

## Chapter 2—Understanding Politics, Laws, & Economics

### TRUE/FALSE

1. Formal and informal policies are popularly known as "the rules of the game."

ANS: T                      PTS: 1                      DIF: Moderate                      REF: p. 20  
 OBJ: 2.1                      NAT: AACSB: Tier 1 Communication | Tier 2 Legal Responsibilities

2. Two "pillars"—the regulatory and the normative pillar—support informal institutions.

ANS: F                      PTS: 1                      DIF: Easy                      REF: p. 21  
 OBJ: 2.1                      NAT: AACSB: Tier 1 Reflective Thinking | Tier 2 Legal Responsibilities

3. Informal institutions include laws, regulations, and rules.

ANS: F                      PTS: 1                      DIF: Easy                      REF: p. 21  
 OBJ: 2.1                      NAT: AACSB: Tier 1 Communication | Tier 2 Legal Responsibilities

4. An important source of transaction cost is opportunism, defined as seeking self-interest with guile.

ANS: T                      PTS: 1                      DIF: Moderate                      REF: p. 22  
 OBJ: 2.2                      NAT: AACSB: Tier 1 Analytic | Tier 2 Strategy

5. Institutional transactions in countries such as China, Poland, Russia, Brazil, India and South Africa create both huge challenges and tremendous opportunities for domestic and international firms.

ANS: T                      PTS: 1                      DIF: Moderate                      REF: p. 22  
 OBJ: 2.2                      NAT: AACSB: Tier 1 Diversity | Tier 2 Environmental Influences

6. In the IT industry in China and India, managers do not have to excel in the game of market responsiveness and innovation because the rules of the game are defined by the global heavyweights.

ANS: F                      PTS: 1                      DIF: Difficult                      REF: p. 22  
 OBJ: 2.3                      NAT: AACSB: Tier 1 Technology | Tier 2 Information Technology

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

ANS: T                      PTS: 1                      DIF: Moderate                      REF: p. 23  
 OBJ: 2.3                      NAT: AACSB: Tier 1 Reflective Thinking | Tier 2 Legal Responsibilities

8. Democracy was pioneered by the Athenians in ancient Greece.

ANS: T                      PTS: 1                      DIF: Easy                      REF: p. 24  
 OBJ: 2.4                      NAT: AACSB: Tier 1 Communication | Tier 2 Environmental Influences

9. South Africa, South Korea, Taiwan, and most Latin American countries practice communist totalitarianism.

ANS: F                      PTS: 1                      DIF: Moderate                      REF: p. 24  
 OBJ: 2.4                      NAT: AACSB: Tier 1 Diversity | Tier 2 Environmental Influences

10. Totalitarian countries often experience wars, riots, protests, chaos, and breakdowns, resulting in higher political risk.
- ANS: T                      PTS: 1                      DIF: Easy                      REF: p. 24  
OBJ: 2.4                      NAT: AACSB: Tier 1 Diversity | Tier 2 Group Dynamics
11. Firms operating in democracies almost never confront political risk.
- ANS: F                      PTS: 1                      DIF: Moderate                      REF: p. 25  
OBJ: 2.3                      NAT: AACSB: Tier 1 Communication | Tier 2 Legal Responsibilities
12. Common law is "the oldest, the most influential and the most widely distributed around the world."
- ANS: F                      PTS: 1                      DIF: Moderate                      REF: p. 25  
OBJ: 2.5                      NAT: AACSB: Tier 1 Analytic | Tier 2 Legal Responsibilities
13. Civil law is derived from Roman law and was strengthened by Napoleon's France.
- ANS: T                      PTS: 1                      DIF: Moderate                      REF: p. 25  
OBJ: 2.5                      NAT: AACSB: Tier 1 Analytic | Tier 2 Legal Responsibilities
14. Iran and Saudi Arabia are common law countries.
- ANS: F                      PTS: 1                      DIF: Moderate                      REF: p. 26  
OBJ: 2.5                      NAT: AACSB: Tier 1 Diversity | Tier 2 Environmental Influences
15. The single most important source of funds for new start-ups in the United States is the mortgage of entrepreneurs' houses.
- ANS: T                      PTS: 1                      DIF: Difficult                      REF: p. 26  
OBJ: 2.6                      NAT: AACSB: Tier 1 Reflective Thinking | Tier 2 Motivation Concepts
16. Intellectual property rights (IPRs) include rights associated with patents, trademarks, and copyrights.
- ANS: T                      PTS: 1                      DIF: Easy                      REF: p. 27  
OBJ: 2.6                      NAT: AACSB: Tier 1 Communication | Tier 2 Operations Management
17. The "invisible hand" of market forces noted by Adam Smith in the *Wealth of Nations* in 1776 characterizes a pure market economy.
- ANS: T                      PTS: 1                      DIF: Moderate                      REF: p. 27  
OBJ: 2.7                      NAT: AACSB: Tier 1 Analytic | Tier 2 Creation of Value
18. The economic system of most countries is a market economy.
- ANS: F                      PTS: 1                      DIF: Moderate                      REF: p. 28  
OBJ: 2.7                      NAT: AACSB: Tier 1 Communication | Tier 2 Legal Responsibilities
19. Managers considering working abroad should have a thorough understanding of the formal institutions before entering a country.
- ANS: T                      PTS: 1                      DIF: Easy                      REF: p. 30  
OBJ: 2.8                      NAT: AACSB: Tier 1 Analytic | Tier 2 Leadership Principles

