

5.5: Legal Risk

Learning Objectives

After reading this section, students should be able to ...

1. define legal risk
2. appreciate the importance of the legal environment

What is legal risk?

Legal risk is the risk arising from failure to comply with statutory or regulatory obligations (<http://www.ffiec.gov>).

Generally, all laws in the host country will apply to an entrepreneur's local business operations. Examples include filing procedures, employment law, environmental law, tax law, and ownership requirements. The World Bank has a rather extensive country business law library which can be accessed from their website. This can be helpful in the initial phases of considering the legal ramifications of direct investment in a given country.

Student Example

In 2015, the German car manufacturer, Volkswagen was found guilty of making cars that were not meeting the emission standards of the U.S, through the years 2009-2015. Devices that were called “defeat devices” were made by engineers to detect when vehicles were being tested and produced fake results. Ultimately, Volkswagen faced a huge lawsuit and CEO Martin Winterkorn was charged with fraud and conspiracy in the U.S.

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Many countries limit foreign ownership of assets and legally force foreign companies into a joint venture with a local partner in order to do business there. Poland, for example, limits foreign ownership of farmland and will continue to do so for another decade under agreements with the EU (Dadak, 2004).

It is important to remember that while doing business outside of the home country certain home country laws will still apply. Applicable laws differ from country to country, but one common extension is employment law.

The extent of jurisdiction beyond national boundaries varies widely. In anti-trust for instance, the United States law covers only situations where the violation affects the US, (meaning that it does not matter where the act causing the violation took place), while the EU considers only where the antitrust offense was implemented (Shaffer et al., 2005, pgs 657-664).

In order to minimize exposure to legal risks arising from confusion and excess cost, a company should seek legal advice if possible. In making such arrangements, written contracts should be used. This can minimize confusion in case of litigation.

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