# 7. Multinational enterprise strategy for developing countries

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## INTRODUCTION

Firms in developing countries, which have been isolated from the world economy by protectionist policies, may urgently need restructuring after any move towards trade and investment liberalizing policies. Some countries can serve as interesting models of transition, such as Mexico, which prepared for entry into the managed trade of the North American Free Trade Agreement (NAFTA) by a brief period of internal market liberalization and privatization under President Salinas and his predecessor. Today Mexico is developing competitive MNEs with access to the large US 'triad' market, especially in such sectors as cement and glass. The Mexican model is now replacing the self-sufficient Prebisch-type strategies attempted, with unsatisfactory results, by some Latin American countries in the 1960s and 1970s. Mexico's market access policies provide opportunities for domestic firms to develop global best practice technologies and processes, whereas 'shelter-type' strategies do not develop such long-run competitive advantages (Rugman and Verbeke, 1990).

In this chapter, the unit of analysis is the firm and the literature to be incorporated is from business policy and strategy. Virtually all this literature has been developed for analysis of decision-making by managers in 'triad'-based firms. The 'triad' consists of the United States, the EU and Japan. Multinational enterprises with a home base in these triad markets account for over 80 per cent of the world's stock of foreign direct investment (Rugman, 1996a; United Nations, 1998).

The most influential work on strategy from this perspective is that by Michael Porter (1980, 1990). In particular, his 'diamond' framework of international competitiveness demonstrates how a triad-based firm can build upon the four domestic diamond components (factor conditions, home demand, rivalry/market structure and related/supporting activities) in order to enhance the country's international competitiveness. Government and chance also affect competitiveness, but are not central determinants.

According to Porter (1990), the firm is the vehicle through which a country can achieve competitiveness. The company uses the home country diamond as a staging ground to develop new technology, products and processes, and then it exports these on a global basis. In the Porter (1990) framework, inward FDI is not a source of competitive advantage, but outward FDI by strong home-based MNEs is a way to expand to supplement exports from the home country.

These ideas have been modified and adapted to the strategies of firms from small open economies (SOEs) such as Canada, Norway and New Zealand in Rugman (1996b). By SOEs, I mean all 'non-triad' economies (where the triad consists of the huge markets of the EU, United States and Japan). In comparison to the triad markets, all other economies are 'small', including Canada, India, Korea and China (see Rugman, 2000). By definition, all developing countries are 'small' and are also becoming 'open', so the adapted SOE double diamond is particularly relevant to this chapter. Two points are especially important. Firstly, non-triad firms will need access to one or more of the triad markets if they are to have any chance to build up a successful global business. Thus political factors governing market access become vital; especially with the lack of a multilateral investment agreement, which would set rules for national treatment and benefit firms from SOEs seeking transparent and reliable rules for FDI. Secondly, the modern literature on FDI contradicts the Porter (1990) allegation that inward FDI does not promote competitiveness. Rather, it finds that inward FDI serves to transfer technology, increase productivity and employment, and provide overall net social benefits (Dunning, 1958, 1998; Caves, 1996; Rugman, 1981, 1996b; Rugman and Verbeke, 1998).

The literature on strategy for MNEs for both large and small open economies, as well as the FDI literature, has focused on advanced economies. Therefore it is necessary to re-evaluate and apply this literature from the perspective of a firm in a developing country. Some recent work has done this, such as Barclay (1998). She has applied the eclectic paradigm of Dunning (1980) and other FDI models to analyse the strategies of all the MNEs in the three Caribbean countries of Trinidad, Jamaica and Barbados. The interaction between strategy and FDI literature is a rich feeding ground for writers and some of the more useful ideas need to be surfaced.

MNEs, whether foreign or domestic, are not the whole answer, but modern business school research demonstrates that they are usually at the hubs of business networks and clusters of successful industries. The MNE is often a 'flagship' firm and its presence in a cluster offers opportunities for key suppliers and customers to act as intermediaries and partners in the promotion of growth and development (Rugman and D'Cruz, 1997, 2000). The role of government and other parts of the 'non-business infrastructure' is also important, since these too could potentially form partnerships with MNEs and other businesses to develop flagship relationships.

