

Global Business



Module 2: Formal Institutions



Agenda for module 2:

Regional insights & Formal institutions

Global business: Regional insights

Emerging markets and de-globalization pressures

Introduction to institutions

Formal national institutions

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The world has changed and is continuously changing

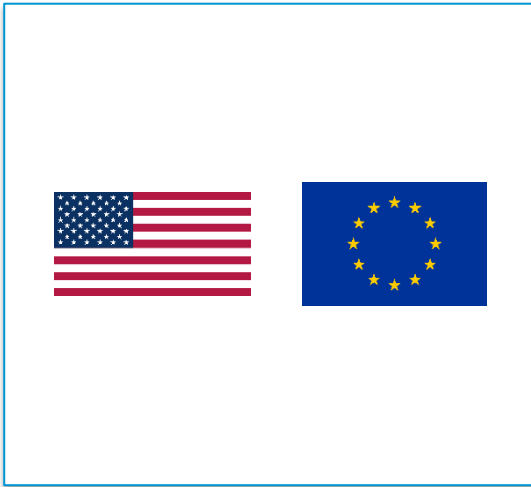
Global business: Regional insights



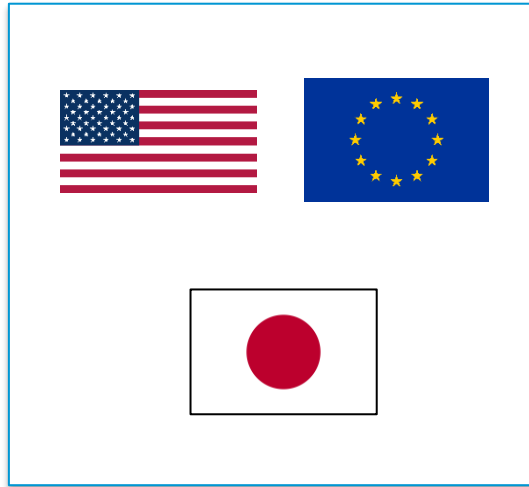
Global economic power has shifted significantly since the end of WW II

Global business: Regional insights

After second world war,
global business was
dominated by Europe and
the US



With the growth of Japan,
a triad of global economic
powers was formed in
the 1980s



Emerging markets are
again changing the
puzzle of global business
in the new millennium



[Vecteezy.com](https://www.vecteezy.com)



The distribution of economic power around the globe is changing

Global business: Regional insights

Africa

Being labeled the “hopeless continent” in 2000 by The Economist, we now have a more positive perspective

Asia

Asia is the global economic growth engine since the 1990s, with specific significance of China and India

Europe

Being the birthplace of global business, Europe currently tries to find its position between Asia and North America

North America

With the US as the strongest global economy, North America runs more aggressive global economic strategies than Europe

South America

While being resource-rich, South America struggles to develop a strong position in the global economy

UP-TO-DATE READINGS AND VIDEOS

Find up-to-date readings and videos on the different regions in the online learning environment



Europe – History: A long history of trade led to Europe's leading position

Global business: Regional insights

To study at home

Since 500 BC

Cross-border Economic Activities develop; trade routes to China exist since 500 BC (e.g., Silk Road) – see previous slides

Age of Exploration (15th to 18th Century)

Global explorations and colonization by European powers and establishment of colonial trade networks

Industrial Revolution (18th to 19th Century)

Technological advancement revolutionizing production and a surge in international trade and global business expansion

World Wars Impact (20th Century)

Economic shifts and restructuring post-World Wars and the emergence of global institutions like IMF and World Bank

European Integration (Mid-20th Century-)

Formation and evolution of the European Union and impact of the EU's Single Market on business dynamics

Era of Globalization (Late 20th to Early 21st Century)

European businesses play central role in global interconnectedness and technological advances reducing international business barriers

Europe – Present & Future: Today, Europe is not leading anymore and struggling to hold its position



- **Role in world trade & economics:**
 - As mentioned: The largest amount of FDI is between US-Europe, **BUT** this can (and most likely will) change
 - Europe is struggling to maintain its good position (reasons below)
- **Power of EU vs. nations:** Role of the single market and trade policies
- **Digitalization:** Europe embraces digital transformation but is behind China and the US
- **Sustainability:** Initiatives under the European Green Deal for sustainability
- **Politics:** Various countries are struggling with polarization
 - Brexit: Adjustments in response to new trade barriers
 - Elections: Right-wing parties won various elections across countries, partly resulting in protectionist tendencies
 - War (Russia-Ukraine)

European Green Deal: Distinctive Blueprint aiming for Europe's transition to a climate-neutral economy by 2050.

Sustainability in Europe: European Green Deal, Circular Economy Action Plan, Farm to Fork Strategy, Renewable Energy Directive

Digitalization in Europe: Strong Data and Privacy laws (GDPR), Digital Single Market, Digital Innovation and Research initiatives (Horizon Europe)

Europe – Firms: But many European firms still hold important international positions

Global business: Regional insights

To study at home



Siemens AG

- Founded in 1847, Siemens & Halske (now Siemens AG)
- Pioneers in electrification and automation
- Operations across 200+ countries
- Focus on innovation in energy, healthcare, and smart infrastructure globally



Wienerberger AG

- Founded in 1819
- World's largest brick producer; key player in clay roof tiles
- Operations in 25+ countries, strong in Europe, North America, Asia
- Emphasis on sustainable production and building materials



Capgemini

- Founded in 1967
- Global leader in consulting and technology services
- Presence in nearly 50 countries, with a workforce of over 270,000
- Strong focus on digital transformation and innovation across multiple industries

North America – History: From colonization to the worlds' economic powerhouse

Global business: Regional insights

To study at home

Pre-1400s	Indigenous trade networks across the continent
1400s & 1500s	European exploration initiates colonization and first international trade routes (Christopher Columbus 1492)
1600s & 1700s	Mercantilism and the triangular trade dominate the economy, with European powers exploiting resources
1800s	Industrial Revolution and infrastructure projects (e.g., Transcontinental Railroad) spur growth and expansion of MNCs
1900s	World Wars, the Great Depression, and the creation of international economic institutions (IMF, GATT) reshape trade policies
1994	NAFTA established significant shift towards regional economic integration among Canada, Mexico, and the USA
2000s	Digital revolution, 2008 financial crisis, sustainability trends, COVID-19 Pandemic → new challenges, transformation of global supply chains and business practices



North America – Present & Future: Staying on top is difficult amidst foreign competition & internal struggles

History of international business

To study at home



- **Role in world trade & economics:** Preparing for the rising influence of emerging markets (especially China) through policies (subsidies for innovation and increasing protectionism e.g., tariffs)
- **Digitalization:**
 - Businesses are rapidly integrating digital technologies to streamline operations and access new markets (e.g., **USMCA**)
 - Government subsidies for innovation in AI, blockchain, and IoT are expected to revolutionize business operations and market approaches (aim at staying competitive with China)
- **Sustainability:** Shift towards sustainability, with companies increasingly committed to environmental, social, and governance criteria (ESG); regional- and state-level sustainability initiatives
- **Politics:** Tensions within the US given an increasing polarization (i.e.,) and populism

USMCA: Free trade agreement that replaced the North American Free Trade Agreement (NAFTA) with several updates reflecting modern trade issues (digital trade, intellectual property, ...).

Sustainability in North America: Whilst there are no comparable federal policy to the European Green Deal, there exist several regional / state-level commitments: Green New Deal, Regional Greenhouse Gas Initiative, California's Climate Policies, ...

