UNC SCHOOL OF LAW

NORTH CAROLINA JOURNAL OF INTERNATIONAL LAW AND COMMERCIAL REGULATION

Volume 39 | Number 2 Article 2

Winter 2014

Legal Competitive Advantage and Legal Entrepreneurship: A Preliminary International Framework

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Cover Page Footnote
International Law; Commercial Law; Law

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Justin W. Evans† & Anthony L. Gabel††

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I. Introduction

This article considers how the international business best strategically accounts for the various legal environments in which it operates. In light of globalization's prominence, it seems strange that so little literature has investigated the law's role in international business strategy. Questions thus arise: how can the law engender competitive advantage across jurisdictions, and how should international executives and their counsel approach the law strategically? This article submits that the answers to these questions largely turn upon meaningfully defining "the rule of law" and on the recognition of a new breed of attorney—the

entrepreneurial lawyer. This article proposes a framework to guide the synthesis of law and international strategy.

Nearly a decade has passed since Larry Downes presciently observed that "[l]aw is the last great untapped source of competitive advantage."[1] Yet "the gulf between the lawyer and strategist remains wide. Managers view the regulatory environment as an impediment to growth," while "[l]awyers train primarily to advocate rather than to counsel"[2] and to minimize their clients' exposure to risk.[3] The dissonance between managers and attorneys has led to the law's pronounced neglect as a strategic business resource.[4]

Discussing the law's role in competitive advantage raises a serious challenge: virtually all of the literature on point assumes a high rule of law backdrop and, in particular, takes for granted the presence and correctness of Western institutions.[5] Still, "it may be possible to build a definition of the rule of law around a central tenet of Western and non-Western traditions."[6] By necessity, defining the "rule of law" is a fluid, qualitative process, but it need not be arbitrary. While this article addresses some abstractions, its

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1 Larry Downes, *First, Empower All the Lawyers*, 82 HARV. BUS. REV. 19, 19 (2004).

2 Robert C. Bird, *The Many Futures of Legal Strategy*, 47 AM. BUS. L.J. 575, 575 (2010). Most firms neglect the law, treat it as a rank constraint, or lobby for favorable laws; few firms view the law as an opportunity. Antoine Masson, *The Crucial Role of Legal Capability in the Realisation of Legal Strategies*, *in* LEGAL STRATEGIES: HOW CORPORATIONS USE LAW TO IMPROVE PERFORMANCE 101, 114 (Antoine Masson & Mary J. Shariff eds., 2010); *accord* Robert C. Bird, *Pathways of Legal Strategy*, 14 STAN. J.L. BUS. & FIN. 1, 8 (2008) ("In virtually every industry, there is no consistent way firms address legal issues.").

3 *See* Downes, *supra* note 1, at 19.

4 *See* Bird, *The Many Futures of Legal Strategy*, *supra* note 2, at 575.

5 *See, e.g.*, Robert L. Nelson & Lee Cabatingan, *A Preface and Introduction*, *in* GLOBAL PERSPECTIVES ON THE RULE OF LAW 3 (James J. Heckman et al. eds., 2010) ("A related concern is whether the terminology of the rule of law contains an effort to impose a Western or perhaps even a United States perspective of law on the rest of the world . . . . It would be wrongheaded to equate the rule of law with a particular legal tradition's prescriptions for the character and role of legal institutions."); *see also infra* Part III.A (discussing the many definitions of "the rule of law").

6 Nelson & Cabatingan, *supra* note 5, at 3; *accord* Joseph Raz, *The Rule of Law and Its Virtues*, *in* LIBERTY AND THE RULE OF LAW 3, 7 (Robert L. Cunningham ed., 1979) ("Many of the principles that can be derived from . . . the rule of law depend for their validity or importance on the particular circumstances of different societies.").

most basic inquiry is the practical question of how managers and their counsel ought to account for the law in international business strategy.[7] This article contends that the "rule of law" describes the very realm of opportunity for strategic legal advantage. Extracting competitive value across jurisdictions requires that we understand the "rule of law" from the business perspective—in effect, the extent to which legal institutions reallocate business opportunities away from the market and into the legal and political systems of a given jurisdiction.[8]

Countries observe the rule of law in different ways and to differing degrees. Western impulses prefer "high rule of law" jurisdictions: transparent legal systems that empower firms to plan and act in the economic realm.[9] Correspondingly, firms disfavor "low rule of law" jurisdictions where opaque legal systems create economic uncertainties and risks.[10] Jurisdictional rule of law differences can be traced to several basic sources of legal flexibility.[11] Depending upon their variety and prevalence, these flexibilities create both legal risks *and* legal opportunities.[12] Using the framework proposed here to identify strategic opportunities in the law, the entrepreneurial lawyer is then poised to integrate the law with the client's strategy.[13]

A few general items are noteworthy. First, whereas the recognition of opportunities for legal advantage may require a macro-perspective, the question of how best to capitalize upon opportunity is driven by the individual firm's vantage. Second, this article is concerned only with "legitimate" legal functions.

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7 BRIAN Z. TAMANAHA, ON THE RULE OF LAW 114-26 (2004) ("*Realpolitik* remains a predictable mainstay of international law.").

8 *See generally infra* Part III.

9 *See* David Silverstein & Daniel C. Hohler, *A Rule-of-Law Metric for Quantifying and Assessing the Changing Legal Environment of Business*, 47 AM. BUS. L. J. 795, 796 (2010) (noting that Rupert Murdoch declared that he would prefer to invest in India over China because India had a rule of law, whereas China presented unknown risks and barriers).

10 *See id.*

11 *See infra* Part III.C.

12 *See* Silverstein & Hohler, *supra* note 9, at 798 ("On the other hand, many societies lacking in one or more of the supposed minimum set of legal criteria nevertheless exhibit a thriving business sector . . . and clear paths toward sustainable economic growth.").

13 *See infra* Part IV.

This article adopts Suchman's conception: "[l]egitimacy is a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions."[14] Organizations must manage their legitimacy,[15] but "[b]ecause informal institutions vary widely across cultures, what is illegitimate in one culture may be widely seen as legitimate in others."[16] Finally, we embrace North's institutional typology:[17] "[f]ormal institutions refer to laws, regulations, and their supporting apparatuses . . . [;] [i]nformal institutions refer to norms, values, and beliefs that define socially acceptable behavior."[18]

This article's aims are modest: to propose a preliminary model for utilizing the law in competitive advantage and to suggest areas of future research.[19] This article is the first work of which the authors are aware to propose and develop linkages between the rule of law, legal competitive advantage, and legal entrepreneurship.

Part II of this article addresses several relevant links between law and business. Part III concerns the discovery of opportunities to use the law in competitive advantage; as such, it explores the nature of the legal system, offers a preliminary rule of law framework, and defines the "rule of law" in a manner meaningful to international firms. Part IV then considers how legal opportunities are best cultivated as sources of competitive advantage. This is accomplished by developing the idea of legal

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14 Mark C. Suchman, *Managing Legitimacy: Strategic and Institutional Approaches*, 20 ACAD. MGMT. REV. 571, 574 (1995).

15 *Id.* at 585-601.

16 Justin W. Webb, Laszlo Tihanyi, R. Duane Ireland & David G. Sirmon, *You Say Illegal, I Say Legitimate: Entrepreneurship in the Informal Economy*, 34 ACAD. MGMT. REV. 492, 506 n.4 (2009).

17 *Id.* at 494.

18 *Id.* at 494-95.

19 For example, the rule of law might be quantified. Such an endeavor is beyond the scope here, but this is not problematic, for qualitative work is "well suited to support and facilitate comprehension of phenomena that are not well understood . . . and to develop existing theory 'by pointing to gaps and beginning to fill them.'" Johanna Mair & Ignasi Marti, *Entrepreneurship In and Around Institutional Voids: A Case Study From Bangladesh*, 24 J. BUS. VENTURING 419, 424 (2009) (citation omitted).

entrepreneurship. Part V concludes the article.

II. An Overview of the Law's Role in Strategy and Competitive Advantage

A. What Do "Strategy" and "Competitive Advantage" Mean?

"Strategy is about seeking a competitive edge over rivals"[20] by discovering and exploiting "value-creating opportunities."[21] International strategy, then, concerns the discovery and exploitation of value-creating opportunities within and across foreign environments. Most business literature approaches international strategy along two well-established lines: the industry-based view, which "argues that conditions within an industry . . . determine firm strategy and performance," and the resource-based view, which "suggests that it is firm-specific differences that drive strategy and performance."[22]

Peng and his coauthors propose that although the industry and resource views are insightful, they neglect the context in which competition occurs.[23] "This is not surprising, because [the] industry- and resource-based views arise primarily out of research on competition in the United States, in which it may seem reasonable to assume a relatively stable market-based institutional framework."[24] As we will see, the existing "law as competitive advantage" literature *also* assumes a high rule of law context.[25] Yet advanced institutions are not descriptive of most jurisdictions.[26] "[T]here is increasing appreciation that formal and

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20 George S. Day, *Maintaining the Competitive Edge: Creating and Sustaining Advantages in Dynamic Competitive Environments*, *in* WHARTON ON DYNAMIC COMPETITIVE STRATEGY 48, 48 (George S. Day & David J. Reibstein eds., 1997).

21 Gerald Keim, *Business and Public Policy: Competing in the Political Marketplace*, *in* THE BLACKWELL HANDBOOK OF STRATEGIC MANAGEMENT 583, 583 (Michael A. Hitt, R. Edward Freedman & Jeffery S. Harrison eds., 2001).

22 Mike W. Peng, Denis Y.L. Wang & Yi Jiang, *An Institution-Based View of International Business Strategy: A Focus on Emerging Economies*, 39 J. INT'L BUS. STUD. 920, 920 (2008).

23 *Id.* at 920.

24 *Id.* at 921.

25 *See infra* Part II.D.

26 Peng, Wang & Jiang, *supra* note 22, at 921.

informal institutions . . . significantly shape the strategy and performance of firms . . . in emerging economies."[27] As such, the existing literature has little applicability to legal competitive advantage internationally.

Peng and his colleagues argue persuasively that institutions should be the third leg in the "strategy tripod"—a robust international strategy will account for industry-based and firm-specific considerations, as well as for institutional realities.[28] "[A]n institution based view of strategy focuses on the dynamic interaction between institutions and organizations" such that strategic choices are "a reflection of the formal and informal constraints of a particular institutional framework that managers confront."[29] This article focuses on how a key institution—the law—should be harnessed to the firm's advantage in widely varying institutional contexts.

Competitive advantage is simply "an *advantage* over your *competitors*."[30] Oberman observes that "business organizations can treat social and political institutions as firm resources, effectively creating . . . *institutional* resources."[31] Institutional resources "cannot be perfectly controlled by a firm, but can nonetheless often be exploited . . . to achieve or maintain competitive advantage."[32] The law is one such institutional resource. Competitive advantages derived from institutional sources are fundamentally different from advantages achieved through industry characteristics or firm assets.[33] Part IV.D.1 will discuss the point further.

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27 *Id.*; *accord* Ted London & Stuart L. Hart, *Reinventing Strategies for Emerging Markets: Beyond the Transnational Model*, 35 J. INT'L BUS. STUD. 350, 352 (2004) (noting the prevalence of informal institutions in developing countries and the success of firms that leverage them).

28 Peng, Wang & Jiang, *supra* note 22, at 921.

29 *Id.* at 922-23.

30 GEORGE SIEDEL, USING THE LAW FOR COMPETITIVE ADVANTAGE 4 (2002).

31 William D. Oberman, *Strategy and Tactic Choice in an Institutional Resource Context*, *in* CORPORATE POLITICAL AGENCY 213, 215 (Barry M. Mitnick ed., 1993).

32 *Id.* at 214-15.

33 *See id.* at 215-16.

B. The Law and Its Relevance to International Business

It is necessary to first define "law" before attempting to define the "rule of law." Many definitions exist.[34] For Roscoe Pound, "law" has three meanings: (1) "the legal order—the regime of adjusting relations and ordering conduct by the systematic and orderly application of the force of a politically organized society," (2) "[t]he body of authoritative materials of or grounds of or guides to determination," and (3) "the process of [actually] determining causes and controversies according to the authoritative guides."[35] If these three meanings "can be unified, it is by the idea of social control."[36] Thus, "the law is whatever is done officially."[37] Because this article seeks a practical framework, it embraces Pound's realist view.[38]

The state can exert control by several means, including command regulation, self-regulation, and incentive-based regimes.[39] "[I]n most regulatory contexts combinations of [these] methods tend to be employed."[40] "Regulation often appears to be a game in which the rules are uncertain, the method of scoring is in dispute[,] and the distinction between players and spectators is unclear."[41] "This is because regulators' mandates tend to be imprecise" and because regulators "carry out a number of functions that are not always compatible," such as exercising control but also enabling markets.[42] Regulators must encourage

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34 *See, e.g.*, WILLIAM SEAGLE, THE QUEST FOR LAW 4 (1941) (listing various definitions of "law" over time and across cultures).

35 ROSCOE POUND, SOCIAL CONTROL THROUGH LAW 40 (1942).

36 *Id.* at 41.

37 *Id.* at 40; *accord* DONALD BLACK, THE BEHAVIOR OF LAW 2 (1976) ("Law is governmental social control."); SEAGLE, *supra* note 34, at 7 ("[L]aw is a mode of regulating conduct by means of sanctions imposed by politically organized society.").

38 Some philosophical commentaries help to illuminate the law's practical facets. *See, e.g.*, LON L. FULLER, THE MORALITY OF LAW 38-39 (revised ed. 1978) (discussing the eight conditions under which legal systems fail).

39 ROBERT BALDWIN & MARTIN CAVE, UNDERSTANDING REGULATION 35-55 (1999).

40 *Id.* at 57.

41 *Id.* at 334.

42 *Id.*

efficiency and other social goals; they must balance various interests and trade-offs.[43] Rarely can regulators "deal with issues in isolation."[44] "[R]ules are necessary in a world of uncertainty and incomplete knowledge. They arise from the complexity of the environment[,] the computational limitations of the individual . . . and the importance of predicting the behavior of" others.[45] The value of rules as behavioral guides varies across societies.[46] International strategy must account for rules, for "[m]anagement is largely concerned with issues whose outcomes are uncertain."[47]

The law is a regulatory institution:[48] "regulative processes involve the capacity to establish rules, inspect or review others' conformity to them, and as necessary, manipulate sanctions . . . in an attempt to influence future behavior."[49] Similarly, the "rational materialist" view "sees organizations as rational wealth maximizers and sees the law as a system of substantive incentives and penalties . . . . Thus, organizations instrumentally invoke or evade the law, in a strategic effort to 'engineer' legal activities that bring the largest possible payoff at the least possible cost."[50] We accept these views but further urge that the law can and should be used to the firm's competitive advantage.[51]

"Successful business strategy is about actively shaping the game you play, not just playing the game you find."[52] This is particularly true in international business,[53] where the firm must

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43 *Id.*

44 *Id.* at 335.

45 SVETOZAR PEJOVICH, ECONOMIC ANALYSIS OF INSTITUTIONS AND SYSTEMS 23 (2d ed. 1998).

46 *See id.*

47 P.G. Moore, *The Manager's Struggles with Uncertainty*, 140 J. ROYAL STAT. SOC'Y 129, 129 (1977).

48 *See* W. RICHARD SCOTT, INSTITUTIONS AND ORGANIZATIONS 34-45 (1995).

49 *Id.* at 35.

50 Lauren B. Edelman & Mark C. Suchman, *The Legal Environment of Organizations*, 23 ANN. REV. SOC. 479, 481-82 (1997).

51 *See infra* Part III.

52 Adam M. Brandenburger & Barry J. Nalebuff, *The Right Game: Use Game Theory to Shape Strategy*, *in* HARV. BUS. REV. ON MANAGING UNCERTAINTY 67, 70-71 (1999).

53 *See* Keim, *supra* note 21, at 583 (noting that opportunities and threats evolve from the interaction between firms and institutions).

proactively shape its legal game.[54] Doing so requires a distinctive type of lawyer.[55] "Legal counselors to transnational enterprises have to approach their work differently. They need to understand their business clients' global objectives and strategies, their competitive strengths and weaknesses, [and] their strategic competencies . . . ."[56] Most significantly, global attorneys must be entrepreneurial.[57]

C. Existing Literature on the Law as Competitive Advantage

Few scholars have considered the law a source of competitive advantage.[58] Four major works have begun exploring this topic:[59] George Siedel's *Using the Law for Competitive Advantage*, Constance Bagley's *Winning Legally: How to Use the Law to Create Value, Marshal Resources, and Manage Risk*, G. Richard Shell's *Make the Rules or Your Rivals Will*, and the multi-author *Legal Strategies: How Corporations Use Law to Improve Performance*. A few articles are also relevant.[60]

This literature is praiseworthy for its willingness to consider the law's potential upside and for its position that firms should take a proactive approach toward the law.[61] Bagley rightly observes that "[m]anagers who view the law purely as a constraint . . . will miss opportunities to use the law and the legal

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54 Clarence J. Mann, *Forces Shaping the Global Business Environment*, *in* BORDERLESS BUSINESS 1, 18 (Clarence J. Mann & Klaus Götz eds., 2006) (noting several studies that identify the legal system as one of the most important influences on foreign investment decisions).

55 *See generally infra* Part IV (introducing and discussing the "entrepreneurial lawyer").

56 William G. Frenkel, *The Fragmented Legal Environment of Global Business*, *in* BORDERLESS BUSINESS 144, 158 (Clarence J. Mann & Klaus Götz eds., 2006).

57 *See infra* Part IV (discussing legal entrepreneurship).

58 Bird, *The Many Futures of Legal Strategy*, *supra* note 2, at 575 ("The full potential of law as a value-added business tool has only begun to emerge in the academic literature.").

59 *Id.* at 582-83. Siedel's work is the most extensive on the law as competitive advantage, but its theoretical scope is limited to rudimentary legal planning in the United States context. The other works offer somewhat more substantively valuable insights, but without any significant demonstration of the far-reaching implications of their claims; they, too, are limited to the high rule of law context.

60 *Id.* at 576-83 (reviewing these articles).

61 *See id.* at 576.

system to increase both the total value created and the share of that value captured by the firm."[62] Regulation clearly imposes costs,[63] some of which are hidden.[64] But regulation also presents great opportunities to the firm.[65]

A related body of literature argues that international firms can utilize political strategies, the aim of which "is to obtain a competitive advantage through effectively interfacing with noneconomic actors, including the government . . . . '[I]f a firm cannot be a cost, differentiation or focus leader, it may still beat the competition on another ground, namely, the non-market environment.'"[66] Similarly, Elizabeth Bailey observes that "[t]he strategic interaction between the private and the public sectors needs to be understood as a dynamic driver of competitive advantage . . . . Public sector policies can create and help sustain competitive advantage for firms, or can undermine and even destroy advantages."[67] Additionally, Bagley writes that "[i]nstead of just reacting to regulations after they are adopted, firms can propose rules that would be favorable to them by lobbying and engaging in other political activities."[68] Thus, firms can utilize the regulatory process to frustrate competitors[69] and to seek

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62 Constance E. Bagley, *What's Law Got to Do With It?: Integrating Law and Strategy*, 47 AM. BUS. L.J. 587, 588 (2010).

63 *See generally* PETER CHINLOY, THE COST OF DOING BUSINESS (1989) (discussing the costs imposed upon firms by the regulatory apparatus in the United States and abroad).

64 *Id.* at 3.

65 Barry M. Mitnick, *The Strategic Uses of Regulation—And Deregulation*, *in* CORPORATE POLITICAL AGENCY 67, 67 (Barry M. Mitnick ed., 1993) ("The publicized costs to business in some areas of regulation do not fairly represent the range of regulatory impacts; in fact, regulation [provides] significant . . . business opportunities.").

66 Allen J. Morrison & Kendall Roth, *International Business-Level Strategy: The Development of a Holistic Model*, *in* INTERNATIONAL STRATEGIC MANAGEMENT 29, 36 (Anant R. Negandhi & Arun Savara eds., 1989). This article makes somewhat different arguments. Legal competitive advantage is necessary even if the firm is a cost, differentiation, or focus leader, and legal advantage can help the firm to become a cost, differentiation, or focus leader.

67 Elizabeth E. Bailey, *Integrating Policy Trends into Dynamic Advantage*, *in* WHARTON ON DYNAMIC COMPETITIVE STRATEGY 76, 77 (George S. Day & David J. Reibstein eds., 1997).

68 Bagley, *supra* note 62, at 590.

69 ROGER G. NOLL & BRUCE M. OWEN, THE POLITICAL ECONOMY OF

substantive changes to the law.[70] While these are helpful ideas in advanced markets, the next section illustrates how greatly they must be modified to apply outside of places like the United States.

D. Why Globalization Matters: Limits of the Existing Literature

In many jurisdictions, the international firm is caught between powerful tidal forces. Western multinationals "long accustomed to the rule of law must come to terms with the rule of man,"[71] but at the same time, states must embrace law (at least in some form) if they are to participate in the global economy.[72]

A few works in strategy and economics note that most scholarship assumes a strong institutional context.[73] The existing "law as competitive advantage" research makes this assumption as well.[74] The insights and recommendations of this literature are valid, but are limited to jurisdictions in which high rule of law conditions prevail.[75] On the international scope, assuming a strong institutional context begs the very question: the character and prevalence of strategic legal opportunities depend upon the nature of the legal system.[76] Western companies "in emerging-market economies cannot take existing institutions and business practices for granted, as they are still evolving and inexperienced."[77]

Examples illustrate the literature's high rule of law

DEREGULATION 39 (1983).

70 *See generally* Bailey, *supra* note 67 (discussing why firms should be proactive in shaping the law in addition to complying with it).

71 JOHN J. DANIELS, LEE H. RADEBAUGH & DANIEL P. SULLIVAN, INTERNATIONAL BUSINESS 116 (14th ed. 2013).

72 *See* Kathryn Hendley, *The Rule of Law and Economic Development in a Global Era*, *in* THE BLACKWELL COMPANION TO LAW AND SOCIETY 605, 605 (Austin Sarat ed., 2004).

73 *See, e.g.*, Peng, Wang & Jiang, *supra* note 22, at 920-21; Matthew C. Stephenson, *Legal Realism for Economists*, 23 J. ECO. PERSP. 191, 191 (2009) ("Most economic theory presumes—often implicitly—a system of law and adjudication.").

74 *See infra* Part II.D.

75 Some scholars in other disciplines recognize the impact of the institutional assumption. *See, e.g.*, DANIELS, RADEBAUGH & SULLIVAN, *supra* note 71, at 115; PEJOVICH, *supra* note 45, at 16.

76 *See* Frenkel, *supra* note 56, at 144 ("[T]he work of international business attorneys is shaped by varying and often conflicting jurisdictions and legal systems.").

77 *Id.* at 149.

assumption. Bird's pathways to legal strategy[78] are embodied by American companies in the American legal context,[79] and his examples do not contemplate markets outside the United States.[80] Of course, as Noll and Owen note, "[r]egulated firms can use the regulatory mechanism itself to impose costs and delays on their would-be competitors."[81] But strategy concerns more than saddling rivals with red tape; legal competitive advantage should focus primarily upon positioning one's own firm uniquely.[82]

Robert Ackerman's model assumes a high rule of law.[83] According to Ackerman, a "zone of discretion" exists—a time in which "astute and perceptive managers have considerable opportunities to slow or . . . reverse emerging legal regulation."[84] Silverstein and Hohler suggest that Ackerman's model has been ignored because business intervention in the policy process is ethically disquieting.[85] But Ackerman's real difficulty is that he assumes a high rule of law: in order for all regulated parties to have the opportunity to effectively intervene in the law-making process, a reasonably transparent and stable system, as well as the liberty to challenge the state, are required—all hallmarks of the high rule of law. Firms can do far more than simply lobby to change the law's content. Moreover, as Ackerman implies, the manager's discretion is not the only relevant viewpoint; the degree of discretion invested in authorities is equally important.[86] Legal

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78 Bird, *Pathways of Legal Strategy*, *supra* note 2, at 12-38 (discussing his strategies of avoidance, compliance, prevention, advantage, and transformation).

79 *See generally id.* (discussing such firms as PepsiCo, Google, IBM, and Lincoln Electric Company).

80 *See generally id.* (focusing only on companies' operations in the United States).

81 NOLL & OWEN, *supra* note 69, at 39.

82 Hitting one's rivals with onerous regulations may constitute a competitive advantage if it can be replicated consistently. But the efficacy and efficiency of this approach is doubtful, particularly in a free market where competitors may be numerous, enter and exit the industry frequently, and adapt quickly, and in high rule of law environments, where such strategies may be viewed as frivolous or as otherwise illegitimate.

