



Chapter 2

Avoiding the pitfalls of the international political and legal environment

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Book Content

Learning objectives

After reading this chapter you should be able to:

- explain the functions of government in terms of its effect on international marketing
- identify those aspects of the local political-legal environment that affect a firm's international marketing
- recognise those aspects of the political-legal environment in the overseas country that will affect the risk of operating in that country
- determine which options are available to minimise political-legal risk
- calculate how the legal environment in an international market influences each element of the marketing mix
- explain the increasing dilemma in international marketing regarding the protection of intellectual property
- assess the way legal systems differ and the effect of these differences on the drawing up of contracts and resolving disputes
- identify the ways in which the impact of national laws might be minimised in the international environment.

Discussion Questions

1. How can firms maximise the opportunities offered when foreign governments act as facilitators of involvement?

Firms can maximise their opportunities by:

- constantly monitoring the international environment to seek out those nations whose governments offer incentives to market goods and services in that country
- constantly monitoring their domestic environment to seek assistance from governments that may aid them with their export activity

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- constantly monitoring their international environment to seek out changes in governments or government policy that is likely to lead to governments acting as facilitators of involvement.

2. How can firms minimise the inconvenience to their international operations when foreign governments act as regulators of international commercial involvement within their borders?

The primary focus is that firms should study the plans (often five-yearly) to proactively manage the effects of any likely regulatory changes planned by the government.

The second way for firms to minimise the inconvenience to their international operations is to ensure that all of their corporate and marketing practices in that country/those countries abide by the regulations of the government (e.g. manufacturing, human resources, product quality standards, taxation).

All governments act as regulators – some more so than others in some way. A third way to reduce the inconvenience is to select those nations whose government regulations are less stringent and/or those governments who act as regulators in a minimal way.

3. What are the key differences between various forms of political instability?

The three sources of political instability are:

- *political sovereignty* which refers to forms of government control of an enterprise, often practised in developing nations
 - o one common form of protection is to increase taxes paid by foreign firms
- *political conflict* which refers to internal war, conspiracy and turmoil
 - o can have direct effects such as damage to property or indirect effects such as shortage of inputs
- *political intervention* which refers to decisions by host country governments that force companies to change strategies, policies or operations
 - o could involve expropriation (official seizure) or domestication (e.g. gradual transfer of ownership).

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4. Discuss how you would evaluate the degree of political risk your fibreboard plant in Indonesia is likely to face at the present time.

There are four main types of political risk – general instability risk, ownership risk, operating risk and transfer risk. Students should be encouraged to consider each of the four types relative to the fibreboard plant – for example, is the firm allowed to repatriate profits and capital (transfer risk)?

The question asks students to assess the current levels of political risk so requires some knowledge of the current Indonesian political situation. Students should be encouraged to conduct their own research as to the current situation. A Google search on 'political risk index' will point students to a range of organisations that assess political risk. Political risk information can also be found at www.imf.org and www.worldbank.org (search 'Indonesia political risk').

5. What steps can you take to minimise political risk in the countries in which your firm is presently involved?

There are a number of steps that can be undertaken to ensure that the degree of political risk in a country is minimised:

- *company behaviour* includes being politically neutral and politically sensitive, combining investment projects with civic projects where possible and behaving responsibly in all aspects of a firm's operations (e.g. marketing, HR etc)
- *contributions to the host country* involve behaving like a good corporate citizen (e.g. supporting local cultural events, buying local etc)
- *localising operations* refers to the gradual sharing of ownership with local owners, including local governments
- *political risk insurance* allows firms to shift operational risk to a third party (e.g. insurance company).

Firms need to be aware of the impact of home government actions that can either enhance or retard the position of firms operating offshore e.g. providing aid compared to criticising government leaders or their policies. They also need to take care when operating in multiple markets that the actions in one market, e.g.

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taxation minimisation or maximising returns, does not expose them to political risk in other markets.

6. To what extent did the Australia-Japan sugar dispute reflect a clash of legal systems as opposed to a clash of cultures?

The clash of legal systems centred on the differing views of the law of contracts. The Japanese demanded renegotiation of the contract after the world price of sugar fell in response to stagnant demand and escalating deficit. This was an interpretation of the clause: 'both contractors shall re-examine the operation and continuity of this contract at least once a year'. The Japanese viewed the contract to be flexible, in that it could be renegotiated when a change in their commercial situation meant the contract became financially untenable, and believed that, under the circumstances, the other party was also obliged to agree to renegotiate.

