

CHAPTER II. LITERATURE REVIEW

Culture

2.1 The Evolution of Culture

Informal rules of behavior which Denzau and North (1994) designate as institutions are studied by many as the factors that influence personal decisions and the decisions of the organization. It is necessary to study the organization because it is dependent on the entrepreneur that governs it. These are learned behaviors that teach people how to look at the world and make decisions accordingly. The frame of reference that a person has that directly influences their decision making is called a mental model.

A person's mental model is a direct catalyst for the types of decisions that are made. The formation of a model happens like this, first a person learns how to interpret the environment. Humans have historically lived in groups since people needed each other's assistance for survival. These groups of people share the same learning experiences or interpretations of the environment. Basically they work together for survival and come up with better methods of manipulating the environment to better facilitate their survival together. This group learning takes the form of a cultural background. People who share the same culture background share convergent mental models that have been developed in response to the environment (Denzau and North 1994, Hofstede 1993). Convergent means that these models that were previously held by individuals have come together to form mental models to be held by society.

Groups of people who are from different areas of the globe will have different learning experiences because the environments in which they live are different. The way in which people interpret their environment leads to their concept of reality. This can be evident in the variety of religious beliefs around the planet and the subsequent wars over territory. Therefore, when people of other cultures get together a clash of different interpretations of reality come into contact. "...different cultures, which often simultaneously co-operate and compete and thus have different and conflicting objectives". (Petrovic and Kakabadase 2003) It is these conflicting interpretations that can increase or decrease a country's Gross National Product, not to be confused with Gross Domestic Product.

This is especially true if there are different interpretations of ethical standards. Ethical or unethical decision making will affect an organization's ability to increase its profits as well as

affecting the internal structure, marketing strategy, and employee relations. (Ford et al 2005) These differing ethical perspectives, whether it be based on a society's designated moral standards such as copyright laws or an organization's corporate culture as to the question of whether the use of bribery to achieve a contract is acceptable or not, will be shown in the values and beliefs of the organization. This is an institutional framework. The number of disputes filed against other countries can show differences in ethical frameworks. Ethical frameworks are a subdivision of institutional frameworks, a part of the whole. A differing ethical framework is a threat to economic performance. Therefore a better understanding of institutional knowledge perhaps could lead to decreased amount of free-riding among countries.

2.2 The Importance of Cultural Knowledge Today

Differences between peoples are area specific. Some areas of the world have a more harmonious homogeneous cultural reasoning, such as Sweden or North Korea. Smaller areas with indigenous populations making up the majority are easier to classify. Larger regions such as the United States with its multicultural background and divergent ethnic groups or China with a multitude of language dialects and a proliferation of sub-cultures would make it harder to classify.

Culture can manifest itself in two major forms, informal social rules such as norms and mores, and formal constraints on the citizens of the collective such as laws and constitutions. In a homogenous culture this may not be a distinctly important strategic business variable when people "operate mainly within their native socio-cultural context rather than another social-cultural context"...however..."organizations often operate subsidiaries in other countries and employees in subsidiaries are exposed to the socio-cultural environment prevalent in a given country as well as the organizational structures imposed by the multinational organization that has been shaped by a different socio-cultural environment" (Fisher et al., 2005).

In addition to a company having subsidiaries in foreign locals, another possible situation calling for the need of a professional's cultural competence would be the international joint venture (IJV). This is becoming increasingly important in the areas of the world such as China and Eastern Europe that used to have state owned enterprises but are now privatizing. Petrovic and Kakabadse (2003) define an international joint venture (IJV) as "a separate legal entity representing the partial holdings of two or more parent firms, in which the headquarters of at

least one is located outside the country of operation of the joint venture. This new entity is subject to the joint control of its parent firms, each of which is economically and legally independent of the other.” In many of the newly opened economic zones the IJV is the only means of entry into the countries market. The professional sent to head up that IJV must demonstrate the needed cultural empathy.

This is especially true as the nature of foreign assignments is changing. No more are people going on foreign assignments to get the job done (being one specific job) known as expatriation. Nor are they being sent to integrate the locals to the ideals of the home country known as inpatriation. Instead the emphasis is now on enhancing individual learning in conjunction with organizational learning across the whole system of the organization known as transpatriation. The need for greater cultural competence for Americans is apparent as many American managers believe that the world stops at the United States borders perhaps because of the massive impact by American researchers on human resource practices. (Adler & Bartholomew 1992)

There is a relentless need for talent to be developed to create tomorrow’s leaders due in part to the out/insourcing of work around the world. According to Gandossy & Kao (2004) leadership talent is expected to decrease so executives are scanning the globe to find new talent of the new generation. This talent can be found in the foreign educated individuals who have the cultural sensitivity to effectively deal with people in other cultural settings. Much importance is placed on the formal rules of a country’s culture but true knowledge about a culture different from one’s own comes from the knowledge about a society’s informal culture. Since each nation has a different informal culture, no matter how similar some countries might be to each other, this understanding of informal culture that can lead to greater economic performance through international trade. This is due to the fact that the informal culture, or institutions, support the rules of the national area such as the importance of religion, language, ethnic background, history, or political systems. (House et al. 2001) The political systems are what guide the activities of a country’s economy by dictating the practices that organizations within that country have to adhere to. It takes a new kind of leader to manage people from many different cultures; a manager best trained by first hand experience of working, studying, or relating outside his or her national boundary. The type of knowledge gained here is known as tactic knowledge or “knowledge which draws on the experience and learning of a person and which is hard to

reproduce or share with others” as opposed to explicit knowledge where “knowledge can be documented, categorized, transmitted to others as information, and illustrated to others through demonstrations, explanations and other forms of sharing” (Debowski 2006). It is difficult to understand another cultural belief system through the use of documents as a way of learning. This provides theoretical or explicit foundations but not practical ones. Leaders that have been educated through tacit knowledge are the most valuable due to their knowledge based on experience.

2.3 The Culture Cycle of Economic Success

The neo-institutional school of economics acknowledges the importance of how the culture of a country affects a country’s economic growth. Institutions are the representations of the informal belief systems that are contained within a nation’s internal identity. (North 1994) These belief systems have been created from the evolution of knowledge gained about how to interpret the environment, also known as shared mental models. They are shared because more than one person holds them to be true (Shepsle 2001).

According to North & Lance (1971), this is a result of three factors: trade, capital flow, and regional expansion. The investment in infrastructure caused by the three factors resulted in the division of labor and organizational innovation and reform. An increase in innovation led to a need for the protection of intellectual property rights. It is this effort that has led to increased membership in the World Trade Organization with one of the goals being to reduce transaction costs.

A dispute is created when a company or nation feels that the rules of free and equitable markets have been breached. How a dispute is resolved can be a sign of the values held by that region.

The goal of membership in the WTO, regional trade agreements, or any trade across national boundaries is to increase in social welfare. As regions expand and greater resources are made available, regional businesses grow. This growth results in an increase in employment. An increase in employment creates a need for knowledgeable individuals on the staff. If knowledgeable individuals cannot be found within the region then the businesses have no choice but to import individuals from other regions. Since it is in the regions’ best interest to cultivate

the knowledge of the workforce within its own region this leads to investment in education on knowledge.