83 Silverstein & Hohler, *supra* note 9, at 804-06 (2010) (citing and discussing Robert W. Ackerman, *How Companies Respond to Social Demands*, 51 HARV. BUS. REV. 88 (1973)).

84 *Id.* at 805.

85 *Id.* at 805 n.35.

86 *See* Robert W. Ackerman, *How Companies Respond to Social Demands*, 51

costs and legal risks may tend to rise as regulations become more numerous and complex,[87] but whether strategic opportunities are also correspondingly reduced is a function of the jurisdiction's rule of law observation.[88] Indeed, some jurisdictions, such as China, have shown the opposite—formal laws are more numerous today than thirty years ago, yet no opportunities for legal entrepreneurship existed then, whereas today they are bountiful.[89]

Mitnick's work assumes the uniform application of law.[90] Discussing the fact that regulation may produce a net benefit for regulated firms, Mitnick asserts that "although any one firm may not be better off compared to the preregulation state, that firm may yet be in a position of comparative advantage with other compliant firms."[91] This observation is undoubtedly valid in states with a truly uniform application of laws, but since most jurisdictions do not fit this ideal, the international relevance of Mitnick's observation is greatly circumscribed.[92]

Bagley argues that the exploitation of legal "loopholes" is per se wrong and that many companies deliberately violate the law.[93] However, this assumes that unlawful conduct is defined with reasonable clarity. In lower rule of law environments, "creative compliance" is not fraudulent; it is invited—even necessitated—by the legal system's design. In some locations, all legal compliance might necessarily be "creative" by Western standards.[94]

HARV. BUS. REV. 88, 90 (1973).

87 Legal and political risks will also rise as the volume and quality of regulation *descend* below a certain threshold. *See infra* Part III.B.

88 *See generally infra* Part III (examining the law's potential role in company strategy).

89 *See generally* KEMING YANG, ENTREPRENEURSHIP IN CHINA (2007) (discussing the growth of the Chinese economy in relation to the country's evolving reforms).

90 *See* BARRY M. MITNICK, THE POLITICAL ECONOMY OF REGULATION 1-20 (1980) (discussing the definition and object of regulation).

91 *Id.* at 70.

92 *See* Frenkel, *supra* note 56, at 144 ("The biggest hurdle for global companies from a legal perspective remains fragmentation of business law among nations whose legal systems function largely in isolation of one another.").

93 *See* Bagley, *supra* note 62, at 619-23.

94 Even firms in high rule of law environments seek to avoid adverse rules through "creative compliance"—"the process whereby those regulated avoid having to break the rules . . . by circumventing the scope of a rule." BALDWIN & CAVE, *supra* note 39, at

Some theories contend that globalization will spur a convergence of cultures and laws,[95] but this is doubtful. Cultural differences and local interests will remain highly influential in international business,[96] and although a higher degree of commonality now exists than at any other time, the laws of nations are far from converging.[97] "[R]ather than eliminating diversity, globalization reorders diversity. Localities are forever changing but they are certainly not disappearing."[98]

Most strategy research (on which the "law as competitive advantage" literature relies) also neglects the law's institutional role.[99] For instance, Chinloy notes that "[a]ll firms must comply with the legal system" and that "[s]ome firms are more efficient at compliance."[100] Though this is undoubtedly true, Chinloy assumes the luxury of relatively few legal uncertainties.[101] In any legal system, the question for managers and their counsel ought not to be compliance alone, but also whether the firm can affirmatively

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95 *See, e.g.*, George J. Siedel & Helena Haapio, *Using Proactive Law for Competitive Advantage*, 47 AM. BUS. L.J. 641, 645-47 (2010) (arguing that laws have converged across countries to such a degree that comparative legal advantage can no longer be achieved). Siedel previously argued that "the law itself is being globalized—thus creating an increasingly level playing field for business and new opportunities to use the law for competitive advantage." George Siedel, *Six Forces and the Legal Environment of Business: The Relative Value of Business Law among Business School Core Courses*, 37 AM. BUS. L.J. 717, 733 (2000). For Siedel, then, the law's potential as a source of competitive advantage depends upon similarities across countries. This article submits that meaningful similarities are rare; the institutional *differences* between countries afford the principal opportunities for legal competitive advantages.

96 *See generally* Geert Hofstede, *The Cultural Relativity of Organizational Practices and Theories*, 14 J. INT'L BUS. STUD. 75 (1983) (discussing how management practices should account for cross-cultural differences).

97 JOHN J. WILD & KENNETH L. WILD, INTERNATIONAL BUSINESS 92 (6th ed. 2012) (noting that legal differences between countries endure); *accord* Frenkel, *supra* note 56, at 144 ("[T]he harmonization of laws [across countries] . . . remains the rare and limited exception.").

98 PETER J. TAYLOR, POLITICAL GEOGRAPHY 297 (3d ed. 1993).

99 Bailey, *supra* note 67, at 78.

100 CHINLOY, *supra* note 63, at 1.

101 Uncertainties and flexibilities exist in high rule of law jurisdictions, but they are fewer in number and less varied in scope. *See infra* Parts III.B-D (discussing differing degrees of legal flexibility).

benefit from the law.[102] For firms in which corporate entrepreneurship prevails,[103] this focus will come naturally.

Bailey argues that firms should attempt to influence the substance of the law through lobbying.[104] The laws of lower rule of law environments fluctuate, and firms may very well have occasion to lobby.[105] But firms in low rule of law countries often will find greater advantage in preserving the law as they find it, irrespective of the law's particular content.[106]

Porter accounts for the law similarly—as a constraint,[107] a driver or suppressor of demand,[108] an enabler or inhibitor of emerging industries,[109] an impediment to free trade,[110] and as a general influencer of industry competition[111] and evolution.[112] Porter's classic five forces model guides firms in assessing the attractiveness of a given competitive arena.[113] But the law's "attractiveness" is not the appropriate inquiry. The law is a necessity: firms *must* compete legally. Porter's model "does not focus on the important linkages between private strategy and public policy."[114] Similarly, though it is very useful for its

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102 *See* Downes, *supra* note 1, at 19 ("[L]aw and regulation increasingly determine winners and losers. That means company leaders must work more closely with their legal departments. And they must hire lawyers who know how to use law as a strategic weapon.").

103 *See generally* VIJAY SATHE, CORPORATE ENTREPRENEURSHIP (2003) (discussing the traits of successful corporate entrepreneurship such as risk management, adapting lessons from individual entrepreneurship, and consistently pursuing new businesses).

104 *See* Bailey, *supra* note 67, at 77 (advocating for businesses to shape public policy to their advantage).

105 *See generally, e.g.*, SCOTT KENNEDY, THE BUSINESS OF LOBBYING IN CHINA (2005) (discussing the complexities of lobbying for and against regulations in China due to the tension between privately-owned and state-owned firms).

106 *See infra* Part IV.C.3.

107 *See, e.g.*, MICHAEL E. PORTER, COMPETITIVE STRATEGY 53 (2004).

108 *Id.* at 166.

109 *Id.* at 223-24.

110 *Id.* at 286.

111 *Id.* at 28.

112 *Id.* at 181-82.

113 George S. Day, *Assessing Competitive Arenas: Who Are Your Competitors?*, *in* WHARTON ON DYNAMIC COMPETITIVE STRATEGY 23, 33-42 (George S. Day & David J. Reibstein eds., 1997).

114 Bailey, *supra* note 67, at 79.

purpose, "the resource-based view of the firm[] also treats public policy only indirectly."[115]

International firms require a framework cognizant of institutional differences—a framework best captured by the "rule of law."[116]

E. The Law's Core Tensions: Certainty versus Flexibility and Rules versus Discretion

Since at least Aristotle's time, humans have recognized the inherent tension between stability and flexibility in the law, and the need for balance between these.[117] Such a balance "is the problem of the ages."[118] As Roscoe Pound eloquently observed, "[l]aw must be stable, yet it cannot stand still."[119] Discretion must be built into the rules if the legal system is to be effective,[120] but balancing the two is difficult.[121] State officials might exercise discretion for several reasons: rules can be difficult to formulate, discretion is sometimes preferable to the rules that could be promulgated, and some discretion admittedly ought to be constrained but is not, owing to institutional imperfections.[122] In authoritarian environments, an additional fact is at work: legal flexibilities are helpful in preserving the privileged status of political incumbents,[123] for "[o]rganizations will be designed to

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115 *Id.*

116 *See infra* Part III (detailing a rule of law framework).

117 BENJAMIN N. CARDOZO, THE GROWTH OF THE LAW 2 (1924).

118 *Id.* at 3.

119 ROSCOE POUND, INTERPRETATIONS OF LEGAL HISTORY 1 (1967).

120 *See* CARDOZO, *supra* note 117, at 2.

121 ROSCOE POUND, AN INTRODUCTION TO THE PHILOSOPHY OF LAW 54 (1954) ("Almost all of the problems of jurisprudence come down to a fundamental one of rule and discretion.").

122 KENNETH CULP DAVIS, DISCRETIONARY JUSTICE 15-21 (1969).

123 *See infra* Part III.C (discussing lower rule of law states and legal flexibilities). Mechanisms for replacing inefficient institutions are seldom found in practice. PEJOVICH, *supra* note 45, at 35. One explanation is the "self-interest of the political elite .... To preserve their positions and status, members of the political elite have incentives to create rent-seeking opportunities for a segment of the community that might, in turn, support the prevailing regime." *Id.* at 36. Thus, "[t]he further a country travels away from the rule of law the greater the power of the ruling group to create institutions that strengthen and perpetuate its own powers." *Id.* at 39. But even authoritarians must be minimally effective. John Morison, *How to Change Things with*

further the objectives of their creators."[124]

From the state's perspective as well, both predictability and flexibility in the law are needed. The "rights hypothesis" asserts that "economic growth requires a legal order offering stable and predictable rights of property and contract because the absence of such rights discourages investment and specialization."[125] For all states desirous of meaningful economic growth, the legal system must incentivize private actors.[126] And yet a perfectly predictable, entirely inflexible legal system would be ineffective due to either infinite complexity (to unambiguously cover all possible contingencies) or woeful inadequacy (in seeking simplicity, the law would neglect a vast range of contingencies and would rely upon arbitrariness—standards outside of the law—to fill the gaps). Again, the debate concerns where the optimal balance lies.[127] "Rules may vary [by] degree of specificity or precision; extent, coverage, or inclusiveness; accessibility and intelligibility, legal status and force; and the prescriptions or sanctions they incorporate."[128]

"[S]ome unpredictability in law is desirable," argue Altschuler and Sgori.[129] "Indeed, if a rule had to provide an automatic and completely predictable outcome before courts could resolve conflicts, society would become intolerably repressive, if not altogether impossible."[130] People would have little incentive to participate in the legal process, and the "needs of society change over time. The words of [the] law . . . must take on new meanings.

Rules, *in* LAW, SOCIETY AND CHANGE 5, 5 (Stephen Livingstone & John Morison eds., 1990) (noting that "law has to be made to *work*" in order for incumbents to sustain their positions of power).

124 DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 73 (1990).

125 Donald C. Clarke, *Economic Development and the Rights Hypothesis: The China Problem*, 51 AM. J. COMP. L. 89, 89 (2003).

126 *See id.*

127 Raz, *supra* note 6, at 6 (arguing that the key balance is between generality and specificity in the laws).

128 BALDWIN & CAVE, *supra* note 39, at 101. For a thought-provoking discussion of what rules are, see generally KARL N. LLEWELLYN, THE THEORY OF RULES (Frederick Schauer ed., 2011).

129 BRUCE E. ALTSCHULER & CELIA A. SGORI, UNDERSTANDING LAW IN A CHANGING SOCIETY 150, 150 (2d ed. 1996).

130 *Id.*

The participation that ambiguity encourages constantly bombards judges with new ideas."[131] Lawmakers should not deliberately create legal uncertainties, as sometimes happens in lower rule of law jurisdictions.[132] Instead, while "uncertainty in law is unavoidable," it is "more a blessing than a curse."[133]

Skeptics note that legal ambiguities can disincentivize business.[134] "[E]x post discretion is problematical for deal-making."[135] Yet it remains nearly impossible to eliminate discretion "either because it is hopeless to nail down every margin . . . or because of difficulties in monitoring performance. For either reason, anticipation of exercises of discretion may cause [business] deals to be stillborn."[136] "Uncertainty [in international business] is due largely to the unpredictable manner in which government agencies . . . interpret and enforce regulations."[137] Informal institutions, such as the firm's reputation, can become a substitute basis for doing business, since a "reputation for honoring one's commitments enhances the prospects for gains from subsequent deals."[138]

In any jurisdiction, legal uncertainties generate some degree of administrative discretion.[139] For some scholars, bureaucratic discretion "endangers the . . . rule of law."[140] Many commentators agree that the rule of law requires government "limited by laws that are clear and specific."[141] Yet bureaucratic discretion is "an

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131 *Id.* at 151.

132 *See infra* Part III.C (noting that some lower rule of law jurisdictions deliberately incorporate flexibilities into their legal systems).

133 ALTSCHULER & SGORI, *supra* note 129, at 151.

134 *See, e.g.*, Clarke *supra* note 125, at 89 ("[T]he absence of [a predictable legal order] discourages investment and specialization.").

135 Kenneth A. Shepsle, *Political Deals in Institutional Settings*, *in* THE THEORY OF INSTITUTIONAL DESIGN 219, 229 (Robert E. Goodwin ed., 1996).

136 *Id.*

137 Mann, *supra* note 54, at 18.

138 Shepsle, *supra* note 135, at 229.

139 LAWRENCE M. SOLAN, THE LANGUAGE OF STATUTES 3 (2010); GARY C. BRYNER, BUREAUCRATIC DISCRETION 1 (1987).

140 BRYNER, 139 note 139, at 2; *accord* FRIEDRICH A. HAYEK, THE ROAD TO SERFDOM 72 (1944) (providing that government must be bound by rules previously announced); DAVIS, *supra* note 122, at 28-36 (same). *But see* Raz, *supra* note 6, at 12 (arguing that "[m]any forms of arbitrary rule are compatible with the rule of law").

141 BRYNER, *supra* note 139, at 8.

inevitable, inescapable characteristic of government."[142] Two basic types of bureaucratic discretion exist: the authority to make legislative-like policy decisions, and the authority to decide how general policies apply to specific cases.[143] "Decisions according to rules run in predictable, straight paths. Discretionary decisions invoke an image of unpredictable tangents."[144] Many proponents of legal certainty concede that some degree of official discretion is beneficial.[145] Still, the value of institutions is measured by the degree of stability they engender.[146] Unstable rules "tend to increase . . . risk and uncertainty."[147] Yet stability requires *some* flexibility, for "societal stability depends on how quickly a legal system can adapt to . . . unstoppable social change."[148]

In practice, the distinction between rules and discretion is difficult to maintain.[149] This is partly because the "power to decide [legal questions] becomes the power to define" what is lawful.[150] Managers sometimes think that "the world is either certain, and therefore open to precise predictions . . . or uncertain, and therefore completely unpredictable."[151] This is errant because uncertainty exists in degrees.[152] High rule of law jurisdictions promote sufficient predictability in tandem with some degree of legal flexibility.[153]

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142 *Id.* at 3.

143 *Id.* at 6.

144 GEORGE P. FLETCHER, BASIC CONCEPTS OF LEGAL THOUGHT 43 (1996).

145 For example, delegation to administrative agencies "is held necessary, among other reasons, because of a presumed need for flexibility, and therefore discretion . . . . [A]lmost by definition, regulatory mandates cannot be completely specified." Mitnick, *supra* note 65, at 205. Bryner concedes that some degree of official discretion can benefit society. BRYNER, *supra* note 139, at 3-6; *see also* DAVIS, *supra* note 122, at 3 (providing that discretion may be either reasonable or arbitrary).

146 PEJOVICH, *supra* note 45, at 25.

147 *Id.*

148 Silverstein & Hohler, *supra* note 9, at 799.

149 *See* FLETCHER, *supra* note 144, at 43-59 (discussing the relationship between rules and discretion).

150 *Id.* at 51.

151 Hugh Courtney, Jane Kirkland & Patrick Viguerie, *Strategy Under Uncertainty*, *in* HARV. BUS. REV. ON MANAGING UNCERTAINTY 1, 3 (1999).

152 *See id.* at 5 ("[D]etermining which strategy is best . . . depend[s] vitally on the level of uncertainty a company faces.").

153 SOLAN, *supra* note 139, at 16-17. "The fact that [Americans] agree so often

Part III will argue that the extent to which uncertainties pervade a legal system is described by the "rule of law," and that differing degrees of rule of law observation imply different legal strategies for the firm.[154]

F. Transaction Costs, the Coase Theorem, and the Law

Transaction costs and the Coase Theorem are important to our subject. "Transaction costs" are "the costs of identifying the parties with whom one has to bargain, the costs of getting together with them, the costs of the bargaining process itself, and the costs of enforcing any bargain reached"[155]—in other words, "the price of doing a deal."[156] Six types of transaction cost are recognized: search, information, bargaining, decision, policing, and enforcement costs.[157]

Transaction costs undermine economic efficiency.[158] Uncertainty propagates risk and discourages transactions.[159] Unclear regulations cause economic actors to invest more time lobbying, and because this is a less productive investment than direct economic activity, jurisdictions with ambiguous laws typically stultify their own economic potential.[160] Thus, legal flexibility is a seventh source of transaction costs. Some scholars

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about a law's application rightly gives us confidence in our ability to live under a rule of law that defines our rights and obligations." *Id.* at 18.

154 *See infra* Part III.

155 A. MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 12 (2d ed. 1989). *But see* Douglas W. Allen, *Transaction Costs*, *in* 1 ENCYCLOPEDIA OF LAW AND ECONOMICS 893, 893 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000) (asserting that the phrase "transaction cost" has evolved to the point that its meaning is potentially ambiguous).

156 LARRY DOWNES, THE LAWS OF DISRUPTION 35 (2009); *accord* PEJOVICH, *supra* note 45, at 9 (stating that transaction costs are the resources firms spend to make exchanges as well as resources society expends to maintain institutions).

157 DOWNES, *supra* note 156, at 36. Unfortunately, transaction costs are also common. *Id.* at 37 (noting "that up to 45 percent of economic activity consists of transaction costs").

158 *Id.* at 36.

159 Frans van Waarden, *Institutions and Innovation: The Legal Environment of Innovating Firms*, 22 ORG. STUD. 765, 768 (2001).

160 Susan E. Feinberg & Anil K. Gupta, *MNC Subsidiaries and Country Risk: Internalization as a Safeguard Against Weak External Institutions*, 52 ACAD. MGMT. J. 381, 382-83 (2009).

opine that Western jurisdictions "have too many laws and too many rules such that a reasonable person can be observed acting . . . wholly unreasonabl[y] . . . ."[161] Unclear laws are bad from the societal perspective because "[w]ithout a legal regime specifying who owns what and a system for transferring rights, the market could not operate."[162] Properly devised, however, the law can lower transaction costs.[163]

Efficient institutions reduce transaction costs by supplying effective rules. In places where "the law and informal norms govern exchange relationships, transaction costs are relatively low . . . . By comparison, in environments in which institutions are underdeveloped, transaction costs are high, [and] exchange is therefore costly . . . ."[164] In other words, institutions "represent constraints on the options that individuals and collectives are likely to exercise, albeit constraints that are open to modification over time."[165] Legal constraints are subject to modification over time and can hold differing implications for individual firms. This fact is responsible for the law's potential as a source of competitive advantage. Yet institutions can themselves become sources of uncertainty.[166]

This leads to the Coase Theorem, an idea that has been expressed in many ways.[167] The simplest version states that "[i]f there are zero transaction costs, the efficient outcome [of a bargain] will occur regardless of the choice of legal rule."[168] In the

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161 PATRICK A. MCNUTT, POLITICAL ECONOMY OF LAW 4 (2010).

162 FLETCHER, *supra* note 144, at 157; *accord* Nicholas Dew, *Institutional Entrepreneurship: A Coasian Perspective*, 7 INT'L J. ENTREPRENEURSHIP & INNOVATION 13, 15 (2006) (asserting that institutions establish incentives).

163 SATHE, *supra* note 103, at 47-48 (stating that government regulations can both hinder and facilitate new business creation).

164 Dew, *supra* note 162, 14-15.

165 Stephen R. Barley & Pamela S. Tolbert, *Institutionalization and Structuration: Studying the Links Between Action and Institution*, 18 ORG. STUD. 93, 94 (1997).

166 *See generally* van Waarden, *supra* note 159 (contrasting the United States and Dutch legal systems and concluding that the U.S. system's penchant for emphasizing litigation functions as an institutional source of uncertainty).

167 Steven G. Medema & Richard O. Zerbe, Jr., *The Coase Theorem*, *in* 1 ENCYCLOPEDIA OF LAW AND ECONOMICS 836, 837-38 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000).

168 POLINSKY, *supra* note 155, at 12; *accord* YORAM BARZEL, ECONOMIC ANALYSIS OF PROPERTY RIGHTS 7 (2d ed. 1997).

real world, however, transaction costs always exist to one degree or another.[169] Thus, the Theorem's more nuanced version holds that "[i]f there are positive transaction costs, the efficient outcome may not occur under every legal rule."[170] The Normative Coase Theorem[171] extends this still further: "the preferred legal rule is the rule that minimizes the effects of transaction costs. These effects include actually incurring transaction costs as well as the inefficient choices induced by a desire to avoid transaction costs."[172] As Downes explains:

> Coase believed economists should turn their attention to the practical problem of uncovering [and eliminating transaction costs] . . . . A great deal of regulation and liability laws . . . were unconscious efforts to overcome transaction costs . . . . But the regulations themselves generate so many transaction costs that in many cases doing nothing at all would have produced a [more efficient] result.[173]

In other words, "Coase argued that, from an economic perspective, the goal of the legal system should be to establish a pattern of rights such that economic efficiency is attained. The legal system affects transaction[] costs and the goal of such a system is to minimize harm or costs."[174]

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169 POLINSKY, *supra* note 155, at 12; *accord* PEJOVICH, *supra* note 45, at 12 (providing that the real world "*is not* a Coasian world . . . . The relevant choice is between two or more discrete institutional arrangements with positive transaction costs"); ROBERT COOTER & THOMAS ULEN, LAW & ECONOMICS 95 (5th ed. 2008) (asserting that because transaction costs always exist in practice, legal rules influence whether efficient outcomes are achieved).

170 POLINSKY, *supra* note 155, at 13.

171 Scholars debate whether the Coase Theorem contains a normative element, or whether it is purely descriptive. *See, e.g.*, Medema & Zerbe, *supra* note 167, at 876 (stating that the Coase Theorem is a positive statement with no normative implications); Joseph Farrell, *Information and the Coase Theorem*, 1 ECON. PERSP. 113, 113-14 (1987) (noting this debate among economists).

172 POLINSKY, *supra* note 155, at 13.

173 DOWNES, *supra* note 156, at 37.

174 Medema & Zerbe, *supra* note 167, at 836-37; *see also* David B. Sherman, *Cost and Resource Allocation Under the Orphan Works Act of 2006: Would the Act Reduce Transaction Costs, Allocate Orphan Works Efficiently, and Serve the Goals of Copyright Law?*, 12 VA. J.L. & TECH. 4, 7 (2007) (asserting that property laws ought to minimize transaction costs); SVETOZAR PEJOVICH, LAW, INFORMAL RULES AND ECONOMIC PERFORMANCE 15 (2008) (asserting that clearly defined property rights are crucial to resolving conflicts).

In turn, this aspiration requires that rights be defined "well."[175] "Well-defined rights" are articulated in such a manner that everyone can understand them—that is, rights defined unambiguously.[176] Ambiguous laws generate transaction costs.[177] Property rights can lower transaction costs *if* they are defined with clarity.[178] "Lowering transaction costs 'lubricates' bargaining . . . . One important way for the law to do this is by defining simple and clear property rights. It is easier to bargain when legal rights are simple and clear than when they are complicated and uncertain."[179] Observers outside of economics agree that lawmakers "should use language that is clear, certain, unequivocal, and to the point."[180] In this paper, the "Coasian ideal" refers to the idealized situation in which the law imposes no transaction costs upon society because it is perfectly clear and perfectly functioning.

Llewellyn felt that even in the American legal system, "the leeway available for exploitation by advocates . . . is a wide leeway."[181] For Llewellyn, legal flexibilities are problematic because they are inconsistent with the Coasian ideal. But firms need not passively accept the costs generated by institutional peculiarities. Rather, as with any other social institution, the firm must seek to utilize the law for its benefit, subject to ethical confines. Leeways in the law are not ethically dubious per se, just as market opportunities to outperform rivals are not evil. To the extent a legal system invites competition through its flexibilities, the law is a legitimate arena for entrepreneurial initiative.

