

# Industrialization and Economic Systems in Multinational Management

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## Abstract

*To get a full understanding of any society, it is essential to understand both national culture and the institutional context. Toward this goal, we first looked at examining how both national culture and Social institution combine to form the national context that influences the business culture of any society. The research concluded with the theme that social institutional differences are going to be important now and in the future. We looked at the importance of these social Institutions by showing how they are linked to most of the upcoming research. We concluded by arguing that successful multinational managers are those who can properly assess the institutional context of the society they operate in and design work environments that fit the institutional context. After reading this research we are be able to understand the national context, to understand the basic economic systems, to understand the basic stages of industrialization and implications for multinationals, to understand the world's basic religions, to develop an understanding of education and its effects on multinational operations; to understand the convergence perspective on organizations; to understand the importance of the national context.*

## 1. Introduction

Understanding the institutional context of countries is thus extremely critical for multinational management. At a basic level, a complete understanding of any society cannot be fully achieved unless both the national culture and the institutional context are examined. Both are key element of societies and both have important influences on issues that are related to strategic multinational management. The national context is made up of the respective national cultures and social institutions of society. The national cultures of any society shape the important norms, values and beliefs in any society. These cultural components then provide important sources of influence on the business culture and, thus, what are acceptable and correct ways of doing business. However, closely intertwined with national cultural forces are social institutions seen as the economic system, religion, and education. As we will see later in this research social institutions also represent significant influences on norms, values, and belief people and have implications for the business culture. Social institutions evolve within the constraints of national culture to shape the values and beliefs of individuals and to provide the business context within which some organizational forms can exist.

Social institutions have important influences on individual and the business environment in any society. In concert with national culture, social institutions have shape the business culture. Furthermore, the social institutions also create induced-factor conditions that add to the resources of any society. In turn, this national context provides the environment that influences how firms are formed and how they approve multinational strategic management. This research will provide a basic understanding of the institutional context of societies. In the later section, we briefly discuss the main elements of the

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institutional environments of countries, social institutions and how they influence society. In subsequent sections, we discuss each of the social institutions in depth and their implications for multinational strategic management. We conclude this research by looking at some of the ways social institutions are connected to later chap in the text.

## **2. Social Institutions and Influence on Society**

A social institution can be defined as "a complex of positions, roles, norms, and values lodged in particular types of social structures and organizing relatively stable patterns of human resources with respect to fundamental problems in sustaining viable societal structures within a given environment." In addition to national culture, social institutions profoundly affect people's immediate conditions of life and provide the context that affects psychological differences among people. Similar to national culture, social institutions provide boundaries and norms that prescribe how people behave. In other words, social institutions provide people with behavioral guides when facing different social situations. We consider three key social institutions that have been shown to be the most likely to influence business environment. These are the economic systems (e.g., capitalism or socialism), the level of industrialization, and the types of religion. We also briefly consider the educational system because it has been linked, to a lesser degree, with the business environment. Sociologists also consider the Family as an important social institution. The family, however, have more significant effect on the non-work aspect of individuals and less substantial influence on business environment. As such, extensive discussion of the family is reserved for later research whichever applicable.

Social institutions can have regulative, normative or cognitive influence on individuals. A regulative social institution constrains and regularizes behaviors through its capacity to establish rules, to inspect and review conformity, and to manipulate consequences to reinforce behaviors. The cognitive dimension refers to the widely shared knowledge regarding how things are done in a society. Social institutions that have a normative dimension encourage the dissemination of some shared information to people. In some societies, knowledge and skills regarding how to start new businesses may be widely shared and available. The normative dimension refers to the values and norms promulgated by the social institutions. Relative to our previous example, the normative dimension is an assessment of the degree to which people admire entrepreneurial activities and new product innovation. Social institutions affect individuals as well as organizations. In the case of organizations, however, social institutions, especially the legal and political systems, help define what are legitimate and correct management practices in a particular society. Organizations in that society tend to adopt similar management practices. This pressure from social institutions to follow similar paths in management practices is called organizational isomorphism. Within a nation, isomorphism leads organizations to become similar to each other, but different from organizations located in other nations.

Experts identify three types of isomorphism that are important for organizations: coercive isomorphism, mimetic isomorphism, and normative isomorphism. Coercive isomorphism means that social institutions coerce or force organizations to adopt certain practices. Mimetic isomorphism means that organizations purposefully copy the strategies of the most successful organizations. When people start new organizations or change ongoing organizations, they often imitate what seems to work most successfully. This imitation in turn leads to organizations becoming similar to one another within a particular nation. Normative isomorphism means that organizations indirectly copy the designs, cultures, and strategies of other organizations by conforming to professional and technical norms. Normative isomorphism differs from mimetic isomorphism because copying occurs largely without conscious effort. The preceding paragraphs show that social institutions have significant

influences on both individuals and organizations within countries. In the next few sections, we look at a number of the most important social institutions that impact the business environment of most societies.