This is evident today in the trend of local universities becoming reputable internationally by recruiting foreign students. The more international a school becomes the more lateral learning the students can receive through the diversity of the student body. The result of international study would be a reduction of information costs. Information costs get lower the more varied this knowledge held by the workforce is. One example of this is knowledge of a foreign language. Two employees who speak English, Chinese, Spanish, and Korean are cheaper than having four employees on the staff—one per each language. Therefore there is a negative correlation between languages learned and information costs. Trade is increased through the mutual understanding of different cultural value systems. An individual who has a high level of cross-cultural competence can be this liaison thereby reducing information costs and transaction costs. The competitive advantage comes from the ability to implement new techniques acquired from foreign lands mixed with a capacity for cultural understanding and familiarity to understand a competitive market other than their own. (Fisher, et al 2005)

With increased interaction across national boundaries, knowledge gained from benchmarks, exchange of information, and repeated transactions lead to a change in the current system of doing things. This changes regional cultural value systems¹ as a result of not using the available resources in the most efficient manner. A strategic move towards efficiency and innovation is often made when one region sees how another region has achieved success and then incorporates that success locally. Otherwise, a region would continue on its path dependence. Path dependence is defined as the course of action that individuals and groups will follow naturally because it has historically proven successful. North claims that through path dependence, once a practice has proven to add benefits for the individual or group then there is incentive to continue on that course to keep making profit unless an outside factor changes its perception of the world.

The cycle then starts to run all over again since a change in cultural value systems will then influence international trade, capital flow, and regional expansion. The goal of this cycle is

¹ The terms cultural value systems, culture, and institutions are all used to convey the same meaning. This is done because culture is termed different names between the social sciences and economics. Also the term culture has become a watered down word that has lost significance and has been reengineered using terms like values and institutions so that accurate understanding is made thereby enhancing clarity.

the efficient use of resources. From an institutional perspective, changes in governmental policy and student migration can gauge cultural value change in nations by comparing these policies with economic output. By comparing the trade performance of the United States with the changes in cultural values then how culture affects trade performance can be measured.

2.4 Subdivisions of Culture

Douglass North (1994) makes the distinction between formal and informal constraints using the terms institutions and organizations. This definition is in line with the neo-institutional school of economics.

Institutions are the informal rules of the game while organizations are the players of the game. For a player (organization) to play the game well internationally, they now need to understand many different varieties of institutions. These include: mores, taboos, norms, religions, gender diversity, and acceptance; among others. Some cultures have prepared for this better than others due to fact that they have strategically planned their new entries into markets according to their economic ambitions. Therefore the international player needs to be educated about its opponent. As far as education is considered, many employees from the Western World and especially the United States have not gained sufficient cultural exposure due to the fact that they mostly remain in the vicinity of their native region during their educational progression and after to work.

On the other hand, the developing and newly developed countries, such as those in the Far East, currently have a competitive advantage by having had their workforce trained in a context different from the socio-cultural environment they grew up in. In other words, people from these regions of the world have been sent abroad to study, have lived in a different culture and gained understanding from the experience, and then have returned home with this new knowledge of institutional and organizational understanding. These people display tacit or implicit knowledge which refers to the knowledge that cannot be made fully explicit and typically resides in patterns of relationships, norms, information flows, ways of making decisions, and other organizational factors. (Gulati 1995, Debowski 2006)

The competitive advantage comes from the ability to implement new techniques acquired from foreign lands (Fisher et al. 2005, Hofstede 1993) mixed with a capacity for cultural understanding and familiarity to understand a competitive market other than their own. This

leads to better strategic thinking. By hiring an individual who has been educated abroad and has brought back new knowledge, a firm can increase its competitive advantage. This, in effect, can change or add to the nature of the organizational culture because the organizational culture can be more of a heterogeneous mixture of “the best measures”, otherwise known as benchmarks, taken from different regions. The case of software engineers returning from abroad to create start-up companies in India using knowledge acquired from the United States is a case in point.

2.5 Social Identity through Culture Classification

Hogg and Abrams (1988) expand on the socialization process function which was developed from the theories by Henri Tajfel and John Turner who created the social identity theory. Social Identity occurs in three ways:

1. “Categorization” where stereotyping occurs and we label people according to a category such as religion or nation.
2. “Identification” where we feel most comfortable with the stereotype we relate too, such as Chinese people feeling more comfortable dealing with other Chinese people or Chinese similar culture (such as overseas Chinese). This is also known as in-groups. This is evident in the way that identification alters organizational forces such as the characteristic that Americans like detailed contracts and Chinese prefer contracts based on general principles (Salacuse 2005)
3. “Comparison” where we compare ourselves at the in-group level and individual levels with those who are different from us.

Since the off-shoring and outsourcing of work from the United States is causing great debate on the benefits of globalization added with the developments after 9/11, an even greater need of cultural understanding, both institutional and organizational is needed. Even though the Hogg & Abrams article (1988) about social identification was written before these events, the results of these events are even truer today that countries and individuals naturally sense a danger to the stability of their collective group as in the case of some countries being threatened by WTO membership. In other words, there is a perceived threat to social identity when confronted with factors that could possibly alter the classifications from which society views its place in the world. Two cases in point would be the belief by the French that American culture is destroying and replacing theirs and the fact that factions in Iraq feel threatened that their social identity is

being altered by the American led occupation. Barring incidences of students not being allowed to study in a country due to social threat factors, there is a need now more than ever for people to have cross-cultural understanding to alleviate these perceived threats to social identity and bridge the gap between cultures through institutional understanding.

2.6 Informal Culture or Institutions

“The informal rules of engagement that govern individual and group decision making processes can be generally called institutions...” as abstract principles of governance and as a real way of doing things collectively. (Mantzavinos et al 2004, Shepsle 2005b) In the vernacular, these shared or convergent mental models are called values. When a group of people come together, such as in the case of religion, they have a shared sense of values which are commonly called norms or mores. Shepsle (2005a) cites North (1990) as referring to these institutions as taboos, customs, conventions, codes of behavior, traditions, formal rights, responsibilities, and constraints as are contained in modern contracts, official procedures, and written constitutions. These institutions are further broken down into categories of behavior by various researchers on the subject (Trompenaars and Hampden-Turner, 2004; Hofstede, 2001; Chinese Culture Connection, 1987; House et al, 2001).

All of this is an effort to make sense of these situations in which our mental models are challenged by other information, what Bird (2006) calls sensemaking. “Sensemaking is ordered into cognitive structures commonly referred to as ‘schemas,’ and the behavioral responses they elicit are ‘scripts’”. If one can anticipate another person’s schema then the behavioral script can be anticipated. This would provide strategic advantage to individuals dealing outside their own shared mental model.

The researchers of the social sciences named previously in essence have been trying to create new sensemaking schemas through the use of mainly quantitative approaches. These approaches are collecting information through the use of designed questionnaires seeking culture-value responses. Sensemaking is, in essence, a way to frame a situation to reduce uncertainty. The framing system is often recommended by Trompenaars and Hampden-Turner (2004) as a way of finding equilibrium in situations that would otherwise lead to an excess in either direction. Or in other words, it is beneficial to use a frame that encompasses as many variables as possible in order to make a more informed choice that one’s mental model would

allow, also called a rationality postulate. This is an on-going process because according to Williamson (1975, 2000) our ignorance level of institutions and their resulting interactions are very high, hence the need for individuals who can create order out of what seems like chaos. Until a unified understanding can take place, a pluralistic view is necessary. It is this pluralism that raises transaction costs by putting in the resources to lay out not only the detailed agreements of contracts but also how the negotiating process is to be handled and the binding of the agreement during the contract. Therefore, institutional understanding increases international trade and economic performance. One example of this effort of contractual agreement is the World Trade Organization.

