

INTRODUCTION: SEEING THE POLITICS OF GLOBALIZATION THROUGH THE EYES OF MANAGERS

Rawi Abdelal

Globalization is neither inexorable nor inevitable. Although this era of globalization has fundamentally reshaped the environment in which many of the world's firms operate, managers must recognize that this highly internationalized economy — in which goods, services, and capital flow across country borders — rest on institutional and inescapably political foundations. Politics are, therefore, ever present. In the early years of the new century, those politics are, perhaps paradoxically, making this globalized world economy more complicated for managers. Markets and industries still vary dramatically across national borders. Politics and rules have become increasingly important to the success of firms' selling, buying, and investing abroad.

The central theme of this case book is that the institutional foundations of globalization are undergoing a fundamental transformation within individual countries and at the level of the entire system. Rules should therefore be an integral part of strategy for internationalizing firms. The cases in this book are organized into four parts.

Part I: The Emerging Challenge of Globalization

The first part explores the emerging challenge of globalization. *American Outsourcing* describes the phenomenon of outsourcing and offshoring and explores the broader implications for an American economy that has heretofore remained open to the process by which trade in services essentially locates certain functions outside of the United States. A national debate has raged over whether on balance, and in the long run, the U.S. economy and its workers will benefit, and if the benefits outweigh the costs whether the distributional implications might undermine American public support for globalization.

A series of cases on Porsche — *True to Brand?* And *Made in Germany* — then explores similar themes in Germany and its automotive sector. Highlighting Porsche's decision to enter the SUV market with the Cayenne and share much of the production platform with the Volkswagen Touareg, the cases demonstrate that Germans, too, are increasingly concerned about how their country relates to patterns of production. With much of the assembly ultimately taking place in central Europe, Porsche seems to be straining a core element of its brand — "Made in Germany." A broader question is at stake: As production internationalizes, are there products for which country of origin, however defined, will remain central to their brands?

Part II: The Domestic Politics of Globalization

The next five chapters comprise the second part of the book, which explores the challenges for firms from various kinds of domestic politics. The *Journey to Sakhalin* series offers a narrative that connects developments in Russia to the experience of the country's largest foreign investor, Royal Dutch/Shell. As the Russian government centralizes power and reasserts control over the energy sector, foreign firms such as Royal Dutch/Shell must struggle to find their place in an evolving Russian national interest.

The unhappy experience of Wal-Mart's foray into Germany shows how a collection of formal European rules and informal, societal norms can affect the performance of a company that

is generally considered to have been a juggernaut. Again, managers find their strategies to be inconsistent with prevailing rules, and the price they pay is a heavy one: failure. The experience of managers in *deCODE Genetics* offers a fascinating contrast: whereas the firm had successfully influenced the codification of rules favorable to their enterprise, a societal backlash threatens to undermine that success.

In *Infosys in India: Building a Software Giant in a Corrupt Environment*, students are encouraged to consider the challenges faced by managers of an aggressively internationalizing firm that is based in a local institutional environment rife with petty corruption. Although Infosys has managed to cultivate an impeccable reputation for cleanliness and honesty, the challenges for other Indian firms to replicate that successful strategy may turn out to be even more daunting. Here, the informal rules in India threaten to constrain the success of many promising firms.

Finally, *The Dubai Ports World Debacle* and its Aftermath narrates the ill-fated attempt by a Dubai-based firm, DP World, to manage a handful of American ports whose operations were inherited from a firm it acquired. Although the formal processes governing this cross-border investment had gone very smoothly, the informal political and societal reaction to the deal ultimately undermined it.

Part III: The International Financial Architecture

The next two parts of the book explore politics and rules at the level of the international system. First is the collection of norms and rules that underpins the movement of capital across country borders — that is, the international financial architecture.

International capitalism has always, paradoxically, had an uneasy relationship to capital itself. The international financial architecture — the collection of norms and rules that structure the interactions between governments and international financial markets — has changed dramatically more than once. Capital has alternately been extraordinarily free and fundamentally constrained as international capitalism has evolved over time. No arrangement or orthodoxy has been permanent, although illusions of permanence, inevitability, and inexorability have defined each historical moment.

The first era of globalization, circa 1870–1914, was built upon fundamentally liberal institutional foundations embodied in the practices of the classical gold standard. Policy makers understood that to restrict freedom of capital violated the rules, *albeit* unwritten, of the gold standard. Restrictions being neither normal nor legitimate, capital was as free to flow from one country to another as it has ever been. Bankers, managers, and investors thus enjoyed an age of extraordinary freedom and opportunity.

