State & Society
Management 413
Spring II, 2016
Douglas W. Rae & Ian Shapiro

(1) Spirit of the Course

Business enterprise as we know it evolved within the framework of the modern nation state system, usually dated to the Treaty of Westphalia (1648). The rules of the road for business in each national society have been – and are still being – hammered out over the centuries and decades within the institutions of nation state governments. Aside from the most isolated and least competitive markets, there are no static playing fields left on the planet. Everywhere in the competitive world, governments, elites, consumers, employees, activists, and voters must respond to the needs and demands of business – often to some businesses, industries, and ideologies in preference to others. This course is meant to provide a box of tools that will help you prepare to lead a business firm or nonprofit in settings as different as Chicago and Cochabamba, Beijing and Nairobi, Johannesburg and Singur in West Bengal.

To rub our point in: Imagine yourself as SOM alum Steve Chapman, head of Cummins engine in China, facing that nation’s regulatory effort to manage air pollution attributable in part to Cummins’ diesel engines. How do you relate to the powerful CPC – Communist Party of China – while at the same time meeting corporate goals emanating from Columbus, Indiana? How, at the same time, do you operate within your Chinese joint venture, Dongfeng Cummins Engine Co Ltd? Chapman and his senior staff will visit our State and Society class to challenge you with these and other questions.

State & Society is globally oriented. The United States gets its share of attention, but so do many other places. We touch on a broad array of countries – China, Bolivia, South Africa, India, the United Kingdom, and several others. We also develop eight analytic lenses that apply worldwide. These are examined in detail during Meetings Three & Four, and then applied to real cases in Meetings Five through Thirteen. If you want to think about how much business depends on government at the most basic level, here it is: (i) Business requires physical safety, secure property rights, and enforceable contracts. (ii) The institution that stands behind security, property, and market transactions is the state. (iii) Unless the state can guarantee peace, protect property, and enforce contracts, business goes nowhere good.

In a dynamic economy, government often has to choose which of two or more conflicting property rights protect. Think, for instance, of genome-related patents, or of genetically modified organisms (GMOs). Or look at the several political and regulatory attacks recently created by old-style taxi firms to slow down or kill off
the potent competitive threat posed by Uber. Then is the upending of customary rights and expectations to make way for private delivery of water in Bolivia and Special Economic Zones in India (taken up in meeting Five). Another classic example turns on deregulation of industries, such as the U.S. case of commercial airlines (taken up in Meeting Twelve). As a more open playing field emerges, how should top management seek to protect its assets and also gain control of new ones?

(2) Faculty

State and Society’s principal faculty are Douglas Rae (douglas.rae@yale.edu), Richard Ely Professor of Management & of Political Science, and Ian Shapiro (ian.shapiro@yale.edu), Sterling Professor of Political Science and Director of Yale’s MacMillan Center for International and Area Studies. Both are former chairs of Yale’s Department of Political Science. Except in an emergency, both will attend every meeting of the course and both will be available to consult with students by appointment.

To book a meeting with Doug, call Camille Costelli (203-432-8911) or email her at Camille.costelli@yale.edu. For Ian, the contact is Lourdes Haynes at (203) 432-9368 or Lourdes.haynes@yale.edu.

On three occasions, expert practitioners will join us in class. Steven Chapman and Nathan Stoner, both of Cummins Inc., will join us for our case on that firm’s extensive operations in China, including its joint venture with Dongfeng Motors. James Alexander, onetime CFO of Enron Global Power and Pipelines, will join us to analyze the ethical train wreck that was Enron. Jon Soderstrom, who helped ensure the powerful anti-AIDS drug Zerit could be sold at affordable prices in poor countries will be in class to explain that achievement. In a few cases, we will be preparing video with key players in additional cases for your use. One such is Colin Coleman, the lead Goldman Sachs partner in South Africa, who will participate by video in our discussion of regime change in that country at the end of Apartheid.

(3) Student Responsibilities & Course Grading

• Preparation for class:
  o Read, watch required videos, and participate in Learning Team presentations as indicated in the syllabus
  o Participate in at least one TA class prep session
  o Contribute to group assignment memo

• Write two Case Memos, one from Group A and one from Group B. You are free to pick within the groups, subject to the constraint that your memo is due to your TA no later than the beginning of class on the day we cover the case about which your are writing. Each memo should make use of at least one of the eight analytic lenses discussed in Meetings 3 and 4. Each memo
should be two single-spaced pages in 12-point type with normal margins.

