The International Operations of National Firms and Competitor Advantage

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by

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THE INTERNATIONAL OPERATIONS OF NATIONAL FIRMS AND COMPETITIVE ADVANTAGE

It is more useful to think in terms of the international operations of the firm than in terms of the so-called multinational, transnational or global corporation. International operations refer to all modes of operations, which are not mutually exclusive and can be combined or sequenced. In considering the 'why" of going abroad, it is not enough to have good reasons or attractive locations -- the firm undertaking any international operation must have transferable competitive advantage relative to indigenous players and firms of other nationalities.The nature of these advantages determine the "how" and "where" of international operations. In international as distinct from domestic competition, collective national advantages can be more potent than firm-specific advantages, i.e. differences between domestic rivals. It would be extremely short-sighted for companies not to be concerned about the health of their home bases.

Words, concepts that usher in a new mode of discourse can have a profound effect on our ability to think and to understand the world. There are at least two kinds of intellectual consequences that flow from the pervasive and indiscriminate use of expressions such as the "multinational", "transnational" or "global" corporations. First, the presumption is created that nations (and national differences) cease to matter and an imagery is conjured of a "borderless" world[1] dominated by "stateless" companies[2] where "who is us?"[3] is no longer what it has always been, since "multinational" and the other labels imply that the entities have somehow transcended nation-states and have no home nations. Second, a false, illusory unity of concept is produced, as diverse enterprises, large and small, private and public, coming from different industries and nations (advanced and less-developed) and with totally different structures, are lumped together as if they constituted a distinct but homogeneous species merely by virtue of the label "multinational" or "transnational"; these umbrella terms then give rise to the search for some kind of universal "theory of the multinational enterprise" and uniform recipes for success in "international management".

In an previous article in the California Management Review,[4] I developed a number of objective, measurable criteria of corporate nationality versus stateless globalism (geographical scope and spread of operations, ownership, control, people, legal nationality and tax domicile); these are criteria which can be quantified if the data is available, as distinct from subjective statements concerning a "global" mindset, a "transnational" strategy or a "polycentric" culture. I applied the criteria to show that, with the exception of a handful of "binational" corporations (such as Shell, Unilever and Asea Brown Boveri, that have two parent companies and hence two home nations), *there is no such thing as a multinational, transnational or global firm* (in the sense which the terms intend to convey, of an entity that transcends nations-states) -- *there are only national firms with international (i.e.foreign) operations*. The home nation remains the primary source of a corporation's international competitive advantage, so that weakness at home is unlikely to be compensated by overseas operations. Moreover, when 60 percent or more of a company's operations, assets and people are located in the home nation, it is hard to see how it could transfer the 60 percent wholesale to another country; shifting the home base is not the same thing as shifting a divisional headquarters or changing the legal address of the holding company for tax or political reasons. The firm needs its home nation just as the nation needs competitive, home-based firms.

My thesis also had clear implications for the question "who is us?". Within a "multinational" group there is a home nation and hence there is a home government and a home tax authority. Usually the bulk of the assets and operations is located in the home nation, and the majority of the owners, managers, workers and senior decision makers are citizens of the home nation. It stands to reason that the major share of the profits, tax revenues, and of the best jobs accrue to the home nation or to its citizens at home or abroad. A national firm with international operations is one of us.

What about the second intellectual consequence of the multinational/globalization paradigm? If we discard the "theory of the multinational enterprise" and the myth of international management, what are we going to put in their places? How are we to think and conceptualize about the international business landscape? In the present article I propose a simple, alternative approach -- the conceptual framework of the international operations of national firms.

A CONCEPTUAL FRAMEWORK

A number of points can be made about my approach in order to facilitate comprehension. First, in my framework "going abroad" by the firm refers to *all* modes of international operations including exporting, direct foreign investment (DFI)[5] and any possible combination of *equity* and *contractual* modes (these are enumerated below). In the economics literature, there is insufficient integration between the theory of international trade and the theory of the multinational enterprise. The former tends to focus on nations and to ignore the behavior of firms. The latter tends to dwell on the necessary and sufficient conditions for DFI in overseas production (as distinct from DFI, say, in sales and servicing).[6] I believe that the concept of international operations is preferable for both intellectual and practical reasons. Intellectually, as the historian Arnold Toynbee argued, a larger unit (international operations) is likely to be a more intelligible field of study than a component part (exporting or DFI in production), and, the more specific is the phenomenon to be explained/predicted by a theory, the more cumbersome is the number of assumptions that have to be made. Practically, the firm contemplating international operations is more interested in considering the whole range of possible modes of operations than in analyzing the necessary conditions for one single alternative.

Second, the nature and purpose of a conceptual framework is different from that of a theory. Whereas a theory seeks to prove hypotheses by making assumptions, a conceptual framework aims to provide a clear basis for asking the right questions.

