

# **Formal Institutions: Economic, Political & Legal Systems**

(Mike Peng & Klaus Meyer, International Business)

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Special Topics in Internationalization

Università degli Studi di Bergamo

Dipartimento di Scienze Aziendali

Bergamo, ITALY

# What Did We Learnt in WEEK 2-1?

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## ■ Key Points

- ❖ Formal institutions – Transaction costs;
- ❖ Types of formal institutions;
- ❖ Peng's (2003) Two-Phase Model of Institutional Transition;
- ❖ Varieties of capitalism (*i.e.*, LMEs vs. CMEs);
- ❖ '4' types of political risks;
- ❖ Varying types of legal systems; &
- ❖ IPR protection – Who protects & how? etc.

# Informal Institutions: Culture, Religion & Languages

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- 1. Introduction**
2. Where Do Informal Institutions Come From?
3. Cultures, Languages, Religions & Ethics
4. Debates & Extensions
5. Implications for Practice



## ■ Learning Objectives

- Define what **culture** is & articulate **two** of its manifestations: **language & religion**.
- Discuss **cultures** systematically **differ** from each other.
- Explain how **religions** shape cultures & understand the importance of **ethics**.
- Participate in three leading **debates** on cultures.
- Draw **implications for action** around the world.

# An Institution-Based View of IB



## ■ Dimensions of Institutions

Degree of formality	Examples	Supportive pillars
1 Formal institutions	<ul style="list-style-type: none"><li>&gt; Laws</li><li>&gt; Regulations</li><li>&gt; Rules</li></ul>	<ul style="list-style-type: none"><li>&gt; Regulatory (coercive)</li></ul>
2 Informal institutions	<ul style="list-style-type: none"><li>&gt; Norms</li><li>&gt; Cultures</li><li>&gt; Traditions</li><li>&gt; Ethics</li></ul>	<ul style="list-style-type: none"><li>&gt; Normative</li><li>&gt; Cognitive</li></ul>

The institutional framework governing a particular context

### KEY POINTS

- > When formal institutions are effective, then informal institutions **complement** them, or **accommodate** objectives of powerful players.
- > If, formal institutions are fragile, informal institutions may **substitute** them.



1. Introduction
2. **Where Do Informal Institutions Come From?**
3. Cultures, Languages, Religions & Ethics
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# Where Do Informal Institutions Come From?




## ■ Understanding the Origin of Informal Institutions

- ❖ ... come from **socially transmitted information** & part of the heritage that we call **culture**.
- ❖ Some cultural values have arisen from **religious origins**.
  - **Cartoons that exploded:** Muslims gathered to protest about depictions of the prophet Mohammed printed by news papers in Denmark.
- ❖ **Ethnocentrism:** Those within a society tend to perceive their own culture as *natural, rational & morally* right.
  - American exceptionalism.
  - *Zhong guo* (Chinese) & *midgaard* (Swedish): ‘Middle kingdom’.
- ❖ How can we distinguish different cultures? (**3** ways)
  - (1) Context, (2) Cluster, (3) Dimension (**See the next slides !**)



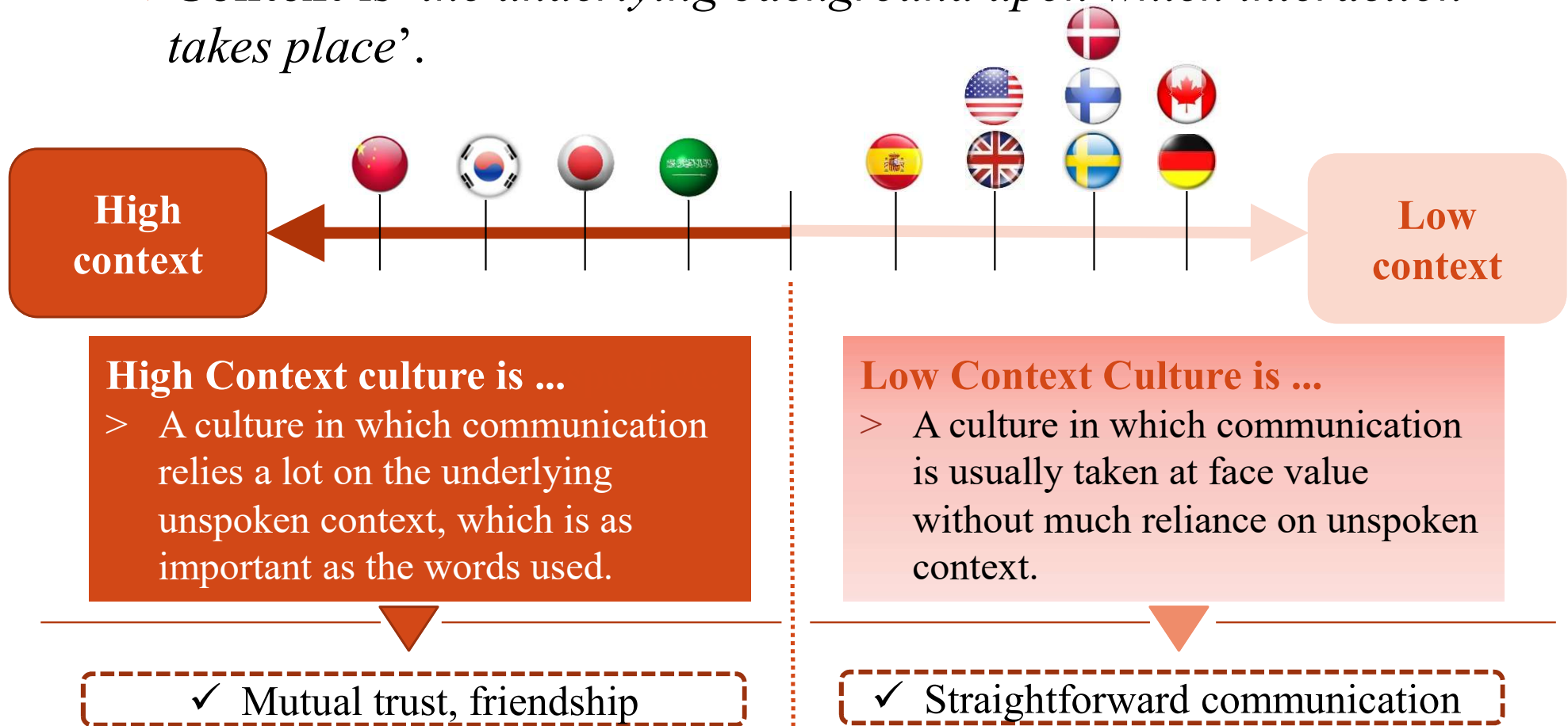


1. Introduction
2. Where Do Informal Institutions Come From?
-  3. **Cultures, Languages, Religions & Ethics**
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## ■ The Context Approach

❖ **Context** is *'the underlying background upon which interaction takes place'*.