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175 COOTER & ULEN, *supra* note 169, at 97 (stating that one should "[s]tructure the law so as to remove the impediments to private agreements"); Avery Katz, *The Strategic Structure of Offer and Acceptance: Game Theory and the Law of Contract Formation*, 89 MICH. L. REV. 215, 228-29 (1990) (same).

176 *See* COOTER & ULEN, *supra* note 169, at 97; Sanford Schane, *Ambiguity and Misunderstanding in the Law*, 25 T. JEFFERSON L. REV. 167, 170 (2002).

177 *See* Feinberg & Gupta, *supra* note 160, at 382.

178 Thomas Hazlett, *Ronald H. Coase*, *in* PIONEERS OF LAW AND ECONOMICS 1, 17 (Lloyd R. Cohen & Joshua D. Wright eds., 2009).

179 COOTER & ULEN, *supra* note 169, at 97.

180 Schane, *supra* note 176, at 170.

181 LLEWELLYN, *supra* note 128, at 122.

G. The Cross-Border Firm: General Considerations

1. The International Environment

Global business is uniquely challenging because of the number and complexity of variables involved, greater volatility across countries, and higher degrees of interdependence.[182] Still, firms confront many compelling reasons in favor of globalizing. These include the growth, efficiency and knowledge imperatives, and the globalization of one's customers and competitors.[183] Globalization will remain a core feature of business.[184] The survival of most large enterprises will depend upon their effectiveness in foreign environments, including foreign legal systems.[185] Yet global presence does not automatically make for global competitive advantage.[186] Because many emerging countries "are open to foreign investors but do not follow orthodox market rules,"[187] Western firms must expressly account for foreign legal systems in their strategic planning.[188]

2. Risks

Firms must proactively manage their international risks[189] and so must be familiar with the localities in which they operate (or intend to operate).[190] Several forms of risk merit attention. *Legal risk* is the most relevant. Western scholars usually define the idea

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182 Clarence J. Mann, *Strategy in a Global Context*, *in* BORDERLESS BUSINESS 33, 34 (Clarence J. Mann & Klaus Götz eds., 2006).

183 ANIL K. GUPTA, VIJAY GOVINDARAJAN & HAIYAN WANG, THE QUEST FOR GLOBAL DOMINANCE: TRANSFORMING GLOBAL PRESENCE INTO GLOBAL COMPETITIVE ADVANTAGE 28-29 (2d ed. 2008).

184 *Id.* at 15-17 (supporting this assertion with numerous examples of how global lines are now well entrenched).

185 DANIELS, RADEBAUGH & SULLIVAN, *supra* note 71, at 116-18 (observing that firms confront myriad legal issues abroad).

186 GUPTA, GOVINDARAJAN & WANG, *supra* note 183, at 21.

187 RUCHIR SHARMA, BREAKOUT NATIONS: IN PURSUIT OF THE NEXT ECONOMIC MIRACLES 187 (2012).

188 *See generally infra* Parts III and IV.

189 Peter Lorange, *Challenges to Strategic Planning Processes in Multinational Corporations*, *in* INTERNATIONAL STRATEGIC MANAGEMENT 107, 112-14 (Anant R. Negandhi & Arun Savara eds., 1989) (discussing international risk management).

190 *Id.* at 113.

without regard to institutions.[191] For example, they view legal risk in terms of litigation[192] or as "the likelihood that a trading partner will opportunistically break a contract or expropriate property rights."[193] Broadly, then, "legal risk" is the likelihood that a firm will suffer financial harm from a legal process or the lack thereof.[194] But our context specifically concerns international firms in foreign markets. For purposes of this article, *legal risk* describes the likelihood that a firm will suffer losses[195] that it otherwise could avoid but for one or more uncertainties or flexibilities in a particular legal system.[196] Significantly, affluent countries tend to regulate business less, and impoverished countries tend to regulate more.[197] This is a fact of great importance as the firm moves from a single, institutionally strong environment to the cross-jurisdictional realm.[198]

Political risk "refers to the threat that decisions or events in a country will negatively affect the profitability of an investment."[199] Assessing political risk requires an evaluation of the government's role, the type of government, social strife, and other related variables.[200] Political risks range from relatively minor occurrences to catastrophic events.[201]

Political risk is a major consideration in foreign investment,

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191 *See generally* Tobias Mahler, *Defining Legal Risk*, http://ssrn.com/abstract =1014364 (last visited Oct. 22, 2013) (listing various definitions).

192 *See* Kevin Johnson & Zane Swanson, *Quantifying Legal Risk: A Method for Managing Legal Risk*, 9 MGMT. ACCT. Q. 22 (2007).

193 CHARLES W.L. HILL, INTERNATIONAL BUSINESS 93 (9th ed. 2013).

194 *See* SHOUSHANG LI, THE LEGAL ENVIRONMENT AND RISKS FOR FOREIGN INVESTMENT IN CHINA 3 (2007).

195 "Losses" include direct financial losses as well as lost opportunities and the like.

196 These include legal ambiguity and incompleteness as well as changes to the law. LI, *supra* note 194, at 3-4.

197 DANIELS, RADEBAUGH & SULLIVAN, *supra* note 71, at 118.

198 This article will again consider legal risk in Part IV.C, *infra*.

199 DANIELS, RADEBAUGH & SULLIVAN, *supra* note 71, at 106; *see also* Stephen J. Kobrin, *Political Risk: A Review and Reconsideration*, 10 J. INT'L BUS. STUD. 67, 68 (1979) (reviewing various definitions of political risk).

200 Syed H. Akhter & Roberto Friedman, *International Market Entry Strategies and Level of Involvement in Marketing Activities*, *in* INTERNATIONAL STRATEGIC MANAGEMENT 157, 164-66 (Anant R. Negandhi & Arun Savara eds., 1989).

201 DANIELS, RADEBAUGH & SULLIVAN, *supra* note 71, at 107-09.

but few firms have formal mechanisms for assessing it.[202] Political risk is difficult to quantify.[203] A political risk may be characterized by certainty, risk, or uncertainty.[204] These are ideal constructs.[205] Any of the three can be approximated in practice,[206] so "while better information can help" to clarify political variables, information "can seldom convert uncertainty into [lower] risk . . . . Opinions formed about future events . . . are inherently subjective."[207] Firms should analyze political risks through a "systematic and relatively rigorous approach to data gathering and problem solving."[208] Quantitative modeling is helpful, but qualitative judgment must still guide the assessment of political risk.[209]

Many assumptions appropriate in developed economies are "dangerous" in emerging markets.[210] Traditional evaluation tools "don't flash warning signals to would-be entrants about the presence of institutional voids."[211] Institutional voids are "the absence of specialized intermediaries, regulatory systems, and contract-enforcing mechanisms in emerging markets."[212] In evaluating a foreign political environment, the firm must consider such factors as the number of groups competing for political power; the limits, if any, upon government regulation; the extent to which private property rights are protected; the power of lobbies; the prevalence of corruption; and the extent to which

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202 Kobrin, *supra* note 199, at 74.

203 *See* Tillman Sachs, Robert Tiong & Daniel Wagner, *The Quantification and Financial Impact of Political Risk Perceptions on Infrastructure Projects in Asia*, 13 J. STRUCTURED FINANCE 80, 80-81 (2008).

204 Kobrin, *supra* note 199, at 70; *accord* Philip Bromiley, Kent D. Miller & Devaki Rau, *Risk in Strategic Management Research*, *in* THE BLACKWELL HANDBOOK OF STRATEGIC MANAGEMENT 259, 260 (Michael A. Hitt, R. Edward Freedman & Jeffery S. Harrison eds., 2001) (defining "certainty," "risk," and "uncertainty" in a similar fashion).

205 Kobrin, *supra* note 199, at 70.

206 *Id.*

207 *Id.* at 71.

208 *Id.* at 77.

209 *Id.* at 76.

210 Tarun Khanna, Krishna G. Palepu & Jayant Sinha, *Strategies That Fit Emerging Markets*, 83 HARV. BUS. REV. 63, 65 (2005).

211 *Id.* at 65-66.

212 *Id.* at 63; TARUN KHANNA & KRISHNA G. PALEPU, WINNING IN EMERGING MARKETS 14 (2010).

contracts are honored.[213]

Finally, jurisdictions vary by *country risk*—hazards originating "from unpredictability regarding the substance and implementation of future government policies, the extent to which a country is governed by rule of law . . . and so forth . . . ."[214] As an amalgam of cultural, political, and legal risks,[215] country risk can be treated discretely in evaluating a market's attractiveness.[216]

Legal, political, and country risks advance a similar idea: non-market forces can exercise dramatic—even deterministic—influences on the firm's economic performance. This idea is expressed in institutional economics: institutions hold profound implications for the firm's risks, costs, and opportunities, and therefore ought to influence the firm's strategy.[217] But firms often fail to account for institutional variables, and managers often view the law only as a burdensome constraint.[218] Parts III and IV, *infra*, propose a starting point for the integration of law and strategy.

3. Costs

Risks necessarily impose costs upon the firm. Clearly, laws impose financial costs. Yet the law's effective integration with strategy is as much an institutional endeavor as an economic one. To this end, the "pattern of ownership that emerges in an [international business] system depends crucially on the structure of transaction costs."[219] In particular, "international linkages typically incur higher transaction costs than purely domestic

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213 Khanna, Palepu & Sinha, *supra* note 210, at 68.

214 Feinberg & Gupta, *supra* note 160, at 382.

215 *See* HILL, *supra* note 193, at 93 (asserting that country attractiveness "depends on balancing the benefits, costs, and risks associated with doing business in that country").

216 GEORGE S. YIP & G. THOMAS M. HULT, TOTAL GLOBAL STRATEGY 257 (3d ed. 2012).

217 *See* Lan Cao, *Looking at Communities and Markets*, 74 NOTRE DAME L. REV. 841, 846 n.86 (1999) ("[N]ew institutional economics also explores how norms develop and operate within the institution and how various norms—for example, norms of cooperation—influence the institutional environment, the firm's internal structure, and consequently its economic decisionmaking.").

218 *See generally infra* Parts III and IV.

219 Peter Buckley & Mark Casson, *Strategic Complexity in International Business*, *in* THE OXFORD HANDBOOK OF INTERNATIONAL BUSINESS 88, 118 (2003).

ones."[220]

Significantly, "[t]ransactions vary in difficulty. It is generally easier to transact in developed than in developing markets."[221] This is largely due to transaction costs, which "offer one measure of how well a market works .... Conducting even simple transactions in developing economies can be a time- and resource-consuming process, posing hazards for those expecting the fluidity of developed markets."[222]

Regulatory compliance imposes upon the firm direct costs as well as indirect costs (the time allocated to compliance).[223] Every "legal system is based on social and cultural institutions. These institutions differ across jurisdictions, creating differences in the cost of doing business."[224] Still, in appraising the law's potential as a source of competitive advantage, the firm must also consider its potential returns. Western executives tend to think they have received a high return on legal costs if they "stay out of trouble."[225] But in low rule of law environments, the potential returns can be far greater.

Chinloy remarked that "[a]ll firms must comply with the legal system" and that "[s]ome firms are more efficient at compliance."[226] This article does not dispute the necessity of compliance, but notes that legally flexible environments typically introduce the likelihood that legal compliance is itself subject to high degrees of flexibility. In the presence of legal flexibility, compliance with the law can assume myriad legitimate forms.[227] Legal costs can thus be highly malleable.[228]

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220 *Id.*

221 KHANNA & PALEPU, *supra* note 212, at 16.

222 *Id.* at 17.

223 CHINLOY, *supra* note 63, at 22.

224 *Id.* at 103.

225 *See generally* Randy Decker, *Economics and Litigation: View from the Inside Looking Out*, 24 LITIG. 36, 36 (1998) ("[M]ost executives view litigation as wasteful ... [and] extremely expensive.").

226 CHINLOY, *supra* note 63, at 1

227 *Id.* at 2 (listing litigation and regulation as two examples).

228 *Id.* at 3.

4. Opportunities

For nearly every risk emanating from a legal flexibility, a corresponding opportunity for value capture is also created.[229] These opportunities often are subtle—perhaps initially almost undetectable, as evidence of their existence can be convoluted and counterintuitive. But these opportunities are nonetheless present.

Some scholars have argued that firms can advantageously exploit institutional voids[230] and that "[i]nstitutional voids have real and first-order effects on business strategy."[231] Khanna and Palepu note that "[t]he development of business strategy in any economy is driven by three primary markets—product, labor, and capital."[232] Arguably, however, the legal market is as strategically important as the traditional markets.

The law can be utilized to the benefit of regulated parties, regulators, or both.[233] International firms may confront higher average risks and costs than their domestic counterparts, but global firms almost invariably encounter greater opportunities as well. Emerging markets "foster a different genre of innovations than mature markets do."[234] This is as true of the legal sphere as it is of the economic sphere.

Foreign firms often resist policy hazards by lobbying or by minimizing the firm's dependence upon the external environment.[235] "[D]eploying political strategies requires . . . interpreting an external environment and acting upon that interpretation. Also, success with political strategies requires the cooperation of external actors over whom a firm may have little control."[236] Moreover, "naïve deployment of political strategies

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229 Some scholars have recognized this in the regulatory context. *See* BALDWIN & CAVE, *supra* note 39, at 2 (noting that regulation can be enabling or facilitative); *see also infra* Parts III-IV (discussing legal opportunities).

230 *See generally, e.g.*, KHANNA & PALEPU, *supra* note 212 (noting that companies can view institutional voids as entrepreneurial opportunities).

231 *Id.* at 28.

232 *Id.* at 27.

233 ROGER D. MASTERS, THE NATURE OF POLITICS 205 (1989) (asserting that private interests will manipulate rules for their own benefit, leading to greater complexity in the law); *see also supra* Part II.C (discussing sources on point).

234 Khanna, Palepu & Sinha, *supra* note 210, at 64.

235 Feinberg & Gupta, *supra* note 160, at 383-84.

236 *Id.* at 385.

can easily backfire. In short, like other complex activities, the effective deployment of political strategies is likely to be subject to significant experience effects."[237] Part IV will argue that firms enjoy a third option in addition to political and operational strategies: legal entrepreneurship.

The opportunity for arbitrage may also exist in the law. Classical arbitrage exploits price differentials, but arbitrage exists in other forms as well.[238] Firms can use Ghemawat's CAGE framework to understand the full gambit of opportunities for arbitrage. The four dimensions of "CAGE"—cultural, administrative, geographical, and economic differences between countries—can function as sources of advantage.[239] The administrative dimension is of interest here: "[l]egal, institutional[,] and political differences from country to country open up a host of strategic arbitrage opportunities."[240] Ghemewat notes that "[f]ew managers ever explicitly treat tax or other administrative arbitrages as a strategic tool, despite their potential. That's partly because executives are reluctant to draw attention to such arrangements for fear that they might be outlawed."[241] Of course, "[i]n some cases, administrative arbitrageurs are actually breaking the law."[242] This article does not propose that the firm should deliberately break the law.[243] The framework here is based on a far simpler truth: the law's meaning can fluctuate even when its language does not.[244]

5. *Managers and Lawyers*

Lawyers are trained to be "risk-averse"—to recommend the action least likely to expose the client to legal risks.[245] In the

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237 *Id.*

238 Pankaj Ghemawat, *The Forgotten Strategy*, *in* HARV. BUS. REV. ON DOING BUSINESS IN CHINA 163, 167 (2004).

239 *Id.* at 168.

240 *Id.* at 170.

241 *Id.* at 171.

242 *Id.*

243 *See supra* Part I (confining this article's reach to legitimate activities).

244 *See infra* Part III.C.1 (discussing substantive legal flexibilities).

245 *See* Richard Kaplan, *Toward Better Communications Between Executives and Lawyers*, UTAH B.J. 18, 18 (2011) (providing that "some lawyers really are or do come off as . . . risk averse"); *see also* Lawrence Rosenburg, *Lawyers' Poker: Using the*

presence of ambiguity, this bias often motivates the attorney to recommend inaction.[246] Avoiding risk is not always wrong, but always avoiding risk needlessly cedes immense value to one's rivals.[247] Risks may impose costs, yet there is a terrible cost to the excessive avoidance of risk.[248]

Managers tend to act "and let the lawyers sort [things] out later."[249] Managers thus perceive that "[a]t any moment the law can shut anything down, and we can't afford to be shut down."[250] The views of managers and regulators can also diverge, which "can lead to unpleasant shocks for managers . . . ."[251]

Because managers and attorneys view the world so differently, few firms have considered what "legal strategy" means.[252] The few who have apply two complimentary approaches: (1) "the managerial approach is aimed at determining which legal choices are the most efficient to improve the performance of the firm;" and (2) "the normative approach is aimed at improving the comprehension of the origin of legal strategies in order to detect the existing legal opportunities."[253] Executives and attorneys can find common ground by forging a common understanding of strategic opportunity in the law. Part III explores this realm of opportunity.

Lessons of Poker to Win Litigation, 54 THE ADVOCATE 10, 10 (2011) (asserting that lawyers are risk-averse).

246 *See* Rosenburg, *supra* note 245, at 10 (asserting that "the thought of losing *at all* is often enough to keep [a lawyer] from taking a risk").

247 *Cf. id.* (providing that a lawyer should "be aware of . . . bias" in favor of avoiding risks and "exploit bias in others").

248 These are the opportunities foregone to harness the law as competitive advantage. *See infra* Parts III-IV.

249 GEORGE FRIEDMAN ET AL., THE INTELLIGENCE EDGE 234 (1997).

250 *Id.*

251 Dennis A. Yao, *Antitrust Constraints to Competitive Strategy*, *in* WHARTON ON DYNAMIC COMPETITIVE STRATEGY 313, 320 (George S. Day & David J. Reibstein eds., 1997).

252 Antoine Masson, *The Origin of Legal Opportunities*, *in* LEGAL STRATEGIES: HOW CORPORATIONS USE LAW TO IMPROVE PERFORMANCE 27, 27 (Antoine Masson & Mary J. Shariff eds., 2010).

253 *Id.* at 27-28.

III. A Preliminary Rule of Law Framework: Identifying Opportunities for Advantage in the Law

"The Rule of Law was consciously evolved only during the liberal age and is one of its greatest achievements."[254] Yet consensus on a single definition of "the rule of law" has never been achieved.[255] This article posits that the "rule of law" reflects the law's potential as a source of competitive advantage in each jurisdiction. As noted earlier, however, virtually all literature on point limits its reach to the world's few highly refined legal systems by assuming the presence of advanced institutions.[256] Thus, the objective of Part III is to define the "rule of law" in a manner useful to international firms.

A. Competing Conceptions of the Rule of Law

Many definitions of the "rule of law" exist.[257] "The content of the term . . . remains contested across both time and geography."[258] Popular definitions embody three core ideas: government limited by law, formal legality, and the absence of arbitrariness.[259] Black's Law Dictionary is typical, defining the rule of law as "[t]he supremacy of regular as opposed to arbitrary power; [t]he

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254 HAYEK, *supra* note 140, at 81-82.

255 Academically, this is not entirely bad; "[i]n part, it is this flexibility—even ambiguity—of rule of law that makes it a fascinating topic of research." Nelson & Cabatingan, *supra* note 5, at 3. But the framework here seeks practical solutions to the questions of legal competitive advantage.

256 *See supra* Part II.D.

257 Rather than reciting these voluminous definitions here, we recommend JOHN W. HEAD, CHINA'S LEGAL SOUL 149-61 (2008) (listing numerous definitions) and MICHAEL J. TREBILCOCK & RONALD J. DANIELS, RULE OF LAW REFORM AND DEVELOPMENT 12-37 (2008) (discussing several definitions).

258 Simon Chesterman, *An International Rule of Law?*, 56 AM. J. COMP. L. 331, 340 (2008). Virtually all governments and political ideologies endorse the "rule of law" but can do so only because no consensus on its meaning exists. *Id.* at 332; *accord* TREBILCOCK & DANIELS, *supra* note 257, at 13 (stating that "the rule of law means whatever one wants it to mean").

259 TAMANAHA, *supra* note 7, at 114-26; *accord* MICHAEL A. SANTORO, CHINA 2020 101 (2009) (equating the rule of law with "impersonal, neutrally applied rules" and "the emergence of human rights and democratic government"); Chesterman, *supra* note 258, at 342 (arguing that the rule of law's core features are the restraint of government arbitrariness, the applicability of the law to "the sovereign and instruments of the state," and equal application of the laws).

doctrine that every person is subject to the ordinary law within the jurisdiction."[260] Courts in the United States have taken a similar view.[261]

Many scholars argue that the "rule of law" must account for more than formal legality; otherwise, it is not a discrete idea apart from "legal rules."[262] Some view the rule of law from the economic perspective—for example, as a situation in which governments announce all rules publicly and ahead of time, such that businesses know which activities are legal and the extent to which government will enforce contract and property rights.[263] Under this view, the rule of law is "a catalyst of economic development."[264] A few organizations have proposed quantifications of the rule of law that trend in this direction.[265]

These definitions can be helpful depending upon one's need. Some are relevant to business on the broadest levels. The economic view, for example, surmises that the law must sufficiently incentivize actors before substantial economic activity can occur.[266] But these definitions tend not to inform the

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260 BLACK'S LAW DICTIONARY 1448 (9th ed. 2009).

261 The United States Supreme Court long ago reasoned, "[n]o man in this country is so high that he is above the law" and that the courts exist in part to defend citizens' rights from undue government incursion. United States v. Lee, 106 U.S. 196, 220-21, 1 S. Ct. 240, 261, 27 L. Ed. 171, 182 (1882). Other courts have emphasized equality, *e.g.*, Blue v. United States Dep't of Army, 914 F.2d 525, 534 (4th Cir. 1990); the three co-equal branches of government, *e.g.*, Morgan v. Principi, 327 F.3d 1357, 1361 (Fed. Cir. 2003); and the role of the courts in upholding the rule of law, *e.g.*, Walker v. Bain, 257 F.3d 660, 677 (6th Cir. 2001).

262 *E.g.*, TAMANAHA, *supra* note 7, at 96-97.

263 Michael Risch, *Virtual Rule of Law*, 112 W. VA. L. REV. 1, 1-2 (2009).

264 *Id.* at 2.

265 Two major quantitative models of the rule of law exist: those of the World Bank and the World Justice Project. The World Bank model captures "perceptions of the extent to which agents have confidence in and abide by the rules of society" through figures such as crime rates. *See* World Bank, *Worldwide Governance Indicators*, WORLDBANK, http://info.worldbank.org/governance/wgi/index.aspx#faq-2 (last visited Oct. 28, 2013). The World Justice Project defines the rule of law as a system in which (1) government is accountable under law, (2) laws are clear, stable, public, and "fair," (3) the legal process is transparent and fair, and (4) justice is delivered by competent and neutral professionals. *See* World Justice Project, *What is the Rule of Law?*, WORLDJUSTICEPROJECT, http://worldjusticeproject.org/what-rule-law (last visited Oct. 28, 2013).

266 In this way, many economic definitions of "rule of law" tangentially embody the Coasian ideal.

individual firm's perspective. Most existing definitions neglect the role of institutions, do not describe the rule of law as a process, and do not sufficiently consider the legal apparatus in context.[267] The definition of an idea this complex cannot be too detailed; no definition alone will function as a blueprint for business planning. Yet a definition more attuned to individual firms can surely be formed. The existing definitions are normative models—aspirational versions of the ideal rule of law, against which political and legal systems might be measured.[268] But these definitions are not guides for individual firms. The next section considers the nature of the rule of law, and what this idea embodies relative to individual firms.

B. The Nature of the Rule of Law: Setting the Legal System in Context

The rule of law cannot be understood apart from its context.[269] Most existing conceptions of the rule of law describe an idealized legal system, weighing the necessity and value of various ingredients, such as constitutions and due process.[270] These conceptions are useful for some purposes, but the model proposed here seeks a practical interpretation of the rule of law. Only a practical, business-oriented understanding of this idea will reveal how the international firm best strategically utilizes the legal realities that it confronts.[271]

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267 MCNUTT, *supra* note 161, at 1.

268 Rogelio Perez-Perdomo, *Rule of Law and Lawyers in Latin America*, 603 ANNALS AM. ACAD. POL. & SOC. SCI. 179, 180 (2006).