Third, as distinct from the concept of the "multinational" firm, my framework does not assume any degree of homogeneity, uniformity or universality between national firms with international operations. The questions can be addressed to any firm or group of firms with international operations, and differences/similarities will emerge at the level of the answers.

Fourth, underlying the questions as a unifying thread and also providing the dynamic dimension is the concept of competitive advantage and its transferability.

Fifth, the need for transferable competitive advantage has been recognized, ever since the pioneering work of Stephen Hymer .[7] for the case of DFI. I now argue that this logic applies to *all* modes of international operations.

THREE BASIC QUESTIONS

In relation to the international operations of firms, the three basic questions are: *Why? How?* and *Where?* This threefold distinction is an analytical device that can contribute to clearer thinking by introducing an order, a structure into the myriad of factors that could affect the firm's decision to go abroad and its chances of success. However, it should not be forgotten that the three aspects are inseparable -- in any international operation, there is a rationale, there is a mode or combination of modes and there is a destination/location.

The rationale for international operations

The most commonly given reasons (by businessmen and management textbooks) for a firm to go abroad are:

(1) to ensure raw material supplies;

(2) to take advantage of low costs of production;

(3) to respond to large and/or fast growing markets; and

(4) to exploit fabulous profit opportunities.

These reasons, however valid, are insufficient to establish a complete, justifiable rationale for undertaking foreign operations. If country X possesses a much needed raw material, why is extraction not being undertaken by local entrepreneurs, who have, all other factors being equal, an inherent advantage over outside investors? Similarly, why are the lower costs not being taken advantage of by local entrepreneurs? What advantage do foreign imports or local production by foreigners have in supplying the local market, in relation to actual or potential local competition? Why are the local profit opportunities not being monopolized by indigenous players? Thus, in addition to the existence of opportunities in a foreign environment, what needs to be explained is why a foreigner is able to exploit these opportunities successfully when there is always the competition, actual or potential, of native players. (For example, in the above case of raw material extraction, the foreign-owned mining company may have enjoyed colonial privileges, may possess superior financial and technical resources, and may control access to its home market for the mineral in question).

This brings us to the question of the competitive advantage(s) of the firm operating abroad, a subject which is so important that it will be analyzed in some detail after we have reviewed *how* and *where*.

Modes of international operations

The modes can be grouped into two major categories: those on the market servicing side and those on the sourcing side. Without being exhaustive, the modes on the market servicing or selling side include: direct exporting, indirect exporting, licensing, franchising, joint ventures, acquisitions, the provision of technical/management services, turnkey projects, DFI in marketing/servicing/distribution, DFI in assembly or packaging, DFI in manufacturing, etc. On the sourcing or supply side, the modes include: arm's length purchasing, subcontracting, original equipment manufacture (OEM), equity participation in and/or technical assistance to suppliers, joint ventures, acquisitions, foreign buying offices, DFI in foreign assembly, DFI in production, DFI in mining or raw material production, etc. In so far as the economic theory of the multinational firm dwells on only one mode (DFI in manufacturing) and compares it with only two other modes (exporting or licensing) at most, that approach can be seen to be rather limited in scope.

The question of the modes of international operations is often treated as one of choosing between different modes, and the literature tends to concentrate on the advantages and disadvantages of each mode. There are two problems with this way of defining the problem -- it assumes that the modes are mutually exclusive and it assumes that each mode has clear-cut and invariant characteristics. In fact, the issue is not so much one of choosing a particular mode as it is of *combining* different modes and, over time, of *sequencing* them. Thus a particular market may be served by a combination of local assembly/manufacturing (for part of the product line) and exporting from the parent company and sister companies in other countries (for the rest of the product line). With a wholly-owned subsidiary, however, licensing may be superimposed on the DFI in order to reduce the level of profits shown by the foreign subsidiary.

Over time, the mode that is most appropriate in a particular stage of the firm's overseas expansion may become much less appropriate in subsequent stages, i.e. the "choice" of the mode may depend on the company's history, current development and plans for the future. Over time, there is, in growing foreign markets, a natural progression from exporting to local assembly and then to more integrated production; factors that facilitate this transition include the initial establishment of a local sales and technical servicing capability, transport costs, tariffs on the finished product, growth in the volume of local sales, etc. while triggering mechanisms often involve the threat of protectionist measures and of competition from indigenous firms. On the other hand, sequencing may be blocked by an unwise choice of mode; a problem to watch out for when licensing is that a license agreement (with an independent party) may preclude the licensor from entering into the market concerned by other means during the term of the contract.

Not only are the modes not mutually exclusive, it is also wrong to think of each mode as if it features were sharply defined. Within each mode there is significant variability. Thus exporting through foreign agents or distributors is a very different ball game than exporting to wholly-owned foreign subsidiaries with shipping, warehousing, distribution, etc. under the firm's control. Contractual modes of operations, joint ventures, etc. vary infinitely. There is considerable scope for the firm undertaking international operations to tailor each mode and the combination of modes to its requirements.

