

## Chapter 2—Understanding Formal Institutions: Politics, Laws, and Economics

### TRUE/FALSE

1. Institutional framework only pertains to a firm's behavior.

ANS: F                      PTS: 1                      DIF: Difficulty: Easy  
 REF: p. 35                      OBJ: LO: 2-1                      NAT: BUSPROG: Analytic  
 KEY: Bloom's: Knowledge

2. An institutional framework is made up of formal and informal institutions governing individual and firm behavior.

ANS: T                      PTS: 1                      DIF: Difficulty: Easy  
 REF: p. 35                      OBJ: LO: 2-1                      NAT: BUSPROG: Analytic  
 KEY: Bloom's: Knowledge

3. The laws of a country are part of the formal institution.

ANS: T                      PTS: 1                      DIF: Difficulty: Easy  
 REF: p. 35                      OBJ: LO: 2-1                      NAT: BUSPROG: Analytic  
 KEY: Bloom's: Knowledge

4. The regulatory pillar supports both informal and formal institutions.

ANS: F                      PTS: 1                      DIF: Difficulty: Easy  
 REF: p. 35                      OBJ: LO: 2-1                      NAT: BUSPROG: Analytic  
 KEY: Bloom's: Knowledge

5. The normative pillar supports informal institutions.

ANS: T                      PTS: 1                      DIF: Difficulty: Easy  
 REF: p. 35                      OBJ: LO: 2-1                      NAT: BUSPROG: Analytic  
 KEY: Bloom's: Knowledge

6. The values and beliefs of a culture are examples of a formal institution.

ANS: F                      PTS: 1                      DIF: Difficulty: Easy  
 REF: p. 35                      OBJ: LO: 2-1                      NAT: BUSPROG: Analytic  
 KEY: Bloom's: Knowledge

7. Cognitive pillar is the coercive power of governments.

ANS: F                      PTS: 1                      DIF: Difficulty: Easy  
 REF: p. 36                      OBJ: LO: 2-1                      NAT: BUSPROG: Analytic  
 KEY: Bloom's: Knowledge

8. *Force majeure* is a method of interpreting a statute by understanding the legislative history leading up to the adoption of that statute.

ANS: F                      PTS: 1                      DIF: Difficulty: Easy  
 REF: p. 36                      OBJ: LO: 2-2                      NAT: BUSPROG: Analytic

KEY: Bloom's: Knowledge

9. Disabling formal institutes does not affect transaction costs.

ANS: F                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 37                      OBJ: LO: 2-2                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

10. Opportunism increases transaction costs.

ANS: T                      PTS: 1                      DIF: Difficulty: Moderate  
REF: p. 38                      OBJ: LO: 2-2                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Comprehension

11. Transitional economies have static institutions.

ANS: F                      PTS: 1                      DIF: Difficulty: Moderate  
REF: p. 38                      OBJ: LO: 2-2                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Comprehension

12. According to the institution-based view, managers and firms make choices outside institutional constraints.

ANS: F                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 39                      OBJ: LO: 2-3                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

13. Proposition 1 of the institution-based view specifically concerns bounded rationality.

ANS: T                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 39                      OBJ: LO: 2-3                      NAT: BUSPROG: Diversity  
KEY: Bloom's: Knowledge

14. Economic systems are examples of formal institutions.

ANS: T                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 40                      OBJ: LO: 2-3                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

15. Right-wing totalitarianism refers to the monopolization of power in the hands of a communist party.

ANS: F                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 41                      OBJ: LO: 2-4                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

16. Theocratic totalitarianism refers to the monopolization of political power in the hands of one religious party.

ANS: T                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 41                      OBJ: LO: 2-4                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

17. Totalitarian countries have less political risk than democratic ones.

ANS: F                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 41                      OBJ: LO: 2-4                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

18. Firms operating in democracies never confront political risk.

ANS: F                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 41                      OBJ: LO: 2-4                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

19. Civil law uses comprehensive statutes and codes as a primary means to form legal judgments.

ANS: T                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 43                      OBJ: LO: 2-5                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

20. The common law tradition is mostly spread in non-English speaking countries.

ANS: F                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 43                      OBJ: LO: 2-5                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

21. Contracts in civil law countries tend to be long and detailed compared to contracts in common law countries.

ANS: F                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 44                      OBJ: LO: 2-5                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

22. Islamic law is the only surviving example of a theocratic legal system that is formally practiced by some existing governments.