## ■ The Cluster Approach

❖ **Cluster:** *Countries that share similar culture together.*

Roman & Shenkar Clusters	GLOBE Clusters	Huntington Civilizations
Anglo	Anglo	Western
Nordic	Nordic Europe	Western
Germanic	Germanic Europe	Western
Latin Europe	Latin Europe	Western
Israel	–	Western
Central & Eastern Europe	Eastern Europe	Slavic-Orthodox
Arabic	Middle East	Islaic
Near Eastern	–	–
India	Southern Asia	Hindu
Sub-Sahara Africa	Sub-Sahara Africa	African
Latin America	Latin America	Latin American
Brazil	–	Latin American
Far East	Confucian Asia	Confucian
Japan	–	Japanese

### KEY POINTS

Why doing business with others within the same cluster?

- > Common histroy
- > Religion
- > Customs
- > Traditions
- > Rules
- > Languages
- > Norms
- > Values

▶ Cultural clusters prevent MNEs from suffering from **the liability of outsidership !**



## ■ The Dimension Approach

❖ There are 2 reasons why the dimension approach (+) is more influential than both the context (–) & cluster (–) approaches !

(–) The **context** approach is to focus only on **one dimension**. What about other dimensions?

(–) The **cluster** approach has relatively **little to offer regarding differences among countries within one cluster**. Differences between Spain & Italy?

❖ Hofstede's dimensions of culture

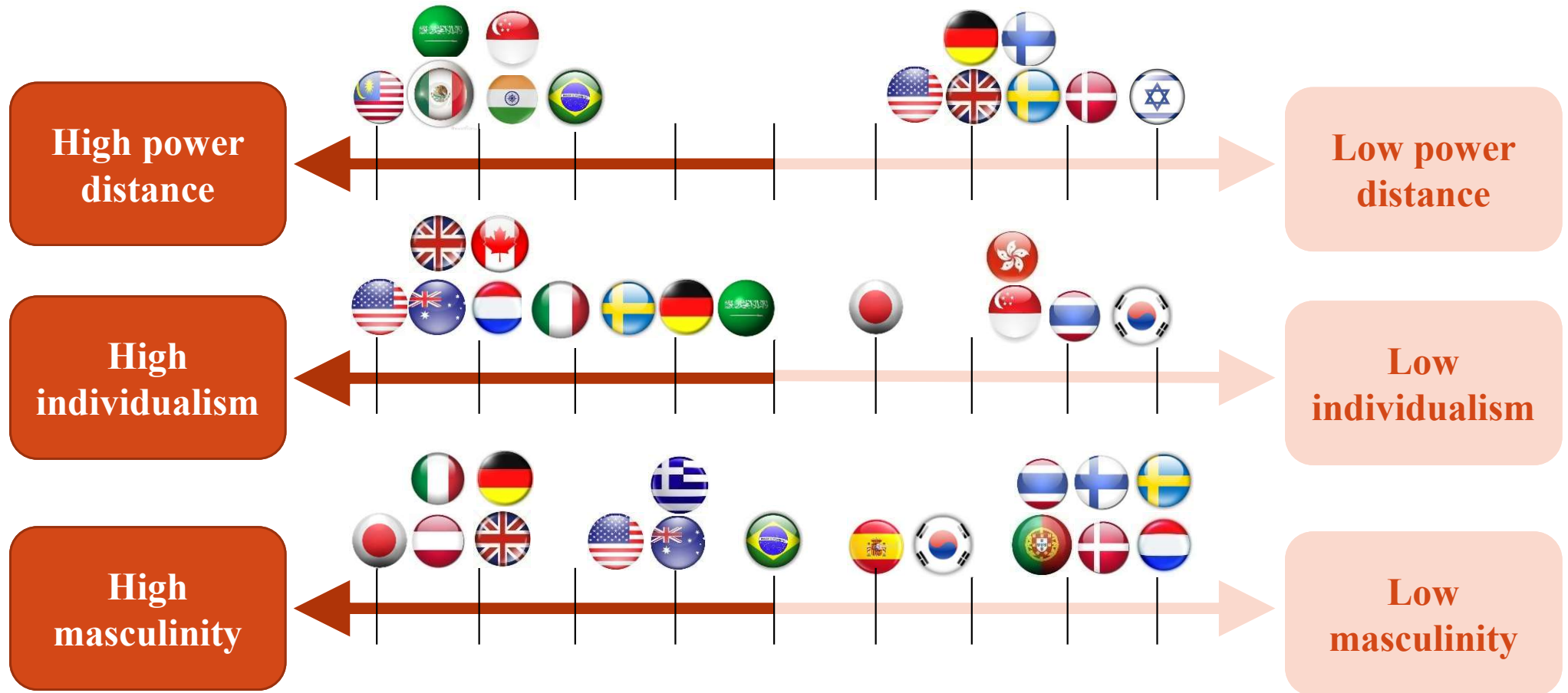
- (1) Power distance
- (2) Individualism
- (3) Masculinity
- (4) Uncertainty avoidance
- (5) Long-term orientation