In general terms, the choice/combination of modes depends on a number of factors:

(a) factors inherent in the modes -- there is a trade-off between the degree of control over the operation on the one hand, and resources committed and flexibility lost on the other. Thus foreign production gives the firm much more control in many ways than exporting or licensing, but requires a much higher level of investment and creates "exposure" in the foreign country;

(b) factors pertaining to the firm -- everything else being equal, a large firm will find it easier to undertake foreign production than a small one. Similarly a large firm possesses more resources to exploit itself globally a technological advantage rather than having to sell (license) it;

(c) factors pertaining to the product(s) -- certain products require local technical support or local assembly for market penetration to be successful;

(d) factors pertaining to the target country -- in the 1950s and 1960s Japan would not let in manufactured imports and inward DFI; the only way in was to license Japanese companies;

(e) the time factor, discussed above;

(f) the nature of the firm's competitive advantage(s), a factor that is so important that it will be amplified after we have discussed the concept of competitive advantage.

Destination/location of international operations

Of the three basic questions, "where" is the one that is most closely connected with factors pertaining to the target countries and regions. With regard to exporting, the questions are: which nations offer the best market prospects in terms of size and growth and after allowing for trade barriers and transportation costs? and: is it the firm's strategy to export to as many countries as possible or is it to concentrate on fewer key markets? Exporting to many destinations usually requires the use of agents, distributors and trading houses or Sogo Soshas, while concentrating on key markets enables the firm to use its own branches and subsidiaries abroad.

With regard to DFI, there are a number of questions:

(1) *what* is being located -- marketing and distribution operations, production plants, assembly units, R&D or technical units, or regional headquarters? The considerations relevant to each will be different. In general there will be, worldwide or in a continent, more marketing/distribution operations than operations of the other kinds. There may also be a need to please host governments by establishing some kind of local presence that can be seen to provide employment and other benefits;

(2) which continent or region (Europe, North America, East Asia, etc.)? which country within the target region (the UK, Belgium or Germany in the European Community)? which area within the chosen country (a "development" area offering generous investment incentives or a location close to established centers)?

(3) for sourcing-oriented operations, what is the trade-off between costs, quality, reliability, speed, geographical proximity, etc.? For market servicing operations, what is the trade-off between the investment needed (allowing for risk reduction techniques such as local borrowing, joint venturing or investment guarantees) and the market/profit potential?

For joint ventures, strategic alliances, acquisitions, etc. a decisive factor is the identification of suitable partners or targets, in addition to the cost conditions and/or market prospects of the countries concerned.

Last but not least, for all modes of operations, there must be a fit between the destination or location chosen and the firm's competitive advantage (see below).

WHY THERE MUST BE COMPETITIVE ADVANTAGE(S)

There are barriers to international operations which arise from the inherent superiority that indigenous players operating in their own environment enjoy relative to foreign firms, and this requires that the firm undertaking a foreign operation must possess a more than compensating advantage if the operation is to be successful. As I pointed out earlier, this was first pointed out by Stephen Hymer in 1960, but there has been over the years a tendency to concentrate exclusively on the initial disadvantages of new DFI relative to indigenous firms. I would like to extend the reasoning and argue that it applies to *all* modes of international operations including the operations of well-established subsidiaries of foreign companies.

Take first the case of exporting. Compared to local producers, imports are handicapped by distance (geographical and perhaps cultural), trade restrictions, non-tariff barriers (NTB) and sometimes by "structural impediments" (including a preference for buying national) -- the factors that enable imports to sell include cheapness (to the extent that it is not cancelled by tariffs and transportation costs), superior quality, the snob value for a minority of buyers, or the simple fact that the product is not made locally. Local production by the foreign firm can overcome some of the disadvantages of exporting, but with DFI there is at first the disadvantage of lack of familiarity relative to native companies. This can be overcome with the passage of time and the incurring of "learning costs". Even then, however, the foreign-based corporation will continue to be burdened by certain handicaps which will be absent for indigenous enterprises. The foreign-owned subsidiary will have to report to headquarters in another nation, perhaps quite far away, and will need continuously to persuade and educate bosses who are likely to be foreigners, while from the point of view of the parent company, it will be operating at a distance. Although the costs of telecommunications and air travel have been declining, expatriate staff invariably costs more than local staff. All this translates into higher costs, reduced flexibility and the risk of not being able to see business opportunities and threats as clearly as the indigenous player, even for the not-so-new DFI. In addition there may be other sources of disadvantages -- exchange rate risk (which may not affect native players to the same extent because they are operating in their "home" currency), a sense of community (which may imply a natural preference for dealing with fellow citizens rather than foreigners and those who report to foreigners), or even outright discrimination.