North America – Firms: Usually, the most well-known MNEs are still from North America

Global business: Regional insights

To study at home



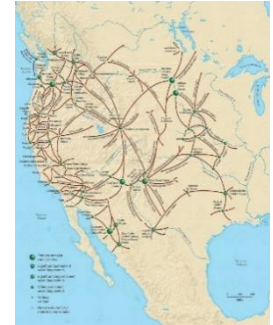
- Founded in 1916
 - Among the largest global aerospace manufacturers
 - Operations in over 150 countries with a significant export footprint
 - Government contracts and commercial products emphasize its public and private sector impact
- Founded in 1976
 - Tech giant in consumer electronics and software services
 - Global retail network and a vast user base across multiple continents
 - Pioneering sustainability in tech manufacturing and renewable energy use
- Founded in 2003
 - Manufacturer of electric vehicles and sustainable energy solutions
 - Expanding global footprint with Gigafactories and Supercharger network
 - Innovating energy storage and clean energy products worldwide

South America – Past: Political instability and social inequality were in the way of SA's international trade...

Global business: Regional insights

To study at home

Pre-1500s	Indigenous trade networks across the continent
Colonial Era (15-19th Century)	European colonization for resource extraction (gold, silver), trade monopolies and forced labor systems
Early Post-Colonial time (19th Century)	Emergence of independent nations, opportunities for international commodities trade and investment
19th and early 20th Century	Expansion of international trade in commodities (coffee, sugar, minerals, rubber) and European and North American investment in infrastructure to facilitate extraction and export (railways, ports)
20th Century	Increased foreign investment, especially from the United States, rise of import-substitution industrialization policies, political instability, economic nationalism and persistent social inequality
Late 20th Century to Present	Adoption of neoliberal economic policies, regional economic integration initiatives, and continuing challenges including income inequality, corruption, and environmental degradation



South America – Present and Future: The factors that hindered international trade in the past still persist

Global business: Regional insights

To study at home



■ **Role in world trade & economics:**

- Key role in global commodity trade, grapples with market volatility
- Regional integration and trade deals are progressing, despite internal economic disparities

■ **Digitalization:**

- Growing tech hubs contrasted with wide digital divides
- Initiatives for connectivity expansion impeded by infrastructure and socioeconomic gaps

■ **Sustainability:**

- Rich biodiversity with initiatives for renewable energy and conservation
- Challenges: deforestation, mining impacts, and policy enforcement

■ **Politics:**

- Economic progress amidst political instability. Anti-corruption and reforms are ongoing, with varying degrees of success across the continent

South America – Firms: Consequently, it is difficult to become a successful international firm from SA

Global business: Regional insights

To study at home



PETROBRAS

- Founded in 1953
- A publicly-held Brazilian multinational corporation in the petroleum industry
- Operates in several segments of the oil, natural gas, and energy industry
- Has a significant international presence with operations in multiple countries



**mercado
libre**

- Founded in 1999
- Largest e-commerce platform in Latin America, often likened to eBay or Amazon
- Operates online marketplaces, fintech solutions, and logistics services
- Listed on NASDAQ, it has expanded across Latin America and globally



EMBRAER

- Founded in 1969
- One of the world's largest manufacturers of commercial jets up to 150 seats
- Strong global presence with customer bases in over 90 countries
- Both privately-owned and publicly-traded, with shares listed on the São Paulo and New York Stock Exchanges

Asia – History: Asia's rise as an international economic superpower began after WWII

Global business: Regional insights

To study at home

European Colonization (16th to 20th Century)

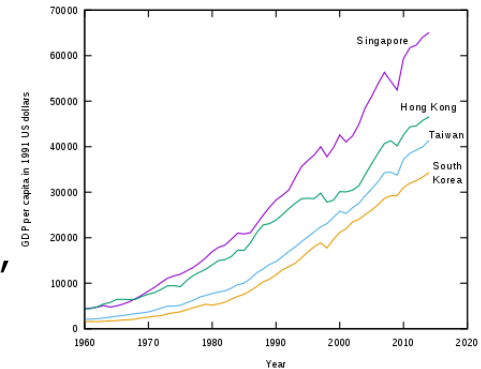
European Colonies control trade routes and resources in Asia

Rise of Trade Companies (1600s-20th Century)

British and Dutch East India companies

Post-World War II (Mid-20th Century)

Asian countries gaining independence, Japan's economic miracle, rapid growth of the Asian Tigers



China's Economic Reform (1978)

Opening up of China under Deng Xiaoping to become a global manufacturing hub and a key international player

Regional Economic Integration (Late 20th C.)

Initiatives like ASEAN and RCEP aim to promote economic cooperation and reduce trade barriers

Digital Revolution (21st Century)

Rise of technology companies transforming Asia into a global leader in technology and innovation

Asia – Present & Future: China and other Asian countries are aiming for international trade leadership

Global business: Regional insights

To study at home



■ Role in world trade & economics:

- Dominant in manufacturing, electronics; pivot to service sectors
- US-China trade tensions, diversifying trade with RCEP and CPTPP

■ Digitalization:

- Leader in tech innovation, e-commerce, digital finance
- High-tech cities contrast with rural areas lacking infrastructure

■ Sustainability:

- Green tech focus, but environmental degradation and urban pollution persist
- Energy demands grow with economic growth, challenging carbon reduction goals

■ Politics:

- Regional power dynamics complex with China's rise. Internal political issues and human rights concerns impact global relations

CPTPP: Comprehensive and Progressive Agreement for Trans-Pacific Partnership

RCEP: Regional Comprehensive Economic Partnership

Technological Initiatives: Made in China 2025: strategic plan to upgrade Chinese industry, with a focus on high-tech sectors, Digital India: campaign to improve online infrastructure and increase internet connectivity, I-Korea 4.0: government initiative promoting the Fourth Industrial Revolution

Asia – Firms: Many international firms come from the Asian Tigers, but we also see a rise in other Asian markets

Global business: Regional insights

To study at home



- Founded in 1969
- Global leader in consumer electronics, semiconductors, and smartphones
- Extensive operations and sales in virtually every country
- Combines public shareholding and family-led business aspects



- Founded in 1999
- Major multinational conglomerate specializing in e-commerce, retail, and technology
- Strong international presence, including key markets outside of China
- Publicly traded with one of the largest IPOs in history



- Founded in 1968
- Leading global IT services, consulting, and business solutions organization
- Operates in 46 countries with a strong footprint in IT outsourcing
- Part of the larger Tata Group and publicly traded on Indian stock exchanges

Oceania – History: From colonialization, to independence, to commodity exporters & tourism hubs

Global business: Regional insights

To study at home

Pre-Colonial Trade

Various indigenous peoples engaged in trade amongst themselves, mainly based on barter (exchange of goods)

European Arrival (16th Century)

Introduction of global trade routes, colonization (Britain, France, Germany) and the beginning of the shift in indigenous economies

19th to Early 20th Century

Expansion of European colonial economies with plantation systems (Fiji, Papua New Guinea), export of sugar, copra, wool, meat, and dairy, and the introduction of labor force from India and China

Post World War II and Decolonization

Movement towards independence, emergence of new nation-states and reorientation towards diversified economies

Late 20th Century to Present

Increased globalization and trade liberalization, the emergence of regional trade agreements, Australia and New Zealand as exporters (minerals, coal), and smaller economies focusing on tourism and niche exports (e.g., bottled water from Fiji)

Oceania – Present and Future: Aiming for a meaningful role in international trade continues to be challenging

History of international business

To study at home



■ **Role in world trade & economics:**

- Australia and New Zealand dominant in mining, agriculture, services, and the global supply of certain raw materials
- Small islands face geographical isolation and limited diversification

■ **Digitalization:**

- Rapid advancements in Australia and New Zealand juxtapose with Pacific islands' connectivity and digital access challenges