**Geert Hofstede (02.Oct.1928 -, NED)**  
> Emeritus Professor at Tilburg University  
> IBM's survey (1971)

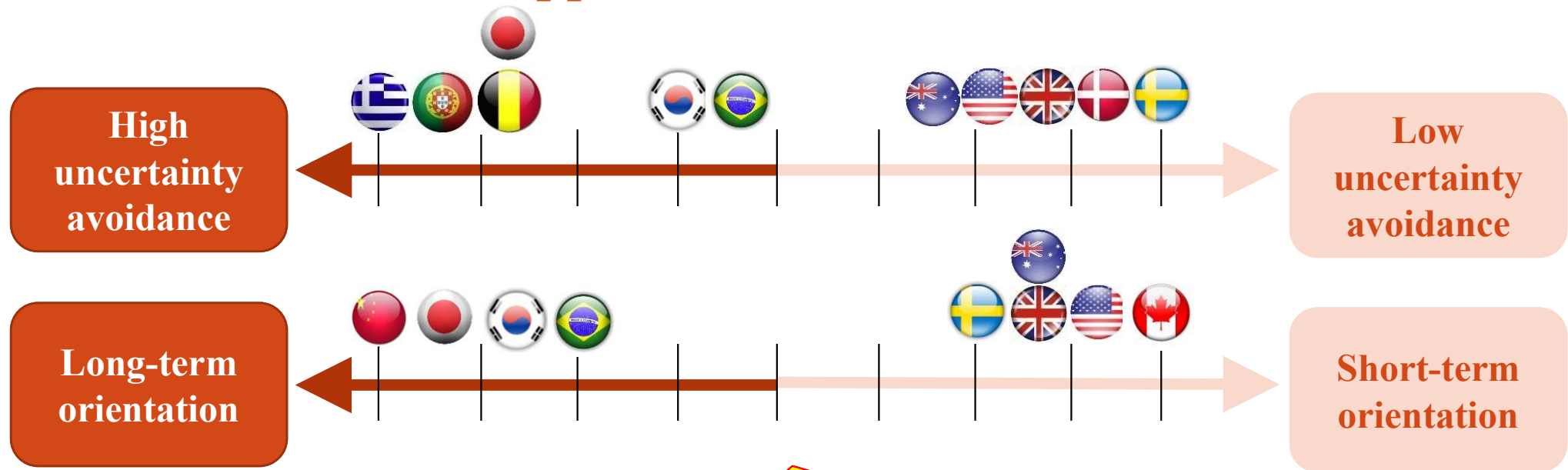


## ■ The Dimension Approach





## ■ The Dimension Approach



## LIMITATIONS

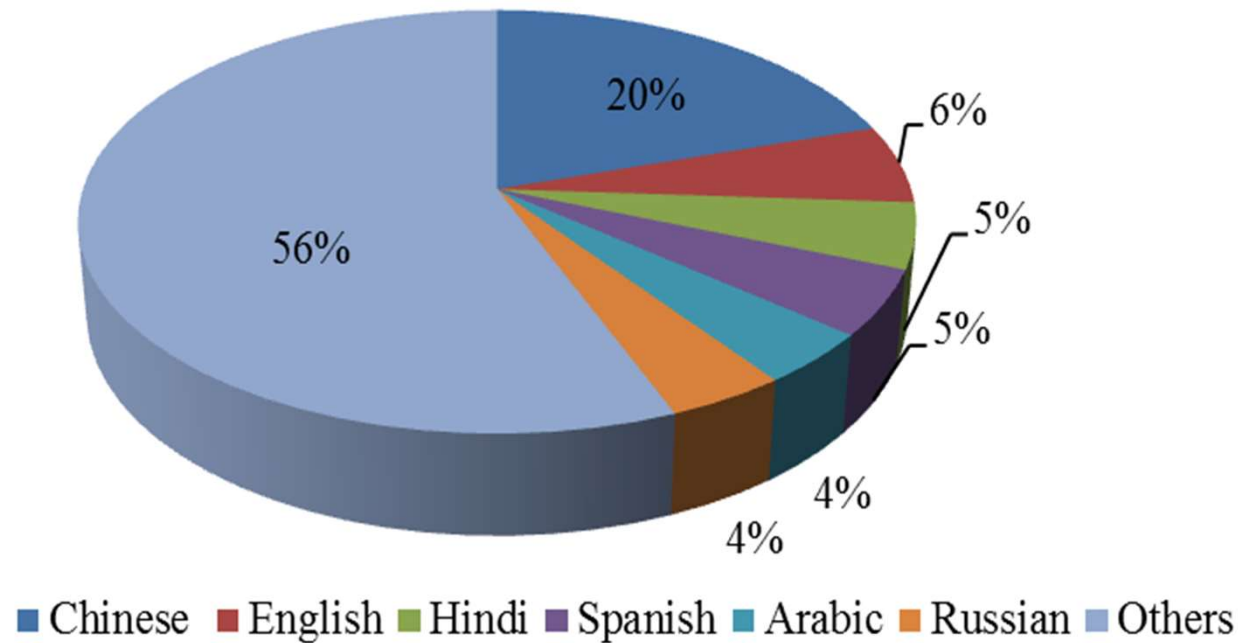
- > ... relied on **a simple analytical tool** for complex & evolving phenomenon in the globe.
- > ... provides **a stereotype**.
- > **Old data**: 116,000 IBM employees working at 72 national subsidiaries during 1967-1973.
- > Variations of norms & values are prevalent and often hard to observe.

# Languages



## ■ Languages are a Major Manifestation of Culture

### DO LANGUAGES MATTER?



### COMMENTS

- > **Chinese** is the world's largest in terms of the number of native speakers.
- > English is a distant second language, followed by **Hindi & Spanish**.
- > **English** is known as the **lingua franca**.
- > Linguistic fluency can be a competitive advantage.
- > **English** as **corporate language**



## Multilinguists in MNEs





## ■ Multilinguists in MNEs

### *Multilinguists in MNEs*

In MNEs, not only top management but technical experts and middle managers have to regularly interact across language barriers when talking to people in other units abroad, or with foreign customers and suppliers. Although MNEs may have an official corporate language, staff in subsidiaries

to be sent to corporate training courses, while head-quarter staff with Spanish language competence were sought out by staff in subsidiaries in Spanish-speaking countries as their primary contact. Shared language thus became a powerful glue in informal networks that facilitated knowledge flows within the MNE.

Multilingual individuals who connect different people in different locations and networks acquire

## Does being bilingual/multilingual boost your employability?

such as Finland. Language competence in the corporate language is thus often a precondition for career advancement. Less obvious, however, is that knowledge of other languages can place individuals in critical bridging positions, to help communicate with each other.

For example, in *Kone Elevators*, a study found that multilinguals often become critical communication intermediaries, which enhances their personal network and their access to knowledge. For example, fluent English speakers in subsidiaries were more likely

opportunities not only by handling specific situations more effectively but by providing new insights and broader awareness about the company and its business partners.

Sources: (1) R. Marschan-Piekkari, D. Welch & L. Welch, 1999, In the shadow: The impact of language on structure, power and communication in the multinational, *IBR*, 8: 421–440; (2) V. Peltokorpi & E. Vaara, 2012, Language policies and practices in wholly owned foreign subsidiaries, *JIBS*, 43(9): 808–833; (3) W. Barner-Rasmussen, M. Ehrnrooth, A. Koveshnikov & K. Mäkelä, 2014, Cultural and language skills as resources for boundary spanning within the MNC, *JIBS*, 45: 886–905.



## ■ Boosting Your Employability

- ❖ Being bilingual/multilingual enhances the rigor of your CV;
- ❖ ...makes you appealing to the eyes of global corporations;
- ❖ ... indicates that you pay respect & appreciation for diversity;
- ❖ ... helps you stand out from the rest in job markets;
- ❖ ... often results in higher salary (*e.g.*, 10-20% salary rise);
- ❖ ... enables you to develop other soft skills (*e.g.*, adaptability, creativity, contextual understanding, empathy, problem-recognition etc.); &
- ❖ ... is important in establishing interpersonal & professional ties.



