Seminar 2 — Institutions, Politics and Culture

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Companion to the Day 2 lecture — ANSWER KEY

Scope. Lecture material only: institutions and income (correlation vs causation); political risk and how it changed shape (from expropriation to regulation); the political-ideology spectrum; sanctions and weaponised interdependence; legal systems and legal origins; ethics, corruption and extraterritorial law (FCPA); national culture (Hofstede, Trompenaars) and institutional voids; and Porter's single/double diamond of national competitiveness.

Part 1. Multiple choice (10 questions)

Choose the single best answer.

1. The risk of **unanticipated actions** by a host country's government or courts against a multinational is called:

(a) exchange-rate risk
(b) political risk
(c) liquidity risk
(d) operational risk

Answer. (b). Political risk = adverse, unanticipated host-government/legal action affecting the firm.

2. Modern political risk has largely shifted from "taking the firm" to "rewriting its terms." This means the dominant form is now:

(a) outright expropriation/nationalisation
(b) creeping/regulatory risk (taxes, local-content rules, licence changes)
(c) currency inconvertibility only
(d) terrorism only

Answer. (b). Expropriation is rarer; the common form is regulatory/"creeping" expropriation that changes the rules after the firm has sunk capital.

3. Under WTO rules, when a country faces **dumping** by foreign exporters it may:

(a) do nothing
(b) impose an anti-dumping duty if injury is shown
(c) nationalise the exporter
(d) leave the WTO

Answer. (b). The WTO permits anti-dumping duties where dumping causes (or threatens) material injury to a domestic industry.

4. The "**legal origins**" literature finds that, on average, **common-law** countries have:

(a) weaker investor protection and shallower markets
(b) stronger minority-investor protection and deeper equity markets
(c) no relationship to finance
(d) state ownership of all banks

Answer. (b). Common-law systems tend to protect outside investors more, supporting deeper, more dispersed equity markets (La Porta et al.).

5. The US **Foreign Corrupt Practices Act** (and similar laws) is notable because it applies:

(a) only inside the United States
(b) extraterritorially — to conduct abroad connected to the jurisdiction
(c) only to state-owned firms
(d) only to imports

Answer. (b). Extraterritorial reach means bribery abroad can be prosecuted at home — a legal-environment risk that travels with the firm.

6. In Hofstede's framework, a society scoring **high on power distance** tends to:

(a) reject hierarchy and expect flat organisations
(b) accept unequal distribution of power and clear hierarchy
(c) avoid all uncertainty
(d) be highly individualist by definition

Answer. (b). High power distance = greater acceptance of hierarchical, unequal authority; it shapes management style and structure choices.

7. The strong cross-country **correlation between institutions and income** cannot by itself prove causation because:

(a) the data are wrong
(b) richer countries can afford better institutions (reverse causation) and both may be driven by omitted factors
(c) institutions never matter
(d) income is unmeasurable

Answer. (b). Reverse causation and omitted variables; identification needs natural experiments/instruments (e.g. settler-mortality-type designs).

8. "**Weaponised interdependence**" refers to states using:

(a) military force only
(b) their central position in economic networks (finance, payments, data) as coercive leverage
(c) tariffs only
(d) cultural exports

Answer. (b). Control of network hubs (e.g. dollar clearing, SWIFT) becomes a tool of coercion — the mechanism behind modern sanctions.

9. A firm chooses actions purely by "the greatest good for the greatest number." This is closest to:

(a) deontological ethics
(b) utilitarian/consequentialist ethics
(c) virtue ethics
(d) cultural relativism

Answer. (b). Utilitarianism judges by outcomes/aggregate welfare, as opposed to duty-based (deontological) or character-based (virtue) ethics.

10. "**Institutional voids**" help explain why emerging-market business groups often:

(a) stay small and single-product
(b) diversify widely and build internal capital/labour markets to substitute for missing institutions
(c) avoid all regulation
(d) never export

Answer. (b). Where external markets/institutions are weak, groups internalise them — diversified conglomerates fill the void (Khanna & Palepu).