■ **Sustainability:**

- Committed to dealing with climate change due to its vulnerability to rising sea levels and extreme weather, however, full transition faces economic and infrastructural hurdles

■ **Politics:**

- Stable governance in major nations provides a favorable business climate
- Smaller islands need stronger regional political collaboration to amplify their voice in global affairs

Oceania – Firms: Not many international firms from Oceania are known outside this region



Australia and New Zealand Banking Group

- Founded in 1835
- One of the largest banks in Australia, providing banking and financial services
- Operates in 34 markets globally, with a strong presence in the Asia-Pacific region
- Publicly traded with extensive international banking and finance operations



- Founded in 1909
- One of New Zealand's largest listed companies, focusing on building materials and construction
- Operates in New Zealand, Australia, and the South Pacific
- Engages in both residential and commercial construction, contributing significantly to local economies



- Founded in 1920
- Australia's largest airline
- Serves 85 destinations across 17 countries, highlighting its broad international footprint
- Publicly traded and known for pioneering long-haul flight services and leading sustainability efforts in aviation

Africa - History: Rising from the post-colonial past has been difficult for African nations

Global business: Regional insights

To study at home

Pre-Colonial Era

Trade networks within the continent and with the outside world, indigenous systems of commerce and exchange

Colonial Era (Late 15th Century – Mid 20th Century)

European colonization led to exploitation of Africa's resources, including the transatlantic slave trade and extraction of raw materials for European markets

Post World War II and Decolonization

African countries gained independence, seeking economic self-sufficiency amidst challenges of political instability and neocolonial influences

Movement towards independence, emergence of new nation-states and reorientation towards diversified economies

Late 20th Century to Present

Integration into global economy, foreign investment, structural adjustment programs initiated by international financial institutions (mixed outcomes)

Africa – Present & Future: Exploitation continues to be a problem in establishing an independent position

History of international business

To study at home



■ **Role in world trade & economics:**

- Africa's market is resource-rich, AfCFTA set to bolster trade self-sufficiency
- Global Partnerships represent opportunities, however, external market dependency and raw material focus remain challenging

■ **Digitalization:**

- Rapid mobile uptake sparks tech growth, however, access is uneven

■ **Sustainability:**

- Renewable energy projects are expanding, leveraging Africa's vast potential
- However, environmental management struggles against the pressures of industrial and agricultural expansion

■ **Politics:**

- Political reforms are emerging, but governance issues, corruption, and civil unrest still pose significant risks to economic stability and investment attractiveness

Africa – Firms: African firms are struggling in establishing an important international role

Global business: Regional insights

To study at home



- Founded in 1981
- One of Africa's largest industrial conglomerates
- Primarily involved in cement manufacturing, sugar, salt, and flour milling
- Extensive operations across several African countries, influencing local economies significantly



- Founded in 1994
- Leading telecommunications provider in Africa
- Operates in 21 African countries and the Middle East, serving over 280 million subscribers
- Publicly traded, known for pioneering mobile money and expanding digital services in the region



- Founded in 1997
- Largest mobile network operator in Kenya
- Known for its mobile payment service, M-Pesa, which has transformed financial services in the region
- Publicly traded and significant for driving innovation in mobile technology and financial inclusion

Agenda for module 2:

Regional insights & Formal institutions

Global business: Regional insights

Emerging markets and de-globalization pressures

Introduction to institutions

Formal national institutions

Beyond geographics, supranational institutions differentiate markets by economic characteristics

Emerging markets and de-globalization pressures

IMF



- IMF differentiates between '**Advanced**' and '**Emerging and Developing**' Economies
- There are **no explicit thresholds**
- Around **17% of all countries** are considered '**developed**'

UNDP



- UNDP differentiates between '**Developed**' and '**Developing**' Countries
- Ranking based on the **Human Development Index (HDI)**
- **Relative threshold: 25%** highest HDI-ranking **countries** are always **developed countries**

World Bank



THE WORLD BANK

- World Bank differentiates between "**High-Income**" and '**Low- and Middle-income**' Countries
- High-income categorization if **US\$ 14,005 GNI per Capita** is exceeded (for 2025)
- Around **28% of all countries** are **high-income**

Across geographic regions, emerging markets become important locations in the global economy

Emerging markets and de-globalization pressures

Emerging Markets (EM) are markets that can **no longer be defined as developing markets** but at the same time **do not meet all characteristics of a developed market**.

EM provide **potential new operational locations and consumer markets** for developed market firms, and at the same time bring **new competitors**. An interesting group of EM are the **BRICS**.



**Emerging
operational locations**



**Emerging
consumer markets**



New competitors



BRICS

The automobile market provides an interesting example for the relevance of emerging markets

Emerging markets and de-globalization pressures



- Founded in 1937 in Germany (HQ in Wolfsburg)
- Multiple Automotive Brands (VW, Audi, Seat,...)
- Almost 700,000 employees globally (2023)
- Revenue above 320 billion € in 2023
- Volkswagen was an early investor in China



- Founded in 1995 in Shenzhen, China
- Multibusiness firm (batteries, electronics, ...)
- Around 700,000 employees globally (2023)
- Revenue above 75 billion € in 2023
- BYD is a relevant global player in automotive

Volkswagen invested early in China as the emerging operational location offered opportunities

Emerging markets and de-globalization pressures

- In **1984**, Volkswagen set up the **Shanghai Volkswagen Automotive Co. Ltd.**, an **International Joint Venture** with three Chinese Partners. **Volkswagen owned 50%** of the equity.
- **Joint Venture partners** were **Shanghai Automotive Industry Corporation** (SAIC, 25%), providing substantial operational support; the Bank of China (15%), supporting the financing of the venture; and the **China National Automotive Industry Corporation** (CNAIC, 10%), providing the network in the Chinese automotive industry.
- The first car produced was the **VW Santana**

-
- **Emerging operational locations**, like China in the 1980s and 1990s, offer **operational opportunities** for investing firms.
 - International firms consider **investing** in foreign factories or facilities in emerging operational locations largely because of **low factor costs**.
 - In the short run, **regulatory and political uncertainty**, cumbersome **administrative processes**, or **challenging infrastructure** provide challenges for investing firms.

At the same time, China represented an attractive emerging consumer location for Volkswagen, too

Emerging markets and de-globalization pressures

- The **Santana**, rather unsuccessful in developed markets, was a **major success in China**, selling up to 300.000 units annually
 - Volkswagen was able to operate with a rather **low marketing and advertising budget** in China as **competition was extremely limited**, and **most sales was business-to-business** in the 1980s and 1990s
 - In **2001**, Volkswagen had a **market share of more than 50%** in China
 - While **absolute sales** were **still increasing afterward**, **market share** was **decreasing** significantly since then
-
- **Economic growth** leads to more **demand** in emerging markets, while **competition** is rather **limited**
 - Consequently, **international firms enter emerging markets to sell their products** (we will hear more about this when we talk about the international product life cycle)
 - **Complex regulations, missing experience** with distribution systems, and **different demand structures** (e.g., different culturally driven preferences) may provide **challenges** for investing firms

Emerging markets also develop new relevant competitors for global markets: BYD

Emerging markets and de-globalization pressures

- The **Chinese market** provided **relevant growth opportunities, not only for international firms**
- BYD **used** its **competencies** in battery development and –production to **develop and produce electric vehicles** (EVs)
- In 2023, **BYD** was the **largest EV producer globally**
- While the **core sales market of BYD** is still **China** (as of 2024), the company is continuously **expanding its global footprint**

-
- **Emerging market firms** may have **significant advantages** (e.g., used to difficult market environments with relevant growth opportunities)
 - Those firms are often **high-end producers in specific markets** and may start competing with developed-world companies
 - Firms, however, could also be **low-end producers** that are highly efficient and competitive (e.g., export-oriented emerging market firms)
 - Such firms regularly display **different internationalization behaviors** due to differences in management styles and “late-comer” status