The first world war, the decade of recurrent international financial crises that followed, and the Great Depression destroyed that liberal order. Then, during the 1940s and 1950s, the rules of the international financial architecture were rewritten to be restrictive by design and doctrine. At that time members of the international financial community collectively shared a set of beliefs about the destabilizing consequences of short-term, speculative capital flows, or “hot money,” and the need for government autonomy from international financial markets. To regulate and control capital became the prevailing orthodoxy. Policy makers then wrote their new consensus into the international financial architecture. The right of International Monetary Fund (IMF), European Community (EC), and Organization for Economic Cooperation and Development (OECD) members to regulate movements of capital was protected by the IMF’s Articles of Agreement (1945), the EC’s Treaty of Rome (1957), and the OECD’s Code of Liberalization of Capital Movements (1961).

As the rules were liberalized in the decades that followed, managers and investors enjoyed another era of freedom, one that spurred massive growth in global financial markets. Freedom for capital movements became the new orthodoxy once again. Unlike the first era of globalization, formal, codified rules explicitly defined these liberal principles and policy practices. The rules of the European Union (EU) and the OECD were rewritten to oblige members, the world's thirty or so richest countries, to allow virtually all cross-border flows of capital. The IMF began informally to promote capital liberalization among its membership, which was nearly universal, and some policy makers sought to amend the Articles of Agreement to oblige members to liberalize capital movements. Central bankers meeting in Basel at the Bank for International Settlements (BIS) endorsed this liberal evolution of government practices. And private credit rating agencies, such as Moody's and Standard & Poor's (S&P) propagated these liberal ideas in their evaluations of sovereign borrowers.

Subsequently, the new orthodoxy of capital mobility was again undermined, this time by a wave of financial crises that struck emerging markets in the 1990s. The EU, OECD, and IMF have since begun a general rethinking within the international financial community of the risks and benefits of capital liberalization. The policy debate on the causes of the financial crises has been heated, and a new consensus appears unlikely. With the very idea of unrestricted capital now suffering a crisis of legitimacy, the managerial implications are dramatic and perplexing, and sure to grow all the more so.

The first set of readings in the module explores the important, but widely misunderstood, place of the credit rating agencies in the international financial architecture. Although few observers deny that Moody's and S&P exercise significant influence over the borrowing practices of sovereign governments and firms around the world, that influence has, until recently, not been the subject of sustained scholarly inquiry. These agencies derive their influence from two sources. The first is the information content of their ratings, and this is reasonably straightforward for students to understand. The second is both more profound and vastly more problematic: ratings are incorporated into financial regulations in the United States and around the world. As a result, these ratings, particularly on the margin between investment-grade and non-investment-grade, literally carry the force of law. A case on S&P's sovereign credit ratings business and an accompanying note on scales and process within the firm allow for a discussion of how S&P managers understand their own ideological assumptions and influence on international capital markets. Because the credit rating agencies are empowered by domestic financial regulations, primarily in the United States, they are the epitome of *ad hoc* globalization. The case suggests that the current regulatory environment is not likely to be a stable political equilibrium, and students are thus encouraged to make informed predictions about how financial regulations in the United States and Europe, especially, will affect the role of the agencies in the coming years.

The second and third sets of readings are designed to introduce students to the causes and effects of European policy makers' embrace of the doctrine of organized, or "managed," globalization. *Bohemian Crowns* is about the experience of one of the Czech Republic's four largest banks during the country's accession to the OECD and the capital liberalization obliged by the organization's Code of Liberalization of Capital Movements. The combination of a fixed exchange rate, rapid liberalization, and a poorly governed banking system turned out to be disastrous for the Czech Republic, leading to a financial crisis that cost the government more than 10% of GDP to resolve. What is most fascinating, however, is that this bank, ČSOB, stood apart from the credit bubble that precipitated the crisis. Students are encouraged to consider the banks' incentives to borrow and lend while under pressure from the government to avoid domestic adjustment, as well as to understand why ČSOB's executives chose to manage their bank more prudently and the institutional mechanisms that allowed them to do so.

Politics and Prudential Supervision and European Financial Integration evaluate students to one of the most important bargains in the history of the decades-old European integration project: a new obligation in 1988 to allow nearly complete freedom for capital movements, *erga omnes* (that is, toward all — non-EU members as well). Europe’s rules for capital freedom at one stroke became the most liberal the world has ever known. Moreover, this European rule made an entire world of integrated capital markets possible. During the late 1980s, Europe faced a turning point: it could create a single financial space that was European, or it could create a financial space that was integrated with the rest of the world economy. Because they chose the latter, the EU provided one of the most important institutional foundations for global capital markets. Major developments followed this move, including a common money and wholesale banking integration. Yet European rules were written with one important carve-out: national banking supervisors could prioritize “sound and prudent management,” even if doing so meant blocking cross-border banking mergers.