Your course grade will be computed using the following weights:

- Class participation (excluding LT presentations) & TA sessions 20%
- Group memo (graded credit/fail) 10%
- Case Memo A (2 pages, single spaced) 20%
- Case Memo B (2 pages, single spaced) 20%
- Final exam 30%

Relevant details are explained more fully in the Logistics Memo.

We especially look forward to your sharing relevant knowledge based on your home country and others you have lived in or come to know during the International Experience. When we do cases concerning China, Bolivia, India, and South Africa, your knowledge of those national systems, or similar ones from the same regions, will be invaluable.

**[4) Course Administration**

_Camille Costelli_ is available by phone or email to help with matters not directly handled in class or by consulting appropriate Teaching Assistants. Her office is on the 5th floor of Evans Hall, phone 203-432-8911, and Camille.costelli@yale.edu. **Doug Rae** is available in office 5536 on the 5th floor of the Bekenstein wing of Evans Hall. His Yale extension is 2-9899. For emergency use, his cell is 203-887-2338. **Ian Shapiro** is available in room 121 at Luce Hall, 34 Hillhouse or by phone at extension 2-3415. **Emma Powers** (SOM ’16) is the Head TA for State & Society. We are pleased to be staffed by ten exceptional TAs, all members of the SOM class of ’16. Here is the full roster:

- Jake Dreier
- Carrie Edmundson
- Helen Goldberg
- Enyi Okebugyu
- Mariana Olcese
- Fona Osunloye
- Emma Powers
- Andres Spinel
- Molly Zeff
- Zhang Zhang

Each can be reached by email, and at least one will be in attendance at every class meeting. TAs will also make themselves available for tutorials, discussion sessions, reviews, and advice as needed throughout the course. For additional information see the Logistics Memo posted on the Classes server.

Attendance is mandatory in all SOM core classes, including this one. You are allowed one unexcused absence, provided you notify Emma Powers (emma.powers@yale.edu) in advance and in writing.

If you are concerned about or unhappy with any aspect of the course, or have a
suggestion to make, please let Emma know. If you are comfortable going directly to
the faculty – Doug Rae & Ian Shapiro – please feel free to start a conversation by
email. Either or both will be happy to meet with you, and to accept constructive
Suggestions about the course.
OUTLINE OF CLASS MEETINGS

Meeting One (Monday, March 28)
World Demographic Transition and the Rise of Modern States

State and Society is intended to help you navigate the political and social environments in which business must operate. The structure and effectiveness of state institutions shape people’s expectations about violence and order, the security of their property, and the enforceability of contracts. “Big government” notoriously can add to the costs of doing business, but weak states present other challenges. The world has plenty of both. Understanding the place of business in interactions between state and society is thus vital to sound business management.

Larger historical processes shape business-government interactions. Why is the cost of labor so much higher in some places than in others? Much of this depends on demography. In ‘young’ countries like Uganda (48% of Ugandans are younger than fourteen) but not in ‘old’ ones like Japan (13% younger than fourteen), population expands at an increasing rate – with knock-on effects for education, wages, and employment. Where a country falls between these extremes depends on its place in the World Demographic Transition. Demographic events that happened in Sweden around the year 1820 are now happening in 2015 in countries like Mali, Haiti, and Vietnam. Much of the logic behind locating the production of goods that will be consumed in France, Japan, or the United States in low-wage countries turns on this uneven timing. Meeting One will explain the dynamics of the demographic transition and its connections with state institutions as they affect business.

Reading

• As our small gift to weary travelers at the close of spring break, State & Society requires no reading for this class. Nevertheless, please look at a demographic profile for your home country or one you have visited recently. Reflect on how demographic differences impact the challenge of operating an assembly plant for smart phones, Nike running shoes, or a petroleum refinery (the last is very different from the other two, right?). Several such demographic profiles are posted on files. A worldwide selection of profiles will be found at: http://esa.un.org/wpp/Demographic-Profiles/index.shtm.