Part 2. Discussion questions (10)

Short, open questions for the table; talking points follow each.

1. **Institutions and income.** "Good institutions cause prosperity." What evidence moves you from correlation to a causal claim, and why is the raw scatter insufficient?

   Answer. The raw scatter suffers reverse causation (rich countries can afford good institutions) and omitted variables (geography, history, culture). Credible causal claims lean on natural experiments or instruments — historically determined institutions plausibly unrelated to today's income (e.g. settler-mortality-type designs) — or within-country institutional discontinuities. The correlation is huge and real, but by itself it cannot tell us which way the arrow points, so policy inferences ("import these institutions") require the identification, not just the cloud of dots.

2. **Political risk has changed shape.** Explain the shift from expropriation to regulatory/"creeping" risk and why the newer form is harder to insure against.

   Answer. Classic risk was outright seizure of assets — discrete, observable, and insurable. Modern risk is incremental rule change (higher taxes, local-content rules, licence revisions, price caps) imposed *after* capital is sunk. It is continuous, deniable and hard to define in a contract, so political-risk insurance and investment-treaty protection bite less cleanly. The firm's exposure is greatest where assets are illiquid and long-lived, because the host can revise terms knowing the firm cannot cheaply leave — a hold-up problem.

3. **Political ideology and the MNE.** How does a country's position on the political-ideology / state-vs-market spectrum shape the risks and opportunities an MNE faces?

   Answer. Ideology sets the rules of the game: more statist/left regimes may bring nationalisation risk, price controls, strong labour protection, and state competitors, but also state-directed demand and subsidies; more market/right regimes bring lighter regulation and easier repatriation but sharper competition and less protection. What matters for the firm is *predictability* as much as direction — stable rules of either kind can be planned for; ideological volatility (sharp swings after elections) is itself a risk. The firm should map where demand, ownership limits, and profit-repatriation rules come from before entering.

4. **Sanctions and weaponised interdependence.** Why have financial-network sanctions become more powerful than tariffs, and what limits their use over time?

   Answer. Control of network hubs — dollar clearing, correspondent banking, payment messaging — lets a state deny *payments*, not merely raise prices, hitting a target broadly and fast (weaponised interdependence). This is more potent than a tariff, which only taxes a flow. Limits: overuse spurs workarounds — de-dollarisation, alternative payment rails, reserve diversification, and barter — that slowly erode the hub's centrality and thus the coercive power. Sanctions are a depreciating asset: each use raises the incentive for targets and third parties to build around the choke-point.

5. **Legal systems and legal origins.** Through what channel does legal origin (common vs civil law) affect corporate finance, and how might it show up for firms listing across borders?

   Answer. Common-law systems tend to protect outside/minority investors more strongly, which raises investors' willingness to fund firms and supports deeper, more liquid, more dispersed equity markets (La Porta et al.). Civil-law origins are associated with more concentrated ownership and bank-based finance. At the firm level, firms from stronger-protection origins access equity more easily; cross-listing into a strong-protection market is partly a *bonding* choice — importing better governance to lower the cost of capital. Caveat: origin is bundled with everything else about a country's history, so it is a marker, not a clean cause.

6. **Corruption and extraterritorial law.** How does the FCPA (and similar law) change the calculus for a firm facing bribe solicitation abroad, and does it disadvantage firms from strict-enforcement countries?

   Answer. It makes foreign bribery prosecutable *at home*, with large fines and reputational damage, so the expected cost of paying rises sharply; firms respond with compliance programmes and by refusing or withdrawing. Debate: in the short run it may disadvantage firms from strict jurisdictions versus rivals from lax ones who can still pay — but the OECD Anti-Bribery Convention and spreading enforcement level the field over time, and the reputational and legal tail-risk of a scandal often outweighs the lost contract. The deeper point: bribery is a symptom of institutional voids that also raise every other cost of doing business there.

7. **Ethics and CSR: home vs host standards.** When an MNE's home ethical/CSR standards exceed local norms, should it follow home or host standards? Use the ethics philosophies from the lecture.