The Australian sugar growers relied more on the security of the contract, having acquired more land to meet the contract requirements on the understanding that it would remain in place for at least five years. The contract also offered some measure of protection against a perceived excess of capacity and inefficiency on the part of the Japanese refiners. One presumes the contract was also to provide a means of protection against just such a slump in sugar prices. The Australian legal system viewed the contract as binding once both governments had exchanged letters and the Australian government supported this view.

7. Discuss the circumstances in which international law can clash with national law as far as commercial matters are concerned. Will globalisation ever create a situation where international law will take precedence over national law?

A hypothetical instance of where international law can clash with national law, insofar as commercial matters are concerned, is the case when a firm from Country A has established a foreign direct investment venture in Country B. During the course of its operations in Country B, the firm encounters difficulty arising from, let's say, a government decision on greenhouse emissions resulting from manufacturing. The firm now finds itself breaching national laws but let's assume not necessarily international standards or laws on this matter. Where does the firm go for initial advice and eventual restitution?

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Globalisation *may* create a situation where international law will take precedence over national law; however, not only will this take time (if it happens at all), it may also be difficult to enforce *globally*. In other words, not every nation is obliged to participate in international laws. How or whether these laws can be enforced will depend on a country-by-country and a case-by-case basis.

8. Comment on circumstances where national law can frustrate global marketing strategy and the potential savings that can result from globalisation.

National laws can frustrate global marketing strategy because each nation has:

- its own legal system
- different interpretation of specific laws
- different influences on the legal systems (e.g. cultural influences, government influences).

Hence, each firm needs to customise its operation in each country to varying degrees, depending on the issues raised above. This is time-consuming and expensive but imperative to ensure a viable overseas operation.

While each country has its own law, there are similarities based on their chosen legal system e.g. common law versus code law, affording potential savings to firms operating in multiple countries. Harmonisation of international trade through organisations such as the United Nations Commission on International Trade Law and creation of laws applied on a regional basis such as the European Union and ASEAN both reduce the cost and make it easier for firms to operate in multiple markets.

9. Under what circumstances would it be worthwhile to file for protection of intellectual property in an international market?

Protection of intellectual property is the protection of a competitive advantage for most international marketers. Often, the costs of protection outweigh the benefits. Generally, there are two circumstances that would support a firm filing for protection of intellectual property.

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The first is if the protection could be gained without revealing proprietary information to competitive firms that would negate the competitive advantage enjoyed by the owner of the intellectual property. Complications arise when each nation has different laws related to the treatment of patents, copyrights, trademarks, product designs and other intellectual property matters.

The second circumstance is when the firm is large enough or has sufficient resources to take legal action if there was an infringement of its copyright. Generally, most Australian firms do not possess the resources required for such action.

10. When is it preferable to arbitrate as opposed to conciliate on the one hand and litigate on the other?

It is really only preferable to arbitrate when the parties in the dispute are unable to conciliate in the first instance. Arbitration has several advantages over litigation:

- ensures an independent resolution is sought to the dispute to which both parties must then abide
- hearings are private and this information remains confidential
- quicker than litigation
- both parties in the dispute have input into the panel
- unlikely to be an appeal.

Litigation is not a preferred option unless absolutely necessary. Disadvantages of litigation are:

- leads to animosity between the disputing parties and this animosity may lead to a cessation of trade activity
- creates a poor image and damages public relations, particularly if the media take an interest in the case
- outcome depends on the country in which the court presides, which may be unfair for one of the parties
- may be difficult to collect the judgement
- considerable opportunity cost in terms of time and funds.

Case Study Solutions

Apple vs Samsung: The Legal Dispute

Taking the battle beyond markets and the boardroom

Question 1

Outline and discuss the implications of Apple's lawsuit on the smartphone and computer tablet industry.

Answer

Students might identify a number of potential trends or developments that might be influenced by the suit which include the following:

- Apple might acquire what could be deemed an unfair competitive advantage which will allow it to determine whether competitors can launch any new innovative products.
- The lawsuit has potential to alter the dynamics of the sectors given the supply chain links that already exist among key players such as Apple and Samsung.
- Google's Android-based smartphone manufacturers might have to review their use of the system given Apple's outstanding legal case with Google, part of which was based on the submissions made during the Samsung case.
- There is potential for more lawsuits and countersuits which might hamper development of new products.
- Samsung's market share lead might be diminished since it might not be able to continue marketing its products in their current form.
- The ruling may potentially result in higher licensing fees that are paid by companies in the sectors for using proprietary technology.

Question 2

Identify and discuss the key lessons that can be drawn from the case study on the impact of the political and legal environment on international marketing.

Answer

Students may highlight any of the following key lessons:

- The increasing role and importance of intellectual property in international marketing.