Schein (1990) cautions that an insider is needed to obtain accurate concrete information through qualitative interview and that too often what outsiders see as a cultural artifact might cause the outsider to misconstrue a culture's practices. "Thus organizational stories, rituals and rites, symbolic manifestations, and other cultural elements come to be taken as valid surrogates for the cultural whole. The problem with this approach is that it fractionates a concept whose primary theoretical utility is in drawing attention to the holistic aspect of group and organizational phenomena." Many researchers use a quantitative analysis to determine the significance of cultural artifacts. It is Schein's intention to doubt any cultural trait examined by quantitative or qualitative means performed by an outsider because he views informal rules as elusive. Bird (2006) would agree with the facet that an outsider can never have complete understanding of another's in-group by saying that an insider provides an emic perspective on the inside of the culture rather than an etic perspective obtained from an outsider. It is the emic perspective that is warranted so that outsiders can form a "sophisticated stereotype" to begin to process the other person's institutions and decision making rationality or schema.

Jackson and Aycan (2001) claim that both an emic and etic view are necessary to examine cross-cultural issues. It must be noted that this is usually placed on the national level and a much closer look would have to be performed to take in organizational, departmental or individual mental models. This can be achieved by the individual who is educated in a foreign locale and who becomes an insider of that locale to a certain degree. The longer a foreigner lives in a foreign environment the more he/she will be seen as part of that in-group. A solution to the emic and etic perspective would be using foreign educated individuals to bridge the gap between the two. According to Alder and Bartholomew (1992) people must learn foreign culture

perspectives as in tastes, trends, technologies and approaches to conducting business. They have to be skilled in working with people from many cultures simultaneously and they must be able to adapt to living in a foreign culture. Here the emphasis is on tacit knowledge through experience though this can also be assisted by explicit knowledge through study. There is now a need for cross-cultural skills on a daily basis throughout one's career not just on a specific assignment and most importantly to interact with foreigners as equals without the mentality of cultural dominance. The foreign educated individuals are just those types of individuals who would display the competence described, such as language skills and knowledge of the rules of engagement.

Institutions and Trade

2.7 The Organization

Fisher et al. (2005) and Ostroff and Bowen (2000) extend these ethical dilemmas to the organization saying that norms, which come from the socio-cultural dimension, affect organizational practices across the board—specifically work attitudes and behaviors. When new members come into the organization they learn these socially acceptable behaviors. If they want continued employment and acceptance they will perpetuate the learned values taught to them if not by the organization then by institutional understanding through study or experience. This requires an internalization of values coming from foreign or other outside sources. (Schein, 1990) Sometimes there needs to be a liaison to bridge the connection between the national culture of the populous with the attitude of the individual or sub-group. There must now also be liaisons to bridge cultural gaps across regional contractual agreements. This is represented in the organizational practices of one company or the agreed rules of engagement of a coalition, such as free trade agreements. Dominant free trades agreements include NAFTA, ASEAN, and the EU. A dominant example of a coalition or cartel is OPEC. For the main objective of this study the WTO is the important contractual trade association, regional trade agreements will satisfy the sub-objectives of the study. The liaisons within the WTO are the countries that act as impartial third party members to settle disputes to ensure the enforcement of rules of trade and to promote the protection and transparency of property rights.

2.8 Organizations in Play

These trade organizations are contracts. Gulati (1995) asserts that transaction cost theorists believe that the anticipated transaction determines the type of contract used in an alliance. This is due to the belief, or more appropriate word fear, of opportunistic behavior by the other partner (uncertainty avoidance). The resulting uncertainty avoidance incurs the costs of negotiating, writing contingent contracts, monitoring contractual performance, enforcing contractual promises, and addressing breaches in contracts. All of which determine if one is to increase revenue through the success of contracts by keeping transaction costs to a minimum to save money. Negotiation is needed to bring both sides together to an agreement—an impartial negotiator, a channel, or a person with institutional understanding would be the best choice. It

must be noted that this is when an initial deal between two opposing parties is struck otherwise as Larson (1992) notes relational factors become increasingly important over time as social control begins to take over. This means that when people start to trust each other the relationship matters more than a detailed outline of guidelines which are initially made out of fear of free riding. As will be addressed later, this closes the gap between the distance in levels of uncertainty avoidance between the two parties. If both parties are benefiting from the contract then the power distance between the two countries approximates equality over time with repeated actions.

This fits with the notion of game theory which rests on the assumption that the more information is known through the process of repeated plays of the game the stronger the agreement is by increasing the level of informed knowledge of other players thereby reducing information and transaction costs. The emphasis here is on an increased amount of informed knowledge, but not complete knowledge which is impossible to achieve. Gulati (1995) goes on to say that the entering of the possibility of trust between alliance partners emerging from prior ties clearly alters assessments of the transaction costs associated with specific alliances. It is an issue of trust.

A person who has been educated in a foreign environment can increase the trust on both sides by better facilitating communication such as in the case of an IJV. Petrovic and Kakabadse (2003) quote “the most important requirements for the IJV general manager are his/her abilities to express vision, values, and expectations, being diplomatic and skilled in cross-cultural understanding and communication. IJV managers will have to develop special liaison skills to cope with mixed loyalties and conflicting goals that characterize shared and conflicting goals that characterize shared ownership and shared decision making...to reduce factionalism.” Early training in an environment from the host country or being educated in the parent country, would be an asset, reducing transaction costs and saving money.

2.9 Why Neo-Institutional Economics?

Denzau and North (1994) use the term institutions to refer to the ideologies that a cultural background embodies. Institutions will be used from hereon in to refer to cultural knowledge that manifests itself in informal rules of behavior (which in turn influence external rules of

behavior). In neo-classical economics, it was assumed that individuals made choices based on substantive rationality or that people had full knowledge about the choices they made. Williamson states this as limited cognitive competence which has the same definition as bounded rationality. (Allen, 1999; Williamson, 2000; Coase, 1937)

However, within the last couple of decades, the use of institutions has come to the forefront of economic theory forming institutional economics or rational choice institutionalism (Shepsle 2005b). An important distinction in institutional economics is that individuals operate with imperfect knowledge of each other and the market is a deciding factor on the choices they make. An example of this is when a consumer goes to buy a new washing machine, due to a myriad of factors they will never be able to make a completely informed decision about which washing machine would be the best one for them to buy because of a lack of foresight, consumer knowledge, degree of knowledge that the sales person is willing to give, knowledge of future markets, knowledge of if the machine will break or not, etc. This fits in with cultural understanding because an individual cannot have full information about the institutional frameworks of a foreign environment. Even if an individual is educated in a foreign environment, full knowledge can never be obtained.

On the other side of the coin, in some countries such as the United States with a mix of different regions and ethnic groups complete knowledge can never be obtained by Americans about other Americans either due to differences in regions, ethnicity, diversity of language, and sub-cultures. “We only have a finite, often very small data sample of real experiences from which to learn... (Denzau and North 1994). The best one can do is to amass as much information as possible in order to increase effective strategic thinking.

Activities in business that stem from and try to resolve incomplete information include communication efficiency and negotiation in an effort to stipulate contracts which as will be seen later, are related to the property rights definition of transaction costs. If free-riding is an option then fraud and theft will be a consequence of incomplete information. It is theorized that if free-riding is naturally in human nature then this will be the most convenient way of conducting operations unless there are constraints preventing it. If self-interest is a governing factor than free riding is an unavoidable consequence. Since incomplete information is a given, methods are needed to either promote or restrain these activities—constraints against free riding and enforcements to govern agreements.