The case explores the most famous, even notorious, effort by the Italian central bank governor to prevent the purchase of an Italian bank, Antonveneta, by a Dutch bank, ABN Amro. Written from the perspective of ABN Amro’s executives, the case explores the logic of the Italian central bank governor’s concerns about foreign ownership of Italy’s banks, describes how the Dutch bank navigated between European and Italian norms and rules, and reflects on the implications for national models of capitalism of European financial integration. In particular, the Italian model has been built upon small to medium-size, family-controlled firms traditionally reliant on bank financing and close relationships with their local bankers in one of the most highly fragmented banking systems in the world. Changing the ways in which Italian banks operate is very likely to transform the practices of Italian firms, and thus Italian capitalism, as well. With Italian resentment against the euro also on the rise, the case can be interpreted as a struggle for the soul of the European project.

The final case in the module focuses on another case, *Chrysanthemum and Dragon*, that explores the influence of the Chinese capital controls regime on the opportunities for and practices of foreign venture capital and private equity firms. Because the case takes the perspective of JAFCO Asia, one of the only Japanese venture capital firms active in China, the political stakes are increased significantly. Ongoing political tensions between the Chinese and Japanese governments set the context for growing economic ties; in the region the phenomenon was described as “hot economics, cool politics.” The case is an excellent coda to the module because China, unlike the other national and regional settings explored in the module, continues to maintain a strict capital controls regime. Not having been obliged by membership in any international organization to liberalize capital flows, China remains a challenging country in which to invest. The case explores the advantages and disadvantages of what has become the most common practice for foreign venture capital and private equity firms investing in China: to invest in China indirectly, through complex offshore holding company structures permitting the investment and exit (via offshore exchanges) to occur entirely outside mainland China. Here again is *ad hoc* globalization the defining process, based on largely unilateral decisions by Chinese policy makers to begin to engage international capital markets on terms they define differently over time.

Part IV: The Politics and Rules of International Trade

The final part of the book explores the politics and rules that both enable and constrain trade in goods and service. Unlike the international financial architecture, the organizations that govern trade are relatively weak, and protectionism remains a recurrent feature of world markets.

The first two cases explore the logic of developed-country protectionism and how it influences the prospects for industrial development in Asia and Africa. *The Delta Blues* explores the paradox of American protectionism against imports of aquaculture from Vietnam just as the United States and Vietnam embrace a greater political rapprochement after decades of enmity. The political logic of this protectionism runs, however, in contrast to the logic that often informs explanations for such protection — namely, that powerful import-competing producers organize to redistribute the diffuse costs of protection to consumers to themselves. In the United States, other logics are often at work. In addition to the high politics of national security, are more traditional “low politics,” putatively prosaic in comparison. In this and many other cases, protectionism seems to serve as a kind of politically acceptable social welfare, in which Americans seem much more willing to protect the unlucky. Naturally, this kind of in-group altruism of Americans comes at the unhappy expense of the Vietnamese, who find their development trajectory undermined by American promises of greater openness that fall apart.

In the next case, *The Market and the Mountain Kingdom*, the effects of developed-country protectionism in the textile and garment industry manifest themselves in the fits and starts of a momentarily booming industry in sub-Saharan Africa, and in the tiny mountain kingdom of Lesotho most specifically. With the end of the decades-old Multi-Fiber Arrangement in 2005, many developing countries were poised to take advantage of what they hoped would be greater market access. Yet protectionism in the United States continues to disappoint developing-country managers in the industry, who must navigate an increasingly complex patchwork of rules that determine which societies and firms get privileged access and on which terms. The American African Growth and Opportunity simultaneously carves out greater market space for the poorest of African countries, and yet its temporariness makes long-term planning difficult.

The next two cases deal with the needs of multinational corporations to protect their intellectual property rights in both the developing world and in Europe. In *Life, Death, and Property Rights*, Western pharmaceutical firms face a growing backlash against their pricing policies for AIDS drugs as a pandemic threatens Africa in particular. Those firms must decide just how much of their intellectual property they are prepared to give away before developing-country governments ultimately take away more. The stakes are huge for all involved.

In *Competition Policy in the European Union and the Power of Microsoft*, one of the world’s most powerful firms — Microsoft — must deal with the increasing role of antitrust authorities in Europe in defining the institutional landscape of their markets. Having overcome such a regulatory challenge in the United States, Microsoft executives seem to have been taken unawares by European competition authorities who are much more aggressive and intrusive into the Microsoft business model. Competition law is necessarily vague, and so it is clear that the interpreters of that imposing legal authority matters a great deal. EU-style competition policy emerges in the case as quite distinct in both logic and implication from American policy. The broadest implication is that, with the integration of Europe, large multinational firms must have not one, but two strategies for dealing with competition law, competition policy, and regulators.

Thus all of the cases highlight how important the institutions of globalization — informal and formal rules at the level of both countries and the system as a whole — constrain and enable the very firms that reproduce globalization daily. Understanding those rules is one of the central managerial challenges of our time.