What about international joint ventures or strategic alliances? There is no direct competition here, yet the thrust of the argument is not altered, for to get a potential partner interested in cooperating with one, one must have *something to offer*, in other words one must possess an advantage. (It may be more accurate to use the expression *relative* or *differential* advantage rather than *competitive* advantage, but I shall stick to the latter as it has much wider currency in the business strategy and management literatures. In this article, competitive advantage refers to any advantage, edge, superiority or strength relative to some one else without necessarily implying direct, frontal competition.) Moreover, the nature and strength of the advantage determines one's bargaining power and thus the division of the gains and costs of the partnership.

Let us now turn to offshore sourcing. This is motivated primarily by the search for lower costs. All other factors being equal, indigenous firms in a lower cost nation should have an edge in managing local costs, so that the foreign company should buy from them rather than undertake manufacturing DFI in that country. That DFI takes place is due to the foreign company's advantages such as proprietary technology, superior experience, skills and management, a better understanding of one's own requirements, the greater certainty of buying from and selling to the same corporate group, etc. Or take the case of

OEM in which local firms produce a product for a foreign buyer who resells it under its own brand name. Why can't the indigenous suppliers sell directly to the final market and so reap higher margins? Again it is because the foreign company possesses certain advantages over local firms, advantages such as a brand name, better access to its own home market, as well as the ability to provide designs, technical assistance, etc. to the suppliers.

In sum, whatever the mode and the destination of international operations, "motives" (such as to exploit cost, growth or profit opportunities abroad) are not enough to constitute a complete rationale, which requires also the possession of advantages, relative to indigenous entrepreneurs and players, which can be transferred to the foreign operation(s). As Case 1 illustrates, this is true even where the motive is to acquire an advantage.

Case 1 Acquiring high tech companies in Silicon Valley, California

Over the years European and East Asian corporate groups have sought to gain access to leading edge electronics and computer technologies by taking over or acquiring a stake in high tech firms in Silicon Valley. Doesn't this disprove the need for an advantage as a condition for international operations? Far from having a technological advantage, these acquirers are motivated by their lack of technological advantage compared to the US electronics and computer industries.

A takeover, however, consists of both the purchase and the subsequent operations. The ability and the willingness to pay a higher price for the target firm than other actual and potential US and foreign investors (which depend on deep pockets, a lower discount rate or a longer time frame, and perhaps on excessive optimism) does not necessarily signify the ability to operate and manage the acquired business successfully. This ability will depend on the acquiring group's relative technical capabilities, managerial strengths, market position, financial resources, etc. as well as its ability to achieve "synergies" between the acquired business and the group as a whole. In other words, it depends on the competitive advantages it can bring to bear on the operation.

In practice, many of the high tech acquisitions in Silicon Valley have so far turned out to be less than successful. Take the case of Acer, Taiwan's leading computer manufacturer. As part of a strategy to reduce its dependence on OEM sales and to build up its market position in the US, Acer acquired in 1987 Counterpoint, a startup that built a powerful minicomputer using multiple micro-processors, for US$ 6 million, and in 1990 it paid US$ 94 million for Altos Computer Computer Systems Inc, a microcomputer pioneer that had an extensive network of distributors. Counterpoint went out of business two years after being acquired, and heavy losses at Altos after the take-over led in 1991 to the parent company's first loss in 15 years. In Singapore, the drive into Silicon Valley has been spearheaded by the government, with state-owned Singapore Technology Holdings Corp. forming a joint venture with Sierra Semiconductor Corp. of San Jose to make wafers for integrated circuits and taking a major stake in Momenta Corp. in Mountain View to make pen-based computers. Losses of more than US$ 100 million were reported in 1992, and Momenta has had to stop manufacturing.

Nor is this kind of sobering experience unique to Asians. In 1989 the French government-owned computer national champion, Groupe Bull, paid US$ 511 million to buy Zenith Data Systems, an Illinois-based maker of personal computers (PCs). In the fall of 1993, as the French government began a campaign of privatizing large state-owned firms, it was reported that Zenith had lost money ever since the take over, that it was the largest single source of Bull's losses, that cumulative losses over three years totaled an estimated US$ 200 million, and that Zenith's share of the booming laptop market had sunk from 23 percent to 9 percent.

The moral is that the lack of something cannot replace the possession of competitive advantages as a basis for international operations if these are to be successful.