269 "Law cannot be understood unless we put law in context . . . ." MCNUTT, *supra* note 161, at 1; *accord* FRED W. RIGGS, ADMINISTRATION IN DEVELOPING COUNTRIES 27-28 (1964) (observing that "differentiated [social] structures . . . scarcely function autonomously").

270 *See* Alan Handler, *Judicial Jurisprudence*, N.J. LAW., Oct. 2000, at 22, 25 (providing that applying the rule of law involves weighing factors "in the balance").

271 The authors are aware of only one scholar who attempts explicitly to ground legal advantages in the nature of legal systems and their functioning. *See generally* Masson, *supra* note 252 (providing that legal advantages are anchored in the nature of the legal system). Masson establishes four ideal legal norms—"clear, comprehensible, realist and considered as known to all." *Id.* at 28. Deviations from these norms suggest certain legal strategies. *Id.* Masson's model is noteworthy, but the model proposed in this article is fundamentally different. *See* Part III. The model in this article plots countries along a spectrum based upon the degree to which the state's institutions provide guarantees or certainties (constants) for firms. This model identifies different

No jurisdiction boasts a perfectly effective legal apparatus, yet most states do not live in anarchy. The rule of law must exist in degrees. Because the legal system is influenced tremendously by its environment, the rule of law is best perceived as a process that accounts for these extra-legal forces.[272] To fully elucidate the "rule of law," both the law and the society it purports to govern must be understood. The task of this section is to describe this context and process in general terms.

Clarence J. Mann proposes that in every society, three "overarching realms both complement and stand in tension with each other," these being the country's economic, cultural, and political systems.[273] Mann's work concerns the management of country-specific risk and treats the legal system as part of the political system.[274] Shane's model similarly relies upon these three major realms, subsuming the legal sphere within the political realm.[275] The legal and political spheres will be treated discretely here, although they largely overlap.[276]

A jurisdiction's political and legal systems are intimately

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fundamental sources of opportunity than Masson's. *See id.* at 29-30 (discussing soft, hazy, crazy, and flexible laws). This model contemplates Masson's notions, but legal opportunities are organized in a fundamentally different manner. *See infra* Part III.C (suggesting three basic types of legal flexibility, with flexibilities defining the realm of opportunities for entrepreneurial activity in the law). Moreover, this model does not suggest a single strategy for each of the three types of legal flexibility. The formulation of strategy is more complex, as described in Part IV. Finally, this model is unique in that it ties together several important and fundamental ideas, some of which have only recently begun to evolve in the literature: namely, the rule of law, legal competitive advantage, and legal entrepreneurship. *See infra* Part III.E.

272 *See* MCNUTT, *supra* note 161, at 1; *accord* RIGGS, *supra* note 269, at 27-28.

273 Clarence J. Mann, *Managing Country Risk*, *in* BORDERLESS BUSINESS 166, 172 (Clarence J. Mann & Klaus Götz eds., 2006); *see generally id.* at 166-90 (detailing the relationships between the political, economic, and cultural realms).

274 *Id.* at 177 (showing the legal base as part of the political system in Figure 7.7).

275 SCOTT SHANE, A GENERAL THEORY OF ENTREPRENEURSHIP 146-60 (2003) (concluding that the institutional environment consists of the economic environment, the political environment, and the socio-cultural environment).

276 *See, e.g.*, ROBERT GILPIN, GLOBAL POLITICAL ECONOMY 25-45 (2001) (discussing the nature of political economy); RICHARD DIEN WINFIELD, LAW IN CIVIL SOCIETY 172-73 (1995) (discussing the political dimension of law and noting that "law receives its ultimate determination" within the "frontier of political justice"); Perez-Perdomo, *supra* note 268, at 180 ("The operation of a political-legal system is closely related to economic, social, and cultural aspects.").

intertwined with its economic environment.[277] Indeed, the entire field of "political economy" is dedicated to the study of these relationships.[278] By virtue of the linkages between law and economics, state officials charged with "interpreting and enforcing the 'rules of the game . . .' are significant economy policymakers."[279] Political forces largely determine the economic realm's contours[280] such that "[t]here is a strong synergy between economic and political institutions."[281]

Culture and history undoubtedly influence the legal system.[282] The evolutionary interplay between law and custom is "a historical process of unusual complexity."[283] Socio-cultural forces include the jurisdiction's culture(s), history, institutions,[284] private interest groups,[285] and extra-legal phenomena.[286] Informal social and cultural institutions impact business as well, particularly at the outskirts of the law's reach.[287] Culture is relevant in two important respects: culture (1) helps to define which activities are legitimate,[288] and (2) suggests the average risk-averseness of firms

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277 For a more detailed diagram illustrating the connections between the economic and political processes, see WOLFGANG KASPER & MANFRED E. STREIT, INSTITUTIONAL ECONOMICS 402 (1998) (Figure 12.1).

278 *See generally, e.g.*, MCNUTT, *supra* note 161 (exploring the political economy of law).

279 Stephenson, *supra* note 73, at 191.

280 DARON ACEMOGLU & JAMES A. ROBINSON, WHY NATIONS FAIL 42-43 (2012).

281 *Id.* at 81.

282 *See generally, e.g.*, Stanley Diamond, *The Rule of Law Versus the Order of Custom*, *in* THE RULE OF LAW 115 (Robert Paul Wolff ed., 1971) (providing that "the customary and the legal orders are historically . . . related").

283 *Id.* at 120.

284 This includes the historical development and path dependency theories.

285 Private interest groups are taken to include all groups outside of the state's immediate purview and include economic, business-oriented groups as well as social groups.

286 These include organized crime, black markets, and other phenomena that are either prohibited or ignored altogether by the jurisdiction's formal legal apparatus.

287 AVINASH K. DIXIT, LAWLESSNESS AND ECONOMICS 25 (2004) (asserting that informal arrangements are key to business transacting); *accord* PEJOVICH, *supra* note 45, at 23 (discussing formal and informal rules); Peng, Wang & Jiang, *supra* note 22, at 927 (discussing the relationship between formal and informal institutions and their impact upon business).

288 *See* Webb et al., *supra* note 16.

originating in the culture.[289]

For its part, law is a form of social control. The law tends to be stronger where alternative forms of social control are weaker.[290]

Though scholars quarrel about the precise nature of these relationships, most agree that a country's political, economic, and cultural systems are intertwined.[291] These intertwining relationships possess significant implications for the firm's strategy.[292]

These very complex connections are illustrated in the following much-simplified figure:

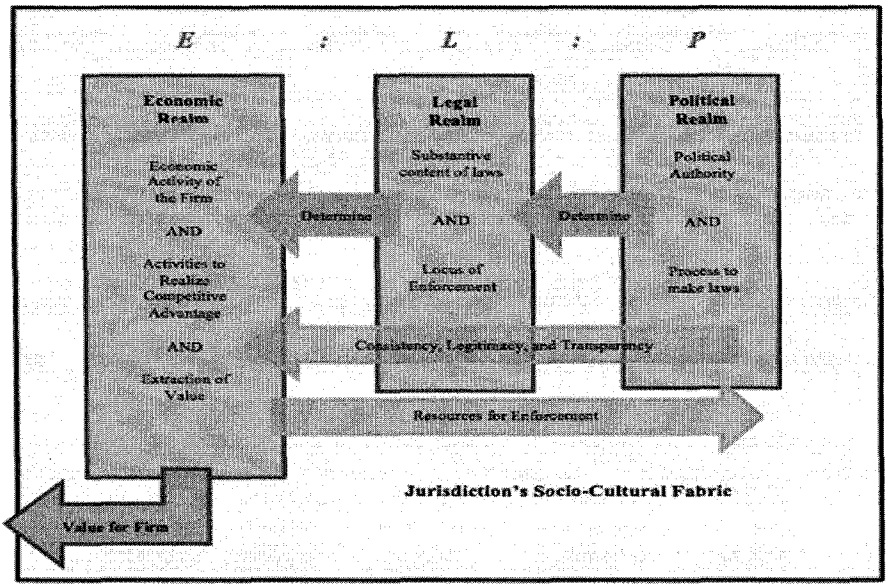

Figure 1: The rule of law process.

Tax revenues from economic activity are collected and allocated by the political system to promote social stability, and

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289 Roy Thurik & Marcus Dejardin, *Entrepreneurship and Culture*, *in* ENTREPRENEURSHIP IN CONTEXT 175, 181-82 (Marco van Gelderen & Enno Masurel eds., 2012) (asserting that uncertainty avoidance impacts entrepreneurship across cultures).

290 BLACK, *supra* note 37, at 105-09.

291 *See generally, e.g.*, Mann, *supra* note 273 (detailing the relationships between the political, economic, and cultural realms).

292 *See generally id.* (discussing the impact of such relationships between political, economic, and cultural realms in the legal field).

the political system also creates formal rules toward this goal.[293] The socio-cultural background supplies informal institutions which impact every step of the rule of law process.[294] The legal system—perhaps the single most important piece of the process—encapsulates the content of the law and attempts to enforce society's formal rules as they are influenced by the economic and political realms and by the society's informal rules.[295]

The law's content and enforcement are shaped by the interactions of these realms. One legal creature in particular—the flexible law—is treated by the literature as an entirely negative phenomenon because it necessitates the redirection of resources from economic activities to the legal realm.[296] Legal activities ordinarily do not return direct profits like economic activities do.[297] In this sense, legal flexibilities are inefficient. This article does not dispute the normative appeal of this reasoning but instead considers whether this maligned phenomenon might possess any value for the firm. Legal flexibilities are a net loss upon the firm *only if*, like any other cost in business, the firm fails to exploit their value-creating potential.[298] Irrespective of its ultimate definition, the rule of law process allows the firm to capture value between and within the legal and economic realms through the strategic exploitation of legal flexibilities.[299]

C. The Three Forms of Legal Flexibility

Brian Tamanaha observes that "[w]hen rules exist and are

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293 *See generally* Svetozar Pejovich, *The Effects of the Interaction of Formal and Informal Institutions on Social Stability and Economic Development*, 2 J. MARKETS & MORALITY 164 (1999) (discussing why there are differences in economic stabilities among countries).

294 *See* Lawrence M. Friedman, *Legal Culture and Social Development*, 4 LAW & SOC'Y REV. 29, 29 (1969) ("[L]egal systems are clearly a part of political, social, and economic development, just as are educational systems and other areas of the culture. No major social change occurs or is put into effect in a society which is not reflected in some kind of change in its laws.").

295 *See id.*

296 *See generally* Isaac Ehrlich & Richard A. Posner, *An Economic Analysis of Legal Rulemaking*, 3 J. LEGAL STUD. 257 (1974) (discussing the legal process from an economic standpoint).

297 *See id.*

298 *See id.*

299 *See id.*

honored by the legal system[,] formal legality operates."[300] But the discussion above reminds us that no legal system is perfectly clear. Degrees prevail—degrees of clarity in the laws themselves, degrees to which the laws are enforced, and degrees to which a legal apparatus is influenced by the extra-legal forces of its environment.[301] Indeed, "[c]onformity to the rule of law is [itself] a matter of degree."[302] Because "[t]here is often a sizeable gap between written law and actual regulatory practice,"[303] any practical definition of the "rule of law" must account for legal flexibilities.[304] The gaps between "the law in theory" and the "law in practice" are cognizable under the "rule of law" rubric.[305] The three major forms of legal flexibility must therefore be considered in detail.

1. Substantive Flexibilities

Substantive flexibilities consist of gaps and ambiguities in the language of the laws themselves, and the resulting pliabilities inherent in such language—that is, ambiguities accruing from the substance of a jurisdiction's laws, as those laws are expressed publicly. In high rule of law environments, the notion of substantive flexibility is often expressed by the idea of "legal arbitrage, which involves the interpretation of ambiguous law in

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300 TAMANAHA, *supra* note 7, at 97.

301 Raz, *supra* note 6, at 4.

302 *Id.* at 8.

303 Frenkel, *supra* note 56, at 149.

304 *See* Raz, *supra* note 6, at 4-12.

305 *See supra* Part III.B. In addition to flexibilities within individual legal systems, "the transnational legal field . . . involves a considerable degree of ambiguity in decision-making since there is often disagreement as to which rules apply in specific cases." Sigrid Quack, *Legal Professionals and Transnational Law-Making: A Case of Distributed Agency*, 14 ORG. 643, 645-46 (2007). Transnational ambiguities are important when two or more jurisdictions' rules might apply to a legal question, or when venue is at issue. *See, e.g.*, Robert Ware III, *The Use of Jurisdictional Arbitrage to Support the Strategic Interest of the Firm*, 38 U. TOL. L. REV. 307 (2006) (arguing that international firms with Internet-focused strategies can use the doctrine of minimum contacts in the United States to support jurisdiction over a given legal conflict, or to defeat it). Once a jurisdiction is settled upon, however, the internal characteristics of the jurisdiction are of interest. This article addresses internal legal flexibilities, not the transnational field.

one's favor to avoid obligations."[306] Bird explains that "[e]ven the most well-intentioned of drafters cannot anticipate all ambiguities in statutory language, and firms exploit these ambiguities to full effect."[307] Avoidance practices amount to "operational effectiveness," which is "simply performing relevant activities better than one's rivals."[308] Yet operational effectiveness is not a strategy: "[a]lthough necessary for superior performance, a firm can . . . outperform rivals through strategy only if it pursues a *differential* practice that it can *preserve*."[309] If substantive flexibilities are to be utilized in a firm's strategy, they must be harnessed in a sustainable manner.

Substantive flexibility is both linguistic (the mechanical dimension) and jurisprudential (the interpretive dimension). The linguistic component is inescapable: ambiguity permeates language.[310] There invariably exists some degree of linguistic ambiguity in the laws of every nation[311] since no language is altogether free from ambiguity.[312] Expressions of the law are virtually never perfect, even when lawmakers intend them to be.[313] If a perfect language existed, "legal interpretation" would be

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306 Bird, *Pathways of Legal Strategy*, *supra* note 2, at 14-16; *see also supra* Part II.G.4 (discussing legal arbitrage).

307 Bird, *Pathways of Legal Strategy*, *supra* note 2, at 14. The use of tax loopholes is a common example. *Id.*

308 *Id.* at 15.

309 *Id.* at 15-16 (emphasis added).

310 *See* Richard Robinson, *Ambiguity*, 50 MIND 140, 141 (1941).

311 "There is an inherent ambiguity in the language of the law." Rozann Rothman, *Stability and Change in a Legal Order: The Impact of Ambiguity*, 83 ETHICS 37, 38 (1972); *accord* SOLAN, *supra* note 139, at 49 ("It is impossible to write a statute whose words will not be subject to debate at the margins.").

312 *See generally, e.g.*, UMBERTO ECO, THE SEARCH FOR THE PERFECT LANGUAGE (1997) (chronicling Europe's elusive search for the "perfect language" in which no ambiguities burden the clarity of expression and noting that no such language exists).

313 As British scholar William Markby noted in the early twentieth century:

> [w]ere the law ideally complete, every command . . . would be expressed clearly and fully . . . . But . . . a great deal of the time of lawyers and judges is occupied in the endeavor to arrange and interpret obscure and conflicting rules, and to make these rules wide enough to cover cases which have arisen. *We are perpetually in search of some clear and authoritative expression of the law, which expression we very rarely find.*

WILLIAM MARKBY, ELEMENTS OF LAW 107 (1905) (emphasis added).

unnecessary.[314] Moreover, contrary to the Coasian ideal,[315] some jurisdictions deliberately engineer substantive ambiguities into their laws.[316] Still, "[t]he law is a profession of words."[317] "To be of any use, the language of the law . . . must not only express but convey thought."[318] Yet legal language tends to be wordy and unclear.[319] This often reflects an "inherent vagueness of language," and as a result, laws often "make many attempts at precision of expression."[320] Although it might be defended on grounds of "precision," legal language is ordinarily no more precise than conventional language.[321] Even in high rule of law jurisdictions, "a law cannot, by itself, indicate exactly which sets of factual circumstances are covered by it and which are not; by necessity a law must be general, must apply to more than one case."[322] Furthermore, "a law must be expressed in words, and . . . 'uncertainty at the borderline is the price to be paid for the use of general [terms].'"[323]

International firms potentially confront a double layer of substantive ambiguity.[324] Robert Rosen explains that "[l]anguage is the expression of culture, enabling us to communicate through the ages with people who share our history and identity."[325] Yet

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314 Ward Farnsworth, Dustin F. Guzior & Anup Malani, *Ambiguity about Ambiguity: An Empirical Inquiry into Legal Interpretation*, 2 J. LEGAL ANALYSIS 257, 257 (2010). Disputants often contest the meanings of words and the semantics of complex laws. SOLAN, *supra* note 139, at 22-37.

315 *See supra* Part II.F (discussing the Coase Theorem).

316 China is an example. WEI LUO, CHINESE LAW AND LEGAL RESEARCH 117 (2005).

317 DAVID MELLINKOFF, THE LANGUAGE OF THE LAW vii (1963).

318 *Id.*

319 *Id.* at 24-27. Although Mellinkoff's work is limited to common law jurisdictions in which English is the official language, *id.* at 3, these characterizations are appropriate in other jurisdictions as well.

320 *Id.* at 22 (quoting Glanville L. Williams, *Language and the Law*, 61 L.Q. REV. 179, 192 (1945)).

321 *See id.* at 290-98 (discussing precision in legal language); *id.* at 345 (noting that legal language is often no more precise than conventional language).

322 THEODORE M. BENDITT, LAW AS RULE AND PRINCIPLE 30 (1978).

323 *Id.*

324 *See* ROBERT ROSEN, GLOBAL LITERACIES 57-60 (2000) (asserting that language divides people into two groups—those who understand it and those who do not).

325 *Id.* at 57.

"[b]y its very nature, a language creates both insiders and outsiders—people who speak and understand it and people who don't."[326] In addition to the obvious differences between broad languages (English versus Mandarin, for example), the law employs a special vocabulary, or "terms of art;" thus, even native speakers will have difficulty grasping legal subtleties absent formal legal training.[327] If the law is to be a source of competitive advantage, the firm must employ experts fluent in both the broad and the legal languages of the relevant jurisdiction.[328] This expert is the *entrepreneurial lawyer*.[329]

Linguistic ambiguities come in several varieties.[330] "Language is like a coin with two faces—lexicon and grammar, and both of these essential features can be sources of ambiguity."[331] A lexical ambiguity "occurs whenever a word has more than one objective or dictionary meaning."[332] In contrast, syntactic ambiguity "has to do with grammatical structure. Words occur in a particular order and grammatical relationships are established by those orderings. There is the potential for syntactic ambiguity whenever a given order of words may allow for more than one grammatical relationship."[333] Thus, words can carry multiple definitions[334] and associations,[335] and context can shift meanings as well.[336] Deeper structural connections can produce ambiguity.[337] Time can also

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326 *Id.*

327 *See id.*

328 *See id.*

329 *See infra* Part IV.

330 For an outstanding discussion on linguistic ambiguities and their implications for Western law, see generally Schane, *supra* note 176.

331 *Id.* at 172.

332 *Id.* at 171; *accord* JAMES R. HURFORD & BRENDAN HEASLEY, SEMANTICS: A COURSEBOOK 128 (1983).

333 Schane, *supra* note 176, at 171; *accord* HURFORD & HEASLEY, *supra* note 332, at 128.

334 *See* GEORGE A. MILLER, THE SCIENCE OF WORDS 151-55 (1991).

335 *Id.* at 155-58.

336 *Id.* at 250-55. Even the non-lingual context impacts word meanings. *See* F.R. PALMER, SEMANTICS 43-58 (1976).

337 *See, e.g.*, JOHN LYONS, INTRODUCTION TO THEORETICAL LINGUISTICS 249-52 (1968) (discussing transformational ambiguity).

alter the meanings of words.[338]

Linguistic ambiguities are of interest because they introduce the possibility of multiple potential, "legitimate" outcomes while holding the language of the law itself, as well as the facts of a given scenario, constant.[339] Unless a rule is crystal clear, "fresh idealizations not found in the words of the rules are entering constantly into the shaping of the meaning of the rules."[340] By definition, linguistic ambiguities allow for multiple readings of the law and thereby create new risks[341] for regulated parties.[342] But substantive legal ambiguities also present the opportunity to read the law in a manner advantageous to the firm and to persuade authorities to adopt one's reading (at least with respect to one's own firm).[343] "Flexibility is the most conspicuous characteristic of legal language . . . . '[A]mbiguity is neither incidental nor accidental. For lawyers and their organized clients, it is the most useful attribute of legal language.'"[344] Together with ambiguities, gaps in the law also qualify as substantive flexibilities: areas cloaked in the law's silence are inviting opportunities for competitive advantage as well.[345]

The jurisprudential component of substantive flexibility is

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338 MELLINKOFF, *supra* note 317, at 397-98 ("A great difficulty, an insuperable one, is to write language that time will not change."); Rothman, *supra* note 311, at 37 ("The meanings of words change as time passes.").

339 Schane, *supra* note 176, at 179-86 (discussing examples from American case law in which linguistic ambiguities invited different resolutions to cases).

340 LLEWELLYN, *supra* note 128, at 44.

341 By "new risks," this article refers to risks that do not occur naturally in an unregulated market.

342 For example, linguistic ambiguities can cause contracting parties to misunderstand their agreement and can inspire conflict between firms and government. Schane, *supra* note 176, at 179-89.

343 *See generally* Lynn M. LoPucki & Walter O. Weyrauch, *A Theory of Legal Strategy*, *in* LEGAL STRATEGIES: HOW CORPORATIONS USE LAW TO IMPROVE PERFORMANCE 41 (Antoine Masson & Mary J. Shariff eds., 2010) (addressing the example of persuading judges on matters of legal interpretation). These scholars rely upon "a conception of law in which cases and statutes are almost wholly indeterminate and strategists infuse meaning into these empty rules in the process of argumentation." *Id.* The meaning attributed to a given rule "derives from social norms, patterns of outcomes, local practices and understandings, informal rules of factual inference, systems imperatives, community expectations, and so-called public policies." *Id.*

344 Rothman, *supra* note 311, at 42.

345 BENDITT, *supra* note 322, at 485-86.

equally important. Since the laws will contain some degree of linguistic ambiguity, every legal system must designate those with the authority to interpret the laws, and which rules, if any, these authorities must observe during the interpretation process.[346] Significantly, authorities have discretion to interpret the law so as to expand their own authority.[347] The decision-maker's degree of discretion is determined in part by whether a rule or a standard applies to the legal issue at hand.[348] For some observers, "[t]here is more discretion in [the average] legal system . . . than is required by the need to apply vague rules."[349] The frequency and scope of these possibilities swell as one descends into progressively lower rule of law environments.[350]

2. *Enforcement Flexibilities*

Enforcement flexibilities exist when the state or another entity could legitimately (lawfully) take a given course of action with respect to the firm, but instead legitimately takes an alternative course of action, or none at all.[351] Enforcement flexibilities are of value because the law's theoretical dimension never imposes itself upon the firm: it is the law in practice that counts. Of course, what is gleaned from the law as it is formally stated can help predict what the law in practice will look like; but this connection, upon which Western attorneys are accustomed to relying, disintegrates in lower rule of law environments.[352] Scholars in

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346 *See, e.g.*, PEJOVICH, *supra* note 45, at 133 (noting that "even the most neutral constitutional frame is subject to interpretation by those in charge of its enforcement").

347 *See* WILLIAM R. BISHIN & CHRISTOPHER D. STONE, LAW, LANGUAGE AND ETHICS 413-15 (1972).

348 Standards are open-ended legal norms that leave the decision-maker with discretion; rules are more specific and concrete norms that leave less flexibility for the decision-maker. Both standards and rules can generate uncertainties for regulated parties. Ehud Guttel & Alon Harel, *Uncertainty Revisited: Legal Prediction and Legal Postdiction*, 107 MICH. L. REV. 467, 479-80 (2008).

349 BENDITT, *supra* note 322, at 32.

350 *See infra* Part III.D.

351 DAVIS, *supra* note 122, at 4 ("A public officer has discretion whenever the effective limits on his power leave him free to make a choice among possible courses of action or inaction.").