In a globalized world with globalized competition, strategic prediction is needed to lower costs and reduce disputes against member countries in trade alliances and this is done by institutional understanding. North (1993) argues that what has made rapid economic process possible is the creation of a system in which anonymous transactions can occur. This is the basis of the belief that deregulation is good for business and that inversely governmental interference is bad for business in a free market economy. Neo-classical economics assume a zero cost transaction world is possible. Only in state run economies, such as North Korea where the state determines its own transaction costs, does an economy approach a zero cost model since transaction costs would only exhibit the costs of exchange which are dictated by the state. (Allen 1999) However, in a free market system, transactions costs will always be positive. So we have to accept transaction costs as a way of doing business but the amount of transaction costs can affect an economy. The higher the transaction costs the lower the GNP for a country because these resources spent on transaction costs cannot be saved. If the resources could be saved then they have the possibility of being allocated elsewhere in business and economic policy to increase other avenues of trade. Therefore reducing transaction costs is one of the goals of efficient resource allocation. But what are transactions costs exactly? There seems to be some debate on the subject.

2.10 The Definition of Property Rights

The general definition would be that transaction costs are created through the making and sustaining of property rights. "...property rights, broadly defined as all laws, rules, social customs, and organizations that generate incentives for behavior" (Allen 1999) which has been the impetus for the creation of neo-institutional economics. The problem in that definition is that it is too broadly defined which creates debate in the economic community on just what transaction costs should be defined as.

Coase (1937) came up with the idea that there were costs involved when using a price mechanism which involved the discovery of what prices are, negotiating and closing a contract; and the difficulty of binding the players to this contract. This is a question of ownership and the allocation of what is owned otherwise known as resources. Therefore transaction costs, being positive in nature in a free market economy, are necessary for the existence of the firm. It must be noted that Coase, who was a believer of neo-classical economics, didn't put the concept of

transaction costs into explicit words until much later in 1960 and when he accepted the Nobel prize for the ideas he put forth in his 1937 work.

Alchian (1965) puts forth the definition of property rights as the “the rights of individuals to the use of resources”. They do not necessarily rely on the state but are a matter of custom and voluntary restraints (Allen 1999). Thus, according to Alchian they are governed by institutions. This definition puts emphasis on economic rights instead of the legal rights of the individual or firm. Allen (1999) goes on to give the definition of property rights as “the ability to freely exercise a choice over a good or service.”

The neo-classical definition of transactions costs are costs that result from the transfer of property rights or as Demsetz (1964) puts it, “Transaction costs may be defined as the cost of exchanging ownership titles.” The important distinction of the neo-classical definition of transactions costs is that transaction costs will only exist when property rights are exchanged between players. So this means that resources have already been allocated and it doesn’t take into consideration the effort put into making contracts but places the means of transaction costs on the buying, selling, and transferring of property and not on the making of agreements. This definition falls short of the complete role of transaction costs in cultures where work goes into the establishing of relationships before contracts are agreed upon with the goal of first creating rapport.

According to the Coase Theorem which claims that property rights should be first assigned to the players who would efficiently use them the most; then, as a consequence, economic resources would not have to be spent on transactions costs. This is a neo-classical view of economic theory which says that property rights can be perfectly set creating the possibility of a zero transaction cost world.

However neo-institutional economics says transaction costs can never be zero because property rights are never perfect. Though property rights can never be perfectly defined it can be theorized that the more perfectly defined the property rights are the more gains from trade can be maximized. Here the emphasis is not on buying, selling, or transferring property but on arranging agreements for business transactions.

For the purpose of this thesis, the definition of transaction costs are the costs incurred by the negotiating and defining of a legal agreement between two or more organizations, whether these organizations are domestic, multinational, or a combination of both. Therefore, transaction

costs arise from a need for transparency of an agreement to bind the players to the game noting also that once the players are bound further transactions costs are incurred by the maintenance of the agreement and the possibility of forfeit of the agreement if free riding or some other form of dispute exists.

2.11 Transaction Costs and Institutional Understanding

The foreign educated individual as a negotiator, the WTO, trade agreements, and other organizations such as UNESCO are examples of parties that have the ability to equalize property rights and lay out contracts between two parties to maximize profits. This follows that the negotiator, the foreign educated person in this scenario, would use institutions as the basis to foresee and understand what would be acceptable in a contract by a foreign party. Unless an entrepreneur wants to create institutional change or perform free riding, he or she would naturally prefer to have property rights clearly defined since this would lead to a greater increase in wealth. The negotiator would naturally have to follow what top management or the entrepreneur would agree to institutionally which would affect each business involved in the contract on an organizational level.

This happens within institutional regions such as a nation and between cross-institutional regions such as international, multinational, or global businesses. This is the establishing of property rights—the establishing of contracts to bind players to the game. Property rights are created by the use of contractual agreements between players to ensure the maximization of profits. Since organizations are becoming organic in nature to strategically survive in the ever-changing global market place, property rights must be maintained and more importantly enforced to prevent free-riding or disintegration. This definition is at odds with the neo-classical economics definition but fits in nicely with the new-institutional economics definition of transaction costs.

2.12 Transaction Costs Incurred

Someone has to decide at some point how the resources will be divided, such as in the case of an IJV, merger, or disputed territory. A case in point is in the South China Sea where property rights over the untapped energy are in dispute between Asian countries. Therefore first property rights must be established and maintained but what happens when a firm undergoes

divestiture due to an unsuccessful merger or failure in the market? Demsetz (1995) says that transaction costs still represent the coordination of resources through market arrangements. This would be attributed to the maintaining aspect. Allen (1999) suggests that the definition of transaction costs depends on the problem faced by the contract organizer. Demsetz (1995) states that the problems that incur transactions costs include:

1. Shirking

The avoidance of responsibility.

2. Knightean Uncertainty

This is defined as risk or “uncertainty arising in situations where moral hazard prevents individuals from assigning accurate probabilities to events and thereby eliminating the ability to contract over the risk.” (Allen 1999)

3. Reduction of Coordination Costs

Where the agreement needs to be altered thereby having a need for negotiation.

4. Agency Problems with Optimism

The question of trust of what will bring financial gain in the future upon which both sides can agree.

These are all issues of strategy which need to be considered and measured when a country enters into trade agreements with other countries. Of course since one can only have incomplete information, the multinational professional will need an education in cross-cultural understanding to make the best decision possible by striving to achieve perfect knowledge as an ideal but that cannot every truly be a reality. Since property rights are never clearly defined, binding the players to contracts to prevent free riding is an issue. According to Allen (1999), property rights are increased in three ways:

1. The individual may steal the good in question.
2. The individual may privatize a good that was previously in the public domain.
3. An individual may cooperate with other individuals with an agreement to divide the new wealth in some fashion.

