further*

Most legal texts differ from one country to another. For example, you will learn that major differences in legal procedures exist in product liability. In the USA, product liability cases are heard by juries that award plaintiffs actual damages plus punitive damages. Outside the USA, product liability cases are most often heard by judges, not juries.

'But What is Product Liability?'

It means that a company and its officers and directors are held liable and are possibly subject to fines or imprisonment when their product causes death, injury, or damage. Strict Liability holds the designer/ manufacturer liable for damages caused by a product without the need for a plaintiff to prove negligence in the product's design or manufacture.

Let us distinguish between different crucial parts of law (non-exhaustive here) that IB needs to have expertise in:

- Business law: the company is a creature of law and legitimate and socially responsible activities. Legal constraints translate societies' attempts to influence business to meet social or other issues, to observe anti-trust laws, child labour laws, equality laws, pollution-control, and/or legislation. Court decisions are precedents for the action of companies.
- Labour law: its goal is to equalize the bargaining power between employers and

employees. Labour law deals with the relationship between employers and unions, and grants employees rights, in particular the right to unionize. It prohibits/allows employers and employees to engage in certain activities for their demands (e.g. strikes).
- Employment law: the individual legal relationship between employee and employer is subject to employment law. Collective bargaining agreements are key here. Legal sources are civil rights acts, fair labour standards acts, social security, disability, medical leave and worker compensation or retirement statutes.
- Intellectual Property Rights regulate and protect copyright, trade marks and patents, in the interests of the creator of materials such as authors, computer programmers, composers, artists, inventors and designers.

‘Does Business Necessarily have to go to Court to Solve Legal Quarrels?’

In legal issues on an international level, many parties prefer arbitration (less formal, private solutions) to litigation (going to court). Sometimes they do not want or wish to accept UN or EU solutions, or do not wish to handle the cost and exposure of going to court in any country.

The International Court of Arbitration of the International Chamber of Commerce in Paris is the best known for arbitration.

People and businesses prefer arbitration for several reasons, mainly suspicion of foreign courts, speed of decision-making, informality of procedures, confidentiality, and avoidance of unwelcome publicity accompanying an open court case.

Taking it *Further*

Current and future challenges in the legal business environment of firms will focus on the regulation of commercial transactions over the internet, signature/ authentication procedures, encryption and security, electronic money and copyright issues. Also, issues of corruption, ethics and social responsibility will need to be dealt with internationally.

‘To What Degree is the International Firm under the Obligation of Good Corporate Citizenship and of Acting Ethically?’

Ethics in IB

> “At this moment, America's highest economic need is higher ethical standards – standards enforced by strict laws and upheld by responsible business leaders.”
>
> (George W. Bush, President of the USA)

The understanding and importance of ethics is subject to cultural differences. However, firms should be familiar with common values and know what to avoid in their practices. The civil society is a group of individuals, organizations, and institutions that act outside the government and the market to advance a diverse set of interests, including opposition to global business.

Companies' citizenship is increasingly scrutinized by the civil society (groups acting outside government → *non-governmental organizations (NGOs)).* The civil society is part of a company's stakeholders, i.e. the community of actors concerned by corporate activities. The so-called 'stakeholder model' holds that a firm needs to satisfy not only shareholder expectations ('shareholder model', focused on profit maximization) but also those of the larger community. NGOs have obtained considerable power in influencing the public perception of MNEs. Good ethical behaviour includes the respect of human rights, adequate labour and environmental standards, fair trade, transparency and contributions to the resolve of contemporary (and evolving) global challenges (e.g. global warming, poverty, terrorism and warfare).

Moral principles are also to rule the managers' decision-making in the case of conflict within the company. The international manager has to adapt to the complex cultural and religious nuances of ethical systems, for example when dealing with conflict between subsidiaries. These decisions are considered ethical when acceptable to the moral or legal norms of the larger community, or the society.

> Issues in ethics span from quality control, to abuse of sick days, to cheating on any stakeholder, price fixing or anti-competitive behaviours, discrimination, or fraud, and much more. In exams, you will often be asked to solve case problems that deal with questions of accountability as a solution to unethical conduct.

An increasingly strong attention is given to Corporate Social Responsibility (CSR), that is ranked by organizations such as the Dow Jones Sustainability Index, and increasingly taken into account by investors and other stakeholders of international companies. The most frequently used term is that of Corporate Social Responsibility (CSR) followed by Corporate Citizenship (CC), Strategic Philanthropy, Corporate Philanthropy and Cause-related Marketing. Corporate Social Responsibility (CSR) is defined as '… the adoption by a business of a strategic focus for fulfilling the economic, legal, ethical, and philanthropic responsibilities expected of it by its stakeholders.' (McAllister et al., 2005, p. 4). This is private business taking account of the impact of its activity upon the larger community, both on a socio-cultural and environmental level, in which 'stakeholder' links complement 'shareholder' relations and partnerships. Ethical behaviour in this context is expressed by initiatives and investments into activities that contribute to the larger community, for example, the elaboration of infrastructures, the reduction of poverty, or the participation in programmes designed to reduce conflict and injustice.

Recommend Reading

HILL (2008):*Part 2*

RUGMAN AND HODGETTS (2002):*Chapters 4 and* 5

- trade diversion
- trade creation
- international law
- product liability
- non verbal communication
- collectivism
- liability

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