BRICS: Emerging markets also become relevant and organized geopolitical players

Emerging markets and de-globalization pressures

- **BRICS** is an **acronym** for Brazil, Russia, India, China, South Africa
- The label **BRICS** was **originally developed** in the context of **international investment strategies** by former **Goldman Sachs** Chairman Jim O'Neill
- **BRICS** today is a **supranational institution** and **geopolitical counterpart to the G7**
- At the beginning of **2024**, **Egypt, Ethiopia, Iran, and the United Arab Emirates** **joined** the organization (now referred to as **BRICS plus**)
- BRICS plus is supposed to give a **stronger geopolitical voice** to the **global south**
- **More than 40 additional nations** either expressed interest or formally applied as **potential future members** of **BRICS plus**



The factors that drive globalization are diverse, interdependent, and condition each other (1/2)

Emerging markets and de-globalization pressures

1. Technology (Unit 5)

- **Innovations** such as telegraphs, telephones, and the internet facilitated instant communication and reduced costs for global exchange of information.
- **Advancements in transportation** vehicles like cargo containers, airplanes, and ships enabled cost-effective movement of people and goods across the globe.

2. Economics (Unit 2, 4)

- Globalization was fueled by the **liberalization of world trade** through agreements like GATT, the Uruguay round, and the WTO.
- Economic opening of previously closed countries and **market deregulation** allowed companies to efficiently operate on a global scale, fostering international business and economic interdependence.

3. Politics (Unit 3)

- Increased mobility of companies and international business activities heightened **competition among countries** to create favorable business environments.
- This competition constrained countries in regulating business activities, limiting their sovereignty and affecting their ability to pursue national interests.

The factors that drive globalization are diverse, interdependent, and condition each other (2/2)

Emerging markets and de-globalization pressures

4. Social (Unit 3)

- Socially, globalization led to a debate on its impact on overall wealth and **divergence between industrialized and developing countries**.
- **Income per capita disparities** increased, leading to social divergence within countries, prompting protectionism, as seen in Brexit.

5. Cultural (Unit 3)

- **Cultural convergence** toward a global culture was driven by increased worldwide mobility of people, information, and products.
- While national traditions still matter, factors like age, job, and lifestyle gained prominence, sparking discussions on the emergence of a **unified global culture**.

6. Ecological (Unit 5)

- Globalization has contributed to **ecological challenges, including pollution, ozone depletion, and the greenhouse effect**. The rising demand for fossil fuels has led to environmental disruptions, necessitating global initiatives like the Earth Summit, Kyoto Protocol, and Paris Agreement to address climate change.

In recent years, political movements and critical events create de-globalization pressures

Emerging markets and de-globalization pressures

Political Developments



Critical Events



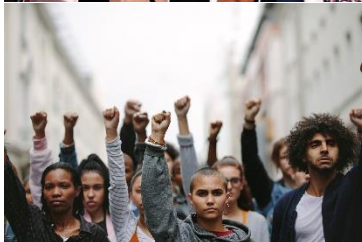
'Trade Wars'

Covid-19
Pandemic

Populist
Politics

Wars & armed
conflicts

(Radical)
Movements





'Trade wars', populism, and radical movements create political pressures on globalization

Emerging markets and de-globalization pressures

- Significant **increases in tariffs in trade** (sometimes referred to as 'trade war') for certain goods, e.g. between China, the US, and Europe, **create direct cost and mistrust in global trade relations**
- **Populist politics** in many nations trigger **negative perceptions toward international trade and investment**
- **Radical movements** around the world **increase the risk and cost of doing international business** (see pirates in Somalia, the planned concerts of Taylor Swift in Vienna, ...)





Recent events brought globalization to a halt by disrupting global supply chains & FDI flows

Emerging markets and de-globalization pressures

- **COVID-19** was **attacking** the **weak spot in global** (cheap/cost-effective) **supply chains**
- Similarly, the **wars and armed conflicts** in Ukraine and Israel/Palestine, **disconnected regions from international trade**
- This **raised questions of risks in such global supply chains** and **whether they should continue to exist in the same way**
- **Supply chain resilience** and **early warning systems** become more important
- Events also **reduced cash flows from existing investment projects**, significantly **negatively affecting FDI flows** (globally in the case of COVID-19 and regionally in the case of recent military conflict).
- Further, many **firms divested** in **countries associated with military conflict** and/or **sanctioned by the international community** (e.g., significant divestments in Russia)

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Global business: Regional insights

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Introduction to institutions

Formal national institutions

A business meeting in Germany

Introduction to institutions

Meeting with your business partner in Germany

- You have just flown in from Mexico to close an important deal with them
- The meeting does not go very well ...
 - You arrive 7 minutes late
 - You talk about your family for the initial 15 minutes of the meeting
 - You downplay the legal issue regarding the appropriate production standards
→ we can be flexible there and in the worst case, we can “negotiate” with the authorities

You are obviously from a different business ‘world’



Institutions as a guiding framework for economic activity and human interactions

Introduction to institutions

Institutions provide the framework for economic activity and human interaction



Formal

Explicit and codified rules, laws, regulations, and organizational structures (e.g., tax regulations, curfews)

Informal

Unwritten, norms, traditions, social practices (e.g., customs of how meetings are held: length of talking about private life, the weather, etc.)

Regulatory

Formal rules, laws, regulations (based on legal mechanisms)

Normative

Social norms, values, beliefs

Cognitive

Shared beliefs, assumptions, mental models shaping an individual's perception of the world

Role of institutions: We will look at formal institutions today

Introduction to institutions

Institutions provide the framework for economic activity and human interaction



Formal Explicit and codified rules, laws, regulations, and organizational structures (e.g., tax regulations, curfews)	Informal Unwritten, norms, traditions, social practices (e.g., customs of how meetings are held: length of talking about private life, the weather, etc.)	
Regulatory Formal rules, laws, regulations (based on legal mechanisms)	Normative Social norms, values, beliefs	Cognitive Shared beliefs, assumptions, mental models shaping an individual's perception of the world

Example: Barrick Gold and its Joint Venture in Tanzania

Introduction to institutions

- Early 2000s: Barrick Gold entered a JV in Tanzania to operate the Bulyanhulu gold mine
- **Disputes arose over tax claims, export regulations, and a significant fine** for alleged environmental breaches and unpaid taxes
- In 2017, the **Tanzanian government banned the export of gold** and copper concentrates, impacting Barrick Gold's operations, and **demanding \$190 billion** in back taxes and penalties from its subsidiary
- After long negotiations with the Tanzanian government, Barrick Gold reached a settlement: Pay \$300 million in tax claims and share future economic benefits from the mine
- Barrick Gold has **implemented various initiatives** aimed at environmental conservation, community development, and responsible resource extraction → Barrick Gold leverages these initiatives to enhance its government relationships