352 *Cf.* Margaret Levi & Brad Epperly, *Principled Principals in the Founding Moments of the Rule of Law*, *in* GLOBAL PERSPECTIVES ON THE RULE OF LAW 192, 192 (2010) ("When coercion is the only or even primary means to achieve compliance, laws

high rule of law jurisdictions sometimes erroneously assume that "the law in theory" and "the law in practice" are unified everywhere,[353] indiscreetly projecting their own experiences upon unfamiliar foreign legal systems.[354] Most of the world does not live in a unified environment. "Even in the West[,] the unity of the formal [law] and [the law in practice] is never complete."[355] This divide represents another opportunity for legal competitive advantage. As C.G. Veljanovski points out, "the impact of regulation depends crucially on the extent and intensity of enforcement."[356] Likewise, "[t]he credibility of rules depends on their enforcement."[357] Thus, the provisions and means for enforcing laws are as important to the firm as the laws' substance.[358] Variations in enforcement present a key challenge to the Coasian prescription.[359] "Rules that are loosely enforced . . . cease to be a predictor of human behavior. The result is higher transaction costs of exchange and fewer exchanges. From an individual standpoint, rules yield a flow of benefits. The source of

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may exist but not the rule of law."); *see also* RIGGS, *supra* note 269, at 57-58 (distinguishing formal law—"the official norm, the theory . . . what ought to be done, as expressed in constitutions, laws, rules, and regulations"—from effective law—"what actually happens, the unofficial conduct, the practice, the informal, the real behavior of people, officials, politicians, administrators, pressure groups").

353 RIGGS, *supra* note 269, at 58.

354 *See supra* Part II.D (critiquing the existing "law as competitive advantage" literature for assuming the presence of high rule of law institutions).

355 RIGGS, *supra* note 269, at 58.

356 C.G. Veljanovski, *The Market for Regulatory Enforcement*, 93 ECON. J. 123, 123 (1983).

357 PEJOVICH, *supra* note 174, at 42.

358 *See* Champe S. Andrews, *The Importance of the Enforcement of Law*, 34 ANNALS AM. ACAD. POL. & SOC. SCI. 85, 85 (1909).

359 One version of the Coase Theorem holds that the initial allocation of rights is unimportant since parties will negotiate the most efficient outcomes to their transactions. But this view "relies, among other assumptions, on the possibility of effective judicial enforcement of complicated contracts." Edward Glaeser, Simon Johnson & Andrei Shleifer, *Coase Versus the Coasians*, 116 Q.J. ECO. 853, 854 (2001) (discussing the flaws of this assumption, including the judiciary's need to "interpret broad and ambiguous language" during the enforcement process). It follows that the consistency and effectiveness of enforcement is partially driven by the frequency and complexity of substantive ambiguities. Our three basic varieties of legal flexibility are decidedly interrelated, though they are discrete phenomena.

those benefits is the predictability of other people's behavior."[360]

There are four primary causes of enforcement variations. First, states are subject to the general law of scarcity: resources are finite, so the resources available for law enforcement are limited.[361] "There is one decisive reason why the society must forego 'complete' enforcement of the rule: enforcement is costly."[362] From the resource perspective, "optimal enforcement requires incomplete and selective enforcement because the social harm flowing from regulatory offences may be less than the private gain. Efficient law enforcement will therefore be discretionary, designed to fine tune rules in the light of firm and offence specific cost factors."[363] This is true even in higher rule of law environments such as the United States.[364]

This leads to the second driver of enforcement flexibilities: some enforcement is discretionary.[365] This discretion may be conferred expressly, may result from substantive ambiguities in the law (such that it is unclear whether a given law must be enforced in a given scenario or against a particular firm, or where it is unclear which state agent is to do the enforcing), or may be imposed by necessity in derogation of the law (agencies may clearly be tasked with enforcement but may be selective due to limited resources).[366] To the degree that discretion controls, the law in practice "will differ markedly from that on the statute books because the enforcement official is not only enforcing the law but he is making it through his enforcement decisions."[367]

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360 PEJOVICH, *supra* note 45, at 24.

361 Veljanovski, *supra* note 356, at 123-24 (discussing the efficiency model, which "predicts that enforcement will be less than complete because of the agency's limited resources").

362 *Id.* at 124.

363 *Id.* Law enforcement will display market-like tendencies because compliance secured by cooperation is "cheaper than legal conflict and yields tangible results if successful." *Id.* at 126.

364 BRYNER, *supra* note 139, at 6 (noting that in the United States, "[v]irtually all [government] agencies exercise discretion in allocating and directing resources for enforcement activities, since the number of regulated entities and actions within agency jurisdictions exceeds the available resources"). For numerous examples of discretion in the United Sates legal system, see *id.* at 9-12.

365 Veljanovski, *supra* note 356, at 124 (discussing efficient law enforcement).

366 *See id.* at 124-28.

367 *Id.* at 128; *see also* Levi & Epperly, *supra* note 352, at 203 (explaining that

Third, perfect information is virtually never available in the real world.[368] Parties may not be aware that their legal rights have been undermined; the administrative apparatus may not enforce every regulation because not every violation will be known to officials.[369] Imperfect information can result in either optimal or suboptimal outcomes for either the firm or the state.[370]

Finally, officials' incompetence and entropy can cause bureaucratic failures.[371] The "self-interest of the administrator generates not only a tendency to rigidity (to minimize the risk of criticism from superiors), but a systematic likelihood of the nonperformance of some proportion of the routinely handled tasks of the bureaucracy."[372] Of course, the regulated party's self-interest "generates an increased sensitivity to any failure in the individual case, if only because the expectation of perfect performance by the bureaucrat has been built into the individual's strategy of behavior."[373] Firms must form sensible expectations concerning enforcement.

Webb and his coauthors observe that "[e]ntrepreneurs exploit opportunities in the informal economy by taking advantage of the imperfections in the enforcement of laws and regulations."[374] Attorneys can craft legal strategies in a similar vein, resulting in heightened market opportunities for the client, and in turn increasing the likelihood that the advantage thus gained over rivals will be sustainable. Enforcement flexibilities are particularly prevalent in low rule of law jurisdictions, so the international firm must readjust its expectations in those places.

3. *Systemic Flexibilities*

The legal system's environment is a vital determinant of both

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"Bureaucrats and officials . . . can engage in corruption, shirk their mandates, and selectively enforce laws," and, thus, "[t]hey have the capability to openly sabotage attempts to [achieve] a rule of law equilibrium").

368 *See* Veljanovski, *supra* note 356, at 126-27.

369 *See id.* at 208-13.

370 *See id.*

371 MASTERS, *supra* note 233, at 206-07 (discussing the Peter Principle).

372 *Id.* at 207.

373 *Id.*

374 Webb et al., *supra* note 16, at 500.

its nature and effectiveness.[375] *Systemic flexibilities* result from the dynamic interrelationships of the constituent parts of the rule of law process (that is, from the legal system's interactions with extra-legal forces), and from the legal system's defining internal attributes other than its substantive and enforcement flexibilities. At a minimum, systemic flexibilities include:

(1) Legal uncertainties resulting from the legal system's interaction with the social/cultural, economic, and political systems of the country, and with foreign influences;

(2) The strength (or weakness) of foundational legal sources, such as constitutions;

(3) The total number of laws and their relative substantive complexities;[376]

(4) The rate and extent of change in the law over time;

(5) The number, complexity, and relative powers of legal authorities, both horizontally (legislative versus administrative versus judicial) and vertically (central versus local levels of the state);

(6) The percentage and effect of laws that are not made public;

(7) The extent to which legal authorities have (and are permitted to have) an interest in the outcomes of legal questions;[377]

(8) The political vicissitudes of the state; and

(9) Variations in legal culture throughout the jurisdiction.[378]

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375 *See supra* Part III.B.

376 PEJOVICH, *supra* note 45, at 47 (observing that the number and complexity of laws in a jurisdiction are partly a function of the interaction between formal and informal rules).

377 Naturally, a legal system's evolution will reflect such interests. *See generally, e.g.*, Daniel Klerman, *Jurisdictional Competition and the Evolution of the Common Law*, 74 U. CHI. L. REV. 1179 (2007) (demonstrating the development of pro-plaintiff bias in English common law prior to 1799 when English judges personally received fees for hearing cases, English courts competed for cases, and plaintiffs chose the forum).

378 Systemic flexibilities tend to be dynamic and fluid and, therefore, highly complex. Variations in legal outcomes within a jurisdiction are explainable in part because many factors affecting legal outcomes, including legal culture, "are not uniform within the neat boundaries of the legal jurisdiction." LoPucki & Weyrauch, *supra* note 343, at 83. Legal determinants "are forged by frequent interactions among members of groups. The locations of these groups are rarely co-extensive with the city, state, or

These phenomena generate uncertainties in the law, but none are substantive or enforcement issues. Systemic flexibilities are the most varied type of legal flexibility and can be the most difficult to recognize, analyze, and exploit.[379]

D. The Fundamental Relationship between Rule of Law Observation and Legal Flexibility

Let us momentarily imagine the "perfect" legal state. By this, we do not imply anything about its substantive virtues. Rather, the "perfect legal state" *functions* perfectly, however its objectives may be defined; it is a legal system perfectly effective at carrying out the enterprises ascribed to it by the culture it governs. The perfect legal state, in other words, is entirely free of the three flexibilities just discussed. The perfect legal state perfectly enforces every law on every occasion. It can do this because it enjoys perfect (infinite) resources and perfect information, and because the laws being enforced are crystal clear, free from substantive ambiguity. Further, the perfect legal system is unaffected by its context, so systemic flexibilities do not inject variations or uncertainties into the legal process.

From the vantage of the perfect system, legal flexibilities amount to "imperfections." Yet, in practice, these "imperfections" present opportunities for significant value capture. The nature of these opportunities and their prevalence will vary across jurisdictions, as do the optimal strategies for harnessing them.

Whenever flexibility or discretion exists in the law, the conclusion of any particular legal question is less than certain prior to its formal resolution. The less assured a legal outcome is, the greater the opportunity: "laws vary greatly in clarity and so in the opportunity they present to organizations for negotiation."[380]

Part III.C revealed three categories of legal flexibility: substantive ambiguities, which exist in the language of the laws themselves; enforcement ambiguities, which result from finite resources, imperfect information, and discretion; and systemic ambiguities, which are kindled in the dynamic interrelationships of

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national boundaries that define the reach of legal doctrine." *Id.*

379 *See id.*

380 SCOTT, *supra* note 48, at 126.

the constituent parts of the rule of law process.[381] The extent to which the international lawyer might utilize these flexibilities depends upon just how flexible the law may be. At issue are three variables: the total quantum of flexibilities in a legal system (how commonly they occur); the nature of the flexibilities (where they occur within the legal system, and the forms they assume); and the flexibilities' average scope (just how flexible the flexibilities are). Legal flexibilities are a question of both *degree* (the "quantity" of uncertainties) and *quality* (the types of risks created). This article posits a proportionate, inverse relationship between (1) the degree to which the rule of law is observed in a given state, and (2) the degree to which legal flexibility exists in the state. This relationship can be expressed visually as follows:

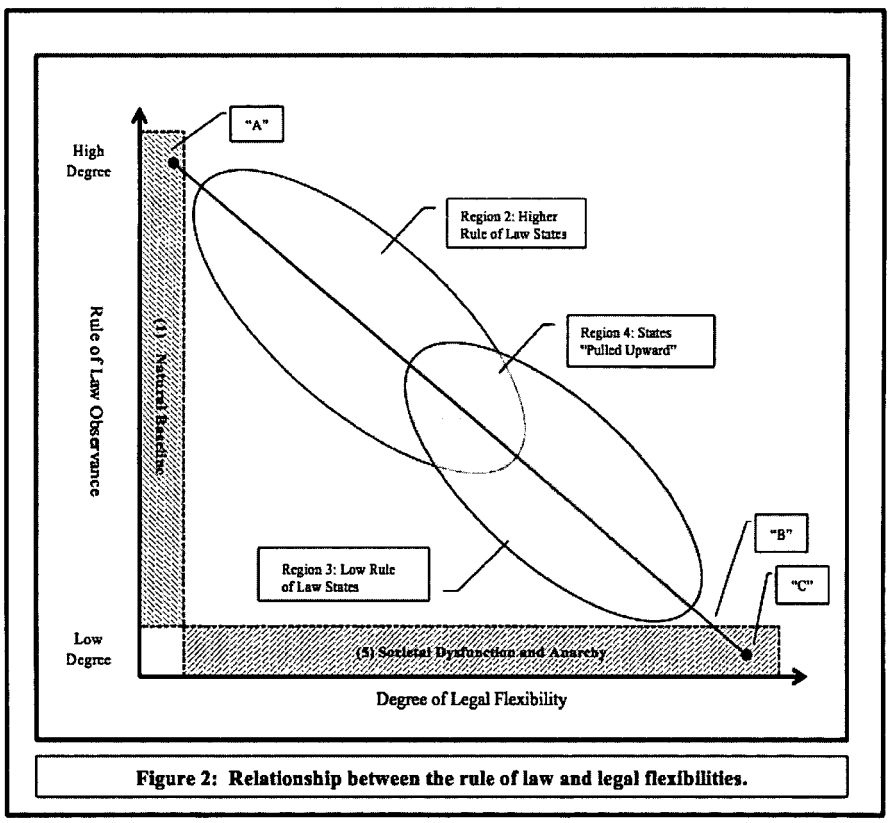

Figure 2: Relationship between the rule of law and legal flexibilities.

All other things equal, then, it is axiomatic that the greater the

381 *See supra* Part III.C.

flexibility there exists in a given state's legal apparatus, the weaker the rule of law is. States are bound and defined by the five regions in Figure 2.

Region (1), the vertical dashed line, represents the "natural baseline"—every state will contain at least this degree of "imperfection" in its legal substance, legal enforcement, and systemic qualities.[382] The law invariably contains a certain minimum degree of flexibility.[383] This inherent flexibility is the result of two forces previously explored. First, no language is perfectly unambiguous: even when states aspire toward the Coasian ideal of perfectly clear laws (and especially when they do not), substantive ambiguities are inescapable.[384] Second, enforcement flexibilities will always exist.[385] Finite resources, discretion for parties and state officials, and imperfect information will preclude the perfect enforcement of the laws.[386] A natural baseline of "imperfection," therefore, prevails in all legal systems. Point (A) represents the hypothetically "perfect" legal system, in which no flexibilities transpire. Such a state does not exist in the real world.[387]

Region (2) represents states whose institutions generally tend toward the Coasian ideal—that is, legal systems that observe the rule of law to a high degree. The United States is an example.[388] Even high rule of law states contain select flexibilities in their laws and experience some degree of legal uncertainty.[389] In the United States, many substantive ambiguities result from the

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382 *See supra* Part III.C.

383 *See supra* Part III.C.

384 *See supra* Part III.C.1.

385 *See supra* Part III.C.2.

386 Veljanovski, *supra* note 356, at 123-24 (discussing the efficiency model, which "predicts that enforcement will be less than complete because of the agency's limited resources").

387 PEJOVICH, *supra* note 45, at 39 (noting that no country qualifies as a perfect rule of law state, as "the concept of the rule of law provides an ideal yardstick for comparison of alternative institutions").

388 *See, e.g.*, Jerry Brito & Drew Perraut, *Transparency and Performance in Government*, 11 N.C. J. L. & Tech. 161, 162 (2010).

389 *See, e.g.*, CARDOZO, *supra* note 117, at 3-4 (discussing areas of uncertainty in American law).

political process.[390] Select enforcement flexibilities also exist in the American judiciary: prosecutorial discretion, an example from criminal law, and settlement during litigation, an example from civil law.[391] In high rule of law jurisdictions, "social control is primarily the function of the state and is exercised through law."[392] Social stability "operates chiefly through law, that is, through the systematic and orderly application of force by the appointed agents."[393] High rule of law states carry out these functions effectively.[394]

In contrast is the state that routinely builds flexibility into its legal system either to serve orchestrated political ends or because it can do no differently under the circumstances.[395] These states are found in Region (3). China is an example of the first type: the Communist Party ensures that legal flexibility is endemic because control is easier to maintain and carries a minimal corresponding loss of legitimacy.[396] Frequently, as in China's case, this type of system revolves around the maintenance of a political monopoly.[397] These states reject the Coase Theorem's goal of legal clarity since the maximization of private economic activity is not the principal goal; rather, the political incumbents' survival is the paramount goal.[398] This stands in contrast to higher rule of law environments, where a stable balance between legal certainties and legal flexibilities is institutionalized.[399] Greatly impoverished

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390 *See generally id.* (discussing uncertainties in the American law).

391 *See id.*

392 POUND, *supra* note 35, at 25.

393 *Id.*

394 *See id.*

395 *See* PETER HOWARD CORNE, FOREIGN INVESTMENT IN CHINA: THE ADMINISTRATIVE LEGAL SYSTEM 93-94 (1997) (noting *inter alia* that in China, "laws are intentionally made ambiguous to enable flexibility in interpretation and implementation").

396 *See id.*

397 *See id.*

398 *See* GILPIN, *supra* note 276, at 41 (noting "[i]n any jurisdiction, the government, powerful domestic interests, and historical experiences determine the purpose of the economy.").

399 DAVIS, *supra* note 122, at 27 ("What is obviously needed [to achieve a high rule of law state] is balance—discretionary power which is neither excessive nor inadequate.").

states also tend toward the low rule of law.[400] Legal flexibility in these places may result from poverty (and insufficient resources for law enforcement) or from the lack of regular political consensus.[401] Ultimately, "[t]he boundaries of the Fourth World are defined not by poverty but by rule of law or the lack of it."[402]

Between the higher rule of law states of Region (2) and the lower rule of law states of Region (3), Region (4) states exist. In isolation, these would be low rule of law jurisdictions, but they are instead "pulled upward" by potent external forces.[403] For example, a developing nation recently acceded to the World Trade Organization (WTO) might historically tend to embrace flexibility, but may now observe the rule of law to a greater degree as a result of the new external pressure (i.e., its WTO obligations).[404] In these states, institutional adaptation is enabled to accommodate outside forces without undercutting the most entrenched domestic interests.[405] In eras past, when comparatively little commerce flowed freely between countries, military domination and colonialism were the primary drivers of Region (4) states.[406]

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400 SHARMA, *supra* note 187, at 187.

401 *See id.*

402 *Id.*

403 The international relations literature categorizes states in terms of their relative power and size. *See, e.g.*, MARGARET P. KARNS & KAREN A. MINGST, INTERNATIONAL ORGANIZATIONS 250-65 (2004) (discussing different sized states). Region (4) states are common: "[s]mall states have been able to bargain with major powers for support on key issues in return for economic concessions." *Id.* at 265.

404 DANIEL C.K. CHOW, THE LEGAL SYSTEM OF THE PEOPLE'S REPUBLIC OF CHINA IN A NUTSHELL 65 (2003); TREBILCOCK & DANIELS, *supra* note 257, at 341-52 (discussing options that powerful states have to encourage rule of law reforms in lower rule of law jurisdictions, including foreign aid and sanctions). *See generally* JAMES C. HSIUNG, ANARCHY & ORDER (1997) (discussing international relations, international law, and the influence of states upon one another in the absence of a global legal order).

405 *See* Steve Charnovitz, *Triangulating the World Trade Organization*, 96 AMER. J. INT'L L. 28, 46 (2002); *see also generally* Krzyztof J. Pelc, *Why Do Some Countries Get Better WTO Access on Terms than Others?*, 65 INT'L ORG. 639 (2011).

406 *See, e.g.*, Veronica L. Taylor, *The New Agenda for Rule of Law Assistance*, 104 N.W. U. L. Rev. Colloquy 260, 260 (2010) (noting that "[c]olonial powers and twentieth-century invaders frequently used the military to organize and deliver both military and civilian justice"); *see also generally* Sandra Fullerton Joireman, *Inherited Legal Systems and Effective Rule of Law: Africa and the Colonial Legacy*, 39 J. OF MODERN AFRICA STUD. 571 (2001) (discussing the effectiveness of common law and civil law colonial powers in Africa's post-colonial environment).

Today, globalization and its myriad forces define the Region (4) states.[407]

Region (5) descends from a low degree of order into societal dysfunctionality. Region (5) represents the threshold for failed states, in which rule of law observance is so low that civil society cannot function. Thus, Point (B) on Figure 2 describes the least stable state likely to sustain a reasonably functional market over time, and Point (C) represents bona fide anarchy, where the rule of law is literally nonexistent. "Anarchy is social life without law, that is, without governmental control."[408] Black urges that "[l]ike law . . . [,] the quantity of anarchy varies across societies, across the settings of a single society, and across time."[409] These societies may intend to establish legal order, but are unable to do so.[410] At the extreme, countries characterized by perennial instability are unable to enforce even basic laws. Anarchy renders the development of organized commerce nearly impossible; in turn, the state cannot effectively raise revenues or fund services, and the cycle continues.[411]

From the state's perspective, both predictability and flexibility in the law are needed simultaneously.[412] An entirely inflexible law is detrimental to the individual firm,[413] yet a "well-functioning law" seldom makes for legal competitive advantage: without uncertainty, there can be no entrepreneurship;[414] without entrepreneurial activity, the firm is deprived of a major avenue for creating competitive advantage.[415] This topic is considered at

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407 *See,* e.g., KARNS & MINGST, *supra* note 403, at 260-65.

408 BLACK, *supra* note 37, at 123.

409 *Id.*

410 Scholars disagree on how order is most effectively initiated. *See generally, e.g.*, Levi & Epperly, *supra* note 352 (suggesting that social elites must initiate the rule of law).

411 BLACK, *supra* note 37, at 123.

412 *See supra* Part II.E.

413 Whether legal flexibility is desirable for a firm will depend upon its ability to manage the risks and opportunities attendant to such flexibility. *See infra* Part IV.

414 YANG, *supra* note 89, at 10 (noting that there was no place for entrepreneurship in the Maoist economy because "the very condition for the emergence of entrepreneurship, i.e., uncertainty, [had] been eliminated").

415 *See* Jeffrey G. Covin & Morgan P. Miles, *Entrepreneurship and the Pursuit of Competitive Advantage*, 23 ENTREPRENEURSHIP THEORY & PRAC. 47, 50 (1999) (arguing *inter alia* that entrepreneurial activity in a variety of corporate contexts can yield

length in Part IV, *infra*.

E. Defining "The Rule of Law" for International Firms

The rule of law, then, is the process by which a society's official rules are generated and implemented.[416] One of the most significant features of this process is the extent to which it supplies certainties in the content and enforcement of the rules. The greater total flexibility there exists in a legal system, the lower its rule of law observation. But something more than the "degree of legal flexibility" is needed to meaningfully define the rule of law for purposes of business strategy. The legal system must again be considered in context.

Let us imagine the total set of all possible value-creating activities in which the firm could engage. This set is labeled A_T (activities, total). In practice, some subset of these activities will be prohibited by either law or cost. Effective legal proscriptions exist where a sufficiently consistent and comprehensive law enforcement system prevails and the expected penalties for engaging in the activity exceed the expected gains. Other activities may simply cost too much. These situations are labeled A_P (activities, prohibited). What remains are the activities plausibly available to the firm, or A_A (activities, available). This can be expressed quantitatively as $A_T - A_P = A_A$.

Under the Normative Coase Theorem, A_A ought to be maximized as a proportion of A_T by (1) permitting most activities (few activities should be illegalized), and (2) implementing unambiguous and well-enforced laws (risks and transaction costs should be minimized by enabling all parties to predict accurately the legal ramifications of a given act).

Just as the law may promote economic activity,[417] the law can also shift an activity from the realm of possibility (A_A) to the realm of prohibition (A_P), and this may happen to some firms but not to others.[418] The law's removal of activities from "possible" to

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competitive advantage).

416 *See supra* Parts III.A-D.

417 *See supra* Part II.E (discussing the rights hypothesis).

418 Much of the Coasian literature appears to assume uniformity in the degree to which legal flexibilities discourage economic activity. But this is really a subjective measure that must be evaluated across individual firms. Adroit firms—those less risk-

"prohibited" can be accomplished in three ways. First, the law might expressly and credibly prohibit the activity by its own terms (for example, a law declaring that "it is hereby illegal to sell cocaine" and providing serious and credible penalties for the sale of cocaine).[419] Second, the law may impose requirements so onerous that compliance is cost prohibitive (for example, requiring 123 steps to open a new business).[420] Such requirements do not expressly prohibit the activity, nor are the requirements unclear. Rather, compliance is simply too costly. The third avenue is through legal flexibility.[421] Legal flexibilities may psychologically disincentivize the firm from pursuing a given activity by introducing uncertainties and risks.[422] Legal flexibilities can also raise costs—the firm must expend resources for lawyers who "transact" with the legal system and thereby manage the flexibilities.[423] Here, the act of compliance is not the problem; instead, costs invariably are incurred to determine and to monitor which acts will constitute acceptable compliance.[424] Often, legal flexibility affords multiple legitimate forms of compliance, in which case the firm must also determine which is optimal.