20. More than 40% of Africa's economy is reportedly informal, the highest proportion in the world.

ANS: T                      PTS: 1                      DIF: Difficult                      REF: p. 30  
OBJ: 2.7                      NAT: AACSB: Tier 1 Analytic | Tier 2 Creation of Value

### MULTIPLE CHOICE

1. An institutional framework is made up of:
- Regulatory and cognitive pillars
  - Formal and informal institutions
  - The political, economic, and legal systems of countries
  - None of these answers

ANS: B                      PTS: 1                      DIF: Moderate                      REF: p. 20  
OBJ: 2.1                      NAT: AACSB: Tier 1 Reflective Thinking | Tier 2 Legal Responsibilities

2. The main supportive pillar(s) for informal institutions is/are:
- Normative and cognitive
  - Regulatory (coercive)
  - Regulatory, normative, and cognitive
  - Cognitive

ANS: A                      PTS: 1                      DIF: Moderate                      REF: p. 21  
OBJ: 2.1                      NAT: AACSB: Tier 1 Analytic | Tier 2 Legal Responsibilities

3. \_\_\_\_ refers to the internalized, taken-for-granted values and beliefs that guide individual and firm behavior.
- Normative pillar
  - Regulatory pillar
  - Cognitive pillar
  - None of these answers

ANS: C                      PTS: 1                      DIF: Moderate                      REF: p. 21  
OBJ: 2.1                      NAT: AACSB: Tier 1 Analytic | Tier 2 Legal Responsibilities

4. \_\_\_\_ are defined as "fundamental and comprehensive changes introduced to the formal and informal rules of the game that affect organizations as players."
- Opportunities
  - Transaction costs
  - Institutional transitions
  - Costs of doing business

ANS: C                      PTS: 1                      DIF: Difficult                      REF: p. 20  
OBJ: 2.2                      NAT: AACSB: Tier 1 Communication | Tier 2 Strategy

5. The institution-based view of global business focuses on the dynamic interaction among:
- Institutions
  - Firms
  - Firm behaviors
  - All of these answers

ANS: D                      PTS: 1                      DIF: Easy                      REF: p. 22  
OBJ: 2.3                      NAT: AACSB: Tier 1 Analytic | Tier 2 Group Dynamics

6. Democracy is defined as a(n) \_\_\_\_ in which citizens elect representatives to govern the country on their behalf.
- Economic system
  - Legal system
  - Political system
  - Emerging economy

ANS: C                      PTS: 1                      DIF: Easy                      REF: p. 24

OBJ: 2.4 NAT: AACSB: Tier 1 Communication | Tier 2 Legal Responsibilities

7. \_\_\_\_ had been embraced throughout Central and Eastern Europe and the former Soviet Union until the late 1980s.
- Communist totalitarianism
  - Theocratic totalitarianism
  - Tribal totalitarianism
  - Right-wing totalitarianism

ANS: A PTS: 1 DIF: Moderate REF: p. 24  
OBJ: 2.4 NAT: AACSB: Tier 1 Diversity | Tier 2 Legal Responsibilities

8. Political risk is associated with political changes that may negatively impact domestic and foreign firms. Which statement about political risk is correct?
- Political risk only exists in communist countries.
  - Firms operating in democracies never confront political risk.
  - Firms operating in democracies are subject to political risk.
  - Political risk is a myth.