Yet "to him that hath shall be given". It appears that Japanese companies, who are likely to have reached a higher level of technological and managerial sophistication than European and East Asian firms, have had a more successful, if more low profile, experience with their investments in U.S. high tech companies. The Japanese often go for minority positions: for example in 1989 Canon paid US$ 100 million for a 16.7 percent stake in Next Inc., a startup by Steve Jobs, Apple Computer's founder. Frequently they seem more interested in acquiring marketing and manufacturing rights than in taking over the U.S. venture. The strategy is probably one of gradual takeover and of using these investments to feed into the building up of capabilities in Japan, which are at a high level anyway and are continuously being upgraded

ADVANTAGES OF NATIONS AND ADVANTAGES OF FIRMS

For healthy companies (including the big "multinationals" but by no means confined to them) and healthy nations, the home nation (or even localities within the home nation) is the primary source of the firm's international competitive advantage. There are at least four reasons for this. First, in most cases the home nation is where the bulk of the firm's assets, operations, employees and senior decision-makers are located. Second, R&D is even more disproportionately concentrated in the home nation,[8] indicating that the main thrust of the firm's innovative effort takes place in the home nation. Third, although an American company, for example, may be able to tap into German sources of advantage by establishing a local presence in Germany, it will not be able to tap those sources better than German firms. Fourth, there may be human obstacles to transferring skills and ideas from the German operation back to the home base in the U.S. Tapping into another nation's sources of advantages can help to reduce disadvantages or to supplement home-based advantages; by itself it cannot provide an advantage compared to indigenous companies based in leading nations, since advantage is always a relative concept.

There is a fundamentally important difference between competitive advantages in domestic competition and advantages in international competition, where the former is defined as competition between companies based in the same home nation and the latter as competition between firms from different home nations. In domestic competition, general characteristics such as the nation's level of development or national reputation (e.g. the advantage of the label "made in Germany") do not constitute an advantage because all national firms benefit more or less equally from them. In international competition, however, these attributes are subject to tremendous differences between nations and can therefore become potent sources of competitive advantage at the level of firms from different nations, in addition to or separately from the advantages that matter in domestic competition.

Other national characteristics that confer international competitive advantages on the nation's firms include factors such as: hard work, honesty, responsibility, team work, a long-term time frame, civic-mindedness, a concern for quality, the level of education, the level of skills, the level of technology, the availability and quality of managers and engineers, the cost of capital, the nature of the relations between banks and industry,[9] patient shareholders, the quality of the government's support for business, the motivation and quality of the labor force and labor unions, the quality of industry associations, the existence of a good supplier base, plus all the factors that Michael Porter[10] calls the diamond of national advantage. Conversely, significant international disadvantage can also arise from general national characteristics, for example, the inability to work together, a reputation for unreliable delivery, a non-supportive government or banking sector, etc.

These sources of advantage arise at the national level but may manifest themselves more potently in certain industries or sectors than in others -- e.g. the German chemical industry, the Japanese electronics and automotive industries, etc. To describe them as industry-specific is not quite accurate, since features such as the quality of supplier industries or the nature of bank-industry relations transcend individual industries. Moreover, national advantage is a dynamic, historical phenomenon evolving over time. Attitudes, values, dynamism, etc. can change over time. "The present state of the nations is the result of the accumulation of all discoveries, inventions, improvements, perfections and exertions of all generations which have lived before us: they form the intellectual capital of the present human race, and every separate nation is productive only in the proportion in which it has known how to appropriate those attainments of former generations and to increase them by its own acquirements."[11]

The advantages that firms possess in relation to their domestic rivals have usually to do with product differentiation, market positioning, or superior size and financial resources; very large differences in management or technology are unlikely to persist because of the relative ease of imitation. National attributes that confer advantage, on the other hand, are more numerous and subject to bigger and more persistent differences between nations. This means that *in international competition, national collective advantages often play a more potent role than "firm-specific" advantages* (i.e. differences between domestic rivals).

This is borne out by two observations. First, from outside the nations concerned, we refer to the competitive advantage of, say, the German chemical industry or of the Japanese automotive industry rather than to the competitive advantage of Bayer versus Hoechst or of Toyota versus Nissan. Seen from outside, the similarities -- in terms of sources and nature of competitive advantage, modes of and destinations of international operations -- between rivals from the same home nation far outweigh the differences. Second, companies from the leading nations can operate successfully in any part of the world, whereas firms from the newly industrializing economies (NIEs) often fail to operate successfully (other than in the exporting mode) in the U.S. or Western Europe (see Case 2) ; this would suggest that the levels of development in the respective home nations can make a big difference.

Advantage relative to whom?

Earlier in this article I argued that the firm undertaking international operations must possess an advantage or edge relative to indigenous players if the operations are to be successful. Now that the concept of national advantages has been introduced, the reasoning can be further extended. In the target country, the foreign company also needs to have competitive advantages in relation to firms from other home nations, especially when these may be expected to enjoy a superior, privileged or preferential position. Thus, as Case 2 shows, NIE corporations operating in the developing countries need to have advantages relative to the "multinationals" from the US, Japan and Europe. Similarly, an American or Japanese company operating in a former British or French colony need to possess compensating advantages in relation to British or French players. In East Asia, given the scale of the Japanese presence, American and European players need to ask what advantages they have in relation to the Japanese. In big contracts open to international competitive bidding, the winner needs to have an overall advantage relative to all other groups from different nations.