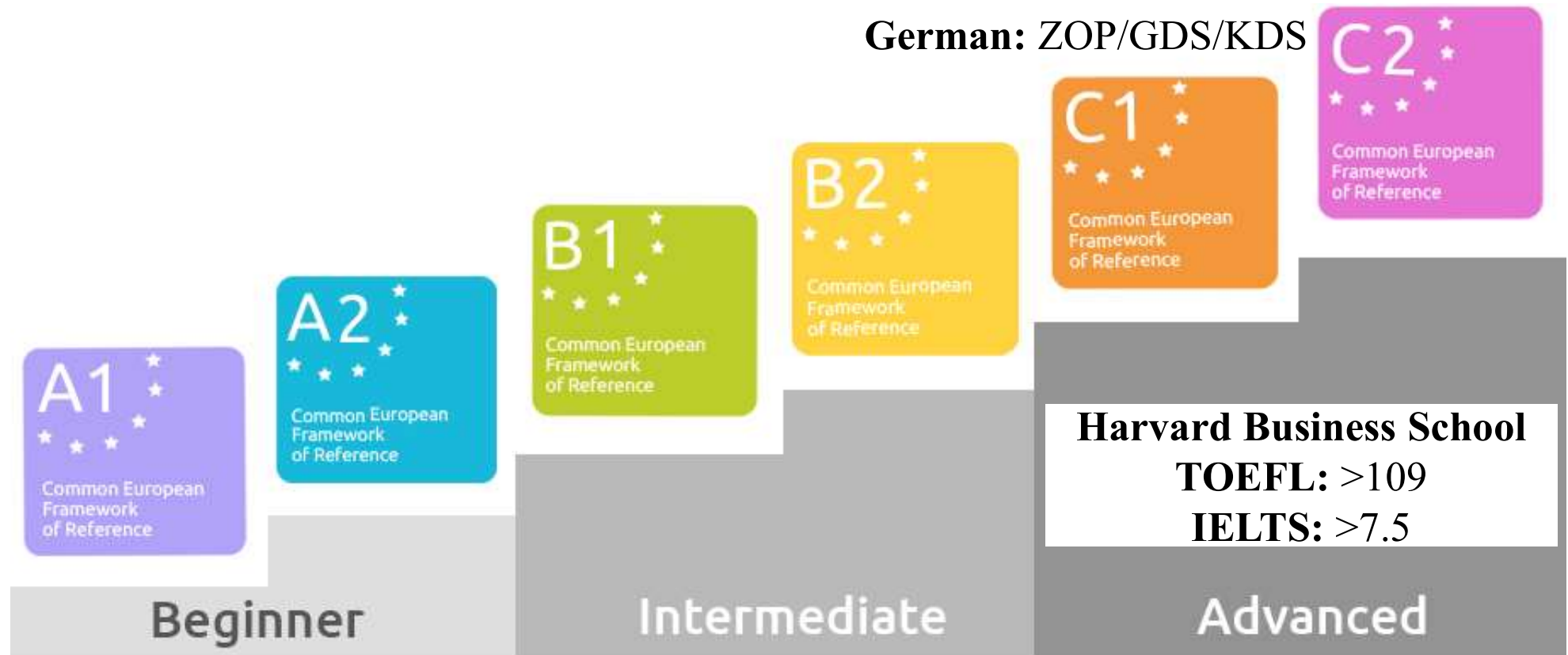
## ■ Common European Framework of Reference for Languages (CEFR)

<<<C2 Level>>>

**English:** IELTS 8.0-9.0

**French:** TCF C2/DALF C2

**German:** ZOP/GDS/KDS

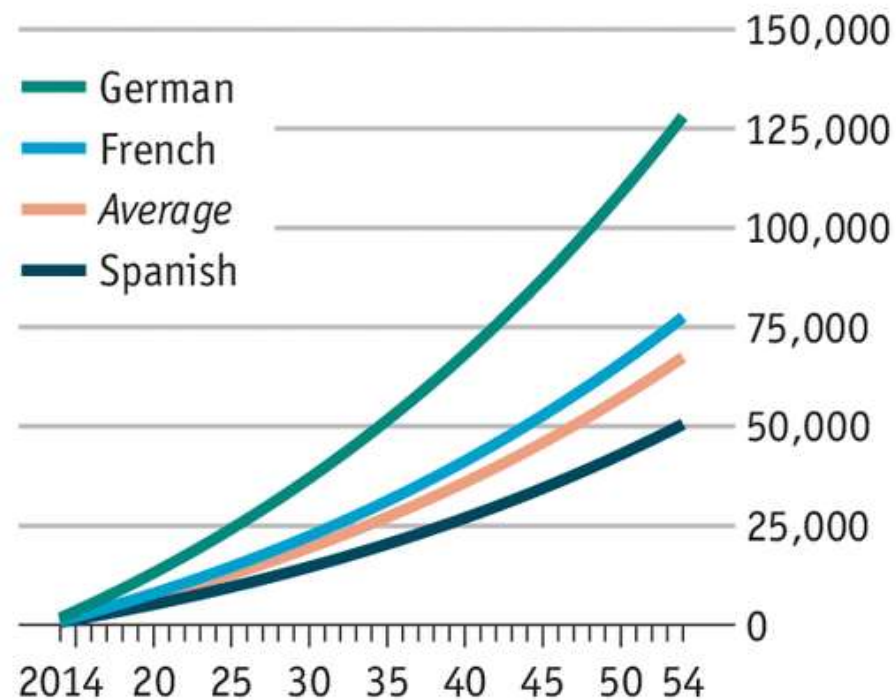




## ■ Impacting Your Annual Bonuses Very Positively

### Accumulated language bonuses

Forecasts, €



Source: *The Economist*



## ■ Improving Your Decision Making & Your Memory

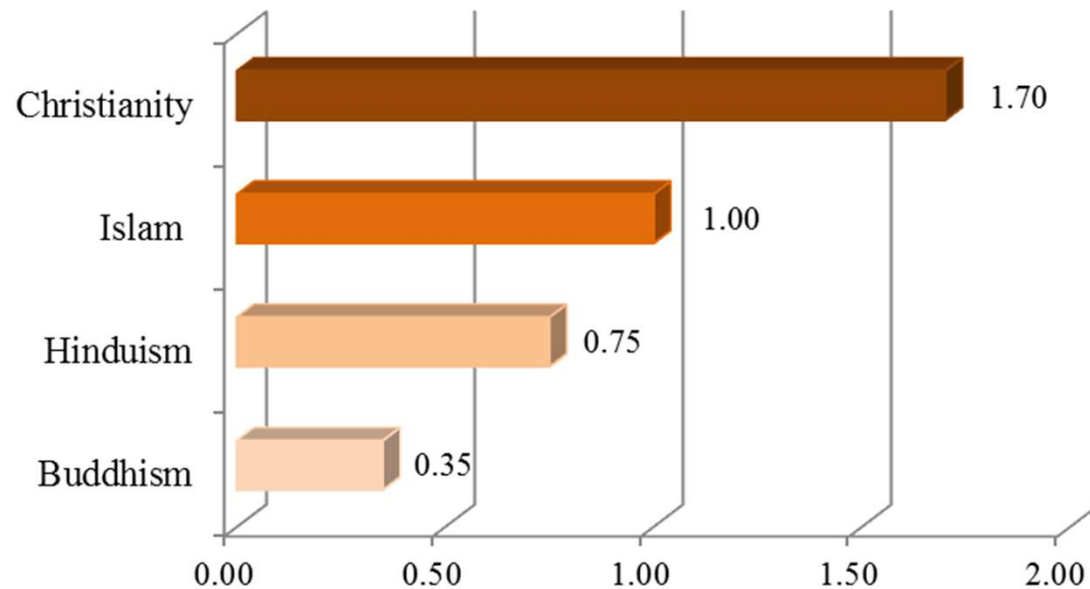


# Religion



## ■ Religion is a Major Manifestation of Culture.

### RELIGION OF THE WORLD (Unit: Billions)



### COMMENTS

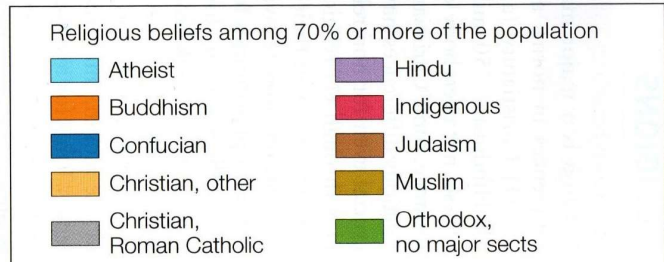
- > How religions affect business? 3 key points !
- > (1) **Religious festivals:** Christmas, Chinese New Year & Ramadan.
- > (2) **Daily & weekly routines vary** (e.g., Muslims interrupt five times a day for prayer.)
- > (3) Religions attach **symbolic value** to certain objects & activities (e.g., cows are holy in Hindu)

✓ **Religious differences** tend to raise emotions, & thus are challenging to handle for business.