ANS: C PTS: 1 DIF: Moderate REF: p. 24  
OBJ: 2.4 NAT: AACSB: Tier 1 Reflective Thinking | Tier 2 Legal Responsibilities

9. More than 80 countries practice:
- Common law
  - Civil law
  - Theocratic law
  - Social democracy

ANS: B PTS: 1 DIF: Difficult REF: p. 25  
OBJ: 2.5 NAT: AACSB: Tier 1 Communication | Tier 2 Environmental Influences

10. Civil law is derived from:
- Greek law
  - Roman law
  - Latin law
  - None of these answers

ANS: B PTS: 1 DIF: Moderate REF: p. 25  
OBJ: 2.5 NAT: AACSB: Tier 1 Communication | Tier 2 Legal Responsibilities

11. Civil law can be best described by which of the following statements?
- It is the oldest, most influential, and most widely distributed law around the world.
  - It is English in origin and shaped by precedents and traditions from previous judicial decisions.
  - It is based on religious beliefs.
  - It has more flexibility because judges have to resolve specific disputes based on their interpretation of the law.

ANS: A PTS: 1 DIF: Moderate REF: p. 25  
OBJ: 2.5 NAT: AACSB: Tier 1 Reflective Thinking | Tier 2 Legal Responsibilities

12. Jewish and Islamic law are examples of:
- Common law
  - Theocratic law
  - Civil law
  - Quasi-democracy

ANS: B PTS: 1 DIF: Easy REF: p. 25  
OBJ: 2.5 NAT: AACSB: Tier 1 Diversity | Tier 2 Environmental Influences

13. \_\_\_\_ are defined as rights associated with the ownership of intellectual property.
- Patents
  - Copyrights
  - Trademarks
  - Intellectual property rights

ANS: D                      PTS: 1                      DIF: Easy                      REF: p. 27  
OBJ: 2.6                      NAT: AACSB: Tier 1 Analytic | Tier 2 Legal Responsibilities

14. IPRs primarily include rights associated with:
- a. Copyrights
  - b. Patents
  - c. Trademarks
  - d. All of these answers

ANS: D                      PTS: 1                      DIF: Moderate                      REF: p. 27  
OBJ: 2.6                      NAT: AACSB: Tier 1 Analytic | Tier 2 Legal Responsibilities

15. \_\_\_\_ are exclusive legal rights of firms to use specific names, brands, and designs to differentiate their products from others.
- a. Patents
  - b. Trademarks
  - c. Copyrights
  - d. Intellectual property rights

ANS: B                      PTS: 1                      DIF: Moderate                      REF: p. 27  
OBJ: 2.6                      NAT: AACSB: Tier 1 Communication | Tier 2 Legal Responsibilities

16. A pure market economy characterized by the "invisible hand" of market forces is noted by:
- a. John Stuart Mill
  - b. Adam Smith
  - c. Aristotle
  - d. Amartya Sen

ANS: B                      PTS: 1                      DIF: Difficult                      REF: p. 27  
OBJ: 2.7                      NAT: AACSB: Tier 1 Reflective Thinking | Tier 2 Creation of Value

17. The government taking a "hands-off approach" is known as:
- a. *Laissez faire*
  - b. Command economy
  - c. Mixed economy
  - d. Liberal approach

ANS: A                      PTS: 1                      DIF: Easy                      REF: p. 27  
OBJ: 2.7                      NAT: AACSB: Tier 1 Analytic | Tier 2 Legal Responsibilities

18. A pure command economy is:
- a. Characterized by the "invisible hand" of market forces.
  - b. Defined by a government taking the "commanding height" in the economy.
  - c. Characterized by a government that only performs functions the private sector cannot perform.
  - d. Characterized by innovation and entrepreneurial activities.

ANS: B                      PTS: 1                      DIF: Moderate                      REF: p. 27  
OBJ: 2.7                      NAT: AACSB: Tier 1 Reflective Thinking | Tier 2 Legal Responsibilities

19. The "division of labor" thesis was first advanced by:
- a. Adam Smith
  - b. Douglass North
  - c. Max Weber
  - d. Francis Fukuyama

ANS: A                      PTS: 1                      DIF: Difficult                      REF: p. 30  
OBJ: Debate                      NAT: AACSB: Tier 1 Communication | Tier 2 Ethical Responsibilities

20. The world's largest democracy is:
- a. United States
  - b. China
  - c. India
  - d. Western Europe

ANS: C                      PTS: 1                      DIF: Moderate                      REF: p. 24  
OBJ: Debate                      NAT: AACSB: Tier 1 Communication | Tier 2 Legal Responsibilities

## ESSAY

1. Identify the basic characteristics of formal and informal institutions.

ANS:

An institutional framework is made up of formal and informal institutions governing individual and firm behavior. Formal institutions include laws, regulations, and rules. Their primary supportive pillar, the regulatory pillar, is the coercive power of governments. Informal institutions include norms, cultures, and ethics. There are two main supportive pillars: normative and cognitive. The normative pillar refers to how values, beliefs, and actions of other relevant players—collectively known as norms—influence the behavior of focal individuals and firms. For firms doing business abroad, formal and informal institutional forces primarily stem from home countries and host countries, but international and regional organizations such as the WTO, IMF, and EU may also influence firm conduct in terms of do's and don'ts.