Meeting Two (Wednesday, March 30)
Business Leadership and South Africa’s Democratic Transition

As of the early 1990s, smart people across the world thought that the racist regime in South Africa, ruled by a tiny white minority, would soon turn into a blood bath. Yet, in April of 1994 South Africa held its first (of five) national democratic elections, against all predictions, defusing an escalating civil war. Many aspects of this story are common knowledge, but what is not well known is that South African big business played a major role at multiple stages of the transition behind the scenes, including in the final dramatic months when the entire process almost collapsed several times. Today’s class explores this business role, which dates back to the relationship developed between big business and the black trade union movement in the 1970s. It illuminates how business leaders think about their relations with politicians and labor organizations when regimes are either potentially unstable or in flux.

Required Case:

• Ian Shapiro, Itumeleng Makgetla and Jean Rosenthal, “We Don’t Have to be Cuba; We Can Be Brazil: The Pivotal Role of Business in South Africa’s 1994 Reforms.” Yale SOM Case 13-010.

This raw case contains background material and interviews with many of the principals. You should read the whole case (front page of every tab) and watch as many of the video interviews as you can. Be prepared to respond in class to questions from the tabs (including videos) as follows: Introduction: LT1; Groundwork: LT2; Thinking the Unthinkable: LT3; Talking to the ANC: LT4; Talking to Government: LT5; Societal Restructuring: LT6; Avoiding Catastrophe: LT7; Managing Spoilers: LT8.

Suggested Further Reading:


A Note on Tools or Lenses Discussed in the Next Two Meetings: The next two classes introduce a working box of eight analytic tools or lenses. Depending on your background, some may be familiar, others not. The idea is to invest these two days in the tools, then ask you to apply them as appropriate to the cases we’ll see in Meetings 5 through 13. You will also be asked to write a short memo on one of the tools.
Your Learning Teams also come into play here. A brief summary presentation is assigned to each learning team. These should not assign speaking parts to more than one or two team members (definitely no more than three), but should be planned by the groups. Due to limitations of time, the presentations should be confined to seven minutes and will be gonged at eight minutes. All students should read the two Lens Assignment Memos that have been posted on the Classes Server for these two meetings. The team should (i) produce a one-to-two page memo addressed to the questions on the posted lens assignment sheet due to your TA before the start of today’s class, and (ii) one or two team members should be prepared to give a five minute presentation of its findings in class.

Meeting Three (Monday, April 4)
See Lens Assignment Memo
Lens Box A

We will cover four the following lenses in today’s class:
- Exit, vs. Voice and Loyalty (LT1),
- Information Asymmetries and Local Knowledge (LT2),
- Loss Aversion and the Sunk Cost Fallacy (LT3),
- Group Think v. the Wisdom of Crowds (LT4).

Meeting Four (Wednesday, April 6)
See Lens Assignment Memo
Lens Box B

We will cover four the following lenses in today’s class:
- Majority rule divide a dollar game (LT5)
- Prisoners’ dilemma (LT6)
- Paradox of collective action (LT7)
- Relative v. Absolute Valuation (LT8)

Meeting Five (Monday, April 11)
Doing Business in Weak States: Bechtel and Tata
LT1 & LT2 class presentation assignments – see memo
Group A1 Case memo Assignment option due

The term failed state conjures up contemporary Afghanistan, Iraq, or Libya. Probably no one in this course is currently planning business ventures in any of them. But how do we know whether some other destination is in danger of
becoming a failed state, or at least unable to perform basic functions that are needed for business to be viable? We will explore these issues through two cases: Bechtel’s attempt to privatize water the water supply in the Bolivian city of Cochabamba in Bolivia, and Tata’s effort to build a plant for their Nano “People’s Car” in Singur, West Bengal. In reading the cases ask yourself why Bechtel and Tata both failed in these seemingly routine ventures. How much can be attributed to the weak states? How much of the trouble arises from economic stress? Other factors? The Finnegan article on “Leasing the Rain” and Wilkin’s review essay on India will help illuminate some these issues.

Required Cases:

- Laura Alfaro et al, “Tata Motors in Singur: Public Purpose and Privare Property. (B)” HBS.