# Religion



## ■ Religions by Country





## ■ Definition & Impact of Ethics

- ❖ **Ethics:** The principles, standards & norms of conduct governing individual & firm behavior.
  - ... are **not only** an important part of informal institutions **but also** a deep reflection of formal laws & regulations.
- ❖ **Recent scandals** (e.g., Enron, Olympus, Toshiba) have pushed ethics to the forefront of global business discussion.

## ■ Managing Ethics Overseas

- ❖ ... is challenging since what is ethical in one country may not be unethical elsewhere.
  - **Firing staff** in the USA vs. in Germany & France?
  - **Gift giving** in Western countries vs. in Japan & China?
  - Hiring employees' children & relatives (**nepotism**) in Europe vs. India?





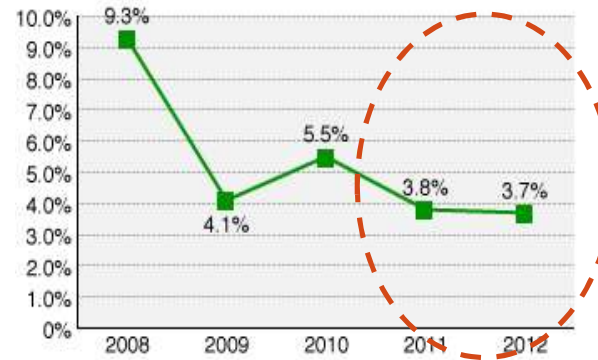
## ■ Olympus Scandal (14 October 2011)



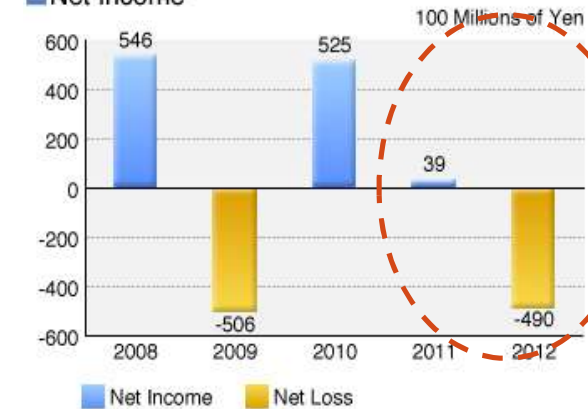
■ ROE



■ ROA



■ Net Income



Source: Olympus website (accessed on 29.01.2013).



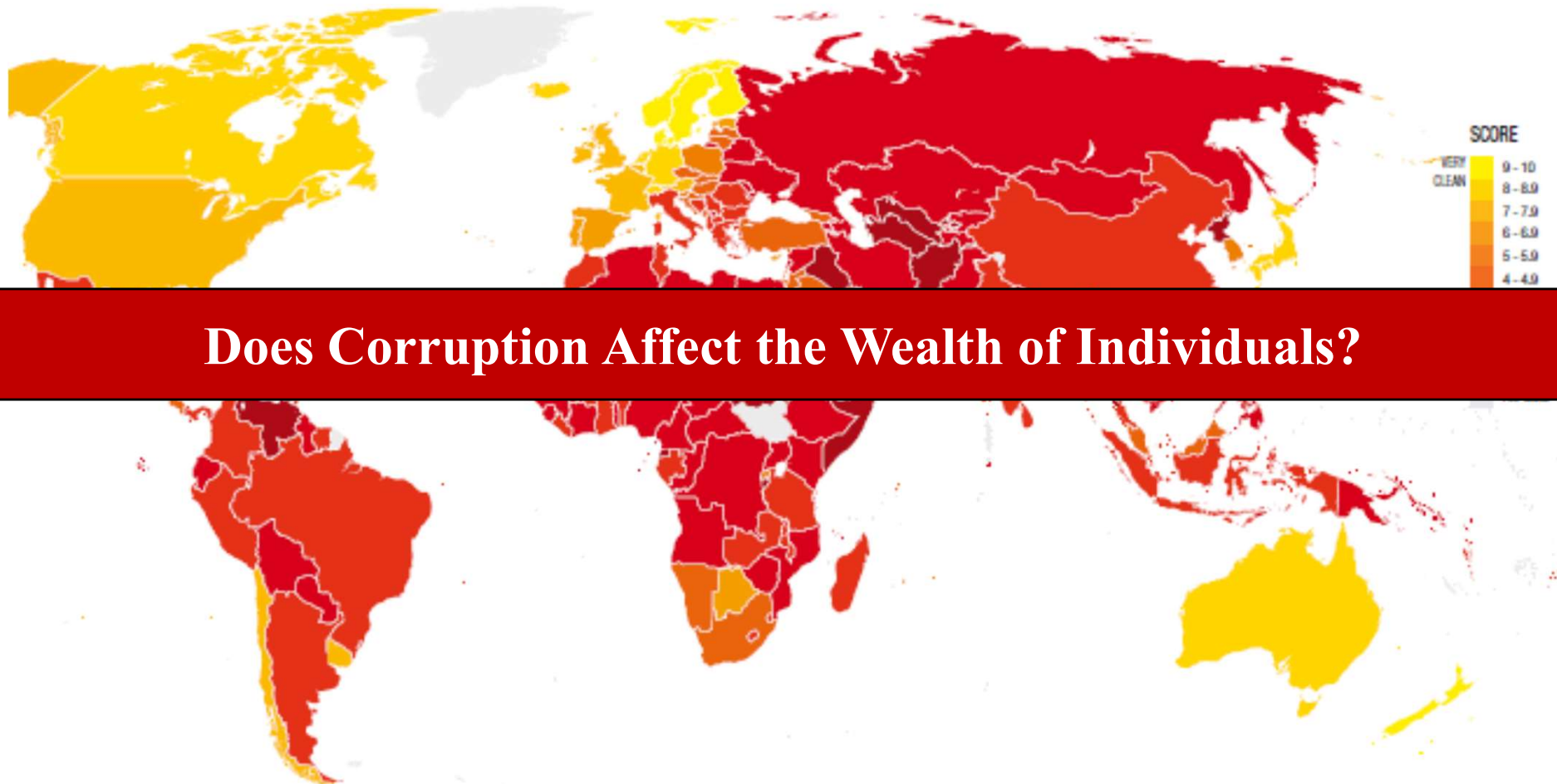
## ■ Toshiba's Billion-Dollar Accounting Scandal



Source: <http://www.economist.com>



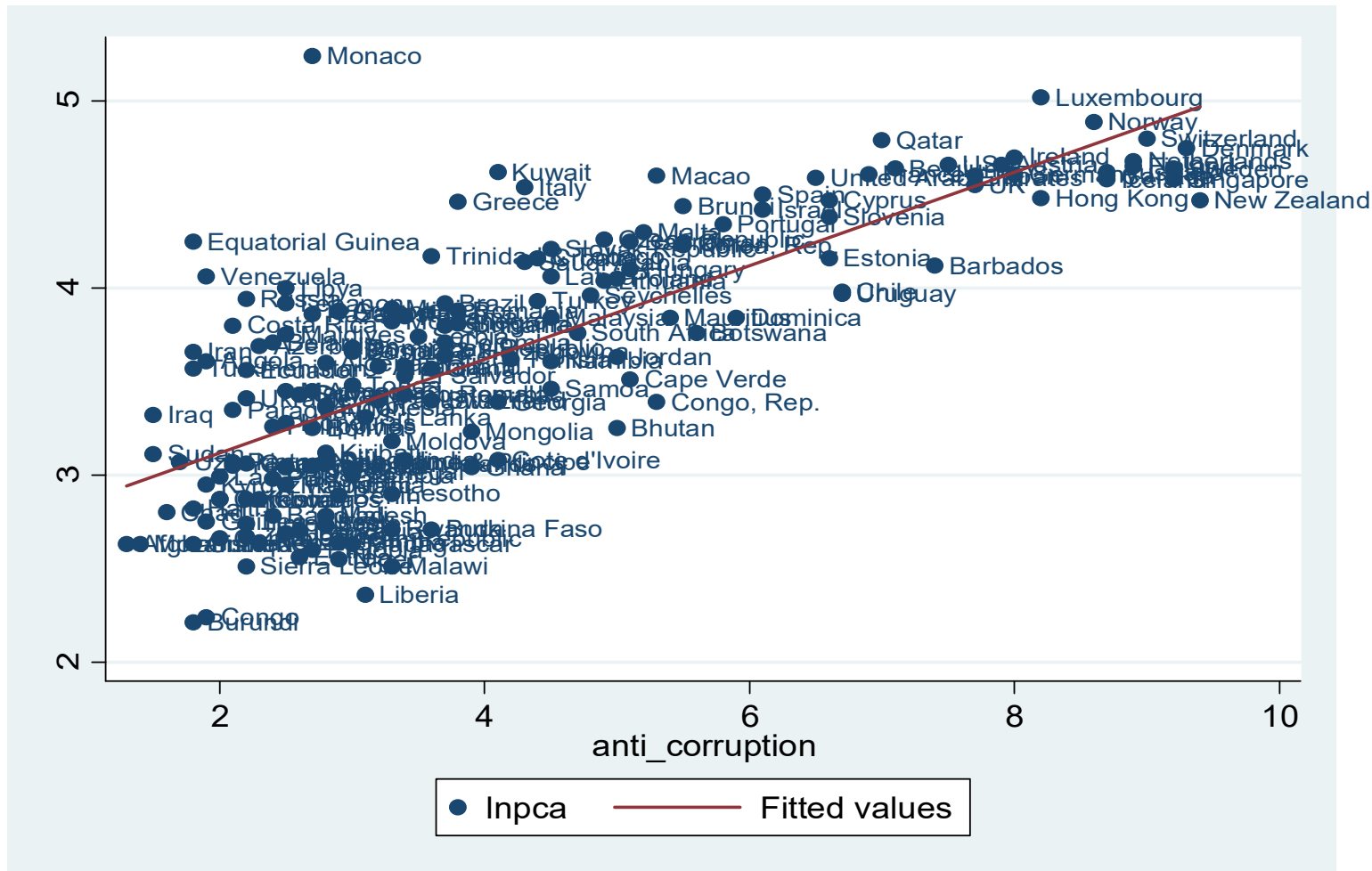
## ■ Corruption Perception Index 2011



Source: Transparency International.



## ■ Does Corruption Affect the Wealth of Individuals?



Source: Own illustration based on the World Bank & Transparency International.



## ■ Why & How Corruption Harms Economic Growth?

❖ **Corruption as a strong constraint on growth & development.**

❖ ... acts as a **major cause of critical problems (-)**:

- Rent seeking;
- An increase of transaction costs & uncertainty;
- Inefficient investments; &
- Misallocation of production factors.

❖ **BUT, ... helps combat various institutional challenges (+)**:

- Cumbersome, lengthy, & complex bureaucratic constraints;
- Inefficient provision of public services; &
- Rigid laws.

**Source:** Murphy et al. (1991), Shleifer & Vishny (1993), Rose-Ackerman (1997), Lui (1985), Lein (1986), Acemoglu & Verdier (2000) & so forth.

# Ghemawat, P. (2001). “Distance Still Matters”



## ■ The Idea in Brief



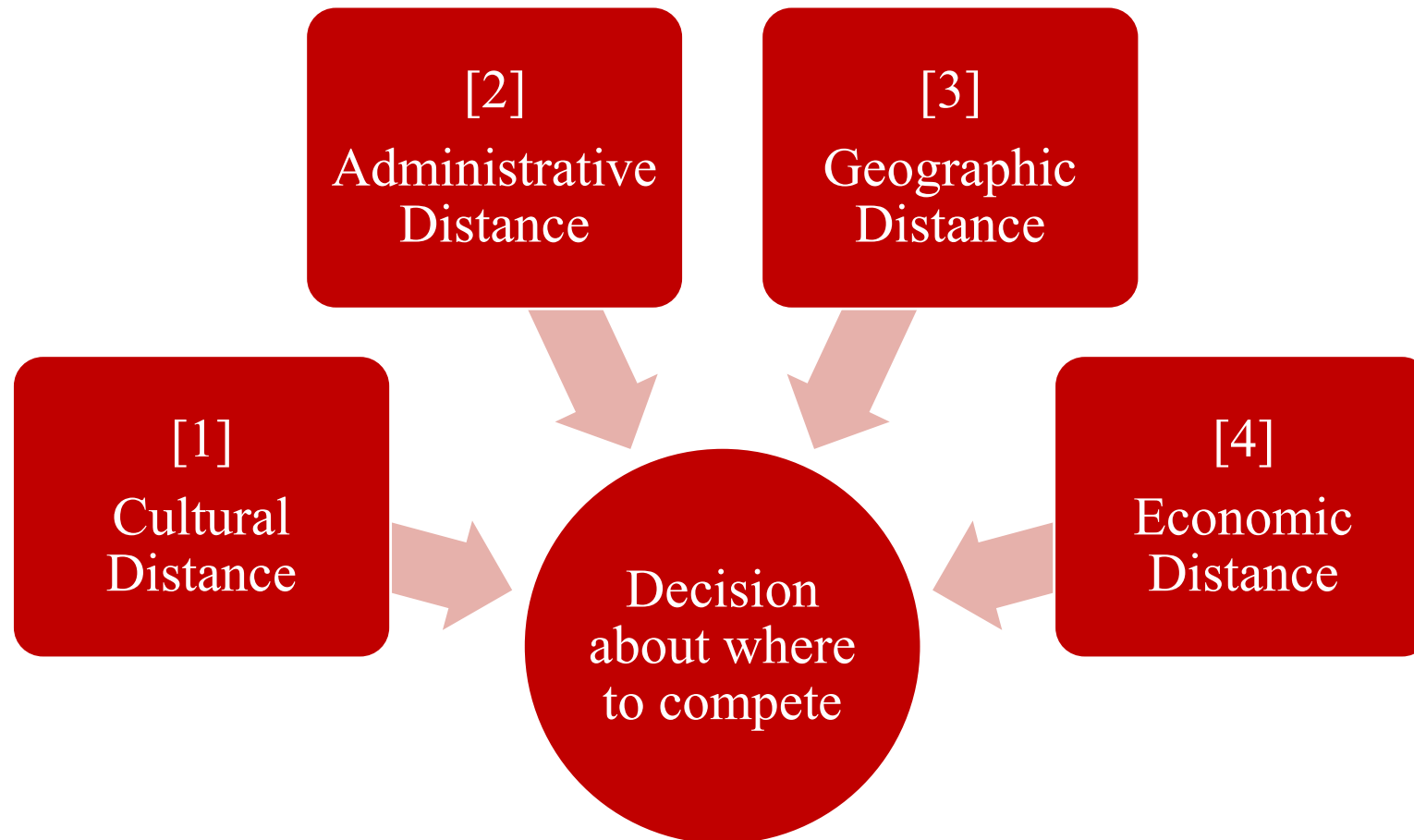
**Pankaj Ghemawat** (born September 30, 1959)

- ▶ Global Professor of Management and Strategy & Director of the Center for the Globalization of Education and Management (the Stern School of Business at New York University)
- ▶ The Anselmo Rubiralta Professor of Global Strategy (IESE Business School)
- ▶ Became the youngest person in the school's history to be appointed a full professor at the Harvard Business School.

*“Information technologies &, in particular, global communications are shrinking the world, turning it into a small & relatively homogeneous place. But when it comes to business, that’s not only an incorrect assumption, it’s a dangerous one. Distance still matters”.*



## ■ The ‘4’ Dimensions of Distance





## ■ How to Calculate “Cultural Distance”?

❖ Example: Distance between Japan & European Countries?

$$CD (GLOBE)_m = \frac{\sum_{i=1}^9 (L_{im} - L_{ij})^2 / V_i}{9}$$

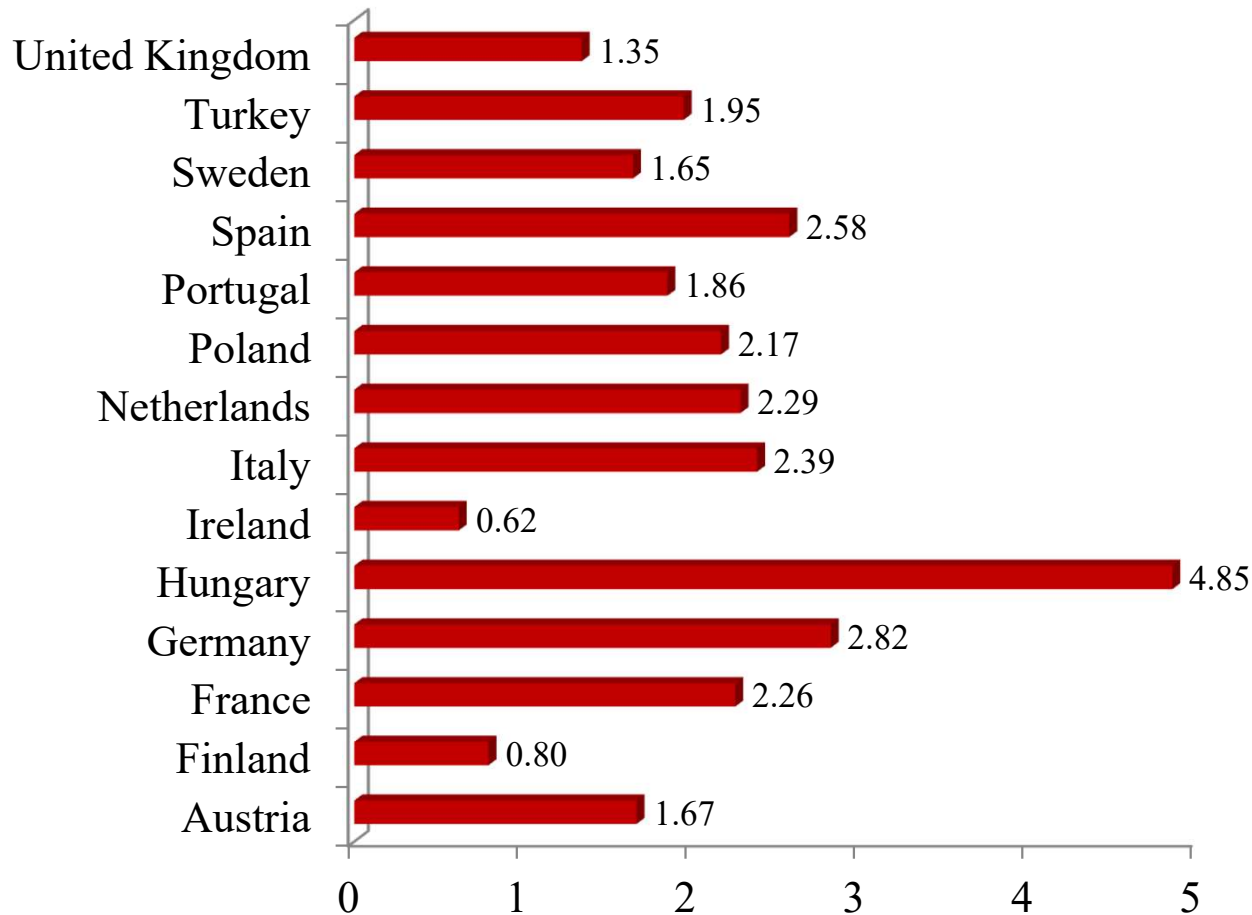
GLOBE’s (2004) national cultural distance index integrates Hofstede’s (1980) national cultural scores in 9 cultural dimensions: (1) assertiveness, (2) institutional collectivism, (3) in-group collectivism, (4) future orientation, (5) gender egalitarianism, (6) human orientation, (7) performance orientation, (8) power distance, & (9) uncertainty avoidance.

**Source:** Kogut & Singh (1988). The Effect of National Culture on the Choice of Entry Mode, *Journal of International Business Studies*, 19(3): 411-432.