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- The importance of the legal system as a mediating factor in how international marketers conduct business across markets. In particular, it demonstrates how different legal systems can impact on decisions that have serious repercussions for international marketers. For example, the main lawsuit was determined by a jury of ordinary citizens as opposed to a legal system where a judge and legal experts would have come up with a judgement.
- The need for international marketers to understand the potential impact of 'home nation' legal and political system bias in settling legal cases as demonstrated in the US and South Korean verdicts.
- The potential use of the legal and political environment as a tool for attaining strategic competitive advantage.

Question 3

Briefly scrutinise/critique the South Korean and American verdicts, analysing their implications on international marketing

Answer

South Korean Verdict

- The verdict demonstrates 'home country' bias in lawsuits which requires international marketers to be sensitive as to when and where they file lawsuits. The ruling was interpreted as being part of an effort by the South Korean government to provide some protection for South Korean companies facing challenges from foreign companies. Hence, this can have implications for international marketers intending to enter the South Korean market. New entrants will have to be very strategic about their modes of entry as acquisitions or new ventures that do not have local partnership might not necessarily get the same 'protection' as that provided to Samsung. Joint ventures or strategic alliances might be the best modes of entry to use. The verdict also demonstrates the importance of critical mass in terms of market size. For Apple, the verdict does not have many consequences since it is only enforceable in South Korea which is an insignificant market for the company's products.

US Verdict

- The verdict also demonstrates the 'home country' bias which requires international marketers to be aware of the potential pitfalls they can face

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when conducting business in foreign markets. The use of a jury in the US also poses questions on whether such complex lawsuits should not be dealt with by panels of experts rather than ordinary citizens who might be influenced by other motives other than the facts at hand.

Question 4

Analyse Apple's motivation for suing Samsung in the context of the potential benefits that Apple was likely to accrue from a favourable verdict.

Answer

Students are likely to present diverse responses to this question. One school of thought that might emerge is one that focuses on the importance of protection of intellectual property in international business which makes Apple's case a good lesson for any companies that might be infringing intellectual property. Another school of thought that might emerge is one that questions Apple's real motive given recent developments in the smartphone and tablet sectors which have seen Samsung becoming the market leader and biggest market challenger/follower respectively. Apple's motive might, therefore, be deemed to be more than just protection of intellectual property infringement and a pre-emptive to close out competitors from the market. In so doing, Apple would accrue the following benefits:

- reduce Samsung's influence in both market segments
- determine the key success factors that shape the industry
- be the eminent market leader in innovation in the industry
- financial gains from resultant damages and increased sales which it can invest in research and development to further entrench its position on the market.

Question 5

Assume you have been appointed as a consultant to Samsung. Advise the board on the potential way forward for the firm, outlining strategies that the firm could use to mitigate the impact of the various judgements.

Answer

An immediate response could be to ensure that the company exhausts the full legal options that are available, such as taking the case right through to the International Court of Appeals.

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- Appeal for support from the South Korean government to lobby for the company at an international political level through organisations such as the World Trade Organisation.
- Lobby for continued policy reform governing proprietary rights.
- Continue to invest in research and development in order to introduce new products that have a clear differentiation from Apple's products.
- Go into alliance with other Android-based manufacturers of smartphones to deal with Apple's claims over proprietary rights.
- Engage in aggressive marketing to sustain the brand in face of the negative publicity emanating from the lawsuits. For example, mitigate the positive yet negative judgement in the UK which deemed the Galaxy as not being 'as cool' as the iPad. This can be used by Apple as part of its marketing campaign to endorse Apple's superior products.
- Highlight the potential impact of the judgement on limiting consumer choices and possible increases of prices of smartphones and tablets.

International Marketing Edge (IMEDGE)

Concept

The IMEDGE section draws on materials covered in each chapter to give students an opportunity to undertake a practical and hands-on exercise which covers a specific international marketing topic. Using information from the chapter and other extra sources, IMEDGE tasks can be done either as group or individual activities.

What are the potential benefits of IMEDGE?

Students

- It requires students to apply theory to a real life scenario using information from the sources identified in the chapter.
- It consolidates students' understanding of key concepts covered beyond the basic theory.
- Unlike case studies, the task involves collecting current on-going data and applying it to concepts covered.