ANS: T                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 44                      OBJ: LO: 2-5                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

23. In the United States, only 1 per cent of the land is formally registered.

ANS: F                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 45                      OBJ: LO: 2-5                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

24. Patents are exclusive rights of firms to use specific names and brands.

ANS: F                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 45                      OBJ: LO: 2-5                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

25. Trademarks are legal rights awarded by government authorities to inventors of new products or processes.

ANS: F                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 46                      OBJ: LO: 2-5                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

26. Adopting the Paris Convention is required in order to become a signatory country to the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights.

ANS: T                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 46                      OBJ: LO: 2-5                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

27. Intellectual property rights are enforced through the informal institution system.

ANS: F                      PTS: 1                      DIF: Difficulty: Moderate  
REF: p. 46                      OBJ: LO: 2-6                      NAT: BUSPROG: Communication  
KEY: Bloom's: Comprehension

28. A copyright is an example of an intellectual property.

ANS: T                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 46                      OBJ: LO: 2-5                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

29. In a pure market economy, the government only performs functions that the private sector cannot do.

ANS: T                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 47                      OBJ: LO: 2-6                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

30. In a command economy, all factors of production should be government-owned or state-owned.

ANS: T                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 47                      OBJ: LO: 2-6                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

31. A mixed economy has elements of both a market economy and a command economy.

ANS: T                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 47                      OBJ: LO: 2-6                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

32. All Western countries practice the absolute *laissez-faire* philosophy in trade.

ANS: F                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 47                      OBJ: LO: 2-6                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

33. The cultural school of thought in economic development suggests that rich countries tend to be endowed with natural resources.

ANS: F                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 48                      OBJ: LO: 2-7                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

34. In private ownership, liquidation of a firm is forced by competition.

ANS: T                      PTS: 1                      DIF: Difficulty: Moderate

REF: p. 50            OBJ: LO: 2-7            NAT: BUSPROG: Analytic  
KEY: Bloom's: Comprehension

35. The Washington Consensus emphasizes using government intervention over state ownership in business.

ANS: F                    PTS: 1                    DIF: Difficulty: Easy  
REF: p. 52                OBJ: LO: 2-7            NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

## MULTIPLE CHOICE

1. The main supportive pillars of the informal institutions are \_\_\_\_\_.  
a. normative and cognitive  
b. regulatory and normative  
c. regulatory, normative, and cognitive  
d. cognitive and regulatory

ANS: A                    PTS: 1                    DIF: Difficulty: Easy  
REF: p. 35                OBJ: LO: 2-1            NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

2. In which of the following ways do formal institutions regulate trade?  
a. By inducing uncodified ethical beliefs into society  
b. By putting faith in individuals to expose perceived wrong doings  
c. By allowing the cultural beliefs of a society to dictate the terms of trade  
d. By imposing laws that make certain trades unacceptable

ANS: D                    PTS: 1                    DIF: Difficulty: Moderate  
REF: p. 35                OBJ: LO: 2-1            NAT: BUSPROG: Analytic  
KEY: Bloom's: Comprehension

3. \_\_\_\_\_ are represented by laws, regulations, and rules.  
a. Normative institutions  
b. Sociocultural institutions  
c. Cognitive institutions  
d. Formal institutions

ANS: D                    PTS: 1                    DIF: Difficulty: Easy  
REF: p. 35                OBJ: LO: 2-1            NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

4. The \_\_\_\_\_ refers to the coercive power of governments.  
a. normative pillar  
b. regulatory pillar  
c. cognitive pillar  
d. informal pillar

ANS: B                    PTS: 1                    DIF: Difficulty: Easy  
REF: p. 35                OBJ: LO: 2-1            NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

5. Which of the following would be considered an example of informal institutions?  
a. Laws

- b. Regulations
- c. Ethics
- d. Rules

ANS: C                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 35                      OBJ: LO: 2-1                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

6. Which of the following would be considered an example of formal institutions?
- a. Laws
  - b. Norms
  - c. Cultures
  - d. Ethics

ANS: A                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 35                      OBJ: LO: 2-1                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

7. The \_\_\_\_\_ refers to the internalized, taken for granted values and beliefs that guide individual and firm behavior.
- a. normative pillar
  - b. regulatory pillar
  - c. cognitive pillar
  - d. formal pillar

ANS: C                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 36                      OBJ: LO: 2-1                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