The flagship framework is particularly useful for developing countries since it explicitly incorporates the role of government in facilitating the development of competitiveness. The government sector is included with other services in the 'non-business infrastructure' in the model of Rugman and D'Cruz (1997, 2000). It is possible for agents in the non-business infrastructure to become network partners with flagship firms. However government itself does not act as a flagship, a point also made by Porter (1990). The role of government in facilitating competitiveness is perhaps the most important insight to be drawn from the application of business school research to issues of developing countries.

## A CORPORATE STRATEGY PERSPECTIVE

Business enterprise strategy has been usefully synthesized by Porter (1980, 1990). He suggests (1980) that there are three type of generic strategies: cost, differentiation and focus. A firm can compete on price by being the lowest-cost producer. Internationally, this requires that economies of scale be earned through large worldwide sales, using at least one triad market as a base. For developing countries, firms in the minerals, forestry and energy sectors are positioned as seeking a competitive advantage in cost. However the danger is that sectors like these can become commodities (with no proprietary competitive advantage) rather than products. A second strategy is to differentiate, for example by brand name products. Not many MNEs from SOEs have succeeded here (except perhaps for Hyundai, Samsung, LG from Korea, and Acer from Taiwan). Certainly few SMEs from SOEs have any hope of building global brand recognition. The third strategy, of niching, is used much more by SMEs and other firms from developing countries. But again, achieving a global niche is difficult.

Within the terms of Porter's three generic strategies an 'offensive' strategy would incorporate any of the cost, differentiation or focus strategies. This implies that the managers of the firm use global benchmarks and best available practice across the value chain as reference points for their strategic decision-making. A 'defensive' strategy could be viewed as one which seeks shelter from foreign competition and worldwide best practice, through government protection. This option is assumed to be unavailable, given the market liberalization measures facing SOEs. It is also assumed that government institutions wish to support efficiency-seeking firms with modern offensive strategies, rather than inefficient and protected firms with shelter strategies.

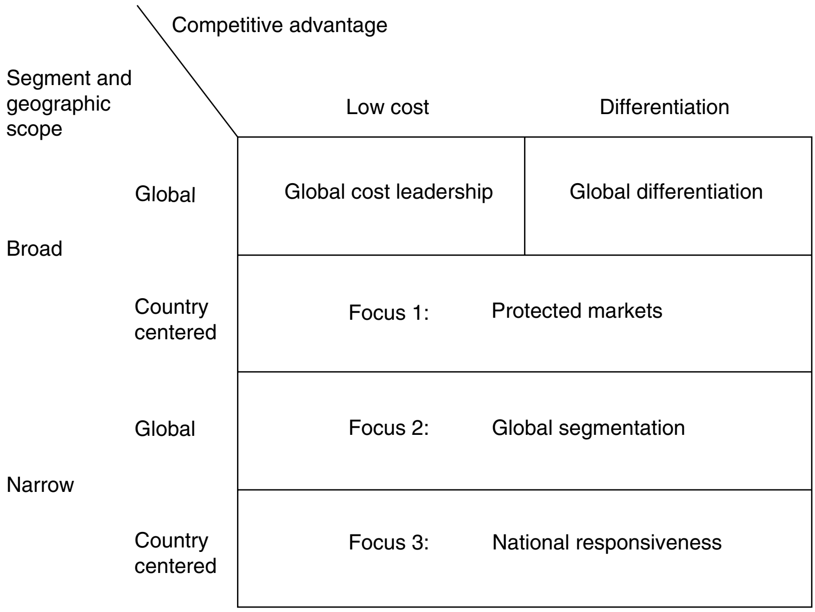
Porter (1980) also advocates the use of entry barriers to maintain competitive advantage. In his 'five forces' model he argues that a firm needs to gain competitive advantage by holding market power over its suppliers, buyers, rivals, potential entrants and potential substitutes. It is a competitive framework where entry barriers are erected by scale, capital (financing) requirements, differentiation, cost of switching from both suppliers and buyers, and government. There has also been extensive discussion in business strategy literature about the nature and relevance of core competencies (Hamel, 1991; Rugman and Hodgetts, 1995, 2000).