Case 2 Production abroad by NIE companies

Why. Companies based in Hong Kong, Taiwan, South Korea and Singapore (the "newly industrializing" economies) have significant manufacturing and raw material extraction operations in Southeast Asia and mainland China, where they are among the leading foreign investors. The motives are not hard to identify: to take advantage of lower costs of production, to ensure raw material supplies, to supply the local market, in the case of textiles to utilize the host nation's export quotas, to exploit perceived profit opportunities, etc. The competitive advantages relative to indigenous players are also not difficult to understand: the NIEs are at a more advanced stage of development and industrialization than many Southeast Asian nations and mainland China, so that the NIE firms often have more production and management experience than indigenous entrepreneurs, better financial resources, a better understanding of customer requirements in the markets of the advanced Western nations, etc.

The question then arises: what advantages do the NIE firms have, in these host countries, relative to the even more advanced "multinationals" from the US, Japan and Western Europe and who possess even more superior technology, management, financial resources and home country political clout? There are at least 5 kinds of relative advantages which are all transferable in the overseas production mode. First, the product made may be simpler and hence cheaper than those made by advanced country "multinationals". Second, the technology used may be simpler, or more easily adapted to local conditions and local inputs. Third, the plants may be smaller and hence require a lower investment outlay. Fourth, the costs of sending out expatriate staff is usually much lower for NIE firms than for US or European companies. Finally, there is the factor of relative geographical and cultural distance, and, except for South Korean firms, the "Chinese connection" gives the NIE companies an advantage in operating in China and in Southeast Asian countries with important ethnic Chinese minorities, an advantage which is denied to the US, European and Japanese corporations.

Where. The nature of these advantages help to explain not only the rationale for international operations but also their destinations. It is true that, in recent years, NIE firms have been attempting to establish manufacturing or assembly operations in the US and Europe, in part to protect their exports from protectionist measures and in part (as discussed in Case 1 above) to gain access to high technology. However, according to a leading Taiwan businessman: " Most Taiwanese investors who have gone to Europe or the US have failed, while most of those who located in Southeast Asia have succeeded." In Singapore, the chairman of the Economic Development Board (EDB), Mr. Philip Yeo, was quoted as saying: " It is hard for Singapore to go into countries like the U.S. and Europe. We will lose our shirts." In South Korea, Hyundai's automotive assembly operation in Canada has been reported to be operating at just over one third of capacity and to be making losses.

How. NIE companies have been able to manufacture successfully in Asia (and Latin America and Africa) but not in the U.S. or Europe mainly because of the current level of development of the NIEs relative to these target countries, which results in their having transferable advantages in the former group but not in the latter. NIE success in exporting to the US and Europe was based on a combination of lower costs with a certain quality of labor and a certain level of technological, entrepreneurial and managerial capability, but this success did not translate into successful manufacturing in the US and Europe because the lower labor costs were not transferable and because the capabilities were not sufficient in an advanced nation context. To produce successfully in an advanced country, the NIE firm must not only be on a par technically and managerially with local firms but also have some relevant advantages. It is probable that many NIE companies have not yet progressed to this stage. With assembly operations, the advantage of lower costs is partially transferred through the export of the parts and components made in the home base. In Europe, NIE companies often select areas of relatively low wages and confine their operations to assembly or finishing.

In the Southeast Asian and Chinese context, the nature of the NIE firms' advantages preclude licensing and franchising as modes of operations, as there is often no patentable product or process and no recognizable brand name. Instead, exporting, DFI and joint ventures are the preferred modes.

Change. The picture painted above may, however, be in the process of changing rapidly. According to data collated at the Science Policy Research Unit (SPRU),[12] Taiwan and South Korea have both seen massive increases in their US patenting in the second half of the 1980s, similar to that seen by Japan in the late 1950s. This puts them way above other developing nations and suggests that technology in Taiwan and South Korea is now attaining world best practice levels in an increasing number of fields.

TRANSFERRING COMPETITIVE ADVANTAGE(S)

Not all advantages possessed by corporations are transferable abroad. The nature of the advantage is a key determinant of transferability. A monopolistic position, due to preferential government treatment and/or a special regulatory regime, may underlie what appears to be a strong market position and performance in the company's home market, but the monopoly is not transferable abroad, *whatever the mode of international operations*. However, the cash generated at home can be used to buy market share and expertise in foreign countries (see Case 3). Relatively low labor costs, combined with

Case 3 The Hongkong bank: how transferable are domestic strengths?