The Coase Theorem counsels that if policymakers' paramount goal is to maximize a jurisdiction's total economic output, the state itself must contribute as few transaction costs as possible.[425] Yet, while a society's interests and those of a given firm will always partially overlap, they are virtually never coterminous. An individual firm is not driven to maximize the jurisdiction's output, but rather to optimize its own performance. The firm remains motivated by its own interests *even if* the legal flexibilities

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averse and those better able to manage costs (those with entrepreneurial lawyers)—can realize greater profits in low rule of law jurisdictions than they could under the Coasian ideal. This is true because the law itself can be a source of competitive advantage.

419 *See generally* SOLAN, *supra* note 139, at 23-37 (discussing ambiguity in the plain language of a law and various interpretations).

420 *See generally* CHINLOY, *supra* note 63 (discussing the costs imposed upon firms by the regulatory apparatus in the United Sates and abroad).

421 *See supra* Parts III.B-D. (discussing differing degrees of legal flexibility).

422 *See supra* Parts III.B-D.

423 *See supra* Parts III.B-D.

424 *See supra* Parts III.B-D.

425 *See supra* notes 175-180 and accompanying text (discussing the fact that ambiguous laws generate transaction costs).

enabling its activities are macroeconomically suboptimal.[426] From the firm's perspective, a marginal reduction in the country's macroeconomic output is "worth it" if the legal flexibility responsible for the reduction can be harnessed to the firm's net benefit.[427]

From the Coasian perspective, then, legal flexibilities are bad because they can render an activity cost-prohibitive or unduly risky.[428] But not all opportunities removed from the economic sphere are deposited into the prohibited realm. The legal and political spheres also hold opportunities, functioning as a sort of limbo between the economic marketplace and the realm of prohibited activities.[429] In low rule of law environments, seemingly prohibited activities are often still available; they simply require legal dexterity to access.[430] Opportunities shifted to the legal realm are in fact preserved (albeit with a much-altered appearance) and are perhaps also amplified (the opportunity's expected value will rise, all other things equal, as fewer rivals can access it in its new form).[431]

Every theoretically-possible business activity resides in one of four places: (1) the economic realm (if transaction costs are nominal such that the opportunity can be accessed with little thought given to the law); (2) the legal realm (if the law's features—chiefly, its degree of flexibility—impose non-trivial costs upon the economic activity); (3) the political realm (if

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426 In this respect, legal flexibilities may subject legal institutions to a tragedy of the commons predicament.

427 *See generally supra* notes 413-16, 418, and *infra* note 490 and accompanying text (providing that law "may promote economic activity" but that a "'well-functioning law' seldom makes for legal competitive advantage," and that firms are profit driven).

428 *See* KHANNA & PALEPU, *supra* note 212, at 53 (providing that "institutional voids impose costs on market participants").

429 *See supra* notes 277-281 and accompanying text (asserting that "political forces largely determine the economic realm's contours"). *See generally infra* notes 482-485 and accompanying text (noting that the legal and political realms define "the boundaries of legitimate activity within the economic sphere").

430 *See generally infra* Part IV.C.4 (explaining that in low rule of law jurisdictions, firms must be creative in order to take advantage of legal flexibilities); *infra* note 474 and accompanying text (stating that attorneys should "think more . . . creatively about their work" by taking a multidisciplinary approach) (quoting Frenkel, *supra* note 56).

431 *See generally infra* note 538 and accompanying text (defining competitive advantage as a firm taking advantage of an opportunity that its rivals cannot).

lobbying or other political action must be undertaken in order to pursue the economic activity); or (4) the prohibited realm (A_P) (if the combined costs imposed by the jurisdiction's institutions, or the lack thereof, exceed the expected value of the activity).[432] Thus, every available activity (A_A) can be expressed as a ratio of the total assets that must be expended to conduct the activity across the economic, legal, and political realms, respectively. Under the Coase Theorem, the ideal ratio is 100:0:0, where no legal ambiguities exist, and where all of the firm's energy can be committed to the economic realm.[433] Legal flexibilities effectively serve as "detours." Where no legal flexibilities exist, the firm can commit all of its resources and attention directly to the economic sphere.[434] All other things equal,[435] the greater the average flexibilities (that is, the lower the rule of law in the country), the more of a detour the firm must take through the legal realm in order to pursue available activities. If the sum of all the legal flexibilities relevant to an activity becomes too substantial, then the law has imposed so many costs that the activity can no longer be profitable (and so is relegated to the prohibited realm).[436] But an activity does not become cost-prohibitive upon the imposition of the slightest cost. Indeed, most legal flexibilities do not render an activity prohibitive; rather, they merely necessitate an expenditure of resources in the legal realm as a prerequisite to realizing the activity's full economic value.[437] It follows that $E =$

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432 *See generally supra* Part III.B (noting that the economic, legal, and political spheres are distinct, but that they all are linked to one another).

433 *See supra* notes 171-74 and accompanying text (discussing the Normative Coase Theorem).

434 *See supra* notes 160, 177-79 and accompanying text.

435 This is an important qualifier. Greater flexibilities make for a greater detour through the legal realm only if the firm passively accepts the costs imposed by the legal flexibilities it encounters. As Part IV will show, however, a given flexibility will not impose the same costs upon all firms in practice, even if all firms are pursuing the identical activity. This is because some firms will manage legal flexibilities to their net advantage by hiring entrepreneurial lawyers capable of navigating the flexibilities more efficiently and effectively, thereby generating new and unique benefits from the flexibilities. *See infra* notes 439-442 and accompanying text.

436 *See* Parts II.F and II.G.3 (discussing regulatory costs).

437 Most opportunities in the legal realm would be profitable without innovation on the firm's part—but the firm can harness legal flexibilities to discover new benefits beyond the immediate economic activity at hand. *See infra* Part IV.

$A_A - (L + P)$, where E is the set of opportunities available in the economic realm and where L and P are the sets of opportunities in the legal and political realms, respectively. The firm's "economic opportunities" consist of available activities that have not been redirected by legal flexibilities to the legal or political realms.

These ideas are illustrated as follows:

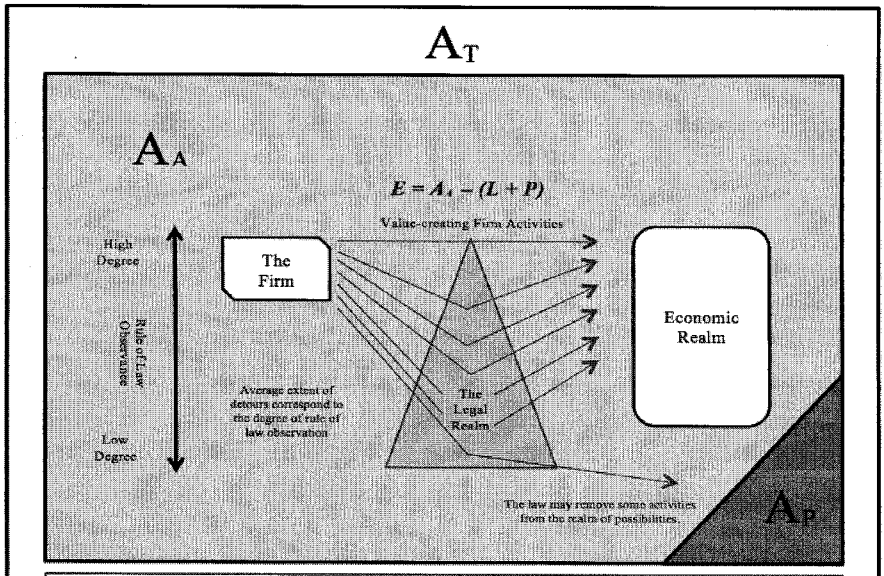

Figure 3: Distribution of the firm's value-creating activities, accounting for legal flexibilities and assuming no intervention by the firm.

Coasian conditions may be best for society at large, but some other set of conditions may be optimal for a given firm. Some of the Coasian literature implicitly treats transaction costs as fixed; it assumes that no effort is made by the firm to manage costs at their source.[438] In fact, transaction costs need not remain fixed—at least, not for every firm. To the degree that an activity's path is diverted through the legal sphere, experts in the law—

438 *See* Thomas Hazlett, *Radio Spectrum and the Disruptive Clarity of Ronald Coase*, 54 J.L & ECON. 125, 131 (2011) (noting that the Stiglerian version of Coasean analysis "implicitly takes 'transaction costs' as a fixed feature of markets, exogenous from the legal rules or regulations imposed by the state," and that this view is "incorrect").

entrepreneurial lawyers—are needed.[439] Initially, the hiring of such an attorney is itself a net cost, but the transaction costs associated with legal flexibilities can be shifted downward by skillful lawyering.[440] Transaction costs are not static; if legal flexibilities create variable costs and variable risks, then they are susceptible, in part, to the firm's influence.[441] The entrepreneurial lawyer dynamically interacts with the sources of these costs, lowering them for the firm.[442] Whereas conventional lawyers may represent a means to avoid certain future costs (those imposed upon the firm's legal breaches), entrepreneurial lawyers are affirmative, net value creating assets for the firm.

For all legitimate activities, some degree of either value capture or risk reduction (or both) will have to occur by way of the law, or else be irrevocably forfeited.[443] Even illegitimate activities must account for the law by eluding it altogether, an exercise which itself imposes transaction costs. Legal flexibilities create two barriers to the free availability of an economic activity. First, there is an innovation threshold; it can be difficult to discern the options for managing a legal flexibility.[444] Second, there is the question of how best to manage the flexibility.[445] By discerning the optimal management of legal flexibilities, the entrepreneurial lawyer is a cost manager.[446] The transaction costs resulting from

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439 *See infra* Part IV.

440 *See* Mitnick, *supra* note 65, at 76-78, 84 (asserting that firms can lower costs by exploiting regulation to their advantage relative to their competitors in the same market, and at other times, that regulation forces competitors out of the market; in either case, "[t]he costs of regulation are real (as can be the benefits), [and] they do not affect all firms in a market equivalently," thereby lowering costs for some while increasing costs for their competitors).

441 *See generally supra* notes 158-163 and accompanying text (providing that "legal flexibility is a seventh source of transaction costs").

442 *See* Dew, *supra* note 162, at 20 (arguing that institutional entrepreneurs effectively act with the goal of reducing transaction costs).

443 *See generally supra* notes 62-65 and accompanying text (noting that the "use [of] the law and the legal system [present opportunities] to increase both the total value created and the share of that value captured by the firm") (quoting Bagley, *supra* note 62, at 588).

444 *See* DING LU, ENTREPRENEURSHIP IN SUPPRESSED MARKETS 15 (1994).

445 *See generally infra* Part IV.C.1 (noting that legal entrepreneurship involves determining "how best to achieve strategic outcomes for the client . . . by the deliberate and innovative exploitation of one or more legal flexibilities").

446 *See generally infra* notes 567-578 and accompanying text (providing that

flexible laws may be too high if the firm is unequipped to cope with them—that is, they may be prohibitively high if the firm confines itself to the economic realm only, without engaging the legal realm.[447]

This discussion suggests many ways to define the "rule of law" from the business perspective. The *rule of law* is the degree to which state institutions supply, or fail to supply, certainties in the rules governing economic activity. The rule of law reveals the extent to which the firm must allocate resources to legal activities in the pursuit of economic opportunities. But it also represents a range of opportunities for value creation unique to the individual firm. It follows that *high rule of law* prevails where institutions supply equally and publicly distributed certainties (security or guarantees—rights, in the lawyer's parlance), and *low rule of law* exists where institutions are not designed with such an end goal in mind (they may be designed with any number of alternative priorities in sight).

To the extent that the firm can distinctively harness legal flexibilities, it is said to possess a *legal competitive advantage.* Low rule of law places supply fewer institutional certainties, and thus, the path to economic value diverges to a greater extent into the legal and political realms. For every degree a legal system is marked by flexibility, it becomes that much more important to approach the law entrepreneurially.

The law is an institution, and "institutional strategy is not so much concerned with gaining competitive advantage based on existing institutional structures as it is concerned with managing those structures."[448] Part IV turns to the subject of how legal

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"[m]any legal uncertainties generate risks," but that these risks can be managed by entrepreneurial lawyers).

447 Again, this article does not challenge the idea that legal engagement is costly. *See supra* Part III.C (discussing legal flexibilities). But given that most jurisdictions in the world are characterized by relatively high degrees of legal flexibility, the question for the international firm is whether it must passively absorb these flexibilities as costs, or whether some value may be extracted in return from them. This article suggests that legal flexibilities, while sure to impose some costs, also supply the opportunity to discover new economic value, particularly when the firm's rivals are not able to manage legal flexibilities as well as the firm.

448 Paul Tracey & Nelson Phillips, *Entrepreneurship in Emerging Markets*, 51 MGMT. INT'L REV. 23, 29 (2011) (quoting Thomas B. Lawrence, *Institutional Strategy*, 25 J. MGMT. 161, 167 (1999)).

opportunities, once identified, are best exploited.

IV. Legal Entrepreneurship: How Advantages in the Law are Secured

Part III revealed the general starting points in the firm's search for legal competitive advantage.[449] But how does the firm identify specific opportunities? How does the firm best pursue an opportunity once identified? How can the firm know whether an opportunity may potentially become a competitive advantage, rather than a fleeting gain? Part IV begins to answer these questions with a simple proposition: the firm needs an entrepreneurial lawyer.

A. The Classical Conception of Entrepreneurship

Like many ideas discussed in this article, definitions of "entrepreneurship" abound. Entrepreneurs are those who create business opportunities[450] by assuming the risks associated with uncertainty.[451] They "pursue opportunities without regard to the resources they currently control."[452] In economic terms, "[e]ntrepreneurs are people who are on the alert for opportunities and ready to exploit them by incurring transaction costs,"[453] thereby overcoming "the constraints to exploiting new knowledge."[454] For some scholars, the entrepreneur's primary challenge is uncertainty; for others, it is innovation.[455] Both are crucial to the legal entrepreneur.[456] "Uncertainty involves

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449 The exact manifestations of legal opportunities will vary, so familiarity with local conditions is key. *See, e.g.*, Robert E. Hoskisson et al., *Strategy in Emerging Economies*, 43 ACAD. MGMT. J. 249, 259 (2000) ("The essence of emerging economies is that they are dynamic and that it is necessary to take account of changes in the institutional environment.").

450 LU, *supra* note 444, at 3.

451 *Id.* at 14.

452 Terrence E. Brown, Per Davidsson & Johan Wiklund, *An Operationalization of Stevenson's Conceptualization of Entrepreneurship as Opportunity-Based Firm Behavior*, 22 STRATEGIC MGMT. J. 953, 954 (2001) (quoting Howard H. Stevenson & J. Carlos Jarillo, *A Paradigm of Entrepreneurship: Entrepreneurial Management*, 11 STRATEGIC MGMT. J. 17, 23 (1990)).

453 KASPER & STREIT, *supra* note 277, at 21.

454 *Id.* at 243.

455 LU, *supra* note 444, at 15.

456 *See infra* Part IV.C (discussing legal entrepreneurship).

imperfect information about changes."[457] Innovations can arise from many sources, including unexpected occurrences, incongruities between expectation and reality, and new knowledge.[458] Innovation "is the act that endows resources with a new capacity to create wealth,"[459] and begins with a scan for potential opportunities—the firm must "go out to look, to ask, to listen."[460]

Entrepreneurs are capable of spotting opportunities and acting upon them.[461] Opportunities may be recognized (if their existence is obvious), discovered (if their existence is obscure), or created (if the conditions necessary to the opportunity's existence can be induced and brought together by design).[462]

Understandably, the entrepreneur traditionally has been viewed as a creature of the economic realm, but "entrepreneurship is by no means confined solely to economic institutions."[463] Entrepreneurs exist in a wide array of contexts,[464] including private, public, and social entrepreneurship;[465] political entrepreneurship,[466] of which judicial entrepreneurship is a variant;[467] cultural entrepreneurship;[468] and institutional

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457 LU, *supra* note 444, at 15.

458 DONALD F. KURATKO & RICHARD M. HODGETTS, ENTREPRENEURSHIP 156-57 (7th ed. 2007).

459 PETER F. DRUCKER, INNOVATION AND ENTREPRENEURSHIP 30 (1985).

460 *Id.* at 135.

461 ROBIN PAUL MALLOY, *Real Estate Transactions and Entrepreneurship, in* CREATIVITY, LAW AND ENTREPRENEURSHIP 6, 13 (Shubah Ghosh & Robin Paul Malloy eds., 2011).

462 S. Venkataraman & Saras D. Sarasvathy, *Strategy and Entrepreneurship: Outlines of an Untold Story, in* THE BLACKWELL HANDBOOK OF STRATEGIC MANAGEMENT 650, 653 (Michael A. Hitt, R. Edward Freedman & Jeffery S. Harrison eds., 2001).

463 DRUCKER, *supra* note 459, at 23.

464 *See generally* ENTREPRENEURSHIP IN CONTEXT (Marco van Gelderen & Enno Masurel eds., 2011) (exploring the various contexts of entrepreneurship).

465 MALLOY, *supra* note 461, at 12.

466 Political entrepreneurs are "people and agencies who seek political advantage from implementing or hindering institutional change." KASPER & STREIT, *supra* note 277, at 403; *accord* EUGENE LEWIS, PUBLIC ENTREPRENEURSHIP 9 (1980).

467 *See* WAYNE V. MCINTOSH & CYNTHIA L. CATES, JUDICIAL ENTREPRENEURSHIP xiv (1997).

468 Michael Lounsbury & Mary Ann Glynn, *Cultural Entrepreneurship: Stories,*

entrepreneurship.[469] Part IV.C, *infra*, describes and distinguishes legal entrepreneurship, but we should first briefly consider why entrepreneurship is relevant to our subject at all.

B. The Law as a Competitive Marketplace

The law is a misperceived idea. Law has been romanticized, at least in the West, as a special realm somehow exempt from the rules applicable elsewhere.[470] Firms ought to view the law for what it is: a marketplace. In some respects, the legal market[471] *is* distinguishable from the economic realm; law's distinguished social role necessitates some distinguishing features. But the law nevertheless remains a marketplace.[472] Like any other market, the legal market requires an entrepreneurial approach to achieve lasting value.

"Basic differences among legal systems make multinational legal planning and compliance extremely difficult."[473] The challenges facing global firms "require attorneys to think more comprehensively and creatively about their work," and "[t]his shift in thinking has less to do with the traditional tools of legal analysis (such as interpreting statutes, rules, and judicial opinions) than with developing a broader perspective on the interaction of different legal, economic, and political systems. Clearly globalization is making the work of business lawyers everywhere increasingly . . . multidisciplinary."[474] This multidisciplinary

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Legitimacy, and the Acquisition of Resources, 22 STRATEGIC MGMT. J. 545 (2001).

469 *See infra* Part IV.D.2 (discussing institutional entrepreneurship at greater length).

470 There are exceptions—for example, law and economics shows how economic insights can apply to legal phenomena. But this Article's concern is somewhat different: firms must first perceive the law correctly before they can achieve legal competitive advantage.

471 The phrase "legal market" colloquially describes the legal realm as an industry (e.g., the business of running a law firm). The phrase is employed very differently in this article. Here, a "legal market" is the total space of a jurisdiction's rule of law process, as described in Part III.B. The legal market is a regulatory zone in which firms can compete to establish advantages, which are then exploited to the firm's economic benefit. *See also infra* Part IV.C.1 (distinguishing the meanings of "legal entrepreneurship").

472 *See supra* note 471 and accompanying text.

473 Frenkel, *supra* note 56, at 145.

474 *Id.* at 158; *see also supra* Part III.B (arguing that the rule of law should be

exercise, if effectively executed, is legal entrepreneurship.

Managers are challenged "to accurately define the existing boundaries and structure of [their] competitive arena . . . ."[475] Similarly, an entrepreneur's "creativity requires both an understanding of current boundaries and recognition of a possibility for setting new boundaries."[476] The entrepreneurial lawyer must accurately define the boundaries of her competitive arena.[477] Some domains are better defined than others.[478] In the traditional economic realm, a "competitive arena may be as broad as an industry or as narrow as a product market."[479] The precise contours of a legal market can be difficult to describe as they differ by jurisdiction, time, and by the firm's unique position within the jurisdiction.[480] The legal market must ultimately be defined as expansively as is necessary to harness the particular flexibilities of interest. This expansiveness can encapsulate all of the realms of the rule of law process—legal, political, economic, and cultural.[481]

As a regulatory institution, the law defines the boundaries of legitimate activity within the economic sphere.[482] To the extent that the legal realm's own boundaries are undefined, the political apparatus must attempt to define the legal realm ad hoc, or else its boundaries are left wholly fluid and transaction costs ensue unabated.[483] In low rule of law jurisdictions, legal flexibilities

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viewed as a process involving the jurisdiction's economic, political, and cultural systems).

475 Day, *supra* note 113, at 23.

476 MALLOY, *supra* note 461, at 13-14.

477 *See* Marco van Gelderen, Karen Verduyn & Enno Masurel, *Introduction to 'Entrepreneurship in Context,' in* ENTREPRENEURSHIP IN CONTEXT 1 (Marco van Gelderen & Enno Masurel eds., 2012) (arguing that many dynamic contexts exist for any entrepreneurial venture and that context is important to fully understanding entrepreneurship); *see also supra* Part III.B (providing that the legal entrepreneur's context will extend beyond the legal realm because the rule of law is a process involving areas beyond the legal sphere).

478 Day, *supra* note 113, at 24.

479 *Id.* at 25.

480 *See generally infra* note 513 and accompanying text (implying that "predicting emerging opportunities" is difficult due to the "law's shifting landscape").

481 *See supra* Part III.B.

482 DIXIT, *supra* note 287, at 1-2.

483 *See supra* Part II.F.

preclude the creation of clear and reliable boundaries for the legal sphere.[484] In this case, the firm itself must proactively define its position within the legal nebula.[485] This is the purpose of legal entrepreneurship and is the driver of legal competitive advantage.

Regulators are constrained in responding to the firm's legal maneuvering.[486] Regulators must consider the legal system's goals and context, as well as its inertia and incumbent beneficiaries. In response to the firm, regulators may make the law more complex or simple, but this often unwittingly creates new opportunities for the firm's legal advantage.[487] Often, the firm's legal maneuvering will draw no response whatsoever—regulators may not care about the firm's activity, may lack the resources (including information) to respond, or may decline to respond because the opportunity cost is too high (too many more pressing issues exist).[488]

Competing in the legal market is a necessity for international firms. The law can be an immense source of competitive advantage as it impacts the firm's access to, and performance in, the economic sphere.[489] Firms that do not compete in the legal market yield to their rivals this vast and largely untapped set of opportunities. Unless one's firm is a law firm, investing time and energy in the legal realm is merely a means to an end: the firm engages the legal realm to further its economic profitability.[490]

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484 *See supra* Part III.D.

485 Where states do not make firms secure in their pursuit of wealth, other forces will intervene. DIXIT, *supra* note 287, at 4; *see also* Oliver E. Williamson, *The Theory of the Firm as Governance Structure: From Choice to Contract*, 16 J. ECON. PERSP. 171, 174 (2002) (explaining that private ordering emerges as an alternative to costly and unreliable judicial resolution of conflicts, particular in the presence of bounded rationality, opportunism and idiosyncratic knowledge). Even then, however, the state must supply basic order. Christopher Clague et al., *Institutions and Economic Performance: Property Rights and Contract Enforcement*, *in* INSTITUTIONS AND ECONOMIC DEVELOPMENT 67, 69-70 (Christopher Clague ed., 1997).

486 *See* Masson, *supra* note 252, at 33-38.

487 *Id.* at 36.

488 *See* Masson, *supra* note 252, at 33-38.

489 *See supra* Part III.E (explaining the relationship between laws and value-creating activities).

490 *See supra* Part III.E.

C. *The Entrepreneurial Lawyer*

1. *The Meaning of Legal Entrepreneurship*

A Google search of the term "legal entrepreneur" returns roughly a dozen results. The terms "legal entrepreneur" and "legal entrepreneurship," though not widely used, do exist, and refer to the lawyer who becomes entrepreneurial to better manage a legal business.[491] Thus, for example, in popular usage, a "legal entrepreneur" entrepreneurially recruits clients for a law firm.[492] These websites originate from the United States and the United Kingdom, so their shared view of legal entrepreneurship is understandable. Attorneys in high rule of law jurisdictions are not thinking along the lines proposed here.[493]

The term "entrepreneurial lawyer" means something very different in this article. Here, entrepreneurship is applied not to the *business* of law, but to the *practice* of law. Our framework is concerned not with recruiting clients, but with how best to achieve strategic outcomes for the client—in particular, how to harness the law to the client's competitive advantage. This is accomplished by identifying and exploiting the legal flexibilities in Part III.C.