PTS: 1                      DIF: Moderate              REF: pp. 20-21              OBJ: 2.1  
NAT: AACSB: Tier 1 Communication | Tier 2 Legal Responsibilities

2. Define the two core propositions of the institution-based view.

ANS:

The first core proposition of the institution-based view is that managers and firms rationally pursue their interests and make choices within the formal and informal constraints in a given institutional framework. The second proposition is that formal and informal institutions combine to govern firm behavior. In situations where formal constraints are unclear or fail, informal constraints will play a larger role in reducing uncertainty and providing constancy to managers and firms.

PTS: 1                      DIF: Moderate              REF: pp. 22-23              OBJ: 2.3  
NAT: AACSB: Tier 1 Analytic | Tier 2 Strategy

3. Outline the differences between democracy and totalitarianism.

ANS:

Democracy is a political system in which citizens elect representatives to govern the country on their behalf. A fundamental aspect of democracy that is relevant to the effective conduct of global business is an individual's right to freedom of expression and organization. Democracy was pioneered in Athens in ancient Greece. Totalitarianism is a political system in which one person or party exercises absolute political control over the population. A totalitarian regime can also be known as a dictatorship.

PTS: 1                      DIF: Moderate              REF: p. 24                      OBJ: 2.4  
NAT: AACSB: Tier 1 Analytic | Tier 2 Legal Responsibilities

4. Discuss totalitarianism and outline the four major types of totalitarianism.

ANS:

Communist totalitarianism centers on a communist party. This system had been embraced throughout Central and Eastern Europe and the former Soviet Union until the late 1980s. It is still practiced in China, Cuba, North Korea, and Vietnam.

Right-wing totalitarianism is characterized by its intense hatred of communism. One party, typically backed by the military, restricts political freedom, arguing that such freedom would lead to communism. In the postwar decades, South Africa, South Korea, Taiwan, and most Latin American countries practiced right-wing totalitarianism. Most of these countries have recently become democratic.

Theocratic totalitarianism refers to the monopolization of political power in the hands of one religious party or group. Iran and Saudi Arabia are leading examples.

Tribal totalitarianism refers to one tribe or ethnic group monopolizing political power and oppressing other tribes or ethnic groups.

PTS: 1                    DIF: Difficult            REF: pp. 24-25            OBJ: 2.4  
NAT: AACSB: Tier 1 Communication | Tier 2 Legal Responsibilities

5. Compare and contrast civil law, common law, and theocratic law.

ANS:

Civil law is the oldest, most influential, and most widely distributed legal system around the world. It uses comprehensive statutes and codes as a primary means to form legal judgments. More than 80 countries practice civil law.

Precedents and traditions from previous judicial decisions shape common law, which is English in origin. Common law has more flexibility because judges have to resolve specific disputes based on their interpretation of the law, and such interpretation may give new meaning to the law. Contracts in common law countries tend to be long and detailed to cover all possible contingencies because common law tends to be relatively underdefined.

Civil law has less flexibility because judges only have the power to apply the law. Contracts in civil law countries are usually shorter and less specific because many issues typically articulated in common law contracts are already covered in comprehensive civil law codes.

Theocratic law is a legal system based on religious teachings. Examples include Islamic and Jewish laws. Islamic law is the only surviving example of a theocratic legal system formally practiced by some governments, such as Iran and Saudi Arabia.

PTS: 1                    DIF: Moderate            REF: pp. 25-26            OBJ: 2.5  
NAT: AACSB: Tier 1 Reflective Thinking | Tier 2 Legal Responsibilities

6. Describe the differences among the three economic systems.

ANS:

A pure market economy is characterized by an "invisible hand" of market forces noted by Adam Smith in the *Wealth of Nations* in 1776. The government takes a hands-off approach known as *laissez faire*. The government only performs functions the private sector cannot perform.

A pure command economy is defined by a government taking, in the words of Lenin, the "commanding height" in the economy. All factors of production should be government- or state-owned and controlled, and all supply, demand, and pricing are planned by the government.

A mixed economy has elements of both a market and command economy. It boils down to the relative distribution of market forces versus command forces.

PTS: 1                    DIF: Moderate            REF: pp. 27-28            OBJ: 2.7

NAT: AACSB: Tier 1 Analytic | Tier 2 Strategy