### 3. Economic Systems

The economic system is the "interrelated network or system of beliefs (concerning work, property, constructs, and wealth), activities (extraction, production, and distribution), organizations (business firms, labor unions, consumer associations, regulatory agencies) and relationships (ownership management, employment, sales) that provide the goods and services consumed by the members of a society." Economic systems are usually reflected in their governments' influence, specifically in whether productive activities are state owned or privately owned. Economic systems can be typified by the extremes of capitalism and socialism with mixtures of elements of both in the mixed economy. The capitalist or market economy refers to an economic system where production activities are "decentralized to private-property-rights holders who carry out these activities for the purpose of making profits in a competitive market. Private individuals own the resources and have the discretion to make production decisions in order to amass more capital. In contrast, the socialist or command economy is one where production resources are owned by the state and production decisions are centrally coordinated. The ideal socialist economies pursue collective goals such as social equality and solidarity. Most socialist economies were found in the communist societies where collective goals were emphasized.

Finally, the mixed economy combines aspects of the capitalist and socialist economic systems. In such economies, certain sectors of the economy are left to private ownership, but other sectors such as health care and education are run by the state. The state determines that some sectors of the economy cannot be run by private interests and thus intervenes and takes control of such sector. The state makes resource allocation and production decisions. Countries such as Sweden, France, Denmark, Italy, and India are examples of mixed economies. Although it is impossible to cover all possible business implications, economic systems have three major implications for strategic multinational management. At a basic level, decisions to operate a country can be made based on the dominant economic type. As a rough guide, multinational managers may want to consider the index of economic freedom to determine the extent of governmental intervention in different countries. Since 1995, the Heritage Foundation, a U.S. based research foundation, has been constructing the index. It defines the index as "the absence of government coercion or constraint on the production, distribution, or consumption of goods and services beyond the extent necessary for citizens to protect and maintain liberty itself." A second important implication for multinational strategic management related to economic systems is the market transitions that many societies go through as they move from socialism to a more market-based system. An important aspect of this transition for many multinational companies has been an increase in international strategic alliances with local companies.

An important component of this market transition for most multinational managers has been to understand socialism and its effects on both people and organizations to better understand the workers' reactions to market mechanisms. Under socialism, most enterprises were mere factories with no need for cost control. Often these enterprises did not have any strategic planning, accounting or marketing departments. Furthermore, central planners guaranteed survival and inefficiencies of these firms by setting up prices that did not accurately reflect costs. Instead, prices were kept low to sometimes encourage heavy consumption of goods that were manufactured according to the central planners. Banks were also managed according to the needs of central planners loans were often made to enterprises on the basis of connections and personal relationships rather than credit worthiness. It is easy

to understand what multinational managers have to experience to facilitate the transition to a market economy. Drastic measures have to be taken to turn around inefficient companies into firms that can perform essential business functions. In addition, managers' thinking has to be changed completely so that they understand management functions and the necessity of being cost effective. Finally, the financial system and firms (and price) have to be left unregulated to more accurately reflect the needs of the market rather than to satisfy the needs of central planners.

#### **4. Industrialization**

The application of the steam engine to the gathering and production processes is largely used to explain the Industrial Revolution in Europe. The latter eliminated excessive reliance on animal power and allowed the building of and use of new machines and equipment that were very effective in resource use. This new ability to gather and transform resources allowed rapid development in many of the Western societies through large factories with large numbers of workers assembled around networks of machines. Such changes dramatically influenced all aspects of society. Industrialization refers to the cultural and economic changes that are brought about by fundamental changes in how production is organized and distributed in society. Industrialization can be categorized as pre-industrial when agriculture dominates and shapes the economic environment. In pre-industrial societies, religious norms and tradition are emphasized and social mobility is discouraged. Occupational placement tends to be based on ascription (family background) and social status is largely determined through inheritance. An industrial society tends to be characterized by the dominance of the manufacturing or secondary sectors. Such societies reflect the prevalence of technological development that makes rapid economic growth possible. Industrial societies tend to require wider ranges of skills in their workforce relative to pre-industrial societies. Occupational placement is based on universalistic criteria such as achievement. Finally, the postindustrial society emphasizes the service sector. The dominance of employment by the service sector leads to a drastic expansion of the role of formal education because there is a need for highly skill workers with specialized skills.