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Instructors

- It is a very useful teaching aid since it asks students to complete a task which involves looking for current information and applying principles covered.
 - It encourages students to keep abreast of current international marketing activities.
 - It can complement other blended teaching and learning activities applied by instructors, for example, discussion questions and research assignments.
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Model Answer - IMEDGE – Chapter 2

Briefly identify some of the key Chinese SOEs that have bought assets in Australia. Outline the nature of potential risks that can arise as a result of the domination of these SOEs in Australia.

i. Key Chinese SOEs that have bought assets in Australia

Key source documents

Students are expected to download and read the main reference article:

Source: Wen, P. (2012), 'Mining Fears of Chinese Invasion', Sydney Morning Herald, August 24-25, 2012.

The article identifies examples of some of the key Chinese SOE investments in Australia.

- Another key source document is the KPMG 'Demystifying Chinese investment' report available at www.kpmg.com/AU/en/IssuesAndInsights/ArticlesPublications/china-insights/Documents/demystifying-chinese-investment-2012.pdf.
- Page 8 of this article identifies 45 Chinese SOEs that have invested in Australia in the last six years.
- The Australian Bureau of Statistics, Austrade and DFAT websites also provide information on Chinese investment in Australia.
- The majority of Chinese SOE investment has been in the resources and agriculture sectors.

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Other sources

There are a number of articles that have appeared in the press focusing on Chinese investment in Australia. Some examples are provided below.

Butler, B. (2012), "ANZ boss rejects Abbott's China line", *Sydney Morning Herald*, August 16.

Coorey, P. (2012), "Abbott's careless talk over China policy could cost jobs says Swan", *Sydney Morning Herald*, July, 26.

KPMG (2011), 'The Growing Tide: China outbound direct investment in Australia',

[www.kpmg.com/au/en/issuesandinsights/articlespublications/.](http://www.kpmg.com/au/en/issuesandinsights/articlespublications/)

ii. **Nature of potential risks that can arise as a result of the domination of these SOEs in Australia.**

Whilst students are expected to identify some of the potential risks that are related to foreign control of host nations' industries, there is room for a critique of this assertion. Various pros and cons exist for foreign control of companies, chief of which is the free market and open trade argument. However, for this task, students should make a distinction between general foreign ownership of firms and that of the Chinese SOE model which has other broad political ramifications; hence the need to study the phenomenon independently.

Potential risks that students can outline include:

- The SOE model demonstrates the different roles that the Australian and Chinese governments play in business and their potential repercussions. The Chinese government has multiple roles through its SOE model which makes it a key participator. This, in some ways, can pose sovereignty problems for Australia. The involvement of SOEs creates a high level of Australian exposure to Chinese influence in the sense that Chinese foreign policy interests might not necessarily be similar to Australia's policies and objectives in the sectors in which the SOEs are investing.
- Loss of Australian control of key industries that are of national interest such as energy and food. This can have repercussions on consumers by way of potential increases in cost of energy and food.

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- There is potential for reverse transfer risk in the sense that Chinese SOEs are not renowned for transparency in the way they operate their businesses and this might become an issue when they come to operate in a totally different environment such as Australia where the level of transparency is generally higher. The potential risk for Australia might be in the possible loss of revenue through potential transfer pricing, repatriation of dividends to China, benefits from preferential tax arrangements offered to SOEs by the Chinese Government as an incentive for investing in Australia.

What actions can home countries such as Australia or New Zealand undertake to manage the influence of these SOEs?

Australia has legislation that governs operations of foreign firms but there is always a need for constant review of these policies to ensure the country benefits from this investment. Students could cite the following actions:

- Continuous review of the policy framework that governs participation of SOEs in the economy.
- Provide more support to institutions that govern these investments such as the Foreign Investment Review Board to ensure that they safeguard the creation of employment and wealth for Australia from the SOE investment.
- Establish a transparent process that ensures that participation of SOEs is strictly on a commercial basis and should not extend to other areas such as foreign policy.

What are the international marketing implications of increased foreign SOE participation in the Australian economy?

Students are required to identify potential implications of SOE participation in terms of the opportunities and challenges they might provide, which include the following:

- an analysis of the potential risks posed by increased foreign SOE participation in Australia
- cultural adaptation for both the Australian and Chinese partners in these ventures

identification of potential sharing of expertise which can enhance research and innovation.

Teaching Notes

Tutorials

1. While there is no universal international law dictating acceptable and legal international business behaviour, there are international agreements between member states such as:

- Hague Convention on Private International Law www.hcch.net
- International Institute for the Unification of Private Law at Rome www.unidroit.org
- United Nations Commission for International Trade Law www.uncitral.org.

Have students explore the websites and discuss how each organisation might positively affect international marketing efforts for a specific company (e.g. international sale of goods). The purpose is to introduce students to efforts under way to make it easier to conduct business on the international level.