8. In which of the following examples can the role of the cognitive pillar be identified?
- a. A firm being exposed after one of its employees turned whistleblower
  - b. A firm being punished for corporate espionage by the courts
  - c. A firm not being able to sell a certain product in a country due to the prevalent cultural beliefs
  - d. A firm outsourcing its jobs

ANS: A                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 36                      OBJ: LO: 2-1                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

9. The key role of institutions is to \_\_\_\_\_ in business transactions.
- a. reduce uncertainty
  - b. increase normative limits
  - c. increase opportunism
  - d. reduce resource costs

ANS: A                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 36                      OBJ: LO: 2-2                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

10. \_\_\_\_\_ is a long-standing legal doctrine that excuses firms from living up to the terms of a deal in the event of natural disasters or other calamities.
- a. *De minimis*
  - b. *Nolo contendere*
  - c. *Force majeure*

d. *Travaux préparatoires*

ANS: C                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 36                      OBJ: LO: 2-2                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

11. Which of the following would be an example of a *force majeure* defense for a seller?
- If the seller decides to stop delivery out of fear of nonpayment
  - If the customer has already accepted nonconforming goods
  - If the goods to be delivered are destroyed in an earthquake
  - If the seller places warranties on the goods

ANS: C                      PTS: 1                      DIF: Difficulty: Moderate  
REF: p. 36                      OBJ: LO: 2-2                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Comprehension

12. The \_\_\_\_\_ view focuses on the dynamic interactions between the laws, cultures and ethics of a country and a firm, and considers firm behaviors as the outcome of such an interaction.
- internal strength-based
  - competency-based
  - institution-based
  - resource-based

ANS: C                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 38                      OBJ: LO: 2-3                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

13. Which of the following is a proposition of the institution-based view?
- Decisions based on bounded rationality should be avoided.
  - Dependency on informal constraints will always increase the political risks associated with a firm.
  - When formal constraints are unclear, informal constraints will play a larger role in reducing uncertainty and providing constancy to managers and firms.
  - Informal constraints always increases transaction costs for the firm.

ANS: C                      PTS: 1                      DIF: Difficulty: Moderate  
REF: p. 39                      OBJ: LO: 2-3                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

14. A fundamental aspect of \_\_\_\_\_ is that it effectively conducts global business by providing an individual the right to freedom of expression and organization.
- communist totalitarianism
  - right-wing totalitarianism
  - democracy
  - theocracy

ANS: C                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 40                      OBJ: LO: 2-4                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

15. Which of the following is a feature of right-wing totalitarianism?
- It does not curtail an individual's right to freedom of expression and organization.
  - It concentrates power in the hands of one or more religious groups.
  - It bases its economic policies on communist ideologies.
  - It does not allow room for political freedom.

ANS: D                   PTS: 1                   DIF: Difficulty: Easy  
REF: p. 41               OBJ: LO: 2-4           NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

16. Which of the following is true of the civil law system?
- It is the most widely distributed legal system around the world.
  - It originated in England, and was then spread as the legal system for all its former colonies.
  - It is shaped by precedents and traditions from previous judicial decisions.
  - It allows judges to interpret the law before making judicial decisions.

ANS: A                   PTS: 1                   DIF: Difficulty: Easy  
REF: p. 43               OBJ: LO: 2-5           NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

17. Which of the following is true of the common law system?
- It is the oldest legal system in the world.
  - It has spread to all English-speaking countries and their (former) colonies.
  - It bases its legal judgment primarily on the dominant religion of the country.
  - It does not allow interpretations of the law by judges.

ANS: B                   PTS: 1                   DIF: Difficulty: Easy  
REF: p. 43               OBJ: LO: 2-5           NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

18. \_\_\_\_\_ refers to a legal system based on religious teachings.
- Common law
  - Theocratic law
  - Civil law
  - Right-wing totalitarian law

ANS: B                   PTS: 1                   DIF: Difficulty: Easy  
REF: p. 44               OBJ: LO: 2-5           NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

19. Intellectual property specifically refers to \_\_\_\_\_ property.
- tangible
  - intangible
  - real
  - moveable

ANS: B                   PTS: 1                   DIF: Difficulty: Easy  
REF: p. 45               OBJ: LO: 2-5           NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

20. Which of the following is an example of an intellectual property?
- Home
  - Scientist's laboratory
  - Office
  - Website

ANS: D                   PTS: 1                   DIF: Difficulty: Easy  
REF: p. 45               OBJ: LO: 2-5           NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge



21. \_\_\_\_\_ are legal rights awarded by government authorities to inventors of new products.
- Copyrights
  - Patents
  - Trade secrets
  - Trade marks

ANS: B                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 45                      OBJ: LO: 2-5                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Comprehension

22. \_\_\_\_\_ are exclusive legal rights of authors and publishers to publish and disseminate their work.
- Patents
  - Trademarks
  - Copyrights
  - Trade secrets

ANS: C                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 46                      OBJ: LO: 2-5                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

23. \_\_\_\_\_ are exclusive legal rights of firms to use specific names, brands, and designs to differentiate their products from others.
- Patents
  - Trademarks
  - Copyrights
  - Trade secrets

ANS: B                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 46                      OBJ: LO: 2-5                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

24. Which of the following would be considered an example of intellectual property rights?
- Rights associated with ownership of vehicles
  - Rights associated with ownership of trademarks
  - Rights associated with ownership of buildings
  - Rights associated with ownership of business contracts

ANS: B                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 46                      OBJ: LO: 2-5                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

25. The TRIPS system was designed to \_\_\_\_\_.
- create IP rights that adhered to the norms of individual countries
  - force firms to enforce IP rights through an informal system
  - make sure that firms follow theocratic laws
  - force firms to innovate while strictly adhering to IPR guidelines

ANS: D                      PTS: 1                      DIF: Difficulty: Moderate  
REF: p. 46                      OBJ: LO: 2-5                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Comprehension

26. Which of the following economies would be characterized as having a *laissez faire* policy?
- Pure market economy
  - Mixed economy
  - Command economy

d. Socialist economy

ANS: A                   PTS: 1                   DIF: Difficulty: Easy  
REF: p. 47               OBJ: LO: 2-6           NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

27. Which of the following is true of a pure market economy?
- All factors of production are owned by the government.
  - All factors of production are privately owned.
  - It has elements of both a market economy and a command economy.
  - Its policies are based on religious decree.

ANS: B                   PTS: 1                   DIF: Difficulty: Easy  
REF: p. 47               OBJ: LO: 2-6           NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

28. Which of the following is true of a command economy?
- All factors of production are privately owned.
  - The government only performs those functions that the private sector cannot perform.
  - It does not allow private entrepreneurship.
  - It strictly follows the doctrine of *laissez faire*.

ANS: C                   PTS: 1                   DIF: Difficulty: Easy  
REF: p. 47               OBJ: LO: 2-6           NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

29. For which of the following types of economies would the factors of production depend on the relative distribution of market forces versus command forces?
- Mixed economy
  - Pure market economy
  - Strict *laissez faire* economy
  - Command economy

ANS: A                   PTS: 1                   DIF: Difficulty: Easy  
REF: p. 47               OBJ: LO: 2-6           NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

30. Which of the following is the argument used by proponents of the “cultural” explanation for the difference in economic development across the globe?
- That rich countries have a smarter and harder-working population
  - That rich countries tend to be endowed with natural resources
  - That rich countries tend to have better market-supporting institutions
  - That rich countries generally tend to have a democratic style of government

ANS: A                   PTS: 1                   DIF: Difficulty: Easy  
REF: p. 48               OBJ: LO: 2-7           NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

31. Which of the following is true of private ownership?
- It tends to force firms into liquidation due to high competition.
  - It empowers the government to determine firm entry.
  - It allows financing only through nationalized banks.
  - Its primary objective is protecting jobs and minimizing social unrest.

ANS: A                   PTS: 1                   DIF: Difficulty: Easy  
REF: p. 50               OBJ: LO: 2-7           NAT: BUSPROG: Analytic

KEY: Bloom's: Knowledge

32. State ownership differs from private ownership in that in state ownership \_\_\_\_\_.  
a. maximizing profits is the sole objective of a firm  
b. management appointments are made by owners and investors based on merit  
c. protecting jobs and minimizing social unrest is the objective of a firm  
d. managers' compensation is determined by competitive market forces

ANS: C                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 50                      OBJ: LO: 2-7                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

33. Private ownership differs from state ownership in that in private ownership \_\_\_\_\_.  
a. maximizing profits is the primary objective of a firm  
b. protecting jobs and minimizing social unrest is the primary objective of a firm  
c. establishing a firm is determined by government officials and bureaucrats  
d. failing firms deemed too big to fail may be supported by taxpayer money indefinitely

ANS: A                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 50                      OBJ: LO: 2-7                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

34. Which of the following is true of private ownership?  
a. Firms are established by entrepreneurs, owners, and investors.  
b. Management appointments are made by government officials and bureaucrats who may also use non-economic criteria.  
c. Firm's objective would be to find a "fair" deal for all stakeholders.  
d. Firms deemed "too big to fail" may be supported by taxpayer dollars indefinitely.