For years the Hong Kong and Shanghai Banking Corporation (HSBC), now the 12th largest bank in the world in terms of assets, has been determined to diversify its operations and asset base away from Hong Kong, its home base,[13] in order to prepare for all eventualities after 1997 when the British colony reverts to Chinese sovereignty. It has even moved the legal address of the parent holding company to Britain. It is an interesting question to ponder whether and to what extent its domestic strengths (HSBC is the largest bank in Hong Kong) have been transferable to operations outside Hong Kong. HSBC's advantages at home have included a quasi-monopolistic position as the *de facto* central bank, good personal relations with leading tycoons and the ruling class, a style that allowed fast decision-making, and massive cash mountains.

Although HSBC's operations in the rest of Asia have apparently been quite successful, it has had difficulties establishing itself and operating profitably in the markets of the advanced Western nations. Thus it has lost more than US$ 1.8 billion (1,800 million) as a result of its acquisition in the 1980s of Marine Midland Bank of New York State. HSBC then lent Alan Bond, the Australian mogul, US$ 1 billion before his empire collapsed. Subsequently it advanced US$ 750 million to Olympia and York (the Canadian developers of Canary Wharf in London) which then went bust.

With the acquisition in 1992 of Midland Bank in Britain (one of the 4 major clearing banks with branches all over the country) HSBC has reduced its Hong Kong exposure to only 31 percent of its total assets. However, the home base still generates a disproportionate 77 percent of profits (in 1992). This would suggest that the bank is more successful, more competitive at home than abroad. Without the cash mountains earned in Hong Kong, however, the foreign ventures would never have been possible. Thus initially these cash mountains were the transferable competitive advantage. Over time, and with the massive investments in acquiring experience and in adopting new information technology, HSBC may develop real competitive advantage in some of its foreign markets in advanced Western nations.

adequate technological and managerial capabilities, is an advantage that can only be transferred abroad by producing at home and exporting the product in which the advantage is embodied; it is not transferable in the foreign manufacturing mode of operations (though it is partially transferable in the foreign assembly mode, as discussed in Case 2).

A new product is an advantage that can readily be transferred through licensing or DFI in foreign assembly/manufacturing, whereas *care* and *skill* in making *quality* products depend much more on the quality and organization of the workforce and are much more difficult to transfer abroad. This is probably a major reason why American corporations have a higher propensity to manufacture abroad or to license, while German and Japanese firms show a stronger preference for exporting.

Again, the choice between greenfield sites and the takeover of existing firms and facilities may be dictated by the nature of the advantage -- pre-existing facilities will not allow the transfer of a revolutionary technology, but acquisitions may facilitate the transfer of advantages such as brand-names, marketing skills and financial strength, especially in mature products.

Transferability of advantage depends not only on the nature of the advantages and the mode of international operations, but an advantage is no longer relevant (i.e. is no longer an advantage) if it does not "fit" with the conditions pertaining to the target countries. It is no good exporting luxury or high performance products to very poor and backward countries. It is no good transferring sophisticated production to under-developed countries that lack the human and physical factors of production. Reputation is usually a transferable advantage. but this may be nullified in certain countries by inadequate copyright and patent protection or ineffective prevention of counterfeiting.

It is important to bear in mind that. even when advantages are transferable. their effective transfer to target countries often requires effort, commitment, investment, time and creative adaptation: i.e. transfer is usually neither automatic nor easy. Effective transfer of technological and managerial advantages may require prolonged training of local staff as well as frequent travel by senior personnel from the home base. Effective transfer of a reputational advantage may require sustained promotion and advertising as well as adapting the product and its image. Transferring a good product may require modification of the product's features as well as the provision of good local technical support and service. As Case 4 demonstrates, sometimes the sources and ingredients of the advantage have to be reconfigured.

Case 4 Hong Kong hotels: transfer of advantage is not straightforward

Because of its geographical location and position as a regional business and financial centre, Hong Kong has developed a world class hotel industry. After successfully transplanting operations to the rest of Asia and to Australia, leading Hong Kong hoteliers such as the Peninsula, the Mandarin, the Regent, and Park Lane are now establishing operations in New York, San Francisco, Beverly Hills and London, often by purchasing existing hotels. Acquiring and renovating existing hotels, or building new ones, may simply be a matter of financial muscle which was not in short supply, but it has been more difficult to transfer the quality of service, which is arguably the hoteliers' most important competitive advantage. In Hong Kong one major ingredient of this quality is a relatively high ratio of employees to rooms, but in the US and Britain labor is much more expensive so that the ratio can simply not be replicated. So other methods have to be used to transfer the quality of service: rigorous in-house training of staff, recruitment of younger and more enthusiastic staff, higher standards of service than the local norm, larger rooms and more luxurious bathrooms, etc. However, transferring top-quality service is not easy, as " you can't bring Hong Kong to the US."