The level of industrialization has important implications for strategic multinational management. First, there is a direct correspondence between the level of economic development and industrialization. As such, pre-industrial societies tend to be the least economically developed. Multinational managers can use such indicators to determine the feasibility of doing business in pre-industrial societies. Given that the long-term prospect of a business in any country depends on the market size and income, pre-industrial societies tend to provide fewer opportunities. However, it is also important to note that pre-industrial societies also provide relatively cheap labor compared with more industrialized societies. It is therefore not surprising that many companies tend to locate their plant in pre-industrial countries. Yet another important issue to consider is that pre-industrial societies tend to have poorer infrastructure and business support. It may be more costly to operate in such societies because the multinational firm may have to provide its own infrastructure and support services. Many African countries are unfortunately found in the pre-industrial category and multinational companies have generally shunned most of them because of political instability.

Industrial societies tend to be more economically developed than pre-industrial societies do. A technological development makes it possible to shift production to the manufacturing sector; these are important changes in the economic environment of the society that affect strategic management. Rather than emphasizing tradition and communal obligations heavily influenced by religious norms typical of pre-industrial societies, industrial societies tend to favor innovation and individualism. Economic achievement becomes the top



priority for industrial societies, and discipline and achievement-oriented norms predominate. Industrial societies tend to present significant opportunities for multinational firms. Multinational companies have access to an environment that is favorable to businesses and a labor force that is often educated and motivated. Industrialized societies also tend to have governments that are usually favorable to businesses. Multinational manager can generally expect that their business endeavors will be facilitated. Furthermore, industrial nations tend to present less nonmarket risks, such as government appropriation, to businesses. In addition to shaping norms for individuals, industrialization also has implications for how industries are shaped. This discussion shows that degrees of industrialization drastically affect how the business environment of any society is shaped. It is therefore imperative for multinational managers to clearly understand the stage of industrialization and other types of industrialization to determine which areas of their businesses are affected.

## 5. Religion

A religion can be defined as a shared set of beliefs, activities, and institutions based on faith in super natural forces. Religions continue to be an important aspect of most societies. The reemergence of Christianity in the United States, the rise of Islamic fundamentalism in the Middle East, the rapid growth of Protestantism in Latin America, and the religious devotion in the former Soviet Union and Eastern Europe all signal that religions continue to be pervasive and important. Religions and work and their interrelationships form the very foundations of human society. In fact, the link between religions and how societal systems are structured for economic purposes form the basis of a famous formulation of the Protestant work ethic by Max Weber. Weber, a famous German sociologist, proposed that the domination of Protestant religions led to the emergence modern capitalism in Western Europe. He argued that Protestant beliefs emphasize hard work, creation of wealth, and frugality. This combination of values allowed individuals to work hard to accumulate wealth. However, their beliefs encouraged them to reinvest the wealth rather than spending it and, thus, formed the basis of the Western European capitalist expansion. Religions are important influences on society. Religions provide individuals with ways to deal with issues that reflect individual wishes and activities. However, religions also affect business and other organizational procedures.

Although there are a great variety of religions around the world, a large percentage of the world population practices only four religions. "Christianity is a faith based on the life, teachings, deaths and resurrection of Jesus" and is clearly the most practiced religion around the world. Christianity started with the birth of Jesus Christ around 2003 years ago and has evolved considerably because of many internal feuds and divisions. Despite the many divisions among Christianity, Christians all share the same belief that Jesus is the incarnation of God who was sent to clean sinfulness of humanity. Jesus is often associated with love and allows humans to connect with God through penance, confessions of one's sins, self-discipline and purification. In general, Christians agree "on the value and dignity of human, labor and happiness." There is a general support for the freedom to accumulate wealth and possessions. However, human and selfishness is nevertheless viewed with contempt and attempts are made to ensure that there is equality of opportunity and fairness for the less fortunate. In addition, Christianity, through the Ten Commandments, provides the basis for what are considered ethical behaviors. The Muslim lives in a society that is heavily influenced by Islamic standards and norms. Islam provides encompassing guidance in all spheres of life, both social and economic. Those who serve Allah and accept the reality and oneness of Allah go to paradise in the afterlife. Muslims also believe that Allah wants them to live. The Muslim to follow five pillars, namely Confession or submission to the will of God, Prayer, Alms-giving, Fasting, and Pilgrimage to Mecca.