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491 *See, e.g.*, Mike O'Horo, *Are You an Entrepreneurial Attorney?*, ATTORNEYATWORK (Aug. 23, 2011), http://www.attorneyatwork.com/are-you-an-entrepreneurial-attorney/ (advocating for the management of small law offices as one would manage any other small business); Cara DiSisto Verwholt, *Case Study: A Legal Entrepreneur Builds a Boutique Practice*, INOVIA (Dec. 1, 2011), http://info.inovia.com/2011/12/case-study-a-legal-entrepreneur-builds-a-boutique-practice/ (discussing a big law attorney who opened her own boutique law firm); Patrick J. Lamb, *Eight Qualities of a New Normal Legal Entrepreneur*, AMERICAN BAR ASSOCIATION (Sept. 4, 2012), http://www.abajournal.com/legalrebels/article/the_new_normal_legal_entrepreneur (discussing traits of lawyers who leave established law firms to start new law firms); Ronald H. Gruner, *A Call for Legal Entrepreneurship*, VALLEX FUND (Jan. 8, 2008), http://www.vallexfund.com/download/LegalEntrepreneurship.pdf (urging reforms to the business model of the legal industry); THE LEGAL ENTREPRENEUR, http://legalentrepreneur.net/ (last visited Jan. 11, 2013) (discussing business topics such as law firm advertising and law office cash flows); ENTREPRENEURLAWYER, http://entrepreneurlawyer.co.uk/ (last visited Jan. 11, 2013) (advising law firms on how to increase revenues).

492 *See* Lamb, *supra* note 491 (stressing the use of unorthodox strategies for legal success when starting a new law firm).

493 *See generally supra* Part II.D (providing that other literature assumes a high rule of law context).

Uncertainty makes entrepreneurship possible,[494] and legal flexibilities spawn legal uncertainties.[495] *Legal entrepreneurship* is best viewed as the process of achieving a distinctive, sustainable position in the economic market (that is, a competitive advantage) by the deliberate and innovative exploitation of one or more legal flexibilities.

2. *The Nature of Legal Entrepreneurship*

Scholars have recognized that political and regulatory changes can create entrepreneurial opportunities in the economic sphere, but do not consider entrepreneurial opportunities in the law itself.[496] This article proposes something more: attorneys can apply the entrepreneur's fundamental skills to the unique circumstances of the legal market, harnessing legal flexibilities and the linkages between law and strategy to craft competitive advantages. While this view expands the role of the traditional Western counsel,[497] global legal leaders are already redefining their position, for "[c]ourage in international business is the virtue of daring to invent and innovate, abandoning old business . . . and pioneering new products and markets, as [the] entrepreneur" does.[498] In an era of highly specialized law practice, this may be a difficult balance to achieve. Still, chief legal officers, legal strategists, and other legal executives should strive to achieve it.

These ideas are not entirely foreign to the West. For example, Edelman urges that "[l]aws [containing] vague . . . language . . . and laws that provide weak enforcement mechanisms leave more room for organizational mediation than laws that are more specific, substantive, and backed by strong enforcement."[499] Karl

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494 WILLIAM BYGRAVE & ANDREW ZACHARAKIS, ENTREPRENEURSHIP 57 (2008).

495 *See supra* Part III.C.

496 *See, e.g.*, SHANE, *supra* note 275, at 25-28 (asserting that deregulation may allow for activities previously prohibited).

497 *See supra* Part I (discussing the prevailing views of Western managers and lawyers).

498 PANOS MOURDOUKOUTAS, BUSINESS STRATEGY IN A SEMIGLOBAL ECONOMY 82 (2006).

499 Lauren B. Edelman, *Legal Ambiguity and Symbolic Structures: Organizational Mediation of Civil Rights Law*, 97 AM. J. SOC. 1531, 1532 (1992). Edelman was concerned with the variability of laws within a single high rule of law jurisdiction. *Id.* The model proposed here adds two new dimensions: variability across jurisdictions and

Llewellyn observed that "[the lawyer's] eye . . . is on manipulating the machinery of the rules for what that machinery can be made to yield."[500] Even in the United States, "[a]n advocate . . . has as his trade to exploit . . . the uttermost leeway of the available lines of respectable, honorable, persuasive argument afforded by our going legal order,"[501] so "a case can hope to stand for anything it says . . . . [And yet] a case can [also] hope to be distinguished down to its narrowest facts and issue."[502] George Stigler notes that firms everywhere seek regulatory benefits.[503] And Douglass North observes that even in high rule of law places, "[t]o the degree that there are large payoffs to influencing the rules and their enforcement, it will pay to create" lobbies.[504] Although the international realm adds new complexities to business, not all dimensions of foreign legal systems are foreign to Western attorneys. The framework proposed here incorporates some of these Western experiences in addition to addressing the more prominent legal features of low rule of law places.[505]

Even in high rule of law jurisdictions, "spending more resources on litigation" may result in better "outcomes for the spenders. If law operated in accord with conventional legal theory, resources would affect results only in the small minority of cases in which determinative facts remained undiscovered or the result specified by law was unclear. Yet, resources consistently produce good or acceptable results . . . ."[506] This phenomenon is magnified in lower rule of law jurisdictions, where legitimate avenues beyond litigation exist for lawyers to influence legal outcomes.[507] Legal investments, then, are best made by the retention of entrepreneurial lawyers.[508]

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the existence of systemic flexibilities.

500 LLEWELLYN, *supra* note 128, at 119.

501 *Id.* In lower rule of law environments, the boundaries of "respectable" argument may assume very different contours.

502 *Id.* at 124-25.

503 Mitnick, *supra* note 65, at 74-75.

504 NORTH, *supra* note 124, at 87.

505 *See supra* Parts III.C-D.

506 LoPucki & Weyrauch, *supra* note 343, at 84.

507 *See supra* Part III.C.

508 "The ability to turn legal resources . . . into legal advantage requires a certain level of capability within the [firm]." Masson, *supra* note 2, at 102. The model in this

A business's value will ordinarily be assessed by traditional methods.[509] The value added by an entrepreneurial lawyer can be more difficult to assess because demonstrating causality is a convoluted exercise in the presence of myriad variables. The law can be an immense source of competitive advantage to the extent that it impacts the firm's access to or performance in the economic sphere relative to its rivals. To accurately assess the value of an entrepreneurial lawyer, the firm must be able to attribute a certain financial success (or some portion of it) to a particular legal advantage. Legal advantage is often necessary, but rarely is sufficient alone, to generate economic value. Once the firm has access to an economic advantage, it must still perform on the "business side" to create value.

What it means to actually exploit a legal opportunity depends upon the nature of the opportunity. For a substantive flexibility, the lawyer must persuade authorities to embrace the firm's interpretation of the law, or at least not to object to the firm's activities.[510] For an enforcement flexibility, the lawyer must determine when the firm can act expansively.[511] As to systemic flexibilities, the lawyer must perceive the influence of extra-legal forces.[512] The entrepreneurial lawyer systematically seeks out advantages through these flexibilities, manages them, and attempts to predict emerging opportunities within the law's shifting landscape.[513]

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article does not assume that legal opportunities are equally available to firms. In low rule of law environments, it is possible to create an opportunity unique to one's firm. This requires entrepreneurial prowess in the legal sphere. Thus, the ultimate differentiator between most firms is whether they employ entrepreneurial lawyers, and if so, their respective skills. Masson concluded that "it is still likely the case that certain characteristics of law itself, such as predictability, continue to play an important role." *Id.* at 115. We fully agree. *See supra* Part III (discussing these characteristics).

509 These include the book value, price to earnings ratio, discounted cash flow, return on investment, and liquidation value methods. KURATKO & HODGETTS, *supra* note 458, at 668-75.

510 *See supra* Part III.C.1.

511 *See supra* Part III.C.2.

512 *See supra* Part III.C.3.

513 *See* R. Duane Ireland & Justin W. Webb, *Strategic Entrepreneurship: Creating Competitive Advantage Through Streams of Innovation*, 50 BUS. HORIZONS 49, 50 (2007) (stating that strategic entrepreneurship builds for future advantages).

3. *The Entrepreneurial Lawyer as an Institutional Entrepreneur*

The law is a regulatory institution.[514] Thus, legal flexibilities are a type of institutional void, which occur "where [the] institutional arrangements that support markets are absent [or] weak."[515] Institutions "matter for markets; they enable and support market activity. Where such institutions are absent or weak, . . . scholars point to the presence of 'institutional voids,' realities that can impact market formation, economic growth, and development."[516] Institutional voids also "result from the conflict, collision and shift among existing institutions."[517]

Institutional entrepreneurs capitalize upon institutional voids.[518] "[I]nstitutional entrepreneurship . . . encompasses the continuous . . . re-combination and re-deployment of different practices, organizational forms, physical resources, and institutions."[519] Thus, the "[e]xploitation of the regulative uncertainty and the weak rules of laws has arguably become an important form of entrepreneurship" in jurisdictions like China.[520] Institutionalization is a matter of degree,[521] and thus, opportunities

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514 *See supra* Part II.B.

515 Mair & Marti, *supra* note 19, at 419. Institutional voids exist outside of the law as well. Firms must "acknowledg[e] the existence of multiple institutional logics and . . . the points at which these logics come together." Johanna Mair, Ignasi Marti & Marc J. Ventresca, *Building Inclusive Markets in Rural Bangladesh: How Intermediaries Work Institutional Voids*, 55 ACAD. MGMT. J. 819, 842 (2012).

516 Mair, Marti & Ventresca, *supra* note 515, at 819-20.

517 Mair & Marti, *supra* note 19, at 430.

518 *E.g.*, KHANNA & PALEPU, *supra* note 212, at 53 (stating that institutional voids can frustrate firms, "[b]ut they can also be a source of advantage for those companies . . . that have local knowledge, privileged access to resources, or other capabilities that can help substitute for missing market institutions. Because institutional voids impose costs on market participants, entrepreneurial ventures that seek to fill these voids can create significant value"); Tracey & Phillips, *supra* note 448, at 24; Webb et al., *supra* note 16, at 498 (discussing institutional incongruence). Perhaps the most eloquent and full discussion is Keming Yang's masterful work, *Entrepreneurship in China*. *See* YANG, *supra* note 89, at 49 (discussing institutional voids from the sociological perspective and the resulting phenomenon of double entrepreneurship).

519 Mair & Marti, *supra* note 19, at 431.

520 Nir Kshetri, *Institutional Changes Affecting Entrepreneurship in China*, 12 J. DEV. ENTREPRENEURSHIP 415, 423 (2007).

521 Tracey & Phillips, *supra* note 448, at 28. Correspondingly, the rule of law exists in degrees. *See supra* Part III.B.

for institutional entrepreneurship exist in degrees.[522] Institutions are of such great importance because "[i]nstitutions, together with the standard constraints of economic theory, determine the opportunities in a society."[523]

When "structural overlaps between spheres expose actors to multiple institutional logics," "[s]uch logics can be [viewed] as 'toolkits' . . . ."[524] Institutional logics reflect cultural expectations about "the appropriate means to achieve a given goal in an institutional sphere."[525] When institutions promote multiple contradictory logics, actors must navigate the institutional contradictions and can benefit from them.[526] Legal ambiguities are analogous to institutional contradictions. Though legal flexibilities may not be contradictions per se (they can be "mere" uncertainties), legal flexibilities present similar opportunities for entrepreneurial initiative.[527]

Entrepreneurship in "informal economies" can involve activities that are clearly illegalized.[528] Although the entrepreneurial lawyer may encounter such situations, most flexibilities do not present clear opportunities to contradict the law. When the law itself is not reasonably clear, it is difficult for one's activity to constitute an express violation of it.

It seems, then, that the entrepreneurial lawyer proposed here is, in many respects, similar to the literature's institutional entrepreneur. This is unsurprising since "[t]he kinds of information and knowledge required by the entrepreneur are in good part a consequence of a particular institutional context."[529] Nevertheless, one noteworthy departure from the literature exists.

Most scholars define the institutional entrepreneur as one who

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522 Tracey & Phillips, *supra* note 448, at 28.

523 NORTH, *supra* note 124, at 7.

524 Toke Bjerregaard & Jakob Lauring, *Entrepreneurship as Institutional Change: Strategies of Bridging Institutional Contradictions*, 9 EUR. MGMT. REV. 31, 33 (2012).

525 *Id.*

526 *Id.*

527 *See supra* Part III.

528 Webb et al., *supra* note 16, at 492.

529 NORTH, *supra* note 124, at 77; *accord* Peng, Wang & Jiang, *supra* note 22, at 931 ("In terms of practical benefits, an institutions-based view can help firms in emerging economies enhance their competitiveness . . . . They need to know more about the rules of the game abroad that may be different from the familiar rules at home.").

creates new institutions altogether, often destroying existing institutions in the process.[530] Classic institutional entrepreneurship may require the destruction of existing norms.[531] But legal entrepreneurship, while allowing for such events, does not require them. Legal entrepreneurship serves to further the firm's goals within the economic realm and is not an exercise for its own sake.[532] Thus, legal entrepreneurship involves innovation, the joining together of unique resources, opportunity recognition, creativity, and so forth—many of the characteristics associated with economic entrepreneurship—but it need not also involve institutional destruction. In the institutional context, "[o]pportunities can be viewed as the likelihood that an organizational field will permit actors to identify and introduce a novel institutional combination and facilitate the mobilization of the resources required to make it enduring."[533] This describes the entrepreneurial lawyer more aptly than one who necessarily creates or destroys existing legal institutions.

Of course firms can seek to change the content of the law,[534] but optimal legal outcomes are often realized without the expense

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530 *See, e.g.*, Rasha Nasra & M. Tina Dacin, *Institutional Arrangements and International Entrepreneurship: The State as Institutional Entrepreneur*, 34 ENTREPRENEURSHIP: THEORY & PRACTICE 583, 595 (2010); Julie Battilana, Bernard Leca & Eva Boxenbaum, *How Actors Change Institutions: Towards a Theory of Institutional Entrepreneurship*, 3 ACAD. MGMT. ANNALS 65, 68 (2009); David Levy & Maureen Scully, *The Institutional Entrepreneur as Modern Prince: The Strategic Face of Power in Contested Fields*, 28 ORG. STUD. 971, 972 (2007); Alistair Mutch, *Reflexivity and the Institutional Entrepreneur: A Historical Exploration*, 28 ORG. STUD. 1123, 1124 (2007); David Daokui Li, Junxin Feng & Hongping Jiang, *Institutional Entrepreneurs*, 96 AM. ECO. REV. 358, 361 (2006); Frédérique Déjean, Jean-Pascal Gond & Bernard Leca, *Measuring the Unmeasured: An Institutional Entrepreneur Strategy in an Emerging Industry*, 57 HUMAN RELATIONS 741, 742 (2004). A few exceptions exist, *e.g.*, Tracey & Phillips, *supra* note 448, at 29 (asserting that institutional entrepreneurship involves "deliberately leveraging resources in order to create *and/or manipulate* the institutional structures in which they are embedded") (emphasis added).

531 Li, Feng & Jiang, *supra* 530, at 358.

532 *See supra* Part IV.B.

533 Silvia Dorado, *Institutional Entrepreneurship, Partaking and Convening*, 26 ORG. STUD. 385, 391 (2005).

534 Bagley, *supra* note 62, at 590; *see also* Keim, *supra* note 21, at 585 (urging firms to intervene in the public policy process since policy often impacts the firm's opportunities).

of lobbying for such changes.[535] It often is preferable for the law's substance to remain exactly as the firm finds it, as "fixes" to the law frequently will benefit rivals as much as the firm. Depending upon their nature and extent, *legal flexibilities can serve the same function as would changes to the law's substance.*[536]

Indeed, the entire notion of competitive advantage consists of those things a firm can do that its rivals cannot.[537] When a law's flexibilities accommodate the firm's interests, changes to the law are not only unnecessary, but are affirmatively undesirable, for changes ordinarily have only two possible outcomes: to clarify that the firm's advantage under the former law no longer exists (that it lacked legitimacy) or to clarify that the firm's former advantage must be extended to its rivals (because it was legitimate). In either case, the firm loses its advantage.[538] A legal flexibility is valueless until it is actually harnessed by the firm,[539] but a clarification to the law might guarantee the new value equally.[540] For all of their costs, flexible institutions allow for individual advantages without necessitating the institutions' destruction;[541] equilibrium and stability are thereby preserved. In

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535 Masson, *supra* note 2, at 114.

536 *See generally supra* Part III.C (discussing the three types of legal flexibilities and how the firm can strategically harness them).

537 *See supra* Part II.A.

538 The only exception is where a change to the law explicitly favors the individual firm in question. Ordinarily such a change is procured at great expense (through lobbying) and may be questioned on grounds of legitimacy.

539 THOMAS L. WHEELEN & J. DAVID HUNGER, STRATEGIC MANAGEMENT AND BUSINESS POLICY 109 (9th ed. 2004) ("An opportunity by itself has no real value unless a company has the capacity (i.e., resources) to take advantage of [it].").

540 *See* Roger A. Kerin, P. Rajan Varadarajan & Robert A. Peterson, *First-Mover Advantage: A Synthesis, Conceptual Framework, and Research Propositions*, 56 J. MKT. 33, 47 (1992) (arguing that a new advantage will soon dissipate if the firm's rivals are free riders); *infra* Part IV.D.2 (discussing first mover advantages).

541 Claus Offe, *Designing Institutions in East European Transitions, in* THE THEORY OF INSTITUTIONAL DESIGN 199, 208-09 (Robert E. Goodwin ed., 1996) (arguing that this is accomplished by defining the scope of discretionary behavior among relevant actors and by providing institutional rules for changing lower-order rules); *accord* Robert S. Gerstein, *The Practice of Fidelity to Law, in* COMPLIANCE AND THE LAW 35, 37 (Samuel Krislov et al. eds., 1972) (discussing H.L.A. Hart's distinction between primary and secondary rules, in which primary rules are the rules applying to the populace as a whole, while secondary rules are "rules which authorize the creation, change, interpretation, and enforcement of the primary rules").

high rule of law jurisdictions, lobbying is often the only legitimate response to an adverse policy.[542] In low rule of law jurisdictions, favorable legal positions can be achieved legitimately without changing the law itself and without extending the favorable position to rivals.[543]

4. The Entrepreneurial Lawyer's Skill Set

Modern global counsel are most effective when they possess fluency in cross-cultural lawyering, work effectively in teams and with outside counsel, and manage risk well.[544] Global counsel must embrace persistent problem-solving, opportunity orientation, tolerance for ambiguity and failure, calculated risk-taking, creativity, and innovativeness.[545] But above all, global counsel must be entrepreneurial.

The entrepreneurial lawyer can recognize opportunities in the law.[546] This turns, in part, upon why states regulate: to address information inadequacies, minimize externalities, assure the availability of services, prevent anti-competitive behavior, promote public goods and public morals, remedy unequal bargaining power, ease scarcity, promote justice and social policy, and to generally plan.[547] Two additional motives for regulation exist: to promote the concerns of powerful private interests and to promote the concerns of political incumbents.[548] Just as firms must manage the uncertainties they find in the law, states seek to regulate uncertainties and thereby manage societal risk. The better the lawyer understands officials' motives, the better the starting

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542 *See generally supra* Part III.A (discussing high and low rule of law jurisdictions).

543 *See generally supra* Parts III and IV.

544 Frenkel, *supra* note 56, at 160-64.

545 KURATKO & HODGETTS, *supra* note 458, at 118-25.

546 SHANE, *supra* note 275, at 45 ("In general, people discover opportunities that others do not identify for two reasons: first, they have better access to information about the existence of the opportunity. Second, they . . . have superior cognitive capabilities.").

547 BALDWIN & CAVE, *supra* note 39, at 9-16.

548 The first and most fundamental priority of any political incumbent is survival. *See, e.g.*, Li Ma, *A Comparison of the Legitimacy of Power Between Confucianist and Legalist Philosophies*, 10 ASIAN PHIL. 49, 50 (2000) ("Even before seeking the common good, the first objective of power is to continue to exist . . . .").

point she will have to anticipate and identify opportunities for legal advantage.[549]

The entrepreneurial lawyer must be culturally astute, or "globally literate."[550] "Global literacy is a state of seeing, thinking, acting, and mobilizing in culturally mindful ways."[551] Globally literate leaders are one of the scarcest resources in international business today.[552] Thus, the entrepreneurial lawyer must work effectively outside of the legal system, in the other realms of the rule of law process.

The entrepreneurial lawyer develops relationships with legal decision-makers, particularly in lower rule of law environments.[553] A "key aspect of institutional entrepreneurship in emerging markets is the capacity of actors to build networks and alliances . . . ."[554] The institutional entrepreneur is a skilled social

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549 *See generally* Allison F. Kingsley et al., *Political Markets and Regulatory Uncertainty: Insights and Implications for Integrated Strategy*, 26 ACAD. MGMT. PERSP. 52 (2012) (offering a brilliant framework for predicting regulatory uncertainties and for integrating such predictions into the firm's strategy). This framework views regulatory uncertainty through the lens of the political market and the corresponding demand and supply sides of regulation. On average, regulations contain the fewest uncertainties where the firm's opponents are motivated by efficiency rather than by ideology, and where competition exists among regulatory authorities. *Id.* at 57. The entrepreneurial lawyer would do well to study this framework as she attempts to predict emerging sources of regulatory uncertainty.

550 *See generally* ROSEN, *supra* note 324 (giving the four global literacies and their importance in the business environment).

551 *Id.* at 57.

552 *Id.* at 25 ("We have a shortage of global leaders at a time when international exposure and experience are vital to business success.").

553 *See generally* Eric W.K. Tsang, *Can Guanxi be a Source of Sustained Competitive Advantage for Doing Business in China?*, 12 ACAD. MGMT. EXEC. 64 (1998) (arguing that in China, for example, a firm's personal relations can serve as a source of competitive advantage); HONG LIU, CHINESE BUSINESS 50-51 (2009) (arguing that the firm's *guanxi* can help it around a regulatory barrier and that if the firm has "connections with top central government officials, any legal and regulatory hurdles can be surmounted"); Peter Peverelli & Lynda Jiwen Song, *Social Capital as Networks of Networks, in* ENTREPRENEURSHIP IN CONTEXT 116 (Marco van Gelderen & Enno Masurel eds., 2012) (arguing that social capital, the "sum of the potential access to resources an entrepreneur accumulates in social networks," is a key driver of entrepreneurial success in places such as China); Elliot Carlisle & Dave Flynn, *Small Business Survival in China: Guanxi, Legitimacy, and Social Capital,* 10 J. DEV. ENTREPRENEURSHIP 79 (2004) (illustrating the importance of personal relations to entrepreneurs).

554 Tracey & Phillips, *supra* note 448, at 29.

actor,[555] for legal theory will always yield to political reality when power is at stake.[556] These skills are also crucial to the entrepreneurial lawyer.[557] "The interaction between business and government is an interaction between *people*," so "it is important to understand the institutional setting in which decision-makers operate."[558] Legal decision-makers are in essence the entrepreneurial lawyer's "customers," and "firms can achieve a competitive advantage by influencing consumers' preferences rather than responding to them."[559] The degree to which entrepreneurs have access to a jurisdiction's elite can profoundly influence their likelihood of success.[560] Gaining such access requires cultural astuteness.[561] Other things equal, an entrepreneur can lower transaction costs as his reputation grows.[562]

Acquiring and interpreting information are also vital skills.[563] Managers' key functions "are all tasks in which there is uncertainty and in which . . . information must be acquired."[564] Information is necessary to lowering both costs and risks. The entrepreneurial lawyer can lower transaction costs[565] with the right

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555 Mair & Marti, *supra* note 19, at 421 ("Recent work has also accentuated the imagery of the institutional entrepreneur as a skilled actor.").

556 *See supra* Part III.C.2 (noting, in the context of enforcement flexibilities, that law enforcers' self-interest, as well as their desire to shape legal rules, can lead to a divergence between the law in theory and the law as it enforced through the coercive power of the state).

557 C.S. Tseng & M.J. Foster, *A Flexible Response to Guo Qing: Experience of Three MNCs Entering Restricted Sectors of the PRC Economy*, 5 ASIAN BUS. & MGMT. 315, 319 (2006) (noting that most successful foreign firms in China excel by developing relationships with key legal authorities, using legal gaps to their advantage, or both).

558 Keim, *supra* note 21, at 595.

559 Kerin, Varadarajan & Peterson, *supra* note 540, at 35.

560 *See* RIGGS, *supra* note 269, at 142-49.

561 *See generally* RICHARD M. STEERS, CAROLS J. SANCHEZ-RUNDE & LUCIARA NARDON, MANAGEMENT ACROSS CULTURES (2010) (providing an outstanding overview of the cultural challenges that business leaders confront).