2.13 Power Distance Theory

Due to the threat of free riding which can be seen in the responsive measure of filing disputes among member countries in the WTO against each other, there needs to be continuous

maintenance of the protection of property rights while attempting to increase wealth by trying to create new property rights for increased resource allocation. A reason for this may be due to the fact that property rights might be incomplete. This process raises transactions costs because both sides want to make sure that there will be no deviation from the agreement. National organizations want to reduce transaction costs to protect their own property rights. The importance for organizations that are multi-national to reduce transactions costs are even more paramount since the process of negotiating property rights and the enforcement of the contracts can lead to the success or failure of international joint ventures, foreign subsidiaries, or foreign trade. The purpose of these organizations is to find the optimal level of resource allocation of property rights that maximize the gains from trade. The issue that both organizations need to resolve so that both parties can benefit from an equal exchange of trade is the Power Dependence Theory which states that bargaining power rests on the exchange relationship between two actors (individuals or organizations) where one actor's power results in another's dependence. (Yan and Luo 2001) Unequal distribution of power can lead to free riding as a cause. Either the one in power thinks it can do whatever it wants because it has dominance or the underdog will see free riding as the only course of action to regain a measure of dominance. With increased trade relationships it is hypothesized later in this study that power distance and uncertainty avoidance lessen between two parties as their economic capacity approaches equality, therefore Power Dependence Theory is true:

1. When players start to do business with each other, the amount of power between two parties is unequal with one party having greater power than the other and that avoidance is high of ambiguous situations as a result.
2. When the players have an unequal distribution of capital making one player have more resources than the other.

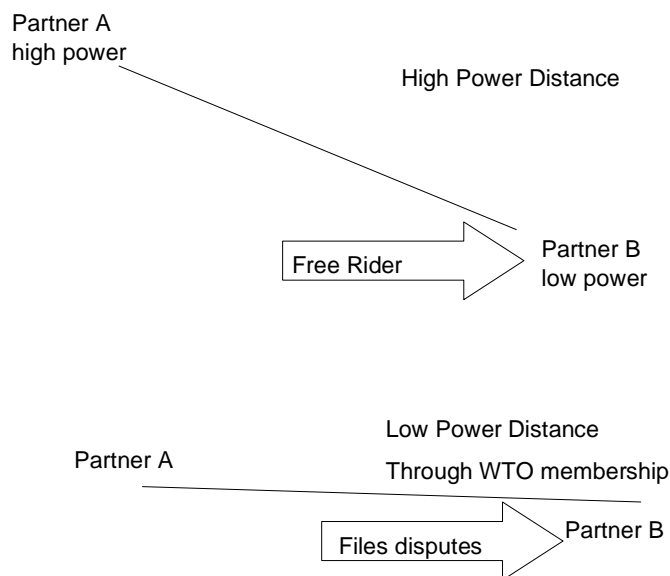
Therefore it would be most beneficial for governments to either strengthen existing institutions or create and maintain new institutions that would minimize transaction costs thereby reducing resource allocation to the lowest possible price. Since governments would create, restructure, or maintain institutions that would be derived from their shared mental models, a need is then created for individuals to obtain cross-cultural institutional understanding. The need for countries to create a contract for the allocation of resources or protection of property rights that reduces transaction costs is what has led to trade organizations such as NAFTA, the EU,

ASEAN, and the WTO. One word that can summarize the function of these organizations is transparency.

If information were costless then that would mean a perfect state of property rights allocation. Since property rights are in a constant state of flux and there needs to be constant maintenance to keep the players within an acceptable playing field information costs can be seen as related to transaction costs and show the need for constraints imposed on the firm by the firm for transparent business practices such as in trade agreements.

When a company enters or changes its behavior in a foreign market the level of uncertainty for the company increases. Making decisions in the face of uncertainty led to the creation of institutions in the first place thereby facilitating the process of learning. As it will be seen, the disposition for welcoming or resisting uncertainty is an important aspect of culture. As uncertainty increases, the cost of transacting also increases and how strong this phenomenon exhibits itself is often country specific. When an individual is faced with a problem and is uncertain of its solution it relies on institutions to facilitate decision making. Therefore, when transactions costs increase so does the importance of institutions, they affect performance (Coase, 1998; North, 1994a).

Figure 1. Power Distance Theory



To summarize, a property rights approach emphasizes that because organizations are dynamic and there are different variations across regions the continuing and end results from transactions can lead to unexpected outcomes. Before this was conceived by Coase (1960) and later by Cheung (1969) property rights were assumed to lead to expected results due to the stipulations on the distribution of property rights. It is these variations across regions that are called institutions. The greater the understanding of these institutions the lower the transaction costs of an arrangement, the lower the disputes against other countries, and the higher the GNP for a country. An understanding of these institutional dynamics is gained through repeated business transactions or by the cultural awareness obtained through foreign education.

Types of Institutions, Aspects of Culture

Only in the 20th century, after two world wars, has the global community turned away from an ethnocentric mentality and has placed more emphasis on a polycentric mentality. This has led to a change of thinking from the belief that other cultures, which are different, need to change and adapt to mirror the conqueror. The era of imperialism used through combat had become unpopular though it can be argued that institutional imperialism has replaced it. In the last half of century there has been effort to understand the existing institutions and how they are different. Not to change them, but to find ways of effective integrative behavior. In an effort to understand mental models that are different from what the individual's frame of reference comes from, researchers have been trying to classify these mental models for easier understanding.

It is the incomplete rationality of the mental maps we have formed to interpret the environment that dictate the choices we are to make economically and organizationally. Since national institutions and collective programming affect shared mental models; a look at the national and international level is needed. The national level is the easiest category to look at for it is the most common form of in-group. For this, Hofstede and The Chinese Culture Connection, the GLOBE project, and Trompenaars & Hampden-Turner are referenced.

2.14 Hofstede's Original Four

Franke, Hofstede, and Bond (1991) assert that differences in economic performance may result, at least partly, from differences in national culture. Their article reviews Hofstede's research on his claims about the dimensions of culture. From a study in the late 1960s to early 1970s conducted on IBM employees Hofstede created four divisions of national culture. These are shown in Table 1 and were published in 1980, (2001 revised version), in the book *Culture's Consequences* by Gerte Hofstede. This was the first attempt to measure culture and to place countries on a country value scale. From his study four dimensions of culture were created. This was the beginning of culture classification.

Table 1 Hofstede's four dimensions of culture based on his 1967 and 1973 study in IBM.

Cultural Trait	Meaning	Inverse Meaning
Masculinity/ Achievement	assertive or competitive orientation, as well as a sex-role distinction	caring attitude toward others, sexual equality, undefined gender roles
Power Distance	endorsement of inequality among employees	expectation of equality between superiors and subordinates
Individualism	the tendency of individuals to primarily look after themselves and immediate families	the integration of people into a cohesive group
Uncertainty Avoidance	taps a feeling of discomfort in unstructured or unusual circumstances, or future outcomes	shows tolerance of new or ambiguous circumstances, risky behavior, willing to test fate

Source:

Culture's Consequences: International Differences in Work-related Values, 1980.

Later, in 1987, another study was published by The Chinese Culture Connection which tested four values common to Chinese Culture as shown in Table 2. Hofstede's framework was seen as having a Western-centric orientation. Therefore the Chinese Culture Connection wanted to perform an independent study to determine any Eastern related dimensions that would have been missed by Hofstede. (The Chinese Culture Connection 1987) The study was relevant enough to show that the four dimensions in Table 1 were indicative of Western values but were not comprehensive enough to characterize people from Eastern regions.

Table 2 The Chinese Cultural Connection four dimensions of Chinese culture from their 1987 study

Cultural Trait	Significance of a High Rating
Confucian dynamism	An acceptance of the legitimacy of hierarchy and the valuing of perseverance and thrift without undue emphasis on tradition and social obligations which could impede business transactions at the expense of competitiveness
Integration	An index of the degree of tolerance, harmony and friendship a society endorses at the expense of competitiveness
Human-heartedness	Open-hearted patience, courtesy and kindness
Moral discipline	Following a rigid set of external and/or internal constraints

Source: The Chinese Culture Connection (1987) Chinese Values and the Search for Culture-free Dimensions of Culture. Journal of Cross-Cultural Psychology 18(2). 143-64.