These pillars have important implications for multinational strategic management. The alms-giving pillar also has critical implications for multinational strategic management and how Islam views business. Multinational managers thus have to ensure that their business activities are conducted in a socially just manner. They also have to ensure that some form of alms giving is practiced. Muslims (and organizations) are required to share the accumulated wealth by charitable giving to the poor. This practice is seen as necessary to decrease social inequalities and personal greed. Multinational companies may thus be well served by participating in such donations. An important consequence of Islam's condemnation of exploitation of others is that Islam prohibits the payment or receipt of interest. Islam regards payment or acceptance of interest as a very serious sin. Such practices are not just ideals but are actually respected in many countries, including Pakistan. In such countries, governments have instituted financial laws that label interest as illegal. For a multinational company operating in a Muslim country, the prohibition of interest presents a serious challenge. However, many Muslim societies have been working in profit-sharing plans to avoid the payment or receipt of interest. For instance, if a multinational borrows money from a bank in a Muslim country, it should expect to be asked to share the profits from the investment as an alternative to interest payment. Multinational managers should thus be prepared to formulate creative but acceptable ways to manage their finances.

Hinduism is a broad and inclusive term referring to those individuals who respect and accept the ancient traditions of India, "especially the Vedic scriptures and the social class structure with its special respect for Brahmins (the priestly class)." Unlike Christianity and Islam, Hinduism has no specific founder, and Hindus place no special significance on historical events or sequences of events. Rather, Hinduism through the Vedic scriptures is seen as timeless and eternal. There are currently about 760 million Hindus residing in India, Malaysia, Nepal, Suriname, and Sri Lanka. Many of the Hindus outside of India share ancestors from India. Spiritual achievement is a very important value for most Hindus. Weber, in a comparison with Protestant values, argued that this emphasis on spiritual achievement conflicts with entrepreneurial desires. He argued that compared with devout Protestants, devout Hindus are less likely to engage in entrepreneurial pursuits. In fact, Hindus believe that the sole pursuit of wealth accumulation makes the search for Brahman difficult. The reality for multinational companies has nevertheless been contrary to Weber's predictions. India has seen a growth spurt in new business creations and multinational managers find that workers are motivated and creative. One aspect of Hinduism that is most likely to have implications for multinational companies in India is the caste system, which refers to the ordering of Indian society based on four occupational groups. The highest caste includes the priests, followed by the kings and warriors, then merchants and farmers. The fourth caste includes the manual laborers and artisans. Although the caste system seems unfair and is illegal in India, its main purpose was to create a higher law that would subordinate individual interests for the collective good. It remains a dominant feature of life in India today. As such, multinational managers operating in India have to be aware of the caste system.

Buddhism refers to the broad and multifaceted religious tradition that focuses primarily on the reality of worldly suffering and on the ways one can be freed from such suffering. Siddhartha, Gautama or Buddha, born a prince around the sixth century B.C. in India, founded Buddhism. Buddhist accounts of the life of Buddha suggest that his father tried to protect him from seeing suffering to prepare him as a king. Buddha was dissatisfied with the impermanence of life, however, and when, he turned 29, he abandoned all riches to become "a wandering ascetic, searching for truth. Today, Buddhism is very popular in Europe and the United States, although most of its followers are found in countries such as Cambodia, China, Japan, Korea, Laos, Sri Lanka, and Thailand. In this section, we looked at

four of the world's main religions and some implications for multinational strategic management. Now, we look at a final social institution, namely education. Education is a key aspect of most societies; although its effects on multinational strategic management may not be as substantial as those of the other three social institutions.

## 6. Education

Education refers to the "organized networks of socializing experiences which prepare individuals to act in society" and "is also a central element in the table of organization of society, constructing competencies and helping create professions and professionals." Education is seen as a critical path to economic development and progress. Most countries want to achieve universal educational enrollment because education enables society to instill the skills, attitudes, behaviors, and knowledge that allow people to demand more and give more to society. Such exchanges enhance the expansion and modernization of society. Education has obvious implications for multinational strategic management. At a basic level, educational levels give an indication of the skill and productivity of workers in any society. The more educated workers are the more skills they possess and the more likely they are to contribute to a country's production, both in products and services. Educational systems have implications for how labor force issues are approached and policies implemented. For instance, the educational systems determine the nature of the workforce. A final issue is the extent to which educational systems actually encourage students to be innovative and creative. In that context, many Asian societies have been grappling with the redesign of educational systems that are extremely competitive at the secondary level but that rely heavily on rote learning.