Suggested Further Reading:


Meeting Six (Wednesday, April 13)
The Integrated Corporation: Ford and the Rise of Mass Affluence
LT3 & LT4 class presentation assignments – see memo
Group A2 Case memo Assignment option due

Very few have ever doubted that capitalism works out pretty well for capitalists and top management. Yet very few have failed to suggest that capitalism can be tough on people without capital and bereft of unusual skills or talents. In the twentieth century, the term “Fordism” arose because the Ford Motor Company made notoriously stiff demands on its manufacturing employees. At the same time, Ford began to create an affluent blue-collar class of workers able to enjoy a lifestyle previously withheld from working people. The key policy at Ford was the $5.00 workday, announced in January of 1914 – roughly double what rival firms were paying. As wages rose, and the price of a Ford Model T declined, its workforce began to enjoy unprecedented mass affluence. But what about the investing public? Our case finishes with the lawsuit Dodge v. Ford (1919) in which two large investors argue that Ford is failing in its obligation to maximize returns to shareholders.
Required Cases:


Meeting Seven  (Monday, April 18)
Market Based “Soft” Apartheid in the United States
LT5 & LT6 class presentation assignments – see memo

Racial inequality and prejudice are enduring features of the American landscape. Occasionally they explode into violent riots, notably following passage of the Civil Rights legislation in the mid 1960s, in Los Angeles in 1992, and most recently in Ferguson, Missouri and in August 2014. These crises garner huge media attention, often triggering ameliorative responses such as the firing of a few public officials. The chronic problems that get less attention are the focus of today’s class. Our particular focus is on racial segregation in housing. Racial covenants and “redlining” were mostly outlawed by the 1960s, but segregation persists for reasons we illuminate with the help of game theorist Thomas Schelling. We also explore the large-scale bipartisan policy response developed in the Clinton and George W. Bush Administrations, which morphed into a tragically self-defeating fiasco thanks to the subprime mortgage crisis and the burst housing bubble of 2007-8. Come prepared to discuss comparable ethnic or racial discrimination and tension in a country you know well, or some other aspect of the race problem in the U.S. In either case, ask yourself what intervention on the part of business owners could help.

Required Reading:

- Joshua Rosner, “Housing in the new millennium: A home without equity is just a rental with debt.”
- Game theorist Thomas Schelling provides us with an ingenious simulation of market-driven self-segregation. You’ll find a good version of it at: [http://ncase.me/polygons/](http://ncase.me/polygons/) Please spend ten minutes with it to understand the dynamics behind the racial segregation tipping game.
Meeting Eight (Wednesday, April 20)
Privatizing Government? Prisons & the Military
LT7 & LT8 class presentation assignments – see memo

Privatization has been a watchword of economic health since the 1980s. Ronald Reagan and Margaret Thatcher led the charge in the advanced capitalist democracies, decreasing government subsidies and sometimes privatizing utilities, postal services, and railways. As communism collapsed in the East, more radical privatization schemes abounded as state assets were transferred to private hands. In many countries even “core” government functions like fighting wars, policing and corrections, and local government services have become candidates for privatization. In today’s class we concentrate on the growing use of private contractors by the military and the movement to privatize prisons, both of which developed in the U.S. over the past three decades and both of which are becoming American exports. Ask yourself how privatizing prisons and the military differ from one another and from privatizing such ventures as mining, steel-making, or the operation of railroads.

Required Reading:
• Michelle Fox, “Cramer: A Fantastic Business to be in,” CNBC, September 26, 2011. Here’s the link for the last named entry: http://www.cnbc.com/id/44677873 Be sure to watch the embedded video before class.

Required Case:
• Jean Rosenthal, Zachary Schlesinger & Ian Shapiro, “Private military contracting.” SOM case
Meeting Nine (Monday, April 25)
Hazards of Dishonesty: Cooking the Books at Enron
LT1 class presentation assignment – see memo
Group A3 Case memo Assignment option due

Ken Lay, Jeff Skilling, and Andrew Fastow were brilliantly successful at running Enron; indeed Fortune magazine named Enron a “most admired corporation” six consecutive times between 1995 and 2000. How is it possible that such a paragon of enterprise would be compelled to file for Chapter 11 bankruptcy in 2002? Enron’s “success” depended heavily on deceptive accounting and outright fraud. Using opportunities arising from the deregulation of natural gas and mark-to-market accounting, they generated massive apparent profits that often did not correspond to real value. The dangerously slippery slope, which starts as clever innovation but ends as criminal fraud, is our major theme in this class. Jim Alexander was CFO of the subsidiary firm Enron Global Power & Pipelines, watching the circus from the center of its ring. In 1995, he concluded that there was something rotten in Denmark, but he could not interest his superiors in his worries. Based on your reading of the case, what do you think those worries might have been?

Guest: James M. Alexander, former CFO of Enron Global Power & Pipelines, and co-founder of Spinnaker Exploration.

Required Video:
- Ian Shapiro interview of Jim Alexander.