2. Have students bring in one article from a newspaper or business publication that illustrates how a country's legal system impacts on the activities of international marketers. The purpose is to expose students to a range of different legal issues and their potential or actual impact on real companies.

Lectures

1. When discussing the types and roles of government, students should be reminded that, while a firm may decide it wants to do business in a particular country, it can only conduct business there with the permission of that country's government. Students can then be asked why governments might give their permission (e.g. government policies as a driving force as discussed in **Chapter 1: Driving Forces**) and to discuss the ways that government can control the activities of the firm once it is established (see **Figure 2.2** detailing laws affecting imports/exports and also international agreements that governments enter into).

2. In the section on sources of political stability, students should be encouraged to consider the possible effects of each of the sources of political instability on a firm's international operations in a selection of countries e.g. Australia compared to Afghanistan. Each of the possible effects should then be categorised in terms of whether it represents sovereignty, conflict or intervention. In the section on political

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risk, students should be asked to identify at least one nation that exhibits each of the four types of political risk.

Assignments

1. An Australian company is considering entering into a joint venture with a French company and one located in Saudi Arabia and has asked for guidance as to potential areas of concern in the legal environment.

This assignment requires students to first identify that three different types of legal systems are involved – common law (Australia), code law (France) and Islamic law (Saudi Arabia). Students will likely identify a range of areas of potential concern e.g. jurisdiction for contract disputes, differences in how ownership of intellectual property is determined etc (see **Table 2.1** for guidance).

2. Explain how a government can act as a regulator, facilitator and participator in an economy. Discuss the potential impact of each role on a firm engaging in international marketing. Provide specific examples of each role being played by a specific government and the impact on a specific firm engaged in international marketing.

This assignment requires students to demonstrate their understanding of the different roles that can be played by governments and how each role might impact on international marketing e.g. statutory marketing authorities (participator) control volume and price; offering export incentives (facilitator). Providing specific examples requires the student to do some research (e.g. grants and assistance from Austrade at www.austrade.gov.au).

Additional Questions

1. Each country has its own laws and legal requirements. Identify and

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discuss how these legal issues impact on each element of the marketing mix.

Legal requirements are generally designed to protect the consumer's or the nation's interest. The actual legal requirement and its effect on each element of the marketing mix will vary depending on the country. However, the international marketer needs to be aware of a number of generic issues, for example:

Product:

- Physical and chemical aspects.
- Standards for purity, safety and performance.
- Packaging – material and nature of the container.
- Labelling.

Price:

The government may control prices or regulate to:

- control inflation
- protect consumers' interest
- ensure price competition in the market
- prevent collusion which reduces competition and is not in the best interest of the consumer
- prevent dumping.

Distribution:

- Control transportation licences or registrations that limit competition.
- Some channels not legal (e.g. door-to-door in France).
- Prohibit anti-competitive arrangements (e.g. exclusive distribution arrangements).
- Control or restrict middlemen.

Promotion:

Mostly concerns deceptive, misleading or fraudulent marketing practices, although in some countries restrictions are based on moral or religious grounds:

- trade descriptions
- bans on advertising certain products
- bans on using certain words and expressions
- limitation on the extent of promotional expenditure

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- content and style of the advertisement
- other promotional elements (e.g. premiums, vending machines and catalogue sales).

2. Identify and discuss the four political risk assessment methods.

The text identifies the following four political risk assessment methods (**Chapter 2: Assessment**):

- *The grand tour* – a first-hand appraisal of the foreign country by senior executives of the international marketing firm.
- *The old hand* – employment of an expert consultant on the country who may be based overseas or in the domestic market.
- *Delphi technique* – involves consulting with a group of country experts, each of whom has a different background and is asked to give independent opinions on that country based on questions prepared by the international marketing firm.
- *Quantitative methods* – involves developing a mathematical relationship among a series of quantifiable variables to predict certain outcomes.

3. Consider the advantages and disadvantages of each of the four political risk assessment methods discussed in Question 2.

<i>Risk assessment method</i>	<i>Advantages</i>	<i>Disadvantages</i>
Grand tour	<i>First-hand meetings with government officials and local businesses.</i>	<i>Information may be misleading – contacts often represent the establishment, not the future political risk.</i>
Old hand	<i>An expert experienced in the country.</i>	<i>If non-national, depends on capability, experience and recency in the country of the consultant.</i> <i>If national, report may</i>

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		<i>be influenced by networks.</i>
Delphi technique	<i>Time-consuming.</i>	<i>Need to pick the right people to include.</i>
Quantitative methods	<i>Statistically valid.</i>	<i>Requires technical expertise.</i> <i>Often a static model.</i>