BARRICK



Agenda for module 2: Formal Institutions

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Political systems

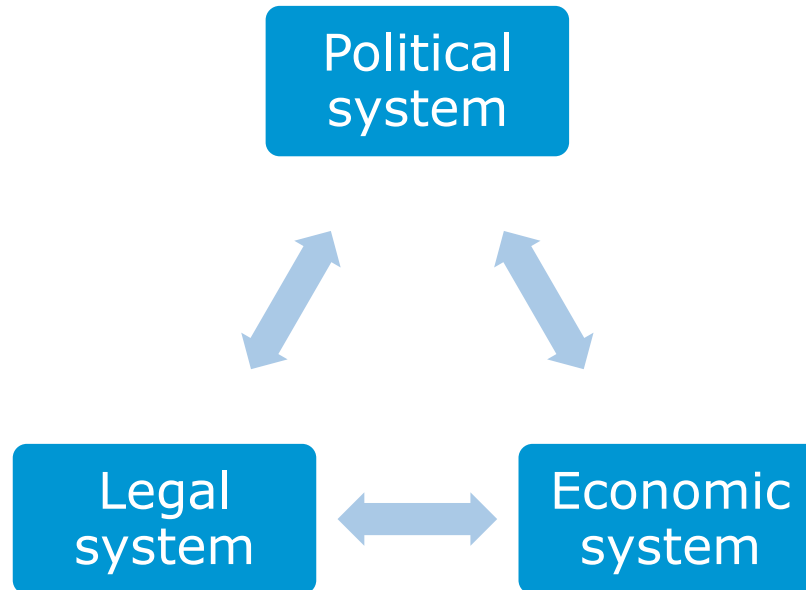
Legal systems

Economic systems

Interdependencies between the dimensions of institutions: political, legal, and economic systems

Formal national institutions

There are strong interdependencies between the institutional dimensions / systems:



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Introduction to institutions

Formal national institutions

Political systems

Legal systems

Economic systems

Understanding the role of the state and politics determines the success of firms...

Political systems

Political Systems: Political organization of a country (e.g., democracy, dictatorship) that can be recognized, observed, or otherwise declared by a state.

Nationalizing resources

Venezuela

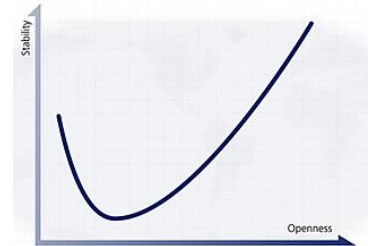
- After being one of the primary oil exporters worldwide, Venezuela's position started to decline
- PDVSA became partner for incoming FDI
- The Bolivarian Revolution in late 1998 led to an increased nationalization of resources



Stability as a crucial factor for firms

J-Curve

- Concept by Ian Bremmer
- Openness does not linearly relate to stability
- Consolidated authoritarian/closed countries can exhibit relatively high levels of stability
- Countries transitioning from closeness to openness frequently face deteriorating levels of stability



The importance of the political system for MNCs

Political systems

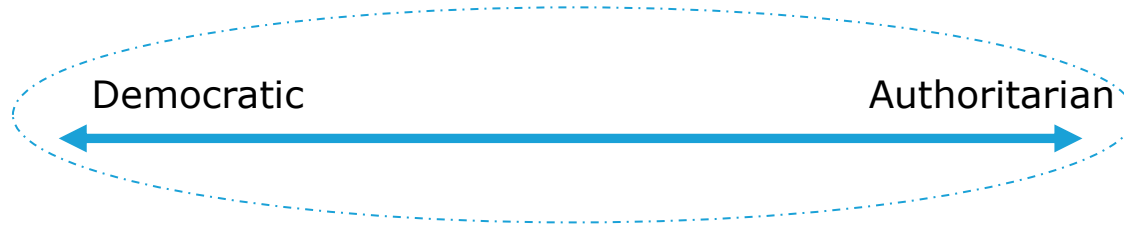


- **Power and authority:** the political system determines ...
 - where political decision-making happens
 - which regulations are established
 - which interests these regulations reflect.
- The political system determines how **MNCs** can **influence policy-making** via ...
 - legal (e.g., lobbying, connections) or
 - illicit means (e.g., bribery).
- The political system determines the **frequency of regime changes** leading to political risk and uncertainty.

Political systems typically come in layers

Political systems

Decision-making is vested in the people or elected representatives



Decision-making is vested in a single, unaccountable leader or a group of individuals

- Most **countries are hard to classify**:
 - Russia is nominally democratic but in reality, a highly centralized authoritarian state.
 - China is a more decentralized authoritarian state with some democracy at the local level and calls for democracy within the communist party.
- Governments are made up of **competing political and bureaucratic interests**. This is true for all political systems.
 - The “Chinese”, “Japanese” or “French” states are not monoliths.
 - Though governments openly support domestic firms relative to foreigners, local governments or some bureaucracies support foreign firms.

Political risks: Macro- and micropolitical risks can have important consequences for nations' stability

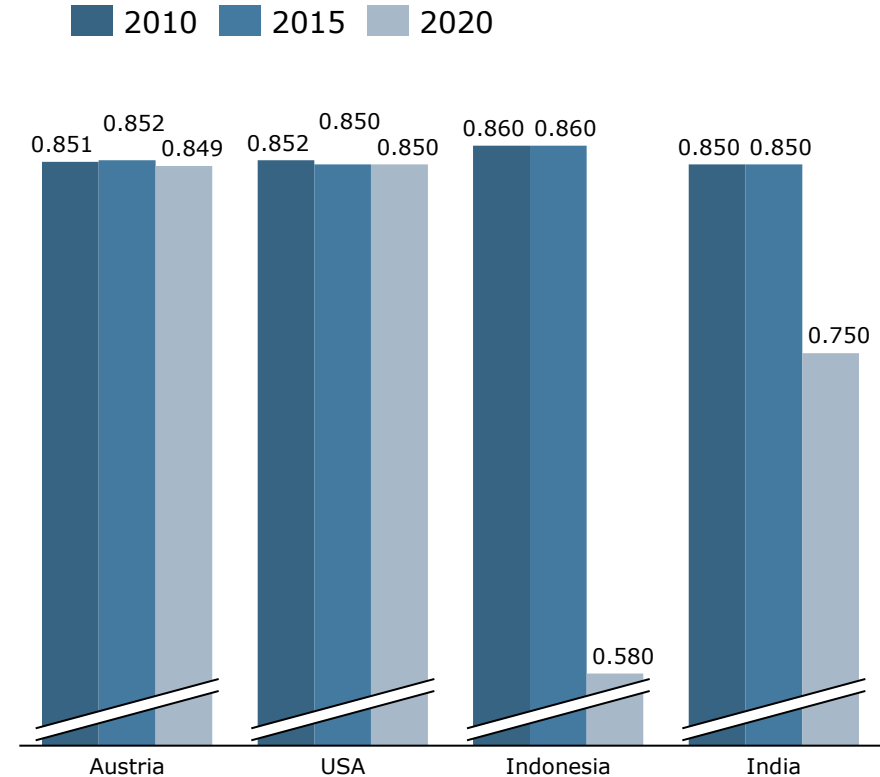
Political systems

- Different national political systems are associated with varying levels of political risk
- **Types of political risks**
 - **Macropolitical risks** affecting all firms in a country (e.g., war, change of government)
 - **Micropolitical risks** affecting only specific firms, industries, or venture types (e.g., regulations, taxes)
- **Potential negative effects on a national level**
 - Government stability
 - Policy changes
 - Geopolitical tensions
 - Changes in the “rules of the game”
- **Measurements of political risks**
 - POLCON: Likelihood of changes in the policy regime
 - ICRG (International Country Risk Guide): Rating comprises 22 variables in three subcategories of risk: political, financial, and economic

Democratic countries tend to come with checks and balances that help protect against political risk

Political systems

- Checks and balances protect against changes and are therefore **“first order” safeguards**.
- Henisz (2000) developed a much-used framework for the assessment of **political constraints (POLCON)**.
- This framework is based on the idea that political systems that have **counterbalancing powers** will lead to a **reduction in risk**.
- As foreign firms generally fear changes to the political environment, more checks and balances are assumed to be **positive for international investments**.



Based on data from the 2022 POLCON release.