## 7. Globalization and Convergence

Despite the evidence presented earlier about how social institutions may cause differences between countries, some experts believe that many management practices, especially those related to strategy and structure, are becoming more similar. This increasing similarity of management practices is called convergence. In fact, many of the multinational management examples will show the effects of convergence. The examples come from organizations throughout the world and illustrate management practices readily copied and used by managers of all nationalities. Coercive, mimic, and normative isomorphic pressures for similarity described earlier not only work within countries but are also beginning to work cross-nationally. For example, agreements among countries such as regional trade agreements and membership in the WTO provide supranational regulatory environments that affect management practices. Cross-border competition, trade, mergers, and acquisitions provide more opportunities to learn about and copy successful managerial practices from anywhere in the world. Normative pressures for similarity come from the internationalization of business education and the movement of managers across borders. The following paragraph will show in more detail how globalization pushes organizations to be more similar.

The similarity of customer demands and the increased likelihood that companies and people shop worldwide limits the options managers have in strategy and structure. This results in managers creating similar organizations with similar capabilities to serve similar customers. Growing levels of industrialization and economic development results in convergence because more organizations have the technical and financial capability to use similar technologies. In turn, the technologies used by organizations limit the strategy and design options available to managers. International competition raises managerial awareness of what people in other countries are doing. The growth of U.S. managers' interest in Japanese management, for example, occurred because of increasing Japanese competition

with U.S. companies. Increased trade means that managers interact more with each other and learn more about the strategies and structures of organizations from different societies. Both competition and trade encourage managers to mimic or copy what works in other nations. As with cross-border trade when companies from different nations combine, such as the recent merger of Chrysler and Daimler-Benz, managers combine the strategies and organizational designs from both nationalities. These combined organizations provide a wealth of information on the organizational practices of other societies. Later, parent organizations use this knowledge to change and improve their own organizations. They must find strategies and structures that work for all the participating companies regardless of nationality. Increasingly, organizations are looking for CEOs, managers and technical experts from any country that can provide the highest level of talent. When managers cross borders, they bring with them the technical and managerial knowledge from their country of origin. This migratory knowledge increases mimic isomorphism, or the ability of managers to copy strategies and designs from other countries. Business education also homogenizes organizational practices. In particular, the large number of international students in U.S. and European MBA programs helps spread common business techniques. Many students return to their home countries with the intent of adopting management practices that best fit their national culture. Cooperative MBA programs between universities in developing nations and partner universities in the United States and Europe also transfer management practices. Despite the trend toward convergence, however, social institutional differences still affect many firms compete through their choices of strategies and designs and how they manage the human resources. Savvy multinational managers must understand these differences if they want to be successful.

## **8. National and International Management**

Social institutions are important key aspects of understanding the business environment in a country. In conjunction with national cultures, social institutions share norms, values and beliefs that determine acceptable and unacceptable business practices. However the national context's role is not only limited to shaping of business practices. The national context significantly influences a company's strategy. For instance, on multinational strategies that the national context determines the comparative advantage of nations, which ultimately determines which strategies multinational companies choose. The concept of comparative advantage refers to the idea that countries prosper when they can produce goods with the lowest comparative cost of production. Thus, countries that have educational systems that emphasize sciences have a comparative advantage through the supply of skilled but cheaper workforce. For instance, India is gradually becoming the center for software development because of a ready access of software engineers. The national context also determines the global platform, namely the areas of business that can be best performed in a country. For instance, most pharmaceutical companies tend to be located around universities and other research and development laboratories in more industrialized nations because of the crucial dependence of that sector on research.

The national context also plays an important role in the human aspect of international management. The national context is also seen as a determinant of the nature of the relationship between workers and their superiors. Furthermore, the national context determines how people view work and sets the stage for motivation in an international context. Finally, the national context also influences how multinationals approach human resource management policies. This discussion clearly shows the impact of the national context on the international management.



## 9. Summary

This research paper first describes social institutions and explained how these affects individuals and organizations. Then it described the economic systems especially reference to the extreme types of economic systems. In societies arranged as socialist systems, the government owns the systems of production, whereas in capitalist systems, private individuals make production decisions. The institutional context also includes industrialization. In that context, we discussed pre-industrial, industrial, and postindustrial societies and their implications for multinational strategic management. Pre-industrial societies are typically less developed and, thus, present significant- challenges for multinationals. In contrast, industrial societies tend to be more economically advanced with the manufacturing sector dominating the economic environment. Finally, in the postindustrial society, services become the dominant sector, and people start shirting from achievement values to more quality of life values. Religion is also an important social institution in most societies. We discussed four of the major world religions - Christianity, Islam, Hinduism and Buddhism and how each of these religions and important components has business implications. The final social institution discussed is education. Educational systems have important implications relative to the available skills and experiences of the workforce in any society. However, other aspects of educational systems, such as the emphasis on sciences and mathematics, were also discussed. Finally, we considered the possibility that the social institutions described in the research paper may actually be causing companies to become more similar than different.

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