Thus, transfer of advantage depends on the transferability of the advantage and on making the effort to effect the transfer. Transferability depends on the nature of the advantage, the mode or combination of modes of operations, and the fit with target country conditions. A simple corollary is this: *the nature of the advantage and the firm's strategy determine the mode of operations and the choice of locations*. Case 5 exemplifies how these factors are inter-related.

Case 5 Japanese automotive manufacturers: how and where to transfer lean production?

There is a controversy as to whether the Japanese lean production system, of which "just in time" is only a facet, is transferable to advanced Western societies. On the one hand it is pointed out that there are Japanese automotive "transplants" in the US and in the UK and that these are operating successfully and that, moreover, Ford has been learning lean production techniques from Mazda and General Motors from Toyota through their jointly owned NUMMI plant (Fremont, California). On the other hand it is argued that lean production is not just a matter of techniques and that its successful functioning depends on the social context, which cannot be reproduced easily in the Western environment. Be it as it may, it is instructive to examine how the Japanese companies have tried to transfer lean production and how this links up with the locations and modes of their international operations.

Traditionally the Japanese automotive firms preferred to export from Japan, where the quality of the labor force and of suppliers was assured. They turned to local assembly and/or production largely because of the fear of protectionist measures. The USAwas their largest export market, followed by Western Europe, and Britain was seen as a convenient gateway to the European Community (EC) market. What is interesting to note is that, within the US and the UK, the Japanese firms have located on greenfield sites and away from traditional automotive centres. In the US, Nissan located its plant at Smyrna in Tennessee; Honda at Marysville, Ohio; and Toyota at Georgetown, Kentucky. In the UK, Nissan located at Washington in the north east of England; Honda at Swindon; and Toyota at Derby. Why? The most important reason, according to the CEO of one of the transplants, was to "stay away from the bad, old habits". Additionally, there would be no strong labor union to contend with, wage rates could be lower than in established automotive centres, the labor force more malleable, and there would be local investment incentives. The greenfield sites are explained by lean production's need for new layout, equipment and work stations.

The Japanese have also discovered that a joint venture with an established local manufacturer may not allow full transfer of lean production. Honda has had two joint ventures with Rover in Britain, to develop the Legend/Rover 800 and the Concerto/Rover 200. Honda technology was difficult to transfer because Rover engineers often had a contrary viewpoint and lean production did not materialize because of Rover's "archaic" practices.

The lean production system requires a certain kind of working relationship between the automotive manufacturer and its suppliers. Transfer of lean production to the US and the UK has meant that the automotive companies have had either to educate local suppliers to Japanese ways or encourage their suppliers back in Japan to establish plants close to their US or UK operations. It appears that the transfer of lean production will be a lengthy process.

IMPLICATIONS FOR PUBLIC POLICY

Since the focus of this article is on firms, I shall make only two points here. A national firm with international operations may well be one of us, as I argued earlier, but "we" often seem to be unhappy when it invests and employs people abroad. In all probability, investment abroad is healthy if it goes hand in hand with domestic upgrading and progress so that it is the less productive, lower value-added jobs and activities that are moved abroad. Furthermore it is often not possible to penetrate foreign markets effectively ;and on a sustainable basis without at least some investment in sales and servicing operations -- the much publicized amount of intra-company trade between nations could be due as much to DFI in this as to DFI in assembly and manufacturing abroad. On the other hand, DFI that transfers the more productive jobs and activities to other nations indicates that there is something terribly wrong with the company or the home nation or both.

The central theme of this article is that the international operations of national firms require competitive advantage. What does this mean for the host (recipient) countries of DFI? It is tempting to believe that competitive advantage will be transferred from foreigners, at little cost -- that something can be had for nothing. In fact what takes place locally is the exploitation of the advantage, not its generation and upgrading (which involve activities that require the greatest skill intensity, create the greatest value-added, provide the best-paid jobs and are the least prone to sudden cut-backs). What is shared are the local benefits of making use of the advantage, not the benefits of owning and controlling the advantage.

IMPLICATIONS FOR COMPANIES

1.. It is more useful and conducive to clear thinking to conceptualize in terms of the international operations of national companies than in terms of the "multinational", "transnational" or "global" firm.

2. The three questions to ask are: why? how? and where? It is useful to consider all modes of operations as non-mutually exclusive alternatives that can be combined in many ways. It is not enough to have good reasons or good destinations for going abroad -- the corporation must have transferable competitive advantage relative to indigenous players and rivals from other nations.

3. Transfer of advantage is neither easy nor automatic, but requires effort, investment and creative adaptation.

4.. The nature of the transferable advantage affects the appropriateness of the modes and destinations.

5.. In international (as distinct from domestic) competition, collective, national characteristics can be a more potent source of competitive advantage than "firm-specific" advantages and differences. It would be extremely foolish and short-sighted for companies to be unconcerned about the health and dynamism of their home nations.

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13.I use the expression "home base" rather than "home nation" because Hong Kong is not a nation.

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