There are central questions to ask when analyzing a political system

Political systems

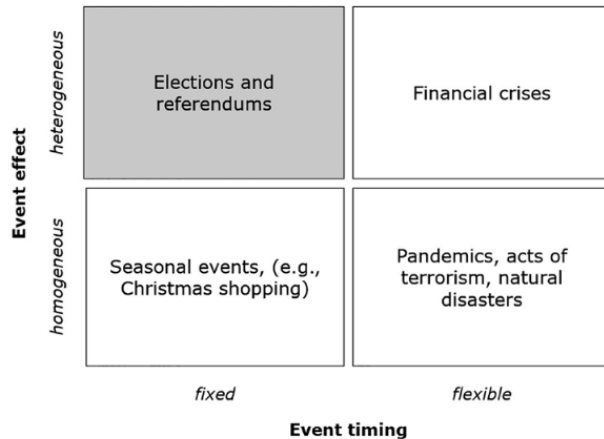
- **Who are the relevant actors?**
President, bureaucrats, interest groups, voters
- **How is power distributed?**
Centralized vs. federal
- **How much power do regional governments have?**
"Heaven is high, the emperor is far away"
- **How stable is a state?**
Particularly in developing countries
- **How stable is policy?**
Again, think about POLCON
- **What is the capacity of government to create and execute policy?**
This question helps in detecting corruption



Elections are a key events with heterogeneous outcomes in democratic states – and bear implications for firms

Political systems

- Elections are **clearly timed events** with **heterogeneous and uncertain outcomes** in democracies
- Elections have **relevant implications** for firm operations, investment, and financing

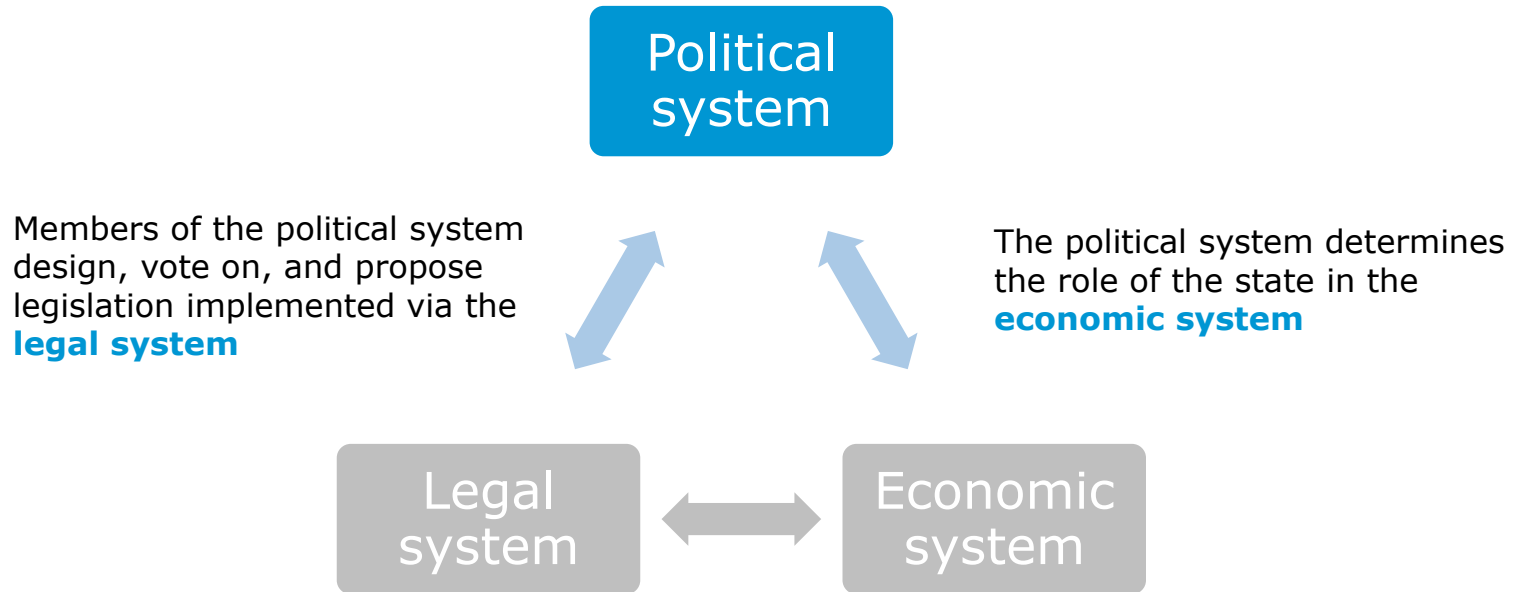


Type of adjustment	Operating activities	Investing activities	Financing activities
Adjustment of internal activities	<i>Cost stickiness:</i> Lee et al. (2020)	<i>Domestic investment:</i> Baker et al. (2016), Jens (2017), Julio & Yook (2012)	<i>IPO activity:</i> Çolak et al. (2017)
	<i>Employment:</i> Baker et al. (2016), Hassan et al. (2020)	<i>FDI, cross-border M&A:</i> Bonaime et al. (2018), Cao et al. (2019), Fraissler et al. (2019), Giambona et al. (2017), Julio & Yook (2016), Lee (2018), Vaaler (2008) <i>Investment efficiency:</i> Col et al. (2018)	<i>SEOs:</i> Jens (2017)
Adjustment by external stakeholders	<i>Obsolescing bargaining:</i> Müllner & Puck (2018)	<i>Investment strategies:</i> Chen et al. (2018)	<i>Stock price volatility:</i> Baker et al. (2016), Białkowski et al. (2008), Goodell & Vähämaa (2013), Pantzalis et al. (2000) <i>Firm financing:</i> Huang et al. (2021), Jens (2017), Kelly et al. (2016), Kim (2019), Pastor & Veronesi (2013) <i>Leverage:</i> Çolak et al. (2018), Gungoraydinoglu et al. (2017)

Interdependencies between the dimensions of institutions: political, legal, and economic systems

Political systems

There are strong interdependencies between the institutional dimensions / systems:



Agenda for module 2:

Regional insights & Formal institutions

Global business: Regional insights

Emerging markets and de-globalization pressures

Introduction to institutions

Formal national institutions

Political systems

Legal systems

Economic systems

Legal systems: International firms are substantially affected by their legal environment

Legal systems

- The national legal system has significant **direct and indirect effects** on firms' activities in a market as home-country laws do not apply abroad
- Across legal systems of the world, we can differentiate between two core types of legal systems
 - **Civil law systems** are based on written law that has been approved by political authorities
 - **Common law systems**, in contrast, are developed through judicial decisions and precedents over centuries



Civil and common law systems rely on different principles

Legal systems

Civil Law

Common Law

Core idea

Relies on codified statutes and comprehensive legal codes established by legislatures

Relies on the development of legal principles and precedents through judicial decisions

Regions

Prevalent in Europe, Latin America, Asia, and parts of Africa

Originating in England, spread to various countries (especially British Commonwealth and the United States)

Judicial Role

Restricted role of judges: interpretation and application of statutes

Judges have the authority to interpret laws and apply legal principles based on past rulings

Stare Decisis *"to stand by things decided"*

The principle of stare decisis / binding precedent is not as central

Doctrine of stare decisis: courts must follow precedents set by previous judicial decisions, ensuring consistency and predictability.

Contract & Legal Codes

Contracts and agreements drafted by MNCs often based on specific provisions outlined in the legal codes

Doctrine of good faith and fair dealing involving business deals; common law principles influence how courts resolve conflicts especially when local statutes are ambiguous

MNCs need to adhere to the respective principles of the legal systems

Legal systems

› Civil Law

- Multinational companies entering foreign countries need to **adhere to local legal principles** (e.g., US firm entering Spain must adhere to principles in Spain's civil code)
- Structured nature of civil law provides **predictability and clarity** in global business dealings
- MNCs can navigate legal requirements and resolve disputes using **explicit provisions in legal codes**

› Common Law

- A multinational corporation from the United States might rely on common law principles when engaging in business ventures in foreign countries, ensuring consistency
- Common law's **adaptability allows** businesses to navigate diverse legal landscapes, utilizing established principles for agreements, risk mitigation, and dispute resolution, contributing to **legal predictability in various jurisdictions.**

Example: Civil law vs. common law and the case of investor protection

Legal systems

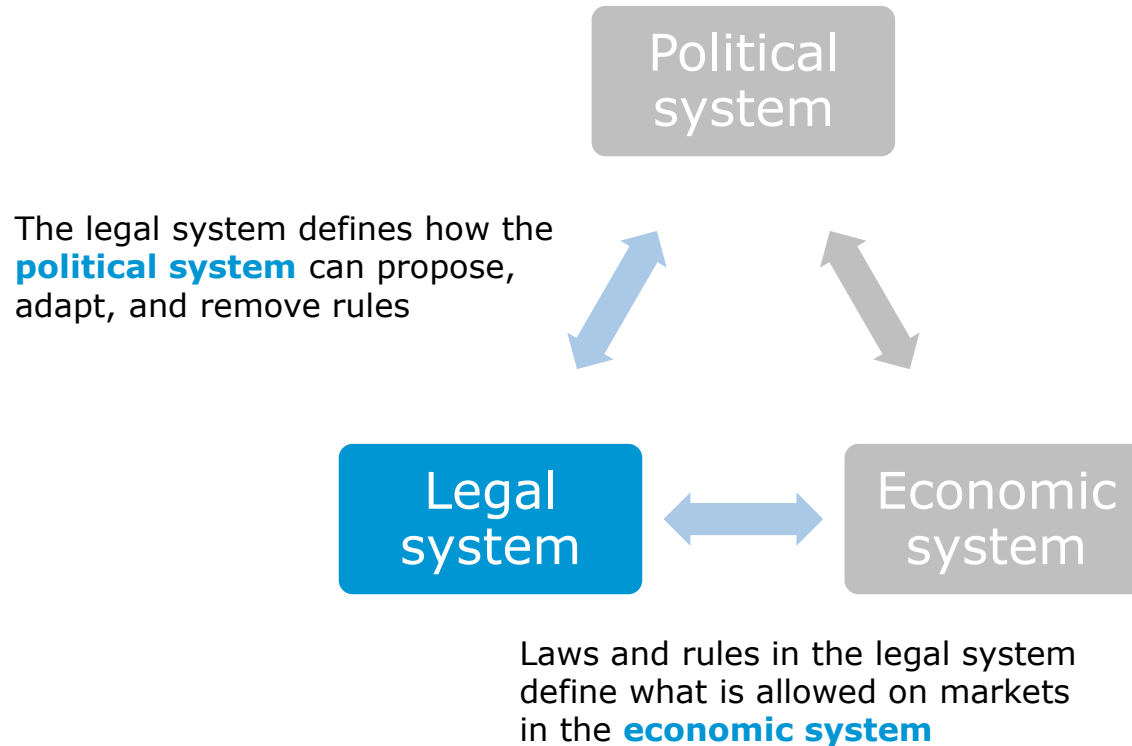
- Most countries adopted their legal system via occupation, colonization, and later independence (yet continuing the legal system)
- Common law system countries have a stronger emphasis on investor protection compared to civil law systems
 - French civil law countries protect shareholders and creditors the least
 - Common law countries (e.g. US) have the highest investor protection rights
- Stronger investor protection rights come with bigger and stronger financial markets
(La Porta et al., 1997):

	External Cap / GNP	Domestic firms / Pop	IPOS / Pop	Debt / GNP	Anti- Director Rigts	One share = One-Vote	Creditor Rights
English Common law	0.60	35.45	2.23	0.68	3.39	0.22	3.11
French Civil Law	0.21	10.00	0.19	0.45	1.76	0.24	1.58
German Civil Law	0.46	16.79	0.12	0.97	2.00	0.33	2.33

Dimensions of institutions: Formal environments are defined by countries' political, legal, and economic systems

Legal systems

There are strong interdependencies between the institutional dimensions / systems:



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Example: Big US retailer in Austria

Economic systems

- Big US retail company expands to Europe, Austria
- The company was very successful at home with its huge, low-cost department stores

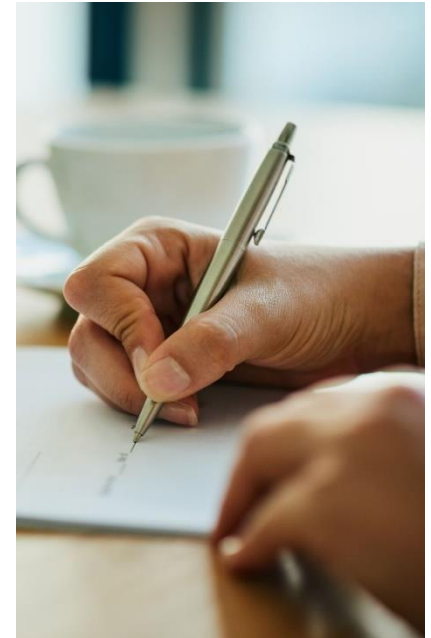


What are potential issues during the expansion?

What challenges come with differences in economic system?

Examples:

- Unionization of employees
- Immobile workforce



Economic systems: It is about who owns factors?

There are different types of economic systems

Economic systems

	Market economies	Mixed economies	State-led economies
Also known as ...	Anglo-Saxon capitalism, (neo)liberal / free market economy	European social democratic models	Command, planned, centralized, or a form of statist economy
Core idea	A country's trade and industry are controlled by private owners for profit	Blend of market-driven capitalist dynamics and state-led interventions	Government has significant control over factors and directs economic activity
Examples	UK, USA	European states (e.g., Sweden, Austria)	Cuba, Singapore, Japan

- In reality, pure forms do not exist as most countries blend in aspects of other systems (e.g., US spends a very large percentage of GDP on defense, healthcare, and education)
- A defining question is **how different states intervene in their economies** and what opportunities and problems intervening presents for business?

Economic systems

- **Economic philosophy:**
 - Minimal state intervention
 - Markets are predominately driven by demand and supply
 - Emphasis on entrepreneurship, private property and competition
- **Characteristics:**
 - Weaker unions
 - Lower taxes
 - Higher inequality
- **Role of the state:**
 - Maximizing economic efficiency
 - Not picking industries or favored firms
 - State is present in defense, health care, or education
- **Examples:**
 - USA, UK, Canada, Australia, or Hong Kong
 - Chile is an example in Latin America



Economic systems

▪ Economic philosophy:

- Government directs economic activity
- Basic mechanisms of market economies present
- Investment, production, and allocation of capital goods based on economic plans

▪ Characteristics:

- Unions not present or prohibited
- State-owned enterprises are common
- Large governmental bureaucracies

▪ Role of the state:

- Directing economic activities
- Picking industries or favored firms

▪ Examples:

- Asian Tigers (e.g., South Korea, Singapore), Japan
- China
- Brazil
- Developing countries



Mixed economic systems: European social democratic models

Economic systems

- **Economic philosophy:**

- Seeking a consensus and balance between business, labor, and state interests
- Blending efficient market mechanisms with state interventions to increase public welfare
- State intervention is necessary to correct market failures

- **Characteristics:**

- Strong unions and restrictive labor regulations (collective bargaining)
- A substantial share of GDP is spent on social services
- Higher equality

- **Role of the state:**

- Strong state involvement in social services (health care, pensions, or education)

- **Examples:**

- Scandinavian countries (e.g., Norway, Sweden)
- Austria
- Portugal



Economic systems affect key factors of international business activity (1/4)

Economic systems

To study at home

1. Market Dynamics:

- **Market Systems:** Demand and supply forces, minimal state intervention, agility, innovation, and continuous market assessment.
- **State-Led Systems:** State objectives influence market access, pricing, and production volume, requiring alignment with predetermined goals.