ANS: A                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 50                      OBJ: LO: 2-7                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

35. Which of the following is true of the Washington Consensus?  
a. It provided measures that governments can take in order to move toward a command economy.  
b. It listed the bail out procedures that governments could follow in case of a firm's bankruptcy.  
c. It advocated more governmental control in trade.  
d. It advocated the superiority of private ownership over state ownership.

ANS: D                      PTS: 1                      DIF: Difficulty: Easy  
REF: p. 51                      OBJ: LO: 2-7                      NAT: BUSPROG: Analytic  
KEY: Bloom's: Knowledge

## 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. Normative pillar refers to how the values, beliefs, and actions of other relevant players—collectively known as norms—influence the behavior of focal individuals and firms.

PTS: 1                      DIF: Difficulty: Easy                      REF: pp. 35-36  
OBJ: LO: 2-1              NAT: BUSPROG: Analytic                      KEY: Bloom's: Knowledge

2. What are 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: Difficulty: Easy                      REF: p. 39  
OBJ: LO: 2-3              NAT: BUSPROG: Analytic                      KEY: Bloom's: Knowledge

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: Difficulty: Moderate                      REF: pp. 40-41  
OBJ: LO: 2-4              NAT: BUSPROG: Analytic                      KEY: Bloom's: Comprehension

4. What is totalitarianism? Outline the four major types of totalitarian systems.

ANS:

The opposite end of democracy is totalitarianism (also known as dictatorship), which is defined as a political system in which one person or party exercises absolute political control over the population. 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, the Philippines, 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: Difficulty: Easy                      REF: p. 41

OBJ: LO: 2-4      NAT: BUSPROG: Analytic

KEY: Bloom's: Knowledge

5. Define political risk. How is it related to nationalization?

ANS:

Political risk is risk associated with political changes that may negatively influence domestic and foreign firms. The most extreme political risk may lead to nationalization (expropriation) of foreign assets. This happened in many totalitarian countries from the 1950s through the 1970s. It has not become a thing of the past. Zimbabwe has recently demanded that foreign mining companies cede 51% of their equity without compensation. It is hardly surprising that foreign mining companies are sick and tired and would rather go to “greener pastures” elsewhere.

PTS: 1

DIF: Difficulty: Moderate

REF: p. 41

OBJ: LO: 2-4

NAT: BUSPROG: Analytic

KEY: Bloom's: Comprehension

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

ANS:

Civil law is the oldest, most influential, and most widely distributed law 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 those in Iran and Saudi Arabia.

PTS: 1

DIF: Difficulty: Moderate

REF: pp. 43-44

OBJ: LO: 2-5

NAT: BUSPROG: Analytic

KEY: Bloom's: Comprehension

7. How can a firm protect intellectual property rights (IP rights) when countries have different levels of IP rights' enforcement?

ANS:

Intellectual property rights (IPR) are rights associated with the ownership of intellectual property, such as patents, copyrights, and trademarks.

The Paris Convention for the Protection of Industrial Property is the "gold standard" for a higher level of IPR protection. Adopting the Paris Convention is required in order to become a signatory country to the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). Given the global differences in the formal rules, much stricter IPR protection is provided by TRIPS. Once countries join TRIPS, firms are often forced to pay more attention to innovation.

IP rights need to be asserted and enforced through a formal system, which is designed to punish violators and to provide an incentive for people and firms to innovate. However, the intangible nature of IP rights makes their protection difficult. Around the world, piracy—unauthorized use of intellectual property—is widespread. As such, IP rights are better protected not only through formal institutions, but also through informal institutions, such as ethical social awareness.

PTS: 1

DIF: Difficulty: Moderate

REF: pp. 45-46

OBJ: LO: 2-5

NAT: BUSPROG: Analytic

KEY: Bloom's: Comprehension

8. 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-owned 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 a command economy. It boils down to the relative distribution of market forces versus command forces.

PTS: 1

DIF: Difficulty: Moderate

REF: p. 47

OBJ: LO: 2-6

NAT: BUSPROG: Analytic

KEY: Bloom's: Comprehension