The Chinese Culture Connection wanted to test if any of the criteria were culture free dimensions. In other words, they wanted to test which attributes individuals possessed in their mental models that were due to institutional influences and which ones were not. In this way, they could see which dimensions influenced Westerners outside of Asia but from which Eastern people were free. They thought one way to do this was to compare the Western criteria with Eastern criteria. Since China has had a major influence on the Asian community The Chinese Culture Connection thought that a Chinese value system would be sufficient for a generalization of the Eastern region as a whole. The success of the Chinese Value Survey led Hofstede to include a fifth indicator of culture termed Long Term Orientation based on a study of 23 countries using the questionnaire developed by The Chinese Culture Connection, see Table 3.

Table 3 Long-term orientation vs. Short term orientation (Confucian dynamism) as Hofstede's fifth dimension

Long-term orientation	Short-term orientation
1. Persistence (perseverance)	1. Personal steadiness and stability
2. Ordering relationships by status and observing this order	2. Protecting your face
3. Thrift	3. Respect for tradition
4. Having a sense of shame	4. Reciprocation of greetings favors, and gifts

Source: Fang 2003: based on Hofstede (1991: 165–6; 2001: 354–5)

Note: Hofstede originally termed his fifth dimension Confucian dynamism only later to change the term to Long Term Orientation (LTO)

He used Long Term Orientation to account for the teachings of Confucius in Chinese society. Taiwan and China rated high on Long Term Orientations while the United States, United Kingdom, and France rated low, meaning that the latter countries exhibit short-term orientation. The relationship between Long Term Orientation and Individualism usually has an inverse relationship. (Fang 2003)

2.15 Problems with the 5th Dimension

If one is interested in Hofstede's fifth cultural dimension it may be better to examine either the original The Chinese Culture Connection 1987 study or look at the more recent and up-to-date GLOBE study because Hofstede has tried to include too much information into one small culture classification. As Fang 2003 puts it, "...instead of clearly describing the fifth dimension as being made up of two opposing poles of Chinese (Confucian) values as he did earlier (Hofstede, 1991), Hofstede now provides a list of the 'key implications' and 'essence' concerning long-term vs. short-term orientation when it comes to differences in family, social

relations and work, in ways of thinking, and in societal norms between short- and long-term-orientation societies...Such treatment makes the fifth dimension even more difficult to understand.”

Many researchers who reference Hofstede for their work, many times ignore the fifth dimension either because they feel it is too complex to be defined as one category or because it is unfamiliar to Western researchers. The question of the addition of the fifth dimension is also raised since Hofstede’s power distance dimension relates to the TCCC’s Confucian dynamism and individualism correlated with integration. Masculinity and uncertainty avoidance didn’t correlate with any of the TCCC dimensions while human-heartedness and moral discipline didn’t correlate with any of Hofstede’s dimensions. Due to the possibility that Hofstede’s four cultural dimensions were biased towards the western side, he added it to his original four categories. It is Hofstede’s transformation of Confucian work dynamism to long term orientation that raises questions of validity.

Another question of Hofstede’s fifth dimension is that long term orientation is contrasted to short term orientation which does not fit within the Chinese model since both long and short term orientation are interrelated and are situation specific. Many aspects of Chinese culture can’t be easily separated because there is always a complex interrelatedness of the two, yin and yang. (Fang 1993) The example of face is a case in point. The aspect of face saving is a condition of short term orientation. Chinese societies such as China, Taiwan and Singapore rate high on long term orientation while the United States and the United Kingdom rate high on short term orientation. It is confusing that a Western country would earn a higher rating than an Eastern country on an Eastern cultural dimension.

Finally Hofstede’s fifth dimension was not constructed on the same grounds as the first four, which were done on IBM employees. Instead, the fifth dimension was tested on university students by the TCCC. The later study didn’t include varied demographics as did the IBM study; the two subjects being compared weren’t consistent. Therefore, the data obtained by TCCC was of a different sample than the one Hofstede originally used, that showed values held by young university students in China and not on people in a global workforce.

Also it must be taken into account that there was a considerable time difference between the testing of the first four dimensions and the fifth dimension, over 15 years. The inclusion of the fifth dimension without a complete retesting of the first four dimensions with the fifth

dimension in a factor analysis poses validity problems and therefore lacks the robustness the original 1980 study had.

The most valuable asset Hofstede offered to the world was the start of a construct that designated what mental models groups of people have, what their mapping processes are, and how these incomplete maps affect decision making. Institutions are after all constructs that guide but do not always predict behavior.

“Culture is a construct, that means it is ‘not directly accessible to observation but inferable from verbal statements and other behaviors and useful in predicting still other observable and measurable verbal and nonverbal behavior.’ It should not be reified; it is an auxiliary concept that should be used as long it proves useful but bypassed where we can predict behaviors without it...The same applies to the dimensions I introduced. They are constructs too that should be reified. They do not ‘exist’; they are tools for analysis which may or may not clarify a situation. In my statistical analysis of empirical data the first four dimensions together explain forty-nine percent of the variance in the data. The other fifty-one percent remain specific to individual countries.” (Hofstede 1993)

2.16 The Globe Study

More recently researchers and cultural examiners have been trying to not just focus on the mental models of the organization’s country of origin but of the organization itself. The Global Leadership and Organizational Behavior Effectiveness research project (GLOBE) extended their study to examine cross-cultural organizational leadership dimensions. The nine dimensions shown in Table 4 were taken from data collected on cultural values from 18,000 managers in 62 countries beginning in 1993. This was an effort to obtain a more complete and updated model and account for variances of behavior that could not be explained by Hofstede’s five dimensional model even after the inclusion of Long Term Orientation.

There is a high degree of correlation between some of Hofstede’s dimensions and the GLOBE’s, however the GLOBE project refined the dimensions for greater clarity. Masculinity has been changed by GLOBE to be called Assertiveness. Similarities can be seen between the GLOBE’s classification, Hofstede’s dimensions and The Chinese Culture Connection study: Confucian dynamism is directly related to power distance and integration turns into humane orientation or individualism under Hofstede. Long Term Orientation also has certain aspects of

the GLOBE's Future Orientation. The latter involves the amount of strategic planning a culture has naturally built into the system while the former is involved with face-saving and having a respect for tradition, however this is a facet much more in line with the Confucian Dynamism aspect than any future planning. Also it must be remembered that the Long Term Orientation dimension introduced by Hofstede is broad and conflicting, hence the GLOBE's effort for clarity.

Two important distinctions are made with the GLOBE model. Individualism gets split into Institutional Collectivism and In-Group Collectivism. The former is a new category that fits in with the neo-institutional economics. A high score here would mean a high correlation of institutions influencing the corporate policy thereby producing path dependence. The Chinese Culture Connection made this distinction when they included Moral Discipline as a cultural dimension, this being the same as Institutional Collectivism. By the same token, In-Group Collectivism is related to the Integration dimension on The Chinese Cultural Connection study—people being more comfortable living and working with their own in-groups.

Assertiveness is directly linked to Hofstede's masculinity dimension and uncertainty avoidance bears the same name in both models. Performance Orientation is a new dimension added to measure cultural values not yet studied.