562 ALBERT BRETON & RONALD WINTROBE, THE LOGIC OF BUREAUCRATIC CONDUCT 123-26 (1982).

563 The cost of acquiring political information varies by firm; hence, the amount of data it is rational to collect will also vary by firm. *See* ANTHONY DOWNS, AN ECONOMIC THEORY OF DEMOCRACY 236 (1957). The firm's ability to use political information hinges on its contextual knowledge. *Id.* at 234.

564 NORTH, *supra* note 124, at 77.

565 *See* Dew, *supra* note 162, at 20 (arguing that institutional entrepreneurs

kinds of information—both "skill-based" information (legal knowledge), as well as unique factual knowledge that is not widely publicized (obtained through one's connections).[566]

Global counsel must be sophisticated risk managers[567]—a skill correlated with entrepreneurship.[568] The entrepreneurial lawyer can benefit by collaborating with others on risk management.[569] Many legal uncertainties generate risks. But uncertainty and risk can be reduced through the firm's own entrepreneurial initiative; thus, uncertainty "will affect [the firm] only to the extent that managerial resources are unavailable to deal with it."[570]

Not all uncertainties constitute risks,[571] though many do.[572] Legal risk is a function of the potential sanctions that might accompany a given course of action (or inaction)[573] as well as the level of performance that a rule demands from the firm.[574] The entrepreneurial lawyer manages these risks through continuous learning and refinement.[575] "Entrepreneurship is 'risky' mainly because so few of the so-called entrepreneurs know what they are doing. They lack the methodology. They violate elementary and well-known rules . . . . But . . . entrepreneurship need not be 'high-risk' . . . . [I]t needs to be based on *purposeful innovation*."[576]

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effectively act with the goal of reducing transaction costs).

566 *See supra* note 545 and accompanying text.

567 Frenkel, *supra* note 56, at 159.

568 LU, *supra* note 444, at 14 (stating that entrepreneurs assume the risks associated with uncertainty).

569 *See* Saad Laraqui, *Road Map to the Changing Financial Environment*, *in* BORDERLESS BUSINESS 235, 236-39, 253 (Clarence J. Mann & Klaus Götz eds., 2006) (urging that regulations impact transactional risks, that finance managers can help to mitigate these risks, and that legal counsel can help finance managers as well).

570 EDITH T. PENROSE, THE THEORY OF THE GROWTH OF THE FIRM 58 (M.E. Sharpe, Inc. 1980).

571 *See generally* Daniel Ellsberg, *Risk, Ambiguity and the Savage Axioms*, 75 Q. J. ECO. 643 (1961).

572 *Id.*

573 BALDWIN & CAVE, *supra* note 39, at 100 (showing that these might include criminal prosecution, fines, and warnings).

574 *Id.* at 120-23 (discussing levels of performance).

575 *See generally* BALDWIN & CAVE, *supra* note 39 (discussing the structure of regulatory systems and how to navigate them).

576 DRUCKER, *supra* note 459, at 29.

The entrepreneurial lawyer must be flexible and adaptive since, by definition, uncertainty pervades his environment.[577] This is particularly true in lower rule of law jurisdictions, where higher degrees, more complex combinations, and more varied sources of uncertainty exist.[578]

D. The Law as a Source of Competitive Advantage

1. Sustainability of Legal Competitive Advantages

Most prior discussions of the law's role in competitive advantage take for granted the "high rule of law."[579] Under these conditions, "the law" is taken to mean unambiguous rules that are consistently enforced and equally applied to everyone, and thus the nature of "legal advantage" is limited to lawyers who know the (well-defined) rules, accept their (well-defined) boundaries, and attempt to innovate within their (well-defined) contours.[580] From the standpoint of legal innovation, the high rule of law environment is a uni-dimensional, relatively small space;[581] high rule of law institutions supply firms with constants rather than with variables along most of the system's relevant parameters.[582]

The practical trouble is that most of the world does not operate under high rule of law conditions.[583] Most international firms will encounter conditions far more flexible. The global entrepreneurial lawyer works in a series of multi-dimensional spaces.[584]

If all jurisdictions adhered to the Coasian ideal of unambiguous, equally applied, and well-enforced laws, there

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577 SHANE, *supra* note 275, at 213.

578 *See generally supra* Part III (discussing the definition of rule of law and the distinctions between high and low rule of law jurisdictions).

579 *See supra* Part II.D.

580 *See supra* Part II.D.

581 This is not to say that high rule of law jurisdictions lack complexity. Many areas of law in high rule of law jurisdictions are more complex than in lower rule of law jurisdictions. But in high rule of law jurisdictions, fewer dimensions are deemed to be "legitimate" areas of lawyerly involvement, and fewer are amenable to strategic exploitation. Legal flexibilities are scarcer in high rule of law jurisdictions. *See supra* Part III.D.

582 *See supra* Part III.D.

583 *See supra* Part III.D.

584 *See supra* Part IV.C (discussing the entrepreneurial lawyer).

would exist very few opportunities for legal competitive advantage, even though specific legal rules differ greatly from place to place.[585] This follows from the nature of high rule of law systems: once a lawyer successfully innovates, the high rule of law system will, by definition, institutionalize the new maneuver—will, by definition, legitimize the innovation, memorializing it and making it available equally to all firms.[586] Legal advantages crafted in high rule of law environments are ephemeral, for they quickly become transparent and imitable.[587]

The essence of competitive advantage is a condition favorable to the firm that is simultaneously outside the reach of its competitors.[588] If the law is to represent a sustainable source of competitive advantage, the advantage must exist in some feature of the legal system other than "lawyers competing on an equal plane." The advantage, whatever its nature or source, must not be easily imitable.[589]

"Causal ambiguity creates barriers to imitation."[590] In other

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585 Greater variations do in fact continue to exist in the substance of laws from place to place. *See supra* Part II.D. Legal *arbitrage* might remain viable under the Coasian ideal, but legal *competitive advantages* would not.

586 *See, e.g.*, LoPucki & Weyrauch, *supra* note 343, at 80 (explaining that successful legal strategies in the United States are almost always copied because "the moves that execute the strategy are usually disclosed in public hearings or on public records" such that "[c]areful observers can piece them together"). In high rule of law jurisdictions, "[e]ven strategies never publicly disclosed or admitted are nearly always in some manner revealed to sufficiently observant opponents." *Id.* Ultimately, if opponents cannot discredit the strategy, then "the legal system recognizes the triumph of the strategy by changing the written law to make it consistent with the case outcomes." *Id.* at 81.

587 *See id.* at 80-81 (discussing why legal innovations in the United States are relatively easily copied).

588 *See supra* Part II.A.

589 Gerald D. Keim & Barry D. Baysinger, *The Efficacy of Business Political Activity*, *in* CORPORATE POLITICAL AGENCY 125, 139 (Barry M. Mitnick ed., 1993) (noting that the question of imitability "takes the form 'will we be able to keep the value our strategy [creates], or will we have to share that value . . . ?' [I]mitation is . . . a severe threat to the ability of firms whose strategies have proven successful to earn sustained profits . . . . [F]or a firm to keep its potential value, it must have a strategy that is costly for others to duplicate").

590 Richard Reed & Robert J. DeFillippi, *Causal Ambiguity, Barriers to Imitation, and Sustainable Competitive Advantage*, 15 ACAD. MGMT. REV. 88, 89 (1990); *accord* Day, *supra* note 20, at 71-72 (arguing that causal ambiguity is driven by tacit knowledge accumulated through experience, coordination among diverse resources, and assets

words, "the most effective barriers to imitation are achieved when competitors do not comprehend the competencies on which the advantage is based."[591] Causal ambiguity is generated by tacitness (skills gained through experience), complexity (having a large number of interdependent skills and assets), and specificity (the transaction-specific skills required for the task at issue).[592] The most potent barriers to imitation arise when several of these forces create ambiguities together.[593]

A legal system's greatest fount of causal ambiguity is its flexibility. For a legal system to afford the deepest and most significant competitive advantages, the very system itself must be in play; the set of opportunities must be largely unbounded, and innovations must not automatically be institutionalized.[594] On average (or in a given instance, anyway), high rule of law conditions must not hold. Both the quantity and quality of opportunities for legal entrepreneurship vary inversely with the degree to which the rule of law is observed.[595] This is not to say that firms should necessarily wish for low rule of law conditions (though in some instances they might rationally do so). Rather, firms should look at the potential benefits, and not only at the risks, to realistically assess a jurisdiction's attractiveness as a business venue.

Two features, then, render the high rule of law jurisdiction a less appealing market for legal entrepreneurs: the total set of potential opportunities for legal advantage is circumscribed and a legal innovator's success is far more readily neutralized.[596] Where the high rule of law prevails, competitors need not learn to innovate; they need only learn to imitate.[597] In the high rule of law

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useful for the specific activities at issue).

591 Reed & DeFillippi, *supra* note 590, at 90.

592 *Id.* at 89.

593 *Id.* at 94.

594 *See generally* Part IV.D.1.

595 *See supra* notes 389, 586-585 and accompanying text (implying that higher rule of law jurisdictions tend toward the Coasian ideal, and are thus by definition less conducive to legal competitive advantages).

596 *See supra* Part III.D (stating that in low rule of law countries there are more opportunities for legal advantage).

597 *Cf. supra* note 590 and accompanying text (providing that causal ambiguities help to preclude imitation by the firm's rivals).

environment, an initial innovation creates a legal possibility, which upon its success invariably becomes a legal rule, thereafter to be utilized by anyone whose lawyer can copy.[598] The innovation will initially create an advantage, but its exclusivity will fade as quickly as it appeared.[599] With so many fewer dimensions at play, lawyers in high rule of law jurisdictions can learn to imitate quickly.[600] It is true that attorneys' skillfulness can shape legal outcomes in high rule of law environments,[601] and that legal advantages can (temporarily) be achieved, but fewer flexibilities exist from which causal ambiguities might be bred.[602] Continual reinvestment is needed in the firm's ambiguous sources of advantage; this reinvestment should target "people with tacit knowledge [who can] utilize that knowledge in other activities."[603] Entrepreneurial lawyers are a necessary and profitable investment for the international firm.[604]

Beyond rivalry, institutional advantages are also threatened by the changing nature of the institution itself.[605] For an established legal competitive advantage, there is always the risk that authorities will change the law. This cannot be avoided but can be managed. The law is dynamic and will constantly fluctuate, or it will soon be replaced by a system capable of adaptation or by lawlessness. Legal strategies must evolve as the law does.

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598 *See supra* note 586 and accompanying text.

599 *See supra* note 587 and accompanying text.

600 *See supra* note 587 and accompanying text.

601 *See, e.g.*, LoPucki & Weyrauch, *supra* note 343, at 78-79 (explaining that superior lawyering can influence legal outcomes even in high rule of law environments because legal rules "are necessarily incomplete in some respects and ambiguous in others," and because "[l]egal outcomes are the products of complex human interactions in which the lawyer can draw not just on written law, but on social norms and prejudices, [informal rules], and virtually anything else that might persuade the decision-maker").

602 *See generally* Reed & DeFillippi, *supra* note 590 (discussing how causal ambiguities surrounding a firm's competitive advantages impede imitation).

603 *Id.* at 97-98.

604 Irene Hau-siu Chow, *The Relationship between Entrepreneurial Orientation and Firm Performance in China*, 71 SAM ADVANCED MGMT. J. 11, 13 (2006) (arguing that human capital is rare, valuable, and not easily imitable, so it is an important driver of competitive advantage). Entrepreneurial lawyers are a rare form of human capital.

605 *See generally* Mair & Marti, *supra* note 19 (presenting a case study from Bangladesh that highlights the complexities of entrepreneurship in a country with evolving informal institutions).

2. *First Mover Advantages in the Legal Market*

An important related issue is the timing of new legal strategies. A "first mover" is "the first firm to (1) produce a new product, (2) use a new process, or (3) enter a new market."[606] First movers can achieve cost and differentiation advantages.[607] Among other benefits, first movers can preempt scarce resources and establish entry barriers for later firms.[608] Legal entrepreneurship enables these advantages and more.

One may think that since low rule of law jurisdictions generally do not institutionalize strategic legal innovations (a fact that does tend to promote the sustainability of advantages), timing is inconsequential. Yet timing is important, even in low rule of law jurisdictions. Once an agency makes "an exception"[609] for a given firm, at least two factors make subsequent exceptions for other firms less likely. First, every exception an agency grants will raise its monitoring and enforcement costs. Second, to the extent that firms are treated differently under the same rule, the agency may risk losing legitimacy. Whether and to what extent these concerns actually materialize will vary according to the firm, jurisdiction, context, and time. The fact that the firm first secures a favorable legal position may bolster its competitive advantage: the state becomes incrementally less likely to apply similar benefits to the firm's rivals.

Rivals may respond to an advantage by imitating it, by assessing that the advantage is not worth the trouble, or by attempting but failing to imitate because of the advantage's complexity.[610] "Maintainability of a first mover advantage is based primarily upon limiting imitability."[611] Imitability

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606 Kerin, Varadarajan & Peterson, *supra* note 540, at 33.

607 *Id.* at 39.

608 Yadong Luo & Mike W. Peng, *First Mover Advantages in Investing in Transitional Economies*, 40 THUNDERBIRD INT'L BUS. REV. 141, 143 (1998).

609 A flexible legal rule is itself unclear, so it is difficult to articulate what constitutes an "exception to the rule." "Exception" is used here to denote a manner of treatment substantially distinguishable from how a majority of firms under similar circumstances are treated under a particular law at a particular time, to the extent a majority treatment can be discerned.

610 Chad Nehrt, *Maintainability of First Mover Advantages When Environmental Regulations Differ Between Countries*, 23 ACAD. MGMT. REV. 77, 86 (1998).

611 *Id.* at 83.

comprises many factors including causal ambiguity, the preemption of scarce resources, the rival's awareness of the innovation, and the competitiveness of the industry.[612] Effective entrepreneurial lawyers will establish legal advantages speedily.[613]

Firms confront three options when addressing uncertainty: the firm can delay acting until the uncertainty is resolved, can act by focusing its resources, or can act by spreading its resources to account for future contingencies, thereby maintaining its own flexibility.[614] "Since strategy is concerned with the future, the strategic context of a firm is always uncertain, although different firms face differing degrees of uncertainty."[615] Entrepreneurial lawyers can reduce the firm's uncertainties, effectively simulating a high rule of law experience in a low rule of law environment.[616] Still, utilizing a legal flexibility can require time, so the entrepreneurial lawyer must be both patient and aggressive.

The firm can either endure legal risks passively, or it can attempt to manage them. The "wait and see" option is a disadvantageous approach to legal uncertainty.[617] Rarely are legal uncertainties definitively resolved in low rule of law places.[618] Legal uncertainties in these jurisdictions are either deliberately built into the system (e.g., China) or are imposed by conditions that are resistant to easy change (e.g., many impoverished nations).[619] Firms cannot passively wait for legal uncertainties to be resolved. This is unlike high rule of law jurisdictions, where uncertainties are resolved publicly and for the sake of predictability.[620] All other things equal, the earlier a firm can

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612 *Id.*

613 *See supra* Part IV.C (discussing the entrepreneurial lawyer).

614 Birger Wernerfelt & Aneel Karnani, *Competitive Strategy Under Uncertainty*, 8 STRATEGIC MGMT. J. 187, 187-188 (1987); *accord* Courtney, Kirkland & Viguerie, *supra* note 151, at 2-3 (noting that in the presence of uncertainty, executives' options are to "bet big, hedge, or wait and see," and that "traditional strategic-planning processes won't help much").

615 Wernerfelt & Karnani, *supra* note 614, at 189.

616 *See infra* Part IV.D.3.

617 *See generally* Johnson & Swanson, *supra* note 192 (advocating for proactive risk management to control risk and reduce legal costs).

618 *See generally supra* Part III.D.

619 *See supra* Part III.D.

620 *See generally supra* Part III.D (discussing high and low rule of law places).

establish competence in the legal market, the better.[621]

3. *The Essence of Legal Competitive Advantage: The Firm's High Rule of Law Experience in a Low Rule of Law Environment*

Much of the Coasian literature assumes uniformity in the degree to which legal flexibilities discourage economic activity, but this simplifying assumption is made to accommodate the macroeconomic vantage.[622] In reality, the extent to which flexible laws discourage economic actors is a subjective measure.[623] Some firms—those more tolerant of risk and those with entrepreneurial lawyers—will find lower rule of law jurisdictions more profitable than the Coasian ideal.[624] With legal competitive advantages in place, the firm can experience a low rule of law environment *as though* it is a high rule of law place, while the firm's rivals continue to experience the jurisdiction as it exists for the average actor. Thus, the firm's risk trajectory can be altered while those of its rivals follow the expected path. Figure 4 illustrates these ideas:

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621 Yael V. Hochberg, Alexander Ljungqvist & Yang Lu, *Networking as a Barrier to Entry and the Competitive Supply of Venture Capital*, 65 J. FINANCE 829, 830 (2010) (noting that where a market is opaque or relatively private, "[h]aving to establish visibility, credibility, access to information, and local knowledge from scratch puts entrants at an obvious cost and time disadvantage relative to incumbents").

622 *See generally supra* Part III.E (discussing the Coase Theorem).

623 *See, e.g.*, PENROSE, *supra* note 570, at 58-59 (discussing subjective uncertainty). "For any degree of uncertainty, the supply of managerial services will determine the amount of expansion undertaken by the enterprising firm. The overcoming of uncertainty has its cost . . . . But its restraining effect on expansion depends on the resources available to meet it." *Id.* at 64; *see also supra* Part III.E (discussing this idea).

624 *See infra* Figure 4.

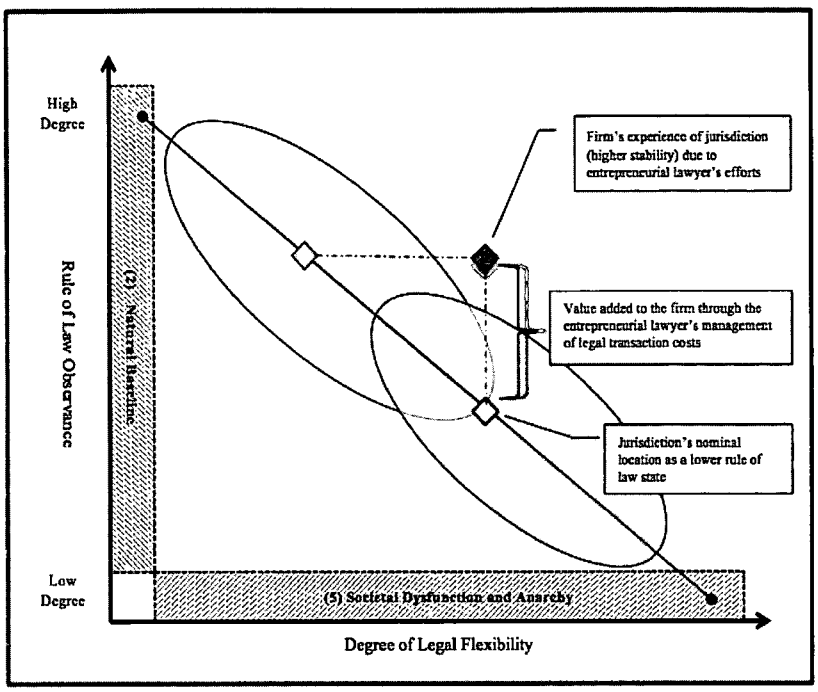

Figure 4: The entrepreneurial lawyer adds value to the firm.

While the Coase Theorem's prescription of unambiguous laws may optimize a society's macroeconomic output, such conditions do not necessarily favor a given individual firm. For the adroit firm, low rule of law jurisdictions can present even more profitable scenarios than the Coasian ideal—precisely because the law, if it is sufficiently flexible, can serve as a source of competitive advantage.[625] From the individual firm's perspective, the question is not simply the prevalence of transaction costs.[626] Instead, the firm must consider both the costs and expected returns—the potential net gain, should competitive advantages be achieved.[627] Both sides of the equation must be considered; the entrepreneurial lawyer can change the equation by lowering costs

625 *See supra* Part III.

626 *See supra* Part III.

627 Mitnick, *supra* note 65, at 69 ("[R]egulatory benefits can accrue to the same firm that is subject to the regulatory costs, and can exceed those costs.").

and increasing the firm's legal standing relative to rivals.[628]

Recall the expression from Part III.E, *supra*: $E = A_A - (L + P)$. A firm's economic opportunities consist of all available activities (those that are not cost-prohibitive and that do not exceed the firm's personal threshold for risk tolerance) which have not been removed to the legal or political realms.[629] By better managing legal flexibilities (L), the firm can reduce its legal costs and discover new competitive advantages, which in turn enlarges the firm's economic opportunities (or the expected value of its activities in the economic realm, E). For any jurisdiction, a "baseline" ratio of economic, legal, and political opportunities (as well as available and prohibited activities) can be crafted; such a baseline ratio represents the trajectory of the firm that passively accepts the costs associated with legal flexibilities. To the extent the firm's entrepreneurial lawyer favorably alters the firm's ratio compared to the baseline figure, the firm has achieved legal competitive advantage.

Every firm would benefit under the Coasian ideal, as each firm would encounter fewer transaction costs on average than under flexible institutions. But such benefits would be shared equally by all firms. In low rule of law environments, the average firm can expect to encounter higher transaction costs than it would in a Coasian environment. Society's macroeconomic output will be lower than under Coasian conditions. But this does not mean that *every* firm will encounter higher transaction costs in the low rule of law jurisdiction.[630] The costs of uncertainties, emanating from legal flexibilities, are distributed unevenly, just as the potential benefits of flexible laws are disbursed unevenly.[631] Several factors drive economic success under flexible institutions. The most important of these is the skill of the entrepreneurial lawyer.

All legal flexibilities are alike in at least one respect: it is impossible for the firm to be literally certain about its treatment under a flexibility prior to engaging in the activity at issue.[632] If this is false, then the law in question is not a flexibility, but is by

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628 *See supra* Parts IV.B-C.

629 *See supra* Part III.E.

630 *See* Parts III.E and IV.

631 *See* Parts III.E and IV.

632 *See supra* Part III.C (discussing lower rule of law states and legal flexibilities).

definition a constant—a certainty. For any legal question ultimately governed by a flexibility, the firm must act under some degree of uncertainty or else take no action at all.[633] But a passive approach to the law is seldom beneficial and will never result in legal competitive advantage.[634] The firm must be willing to take sensible risks in order to achieve competitive advantages in the law. The entrepreneurial lawyer can greatly reduce these risks. The firm's skill at managing legal risk is equal to the degree of "legal confidence" with which the firm can undertake a given course of action. As Figure 4 illustrates, the degree to which the firm successfully manages its legal risks represents the entrepreneurial lawyer's contribution to the firm's value. By effectively managing its legal risks, the adroit firm will experience a low rule of law jurisdiction as though it is a higher rule of law jurisdiction. When the firm does this and its competitors cannot, the firm achieves legal competitive advantage.

V. Conclusion

The law itself can serve as a source of competitive advantage. The "rule of law" describes the realm of opportunity the firm has to harness the law to its competitive advantage. Thus, the "rule of law" is best defined from the business perspective. Three types of flexibility (substantive, enforcement, and systemic) exist in every legal system, and each type can be used to craft legal competitive advantage. The "rule of law," then, is the degree to which a legal system reallocates opportunities from the economic realm to the legal realm.

In order to identify and exploit opportunities for legal competitive advantage, a new type of attorney is required: the entrepreneurial lawyer. The entrepreneurial lawyer approaches the law as a marketplace, much as the traditional entrepreneur approaches the economic market. By harnessing legal flexibilities in each jurisdiction, the entrepreneurial lawyer crafts sustainable competitive advantages for the client.

Riskier jurisdictions (that is, low rule of law places) present greater opportunities for legal competitive advantage than their

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633 *See supra* Part III.C (discussing lower rule of law states and legal flexibilities).

634 *See generally* Kerin, Varadarajan & Peterson, *supra* note 540 (discussing the benefits of being a first mover).

higher rule of law analogues. While the Coase Theorem's prescription of unambiguous laws may optimize a society's macroeconomic output, such conditions do not necessarily favor a given individual firm. For the adroit firm, low rule of law jurisdictions can present even more profitable scenarios than the Coasian ideal.

This article has connected the rule of law, the law as a source of competitive advantage, and legal entrepreneurship to propose a different view of legal strategy. We hope that this framework will serve as a useful starting point as international firms work to integrate the law into their strategies. Many avenues for future research exist, and we hope to contribute to the framework's future development.