Required Case:
- Malcolm Salter, “Innovation Corrupted: The Rise and Fall of Enron.” HBS

Meeting Ten (Wednesday, April 27)
Vioxx and the Business of Tort Liability
LT2 & LT3 class presentation assignments – see memo
Group B4 Case memo Assignment option due

In 1999 Merck began marketing Vioxx, newly approved by the FDA as a wonder drug pain reliever that seemed free of the side effects of other painkillers. Five years later Merck recalled the drug at a multi-billion dollar cost to the company in the face of mounting evidence that Vioxx has significant averse cardiovascular effects. Thousands of lawsuits followed, most of which would eventually settle for some $4.85 billion. Today’s class will explore Merck’s strategy in dealing with the Vioxx disaster in light of changing standards of tort liability and strategies for managing the associated risks.
Meeting Eleven (Monday May 2)
Cummins-Dongfeng in China
LT4 class presentation assignment – see memo
Group B5 Case memo Assignment option due

A diesel engine manufacturer headquartered in southern Indiana, Cummins has been remarkably successful building and marketing high-quality diesel engines in China. Many foreign firms left when the Chinese demanded at least 50% domestic ownership, but Cummins stayed and prospered. Cummins is a high integrity firm, standing in sharp contrast to Enron (Meeting Eight). A major element of the firm’s specific success in China hinges on a close relationship with state-owned Dongfeng Motor Company of Wuhan, China. Steve Chapman and Nate Stoner have managed the firm by embracing China and its ways of doing business. We’ll hear that saga from them during class.

The very possibility of Cummins success, and China’s burgeoning wealth, depends on reforms engineered by Deng Xiaoping, after his rehabilitation by the Chinese Communist Party in 1978. Our excerpt from Ezra Vogel’s fine biography of Deng conveys some hints of the man’s brilliance and discipline.

Guests: Steve Chapman is Cummins Group VP for China and Russia. Nathan Stoner, now at Cummins HQ in the US, was formerly Partnership Director for Dongfeng Motors, China. Both are Yale alumni.

Required Case:

Required Reading:

Suggested Further Reading:

Meeting Twelve (Wednesday, May 4)
Zerit and the Cost of Life-Saving Technologies
LT5 & LT6 class presentation assignments – see memo
Patents build legal barriers around useful and innovative ideas, institutionalizing them as private property for fixed periods of time. Without patents, people would often lack the incentives to develop goods and services that require major investments of human capital, time, and money. Patents enable people to recoup their investments and then some, but this can be at the cost of limiting access to lifesaving technologies by those in most urgent need of them. The resulting tradeoff is stark, and comes to a head in today’s case. Zerit is the key component of the first effective treatment of AIDS, and also the most lucrative drug ever developed at Yale University. Jon Soderstrom, Managing Director or Yale’s Office of Cooperative Research, will take us through the saga that erupted over the availability of Zerit in South Africa, a country with one of the highest incidents of AIDS in the world. The Zerit case, which became a transformative landmark in the licensing of drugs to developing countries, illustrates many of the dilemmas that arise in a world in which it typically costs more than $1billion to develop lifesaving drugs that often cannot be afforded by those who need them most.

Guest: Jon Soderstrom, Managing Director, Office of Cooperative Research, Yale University.

Required Video:
• Doug Rae and Ian Shapiro interview of Jon Soderstrom.

Required Reading:
• Nine points to consider in licensing university Technology,” Yale University, 2007.
• “Statement of principles and strategies for the equitable dissemination of medical technologies,” Yale University, 2007.


Meeting Thirteen (Monday, May 9)
Deregulation & its Critics
Arguments about regulation are as old as capitalism itself, reflecting the fact that some degree of regulation is essential for markets to work, yet its benefits and costs are unevenly distributed. The leading Chicago-school theories of regulation interpret it as a reallocation of income among companies, usually favoring big incumbent firms. Whatever the level and wisdom of regulation, there are always pressures to reduce it. Today’s class considers the pressure for deregulation over the last few decades. We look at two quite different deregulation stories: American passenger airlines and the financial deregulation in the years leading up to the 2008 financial crash. Ask yourself what the costs and benefits of these two deregulations were for different interested players and for the general public.

Required Reading:

• Yaron Brook and Don Watkins, “Why the Glass Steagall Myth Persists,” Forbes, November,

Suggested Further Reading: