



chapter two



# Political and Legal Environment





# Political Environment in International Business

The political environment in international business refers to how a country's political stability, government policies, and international relations affect business operations. Businesses must navigate these factors to manage risks and comply with local laws.

## ✧ ✧ ✧ **Totalitarianism** ✧ ✧ ✧

### 1 Absolute Control by a Single Leader or Party

In totalitarianism, power is held by one leader or party with unchecked authority over all aspects of government and society, leaving no room for opposition or political freedom.

### 2 Extensive State Control and Silencing Disagreement

The government controls the economy, media, and public life, using propaganda and monitoring to silence criticism and restrict individual freedoms.

## Examples

**Nazi Germany under Adolf Hitler**

**North Korea under the Kim dynasty**

**Soviet Union under Joseph Stalin**

# Democracy

## Citizen Participation and Political Equality

In a democracy, political power lies with the people, who have equal rights to participate in free elections and influence government decisions.

## Rule of Law and Protection of Rights

Democracies are governed by laws that apply equally to all, protecting individual freedoms and human rights while ensuring accountability through checks and balances.

**Examples** United States Canada Malaysia

# Socialism

## Public Ownership and Central Planning

Socialism supports the government or communities owning key industries and resources, with decisions about production and distribution made to benefit everyone, not just private individuals.

## Social Welfare and Equality

Socialism focuses on reducing inequality by providing universal access to services like healthcare, education, and housing, and ensuring fair wages and working conditions for all.

**Examples** Sweden Norway Finland

# Command Economies

## Centralized Political Control

Command economies are governed by a single party or a small group that makes key political and economic decisions.

## Limited Political Pluralism

Political challenges and disagreement are often silenced, with the ruling party maintaining tight control over political institutions and media.

## State ownership and Control

Major industries, resources, and infrastructure are owned and controlled by the state, with centralized economic planning.

## Limited Economic Freedom

The state heavily regulates economic activities, limiting private ownership, entrepreneurship, and market forces.

## Impact on Individual Liberties

While providing economic security, command economies restrict individual freedoms and choices in employment, goods, and personal economic decisions.

**Example: North Korea**

# Market Economies

## **Political Pluralism and Democratic Governance**

Market economies feature multiple political parties and democratic governance, allowing citizens to participate in elections, express disagreement, and hold officials accountable.

## **Rule of Law and Protection of Individual Rights**

Legal frameworks in market economies protect individual and property rights, ensuring impartial application of laws and resolving disputes fairly.

## **Private Ownership of Means of Production**

The means of production in market economies are owned and operated by private individuals, corporations, or cooperatives, fostering investment and innovation.

## **Limited Government Intervention**

Governments in market economies play a minimal role, focusing on providing public goods, enforcing regulations, and correcting market failures.

## **Market Mechanisms and Price Signals**

Supply and demand, competition, and price signals guide economic decisions, reflecting the value and scarcity of goods and services in the market.

**Example: United States, Canada, Germany, Japan**

# Mixed Economies

## **Political Pluralism and Democratic Governance**

Mixed economies operate within a framework of political pluralism and democratic governance, where citizens have the right to participate in political processes and enjoy political freedoms.

## **Private and Public Ownership of Means of Production**

Mixed economies combine private ownership with public control or ownership of key sectors like utilities and infrastructure, promoting investment and innovation alongside public welfare goals.

## **Government Intervention and Regulation**

Governments step in to regulate markets, promote competition, and correct market failures, aiming to protect consumers, workers, and the environment.

## **Social Safety Nets and Redistribution**

Mixed economies feature social welfare programs funded through progressive taxation to reduce poverty and inequality, ensuring a basic standard of living for all citizens.

## **Balancing Economic Efficiency and Social Goals**

The challenge in mixed economies is balancing economic growth with social equity and environmental sustainability, achieved through government policies that address both economic dynamism and social needs.

**Example: United States, Canada, Australia**

# Country Risk Produced by Political Systems in International Business

## Government Takeover



### Nationalization of Industries

Process of transferring privately-owned industries (like oil, gas, or utilities) into government control to secure national interests, ensure security, or redistribute wealth.

Example: Malaysia Airlines was fully nationalized in 2015. The government took over the airline to address financial struggles, improve efficiency, and boost its competitiveness globally.



### Expropriation of Assets

Government seizes privately-owned assets, typically offering compensation at market value, though it may be insufficient or delayed, causing disputes and financial losses for businesses.

Example: Lynas Corporation, an Australian mining company, faced challenges in Malaysia with its rare earth plant in Gebeng. The Malaysian government imposed strict conditions, creating uncertainty and leading to disputes over the plant's operations.



# ✨ Confiscation without Compensation

Government seizes assets without offering any compensation, often in politically unstable or authoritarian environments. This creates significant risks for foreign investments and may lead to diplomatic conflicts.

Example: In Malaysia, land disputes involving Indigenous communities (Orang Asli) have led to claims of land being taken without fair compensation or legal process. These conflicts often arise when state-approved development projects clash with traditional land rights.

## Embargoes

### 1 Embargoes restrict trade

A government-imposed trade restriction, often used as a diplomatic tool to protest or disapprove of another country's actions. It can be imposed by one country or through international agreements.

### 2 Types of Embargoes

Common types include trade embargoes (restricting specific goods) and arms embargoes (banning the sale of military equipment).

Example: The United Nations arms embargo on North Korea, aimed at preventing the spread of weapons and military technology.

# Sanctions

1

## Sanctions are punitive measures

Imposed by countries or international organizations to influence behavior, enforce norms, or address issues like human rights abuses and violence.

2

## Types of Sanctions

They can include diplomatic sanctions (cutting diplomatic ties), economic sanctions (restricting trade or finance), and targeted sanctions (aimed at specific individuals or sectors).

Example: United Nations sanctions on Iran for its nuclear program, including restrictions on trade in certain goods and technologies.

# BOYCOTTS

## POLITICAL AND LEGAL RISKS

Boycotts often arise from political tensions or conflicts between countries, leading to legal changes that restrict trade. These can limit market access, disrupt supply chains, and cause financial losses for businesses.

## REPUTATION AND COMPLIANCE RISKS

Boycotts can damage a company's reputation and brand, while also exposing businesses to legal and compliance challenges if they violate sanctions or trade restrictions. Strategic planning is needed to manage these risks.

## EXAMPLE

Nike faced criticism over labour practices in its overseas factories, including allegations of poor working conditions, low wages, and child labour. The brand faced consumer boycotts and protests.

# WARS, INSURRECTIONS, AND VIOLENCE

## WARS AND INSURRECTIONS

Armed conflicts and uprisings can disrupt business operations by damaging infrastructure, blocking trade routes, and creating economic and security uncertainty. Businesses may struggle with supply chain issues, instability, and employee safety.

## VIOLENCE AND ITS IMPACT ON BUSINESS

Violence, including riots or terrorism, threatens employee safety and disrupts economic activities. Companies may face higher security costs, operational delays, and reputational risks if associated with areas of conflict or unrest.

## EXAMPLE

Example: Businesses operating in Ukraine have navigated challenges related to security, legal uncertainty, and economic disruption.

# Managing Of Country Risks in International Business

## PROACTIVE ENVIRONMENT SCANNING

### CONTINUOUS MONITORING OF KEY RISKS

Proactive environment scanning means regularly checking for risks in areas like politics, economy, society, and technology. This helps businesses stay prepared for things like government changes, economic shifts, social unrest, or new laws that could affect their operations.

### STRATEGIC ADAPTATION AND STAKEHOLDER ENGAGEMENT

Businesses should stay updated on local changes, talk to key stakeholders, and plan for possible risks. By adjusting strategies based on new information, companies can stay resilient and continue to grow even when unexpected challenges arise.

## STRICT ADHERENCE TO ETHICAL STANDARDS

### BUILDING TRUST AND REPUTATION

Adhering to ethical standards helps businesses build trust with stakeholders like customers, employees, and investors. It also ensures compliance with local and international laws, reduces legal risks, and helps maintain a positive reputation by preventing corruption and unethical practices.

## PROMOTING SOCIAL RESPONSIBILITY

Ethical practices guide businesses to respect human rights, support fair labor standards, and protect the environment. By engaging with local communities responsibly and adopting sustainable practices, businesses contribute to long-term growth and global development.

## ALLIANCES WITH QUALIFIED LOCAL PARTNERS

### LOCAL EXPERTISE AND NETWORK BENEFITS

Partnering with qualified local entities provides valuable insights into the local political, economic, and regulatory landscape. Local partners help navigate bureaucratic challenges, understand market conditions, and offer established relationships with key stakeholders and government bodies, facilitating smoother operations and market entry.

### RISK MITIGATION AND SHARED RESPONSIBILITIES

Local partners help assess and manage country-specific risks like political instability or legal uncertainties, providing tailored risk management strategies. Shared responsibilities in partnerships reduce individual exposure to risks, foster joint decision-making, and strengthen business adaptability in unfamiliar or volatile markets.

## PROTECTION THROUGH LEGAL CONTRACTS

### CLEAR RESPONSIBILITIES AND RISK ALLOCATION

Legal contracts define each party's roles, obligations, and how risks (like political instability or economic changes) will be shared. This helps avoid misunderstandings and protects businesses from unexpected events.

### DISPUTE RESOLUTION AND LEGAL PROTECTION

Contracts include clauses for resolving disputes (through arbitration or negotiation) and ensuring compliance with local laws. They also protect intellectual property, and allow flexibility to adapt to changes in the business environment.

# Types Of Legal Systems in International Business

## 1 Common Law

### PRECEDENT-BASED & FLEXIBLE

Common law relies on previous court decisions (precedents) to guide future rulings. This allows the law to adapt to new circumstances, making it flexible and responsive to change.

## **JUDICIAL INTERPRETATION & STARE DECISIS**

Judges have significant discretion in interpreting laws, and decisions from higher courts set binding precedents for lower courts, ensuring consistency in legal outcomes.

## **GLOBAL INFLUENCE & CONTRACT LAW**

Common law systems, including those in the UK, US, and many other countries, provide a robust framework for forming and enforcing contracts, which are vital for international business.

## **DISPUTE RESOLUTION & INTELLECTUAL PROPERTY PROTECTION**

Common law also covers issues like torts, intellectual property rights, and offers methods for resolving disputes (e.g., arbitration), essential for cross-border business activities.

# **2** Civil Law

## **CODIFIED SYSTEM**

Civil law is based on comprehensive legal codes that outline rights, duties, and procedures, providing clear rules for legal matters.

## **EMPHASIS ON STATUTORY LAW**

In civil law systems, laws are primarily derived from statutes enacted by legislatures, with judges interpreting and applying these laws in a structured way.

## **CONTRACTUAL AND COMMERCIAL FRAMEWORK**

Civil law provides clear rules for forming, interpreting, and enforcing contracts, corporate governance, and commercial transactions, which is vital for businesses operating internationally.

## **CONSUMER PROTECTION AND INTELLECTUAL PROPERTY**

Civil law also covers areas like consumer rights, competition law, and intellectual property protection, ensuring that businesses comply with market regulations and safeguard innovations.

# **RELIGIOUS LAW**

## **1 DERIVED FROM SACRED TEXTS**

Religious laws are based on religious scriptures and teachings, guiding both personal and public life. Sharia law is derived from the Quran and Hadith, influencing laws around marriage, inheritance, and criminal justice.



## **2** INFLUENCE OF RELIGIOUS AUTHORITIES

Religious scholars or leaders interpret and enforce these laws, impacting legal and social norms.

## **3** AFFECTS BUSINESS TRANSACTIONS

Religious law influences contracts, financial dealings, and ethical business practices.

## **4** CULTURAL SENSITIVITY REQUIRED

Businesses must understand and respect local religious laws to navigate legal and cultural complexities effectively.

## **5** TRADE LIBERALIZATION

The reduction of trade barriers through international agreements has facilitated the free flow of goods, services, and investments across borders, enabling businesses to explore new markets.

# Socialist Law

## 1 Centralized State Control

Socialist legal systems focus on state ownership and control over the economy and resources, promoting collective welfare and economic planning.

## 2 Primacy of State Legislation

Laws are primarily enacted by the state and are designed to promote social equality and collective rights over individual freedoms.

## 3 State Ownership and Control

Socialist legal systems emphasize state ownership in strategic industries, often limiting foreign investment and access to key sectors.

## 4 Regulatory Environment and Compliance

Businesses must navigate strict state regulations, which may involve bureaucratic processes, licensing requirements, and economic planning controls.

# Mixed LEGAL SYSTEMS

## INTEGRATION OF LEGAL TRADITIONS **1**

Mixed legal systems combine elements from different legal traditions (e.g., common law, civil law, religious law), reflecting cultural and historical influences.

## **2** DUAL OR OVERLAPPING SOURCES OF LAW

These systems recognize multiple sources of law, such as statutes, judicial precedents, and religious or customary law, which coexist and interact.

## **3** LEGAL DIVERSITY AND HARMONIZATION

Businesses must navigate the complexities of legal diversity by understanding how different legal traditions interact, especially in contract formation and regulatory compliance.

## DISPUTE RESOLUTION MECHANISMS **4**

Mixed legal systems offer varied dispute resolution options, such as courts, negotiation, and conciliation, requiring businesses to choose the best approach based on local legal preferences.

# Comparative Analysis

## **a** Legal Certainty

Civil Law offers clear, codified laws with a focus on certainty and predictability, while Common Law is more flexible and evolves through case law.

## **b** Judicial Role

Common Law allows for significant judicial interpretation based on case precedents, whereas Civil Law focuses more on applying statutes as written, with less judicial interpretation.

## **c** State Influence

Socialist Law strongly emphasizes state control over resources and economic planning, while Religious Law integrates religious teachings into the legal system and governance.

## **d** Business Implications

Common Law and Civil Law provide clear frameworks for contract enforcement and dispute resolution, while Religious Law and Socialist Law impose additional challenges regarding cultural sensitivities and state control.



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