   Answer. Cultural relativism ("when in Rome") says follow local norms; universalism/deontology says some standards (safety, no child labour, no bribery) are non-negotiable everywhere; utilitarian/consequentialist reasoning weighs outcomes case by case. A defensible middle position: apply *hypernorms* (core universal standards) as a floor while adapting discretionary practices to local context, and recognise reputational spillovers — home consumers and regulators now judge host-country conduct. Following the higher standard is often also strategically rational (licence to operate, talent, brand), not merely principled.

8. **Culture, quantified.** How far can Hofstede/Trompenaars dimensions guide real management decisions, and what are the main dangers of treating national culture as a fixed number?

   Answer. They are useful as a first-order map — for structure, incentives, negotiation style, and marketing tone — and for generating hypotheses about where friction will arise (hierarchy, teamwork, ambiguity). Dangers: the ecological fallacy (nations are not individuals — within-country variation is large), dated and aggregated samples, treating culture as static, and stereotyping. Best practice: use the dimensions to *anticipate* differences and then verify locally, never to script behaviour or over-ride the evidence of the specific people and market in front of you.

9. **Institutional voids and business groups.** Why do diversified business groups dominate many emerging markets yet trade at a discount in developed ones? (This bridges to Day 3.)

   Answer. Where institutions are weak ("institutional voids" — poor contract enforcement, thin capital and labour markets, weak intermediaries), groups *internalise* the missing markets: an internal capital market allocates funds, a group brand substitutes for weak consumer protection, and internal labour markets move managers. That adds value, so conglomerates thrive. Where external markets work well, the same unrelated diversification adds little and invites agency problems and cross-subsidy — hence the diversification discount. Context decides whether internalising markets is a strength or a drag.

10. **Porter's Diamond.** Does national competitiveness explain firm success, or do firms succeed *despite* their home diamond? Discuss the single- vs double-diamond debate.

    Answer. Porter argues that demanding home customers, strong local rivalry, capable supporting industries and specialised factor conditions forge globally competitive firms — the "diamond". Critics note that for small open economies the home diamond is too small to explain success: Rugman & D'Cruz's double diamond adds the neighbouring large economy (Canada drawing on the US diamond). Firms can also build capabilities abroad, not just at home. A balanced view: the home diamond shapes early advantage, but competitiveness increasingly depends on access to *multiple* diamonds and on firm-specific capabilities that can be built wherever the best conditions are.

Part 3. Analytical questions (5)

Structured, exam-style problems; some have several parts. Full model answers follow.

1. **External environmental assessment.** An MNE plans to enter a middle-income country after a change of government. (i) Give two methods of *gathering* information about the environment. (ii) Explain how Porter's five forces are used to *assess* industry attractiveness once the information is in.

   Answer. (i) Information gathering answers "what is going on in the environment?" Methods: asking industry experts to discuss trends and forecast; extrapolating historical industry trends; scenario-writing by knowledgeable managers describing the next 2–3 years; and computer simulation of the industry. Expert opinion is the most commonly used.

   (ii) Assessment evaluates the five forces — rivalry, buyer power, supplier power, threat of entry, threat of substitutes — rating each as attractive or unattractive to judge whether the industry can sustain profit. The change of government feeds the *entry*/regulatory dimension (new rules, licences), the *supplier* dimension (input and political inputs), and an overarching *political-risk* overlay. The output is a structured verdict on attractiveness, not a single number.

2. **Porter's diamond, single vs double.** State the four vertices of the national diamond and the two external variables. Then use *Canada* to explain the double-diamond critique: why does a single home diamond mislead for a small economy next to a large one?

   Answer. Four vertices: (1) factor conditions; (2) demand conditions; (3) related and supporting industries; (4) firm strategy, structure and rivalry. Two external variables: *chance* and *government*. Double diamond (Rugman & D'Cruz): for a small open economy like Canada, competitiveness depends on *both* the home diamond and the neighbouring US diamond — Canadian firms draw on US demand, suppliers, and rivalry, and integrate into US-centred value chains. A single-diamond reading understates how much national competitiveness rests on access to the larger partner's diamond, so it would wrongly diagnose Canadian firms as weak when they are in fact competitive within a bi-national system.