## ■ How to Calculate “Cultural Distance”?



### KEY POINTS

- > Which European countries are culturally distanced from Japan?
- > **Ireland** is the culturally closest country to Japan, followed by **Finland** & the **United Kingdom**.
- > **The largest cultural distance between Japan & Hungary** is observed.
- > How can we use this information in the contexts of international business & global strategy?

Source: Own calculation based on Kogut & Singh's (1988) cultural distance index using GLOBE data.



## ■ How to Calculate “Institutional Distance”?

❖ Example: Distance between Japan & European & North American Countries?

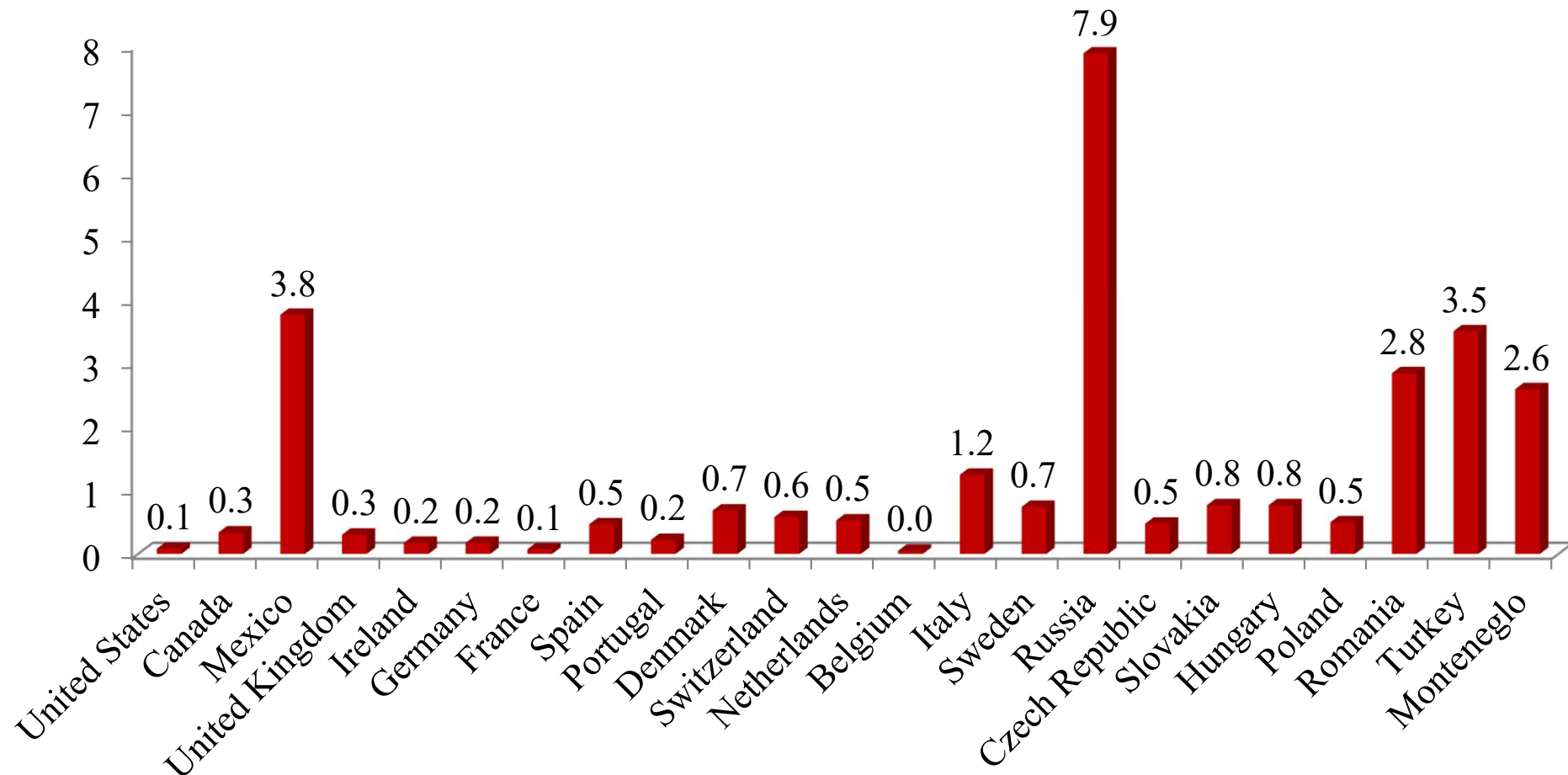
$$\text{Institutional Distance} = \frac{\sum_{i=1}^6 (L_{im} - L_{ij})^2 / V_i}{6}$$

Institutional distance index integrates the 2007 World Bank Governance Indicators in 6 institutional dimensions: (1) voice & accountability, (2) political stability & absence of violence, (3) government effectiveness, (4) regulatory quality, (5) rule of law, & (6) control of corruption.

Source: Kogut & Singh (1988). The Effect of National Culture on the Choice of Entry Mode, *Journal of International Business Studies*, 19(3): 411-432.



## ■ How to Calculate “Institutional Distance”?



Source: Own calculation based on Kogut & Singh's (1988) cultural distance index using GLOBE data.



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## ■ '3' Major Debates

- 1** Units of culture: social groups?

  - > One nation one culture? **NO** (e.g., Germany as Bavarian stereotypes)  
=> Many subcultures coexist within nation states.
  - > Ethnic minorities, religious groups or social strata may develop their own cultures.
  - > A specific organizational culture (e.g., **the IKEA culture**)

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- 2** Cultural convergence vs. divergence?

  - > Convergence toward more 'modern' Western values such as individualism & consumerism.
  - > Strong interests in Western values & brands: Levi-Jeans, Coca-Cola & MTV among
  - > **HOWEVER, cultural values do not change so quickly.**

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- 3** In-group vs. out-group in collective societies?

  - > Collectivists are more collaborative *only* when dealing with their own in-group members.
  - > The flip side is that collectivists discriminate more harshly against out-group.
  - > **No distinction** between in-group & out-group in individualist societies



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# Implications for Practice



## ■ For Managers

- ❖ It is important to enhance **cultural intelligence** (1. *awareness*, 2. *knowledge*, 3. *skills*) leading to cross-cultural literacy.
- ❖ It is crucial to understand & adapt to **changing norms globally**.
- ❖ **Respect for local cultures** will often get you along way.

## ■ For Students

- ❖ Further invest in their own career by:
  - Picking up & master one or several foreign languages;
  - Spending a semester abroad or internship opportunities; &
  - Reaching out to make some international friends who are taking classes with you. => Your international friends can be your future key business contacts.

# Reading Assignments

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## ■ Firm Resources: Competitiveness & Growth

❖ “*SAP Drives Industry 4.0*”. (pp. 88-90 in P&M).

❖ “*Lego’s Secrets*” (pp. 111-112 in P&M).

➔ Please make sure that you understand the content of these articles & summarize your opinions.



# The End of Today's Lecture



ご清聴有難う御座いました。

**Thank you so much!**

**Vielen Dank für Ihre Aufmerksamkeit!**

**Grazie mille !**

## **【Contact Address】**

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