2. Regulatory Environment:

- **Market Systems:** Operational flexibility with rigorous self-regulation to address global standards.
- **State-Led Systems:** Intricate regulatory maze with policies on local sourcing, technology transfers, and partnerships, demanding localized strategies.

3. Labor Dynamics:

- **Market Systems:** Market-determined wages, competitive HR strategies for talent attraction, retention, and comprehensive benefits.
- **State-Led Systems:** Standard wage structures, mandatory benefits, potential for strikes, requiring robust labor relations strategies.

Economic systems affect key factors of international business activity (2/4)

Economic systems

To study at home

4. Financial and Investment Landscape:

- **Market Systems:** Competitive taxation, reduced trade restrictions, currency volatility management through financial hedging.
- **State-Led Systems:** Influenced profits by higher taxes, tariffs, and state-controlled exchange rates, impacting pricing and investment decisions.

5. Corporate Social Responsibility (CSR) and Ethics:

- **Market Systems:** Voluntary CSR initiatives driven by market pressures and ethical considerations beyond compliance.
- **State-Led Systems:** State-mandated CSR activities, legal allocation of profits to societal development projects, and specific ethical standards.

6. Supply Chain Management:

- **Market Systems:** Efficiency, cost, speed, and global best practices drive supply chain optimizations.
- **State-Led Systems:** Adherence to local mandates, quotas, and specific industry services, posing challenges in quality control and efficiency.

Economic systems affect key factors of international business activity (3/4)

Economic systems

To study at home

7. Access to Resources:

- **Market Systems:** Determined by market availability, competition, and costs, focusing on best sources and logistical considerations.
- **State-Led Systems:** State-controlled key resources, leading to negotiations with state entities or authorized distributors.

8. Technology and Innovation:

- **Market Systems:** A competitive environment fosters innovation, necessitating R&D investments and scouting for disruptive technologies.
- **State-Led Systems:** Mandated technology transfers or sharing with local partners for market access, requiring a balance with IP protection.

9. Trade Policies and Tariffs:

- **Market Systems:** Liberal trade policies, minimal tariffs, and potential uncertainties from geopolitical tensions.
- **State-Led Systems:** Protective measures introduce tariffs, quotas, and licensing requirements, necessitating awareness and anticipation of trade barriers.

Economic systems affect key factors of international business activity (4/4)

Economic systems

To study at home

10. Intellectual Property (IP) Rights:

- **Market Systems:** Robust IP rights protect innovations and brand identities, enabling confident R&D investments.
- **State-Led Systems:** Varied IP protections, managers strategize on effective protection and leveraging of intellectual assets.

11. Government Expenditure and State Control:

Overview indicates that state-led economies like Japan or Korea have similar government spending ratios as Market economies, with European mixed economies showing the highest shares around the 30-50% mark of GDP.

States either adopt a “bullet train” or “convoy system” strategy

Economic systems

- Many states had policies to support industries that they believed would be profitable, allowing very fast development → like a **“bullet train”**



- US government does not choose winners. Many firms enter many industries. Some succeed and some fail → a **“convoy system”**



Example of a “bullet train” (or plane): The Case of Embraer in Brazil

Economic systems

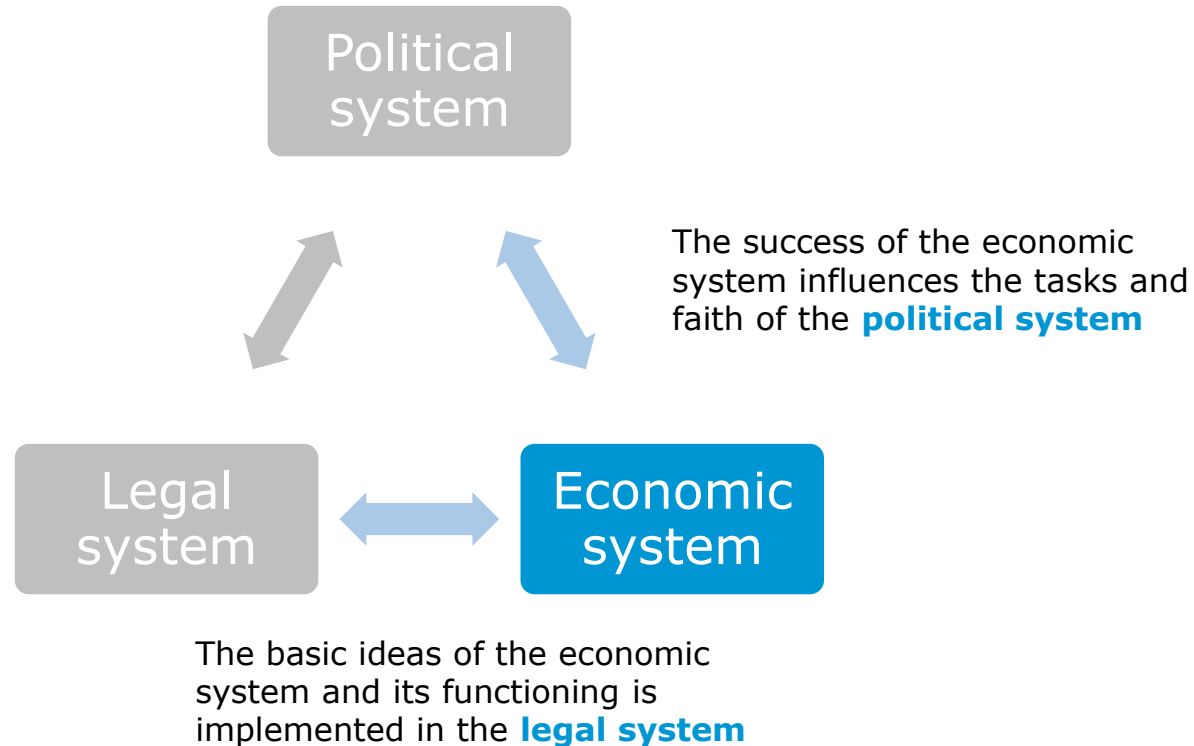
- 3rd biggest airplane manufacturer worldwide (behind Airbus and Boeing)
- Founded by the Brazilian Government in 1969 as *Empresa Brasileira de Aeronáutica* (*Embraer*)
- Existed for two decades as a state-owned enterprise (SOE) before being privatized in 1994
- Substantive post-privatization support by the Brazilian government (e.g., PROEX – export financing program, BNDES – Brazil’s national development bank)
- BNDES helped consolidate and modernize a big part of Brazil’s heavy industry



Dimensions: Formal environments are defined by countries' political, legal, and economic systems

Economic systems

There are strong interdependencies between the institutional dimensions / systems:



2nd module's take-away: Formal institutions, political, legal and economic systems play an important role

Wrap-up

Key concepts

- Globalization landscape in different regions
- Emerging markets and de-globalization pressures
- Formal institutions
- Spectrum of different systems
 - Politic: Democratic vs. Authoritarian
 - Legal: Civil vs. Common law
 - Economic: Capitalism vs. State-led

Key learnings

- Globalization affects regions differently
- The global business landscape sees the emergence of new players and markets
- Formal institutions are key to understanding the environments in which firms operate
- Political, legal, and economic systems are interdependent