3. **Classifying political risk and mitigating it.** A mining firm is considering a large, long-lived investment in a politically volatile country. (i) Classify the political risks it faces (macro vs micro; ownership, operating, transfer). (ii) Design a mitigation strategy.

   Answer. (i) *Macro* risks hit all firms (regime change, war, capital controls, currency inconvertibility); *micro* risks target the firm/industry (sector nationalisation, mining-royalty hikes, licence revocation). By type: *ownership* risk (expropriation, forced local equity), *operating* risk (tax and royalty changes, local-content and export rules, labour law), *transfer* risk (limits on repatriating profit/dividends, FX controls). Long-lived, immobile mine assets are highly exposed to creeping/operating risk once capital is sunk.

   (ii) Mitigation: negotiate stabilisation clauses and host-government agreements; take a local JV partner and hire/host locally to build a domestic stake in the project's survival; use political-risk insurance (e.g. MIGA) and finance through multilaterals so expropriation carries wider costs; structure via treaty-protected jurisdictions; phase capital to preserve real options; and invest in local legitimacy (jobs, community programmes) so the political cost of hostile action rises. The aim is to make good behaviour by the host the self-interested choice.

4. **Sanctions and exit.** After sanctions are imposed, MNEs split into "stay" and "leave". Using political risk, sunk cost and reputation, give two reasons a firm might *stay* and two reasons it might *fully exit*.

   Answer. Stay: (1) large, illiquid, sunk assets whose fire-sale value is far below book — exiting crystallises a big loss, and the firm may believe the disruption is temporary; (2) contractual, employee and host-relationship obligations, or a judgement that continued local profit outweighs the pressure. Exit: (1) reputational and home-market pressure (consumers, investors, regulators) plus secondary-sanction and compliance risk outweighing local profit; (2) operational impossibility — payments, inputs or logistics cut by network sanctions (weaponised interdependence), so the business cannot actually run. The decision is a real-options trade-off between the sunk cost of leaving and the escalating tail-risk of staying; different firms weigh the two differently, which is why we observe both.

5. **Cultural distance (a calculation).** Two countries score on four Hofstede dimensions: Country X: PDI 40, IDV 90, UAI 45, MAS 60. Country Y: PDI 80, IDV 20, UAI 85, MAS 50. (i) Compute a simple cultural-distance measure (sum of squared differences). (ii) Which dimensions drive the gap? (iii) Derive management implications.

   Answer. (i) Differences (X−Y): PDI −40, IDV +70, UAI −40, MAS +10. Squared: 1600, 4900, 1600, 100. Sum of squared differences = **8200** — a *large* cultural distance (a Kogut–Singh index divides each squared gap by the dimension's variance and averages; the ranking of gaps is the same).

   (ii) The gap is driven mainly by **individualism** (70) and by **power distance** and **uncertainty avoidance** (40 each); masculinity (10) barely differs.

   (iii) Implications: X is individualist, low-hierarchy and ambiguity-tolerant; Y is collectivist, hierarchical and ambiguity-averse. Expect friction in: *decision-making* (Y expects clear top-down authority; X expects delegation and initiative); *incentives* (individual bonuses motivate X, group-based recognition suits Y); *rules and process* (Y wants detailed procedures and job security; X tolerates open-endedness); and *staffing/communication* (an X manager parachuted into Y may be seen as under-directive). Recommended adaptations: localise HR and incentive design, respect hierarchy in Y, provide structure and clear roles, and consider a local or bicultural manager rather than a pure home-country expatriate.