The other important implication is the addition of Gender Egalitarianism, a cultural dimension that is often overlooked by many researchers of cultural comparison. Neither Hofstede nor Trompenaars/Hampden-Turner make this distinction clearly. In fact, Hofstede (1980) states that how different sexes are treated are not to be confused with the Masculinity/Femininity dimension. Perhaps this is due to the fact that gender

Table 4 Cultural dimensions taken from GLOBE 2001

GLOBE Cultural Dimensions

Assertiveness	The degree to which individuals in organizations or societies are assertive, confrontational, and aggressive in social relationships
Future Orientation	The degree to which individuals in organizations or societies engage in future oriented behaviors such as planning, investing in the future, and delaying gratification
Gender Egalitarianism	The extent to which an organization or a society minimizes gender role differences and gender discrimination.
Uncertainty Avoidance	The extent to which members of an organization or society strive to avoid uncertainty by reliance on social norms, rituals, and bureaucratic practices to alleviate the unpredictability of future events
Power distance	The degree to which members of an organization or society expect and agree that power should be unequally shared.
Societal Collectivism (Collectivism I)	The degree to which organizational and societal institutional practices encourage and reward collective distribution of resources and collective action
In-Group Collectivism (Collectivism II)	The degree to which individuals express pride, loyalty, and cohesiveness in their organizations or families
Performance Orientation	The extent to which an organization or society encourages and rewards group members for performance improvement and excellence
Humane Orientation	The degree to which individuals in organizations or societies encourage and reward individuals for being fair, altruistic, friendly, generous, caring and kind to others.

Source: House, R., Javidan, M., Dorfman, P. (2001)

classification is often similar inside the national boundary and can be extended to a regional boundary. Therefore, many businesses that do cross-cultural business often do so within a regional boundary, Asia for example. A Canadian company doing business in the United Kingdom or the United States might never come across the issue of gender differentiation in their practices. However, the same company would have to increase the energy spent on strategic planning to do business in many Asian countries when dealing with the subject of female employees.

The GLOBE project was an important step on updating the first measures of understanding into the initial forays of understanding the shared mental models located across boundaries, this being namely the inclusion of intuitions as a mitigating factor of economic performance. It was also a step in tying together national shared mental models not only of the government but also the organization. The underlying belief being that the organization is affected by the institutions surrounding them.

2.17 THT

The last category of institutional categorization includes the work of the social scientists Charles M. Hampden-Turner and Fons Trompenaars, who from now on will simply be known as THT. Their company has been researching and publishing materials to facilitate cultural understanding among today's business professionals. They include both a country specific approach and an organizational approach. In other words, they not only rate countries on a scale according to the dimensions they have created but also organizations. They are the first to realize that institutional change has an effect on organizational behavior as being separate from national shared mental model constraints. And that not only can practices in different companies be compared on culture scales but also the companies themselves because one nation might have companies with different practices. Hence, there is a need to understand organizational culture and not just national culture.

Their scale has six dimensions shown in Table 5. Their dimensions come from specific attitudes towards situations. Such as if a person chooses to apply all rules universally to everyone or make certain exceptions in the light of the circumstances (Universalism-Particularism). This dimension cannot be directly linked to the previous research endeavors.

This dimension is also a management style and must be considered in the way an organization or country will discipline its employees or citizens.

Other new takes on different institutions are the Specific-Diffuse Orientation in which one is rated on how they view a situation. A specific view would be analytical and looking for empirical evidence of why things happen while a diffuse view would be more concerned with looking at the whole picture to explain a situation. In other words, specific views are more focused and impersonal while diffuse views are more concerned with cause and effect by relationships that might be easily explained away by data.

Other relatively new dimensions in this model include: Achieved-Ascribed Status where the former is relying on performance and the latter is relying on what a person can possibly provide in the future. This can also fall under the same category as status through personal relationships thereby having strong Eastern influences. Inner Direction-Outer Direction in which how much power one believes to have over one's environment is the issue. Behavior on this dimension would mean an inner directed person believes that they have more control over the environment and thus tries to change it in opposition to the outer directed individual who tries to adapt to the environment as it stands. Finally the dimension of time is added on the scale of Sequential-Synchronous Time. This is a perception issue. The person who favors sequential time would like things done in order, in a line, on a first come first serve basis and is also very concerned with being on time and keeping appointments. On the other hand people who are more synchronous are often late, can multi-task, or change time schedules frequently in constant adjustment to changes in time. Synchronous time has relations to an outer directed individual since schedules have to be changed as in regards to the changes that environments dictate.

The only common dimension that THT have with the other researchers is the Individualism-Collectivism dimension. This is very much like Hofstede's though it also has the traits of competitiveness vs. harmonious relations involved in it so THT find that masculinity and individualism are so related that they can be grouped together in the same dimension.

The biggest contribution of the THT model is that it is the first of its kind to build in the implications of organizational behavior and organizational culture into its framework. Also, as the research suggests, different individuals inside the nation or organization can also test differently on the scales based on their level of cross-cultural competence. Therefore, someone with institutional understanding is able to reach the implicit goal that THT says comes from

knowing of different institutions; which is to not to be limited to one dimension or one's national dimension. Instead, the mark of a truly global person is that they can portray thinking on more than one dimension. If this happens and a person, an organization, or a country demonstrates competence different from before than institutional change is possible. This is implicitly stated as a gain in core competence.

Table 5 Cultural Dimensions in the THT Model

Universalism Rules, Codes, Laws, and Generalizations	Particularism Exceptions, Special Circumstances, Unique Relations
Individualism Personal Freedom, Human Rights, Competitiveness	Communitarianism Social Responsibility, Harmonious Relations, Cooperation
Specificity Atomistic, Reductive, Analytic, Objective	Diffusion Holistic, Elaborative, Synthetic, Relational
Achieved Status What you've done, your track record	Ascribed Status Who you are, your potential and connections
Inner Direction Conscience and Convictions are located inside	Outer Direction Examples and Influences are located outside
Sequential Time Time is a race along a set course	Synchronous Time Time is a dance of fine coordinations

Source: Building Cross-Cultural Competence. 2000

Economic Performance Measured by Culture as Institutions

2.18 Power

Institutions, which can also be known in the vernacular as national culture, directly affect organizational performance and individual work behaviors (Fisher et. al 2005). They can be formed outside of the game—exogenous, or made by the players themselves—endogenous (Shepsle 2005b). The need to understand institutional effects is paramount because it is easier to understand institutions and work within their constraints than to change an existing institutional framework in order to fit one business model. One reason for this is that the rulers of a nation and entrepreneurs, who are rulers of a business, naturally want to keep the existing institutions in place for the simple fact that the existing institutions have allowed them to create and maintain their power (North 1994b). Thus, it reasons that the power holders will want to keep the existing power structure on the belief that it will allow them to retain their power with the goal of increasing that power. (North 1993) “In game-theoretic language, so long as the *continuation value* of a game exceeds the expectation from replacing it for enough (powerful) players, then we can expect the game to be repeated in the next period...politicians do want, all other things equal, to minimize transaction costs, to reduce risks, and to maintain as much control over their respective fates as possible (Shepsle 2001). The form a game takes can be seen as the current institutional structure that has power over the populous not forgetting that the form of the game also has been derived from previous successful plays of the game. Therefore, the shape of a game has past success as the foundation but changes over time with increased interaction among players. This is the cycle of success and institutional influence described in section 2.3.

That is not to say that politicians and entrepreneurs do not try and change the rules of the game. They do sometimes but only if it is within their interests to do so. That being said, it must also be added that to change the rules of the game is difficult to accomplish. Once a method of transacting has been set the players naturally run this course as a measure of law or formality. This is known as path dependence. To alter path dependence, not only is some sort of proof required that an alternate path will result in a benefit but also there needs to be an effective way to organize people to change the institutions to fit the new desired model, hence the need for a change agent.

In neo-institutional economics, path dependence is changed by opening markets and agreeing to free trade agreements. These are the change agents for economic performance. If

economic performance continues to increase as a result of change then the altered path dependence will be the favored one.

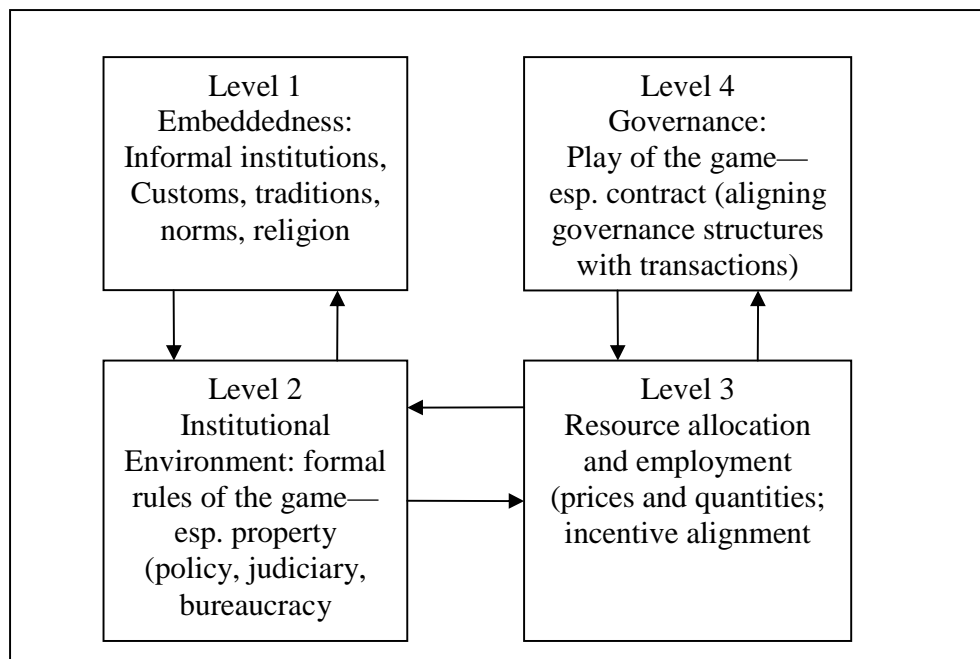
According to Palay (1985) Informal contracts can be more effective if all sides understood each other resulting in a lack of a need of formal contracts that would raise transactions costs. This would increase the effectiveness of business practices and reduce waste brought out by unfair or ambiguous competition. An increase in business transactions will mean more revenue for the company and therefore a higher GNP for the country. However, there is an increasing problem of measuring a country's GNP by using specific corporations since these corporations are becoming more global. A company's ethnicity is becoming increasingly diverse and therefore difficult to determine. GNP is not to be confused with GDP which would measure products or services made only within national boundaries.

2.19 Institutional Influence on a Societal Framework

The way institutions affects economic performance was theorized deeply by Oliver Williamson (2001). In Figure 2 the path of institutional influence is shown. There are four levels, each level affects the environment and rules of the next and then reverses to change the intuitions from they originated from in level 1.

It can be seen from this diagram that institutions in level 1, where the learning of shared mental models takes place, affect the environment where business takes place in level 2. It is on this level that policies are made governing how organizations may conduct business. Level 2 directly affects level 3 where the price of the market is set that governs how the business will conduct its policies in the field. This is where transaction costs are incurred. The field is level 4 where the trade occurs and agreements are made such as the process of doing business in the WTO. The arrows do not just go uni-directionally but bi-directionally showing that the environment where the game is played, such as membership and use of the dispute resolution system of the WTO can filter back to change all levels that came before to the historical institutional framework, the informal rules of conduct and institutional belief structure of the region, in which the nation has until the change been functioning upon.

Figure 2 Institutional Change on Societal Framework



Source: adapted from Williamson, 2000

In this era of globalization, regions are changing how they perceive the world as a result of increased interaction with other regions of the world. This change process is slow and difficult, often being met by resistance.

2.20 Path Dependence

North (1994b) claims that through path dependence, once a region starts to make a profit the incentive is to continue that course to keep making profit unless an outside factor changes the learning of the mental model of that country, i.e. its perception of the world. These can happen in five ways:

1. The continuous interaction between institutions and organizations in the economic setting of scarcity and hence competition is the key to institutional change.
2. Competition forces organizations to continually invest in knowledge to survive.
3. The institutional framework dictates the kind of knowledge perceived to have the maximum pay-off.

4. The mental constructs of the players given the complexity of the environment, the limited feedback information on the consequences of actions, and the inherited cultural conditioning of the players determine perceptions.

5. The economies of scope, complementarities, and network externalities of an institutional matrix make institutional change overwhelmingly incremental and path dependent.

International trade must happen between regions today to increase revenue. Regions are continually looking for ways to increase their international trade and this changes their view of existing institutions (propositions 1 and 2). Due to the fact that shared mental models dictate the rules of engagement of a region, cultural differences make the players define contracts in their best interests (propositions 3 and 4). Thus, though a region follows the path that has historically produced profit, change can happen though it is slow (proposition 5). All of these factors taken together is why more and more regions are joining the WTO and how the WTO is changing or challenging the existing institutions of a region that happens with increased and repeated trade.

This also has influences on the use of language. As a result of globalization and subsequently the effort to reduce differences between nations, some nations are using languages that have not historically been used in that region, English being a case in point. This is an effort to reduce information costs. By changing one of the official languages to English a foreign region would be altered on level 1 of Williamson's diagram.

One factor that can be added to the five propositions North has claimed is population. This could be added as a sixth way since it would be tied to proposition number five that accounts for rate of change. The larger the amount of people a nation has, the slower the rate of change is just because it will take more time to change the thinking and education of so many people. In this way, population can inhibit institutional reform and resist the force of self-interest.

2.21 Ranking Countries

Frankie et al (1991) and Hofstede (1983) point to organizational influences and national influences and then chart the position of where nations scored on four of Hofstede's dimension. Since the testing of whether these positions on the chart change over time with increased

institutional understanding it is necessary to look at the time of the study Frankie et al (1991) and Hofstede (1983) positioned each nation in relation to his cultural dimension.

They were able to place countries on a chart based on their cultural dimension to show the relationships between cultural dimensions and other factors. For example, as of 1970 the trends show that the higher a country scored on the individualism dimension the higher that country also had for GNP for that year overall upon a linear regression line. Also there were regional similarities due to language. The English speaking countries all ranked around the same area when individualism was compared to power distance. In this case: New Zealand, Canada, Australia, and the United States were all found to have small power distance and high individualism (note that England is not mentioned and that these might not just be a language trait but also these are countries that have been recently settled by colonists). East Asian and Latin countries all scored relatively in the same area for high power distance and low individualism. Finally, when power distance was compared to uncertainty avoidance it was generally found that the same countries that had small power distance also had weak uncertainty avoidance while the inverse was true for those that had high power distance. For a look at the graphics and a more detailed analysis please see Hofstede 1983.

Though useful as a starting point, the graphics and analysis Hofstede (1983) uses are based on the year 1970. Therefore, it is problematic to assume that these countries could fit on the same scale if measured over the years after the Cold War and the start of globalization, 1990-2004 the period of institutional reform. There is a need to find out how institutions have changed in relation to their cultural dimensions since that time. This was done by looking at their economic performance from international trade.