Part 4. Case studies

Case A — Carrefour: expansion, retreat, and rules at home and abroad

Carrefour, the French retailer that pioneered the **hypermarket** ("everything under one roof"), became for a time the world's second-largest retailer. It exported a capital-intensive, large-format store model across Latin America (Brazil, Argentina), southern Europe and Asia (China, Taiwan, Japan, South Korea). The model travelled well in some markets and badly in others: Carrefour **withdrew from Japan (2005) and South Korea (2006)**, exited several other markets, and retreated from Russia after a brief presence — while continuing to grow in Brazil and China. At **home**, its expansion ran into France's own institutions: planning and competition laws (the Royer and Raffarin/Galland framework) restricted new large-store openings and regulated supplier pricing, limiting domestic hypermarket growth and pushing the group abroad. **Abroad**, it met a patchwork of retail-zoning rules, labour regulation, local-sourcing requirements, and consumer cultures that did not always suit a giant weekly-shop format.

Questions.

1. Classify Carrefour's obstacles — at home and abroad — as **political**, **legal/regulatory** or **cultural** risk. Which best explains the domestic constraint, and which the Asian exits?

   Answer. Domestic constraint is legal/regulatory (Royer/Raffarin limits on openings and supplier pricing) — an institutional brake at home. Asian exits mix cultural (shopping frequency, format fit, transport) with regulatory (zoning, local sourcing). Classic political risk is minor; the binding forces are institutional and cultural — "distance" includes administrative and cultural dimensions (CAGE), not just geography.

2. Home-market regulation limited growth and *pushed* Carrefour abroad, where it met foreign institutions. Explain this using "institutions shape strategy."

   Answer. Home institutions reduced the domestic return to the hypermarket, raising the relative attractiveness of foreign expansion — institutions endogenously drove the internationalization decision. The irony: escaping one country's institutions means entering another's. Institutional friction is exchanged, not avoided, and must be assessed market by market.

3. Was withdrawal from Japan and South Korea a **strategic failure** or **disciplined portfolio management**? Argue both, then take a position using exit and sunk cost.

   Answer. Failure view: a foreseeable cultural/regulatory misfit, with capital sunk before learning. Discipline view: exiting weak markets to redeploy capital to Brazil/China is rational; holding on compounds losses. Balanced: entry may have over-committed to a poorly fitting format, but the *exit* was disciplined — cutting a losing position and reallocating is correct once the misfit is known. Exit is information and reallocation, not merely defeat.

Case B — Konami is watching its employees: culture, control and talent

Konami, the Japanese entertainment and games company, became known for an unusually strict **corporate culture**. Reporting has described tight control over employees — monitored communications, reassignment of staff away from creative roles, and pressure or restrictions around departing developers, whose names were sometimes kept off projects. The practices sit against the backdrop of Japanese corporate norms: loyalty to the firm, seniority and hierarchy, and an aversion to disruption. They also collide with a global reality: the best game developers are internationally mobile creative talent who can move to studios anywhere.

Questions.

1. Read Konami's practices through **Hofstede**. Which dimensions — power distance, uncertainty avoidance, individualism–collectivism, long-term orientation — do they reflect?

   Answer. High *power distance* (hierarchy, control), high *uncertainty avoidance* (surveillance, rigid roles), *collectivism* (loyalty to the firm, suspicion of the departing individual), and a *long-term*/lifetime-employment legacy. The practices are legible as expressions of Japanese cultural tendencies, not random management choices.

2. Why might these culturally rooted practices become a **liability** when competing for global creative talent?

   Answer. Mobile, individualist creative talent values autonomy and reputation; surveillance and rigid control repel international hires and trigger defections. The very practices that signal stability at home become a recruiting and retention weakness abroad — a corporate culture that is an asset at home can be a liability in the global talent market.

3. Using "culture at two levels" (national vs corporate), how should an MNE reconcile a strong home corporate culture with a multinational, multicultural workforce?

   Answer. Separate portable *core values* from culturally specific *practices*; grant subsidiary and creative units autonomy where local norms differ; avoid exporting control mechanisms that do not travel. National culture is the backdrop; corporate culture must flex at the edges to attract and keep diverse talent — the responsiveness side of the integration–responsiveness trade-off applied to people.

Note. Case adapted from Collinson, Narula, Qamar & Rugman, *International Business*, 9th ed. (Pearson, 2024) and the instructor's seminar handouts; items follow the Warwick Summer School written-exam format. Answer key — set `\answersfalse` for the student sheet.