With its drivers of competition and strategic entry barriers, Porter's five forces model is basically incompatible with the 'five partners' long-run co-operative framework of international competitiveness, developed by D'Cruz and Rugman (1992a, 1992b, 1993) and Rugman and D'Cruz (2000). It is not necessary to dwell here on the different approaches of these two models, since useful insights into SOE management strategy can be obtained by adapting the Porter (1980) 'five forces' framework into a relevant framework for SOE-based managers. To do this requires that a basic aspect of competitive strategy be modified and extended for developing countries. Porter's three generics must be transformed into truly global strategies, which leads to five generics.

Porter's three domestic generic strategies can be extended to take into account the issue of geographic scope in a global industry. The original three domestic generic strategies have been transformed into a set of five global generic strategies (Rugman and Verbeke 1993a); see Figure 7.1. This is a relabeling of Porter's work, where global cost leadership, global differentiation and global segmentation represent the global versions of overall cost leadership, overall differentiation and focus.

There are two main issues associated with this extension of Porter's five generic strategies framework, as shown in Figure 7.1. First, in practice it is very difficult for managers, especially in developing countries, to identify patterns in decisions and actions which are associated with only one of Porter's types of competitive advantage. The strategic intensity (and related economic performance) of a dual focus on cost leadership and differentiation is much more important than choosing between the pursuit of a cost or differentiation advantage (Reitsperger et al., 1993). For example the three largest automobile manufacturers in the world, General Motors, Ford and Toyota, all pursue a combined cost leadership and differentiation strategy, that is economies of scope are relevant. A dual focus on both cost leadership and differentiation is often required across the various segments of the value chain.

A second issue, and one that is much more important for public policy purposes, is that Porter's strategy of 'protected markets' does not fit with




*Source:* Rugman and Verbeke (1993b).

*Figure 7.1 Rugman and Verbeke's five generic strategies*

his other four strategies. In each of the four other cases (excluding protected markets), cost or differentiation advantages remain important, although as discussed, these do not appear to be mutually exclusive in the cases of global segmentation and national responsiveness. In each of these four cases, efficiency (as measured by relative output–input differentials throughout the value chain) determines a firm's economic performance in terms of survival, profitability and growth. In contrast, as Porter (1986, p. 48) recognizes himself, protected market strategies are not efficient in economic terms, since their choice depends on government behaviour. Thus even the extended framework of five generic strategies is not able to incorporate the protected market strategy properly, despite it being considered as one of the five generics by Porter himself.

A final problem for international management in SOEs is Porter's peculiar treatment of 'national responsiveness'. In defining this he states correctly that a firm aims to 'focus on those industry segments most affected by local country differences' and meets 'unusual local needs in products, channels and marketing practices in each country, foregoing the competitive advantages of a global strategy' (Porter, 1986, p. 48). Unfortunately, he then uses the term 'national responsiveness' to describe the behaviour of 'domestic firms without the resources to become international as well as multinationals who lack the resources or skills to concentrate/coordinate their activities worldwide' (Porter, 1986, p. 48). But properly interpreted, national responsiveness is a strategic alternative to other strategies based on globalization and integration; it builds upon firm-specific strengths (Rugman, 1981, 1996; Baden-Fuller and Stopford, 1991, 1993).

National responsiveness is certainly not the result of a firm's internal weaknesses as Porter alleges (1986). His view is in sharp contrast to most mainstream international business literature, such as Bartlett (1986), Bartlett and Ghoshal (1989) and Rugman and Verbeke (1992a), which describes national responsiveness as a strategy that builds upon location-bound firm-specific advantages (FSAs) and MNEs. The 'administrative heritage' of a firm, which leads to national responsiveness, is just as valuable as one which leads to global scale economies. Porter's definition of national responsiveness is inconsistent with international business literature and is misleading for policy purposes in developing countries. Firms in SOEs should consider national responsiveness as a separate, efficiency-based strategic option on its own merits.

Many authors, including Bartlett (1986), Bartlett and Ghoshal (1989), Doz (1986), Ghoshal (1987), Kogut (1985a, 1985b), Prahalad and Doz (1987) and Roth and Morrison (1990), have established the intellectual foundation that makes a distinction between two fundamentally different types of FSAs. Rugman and Verbeke (1991a, 1992a, 1992b) have developed this framework in some detail. There is an important distinction between location-bound FSAs (LB-FSAs) and non-location bound FSAs (NLB-FSAs). The former benefit a company only in a particular location (or set of locations), and lead to benefits of national responsiveness. In the context of international business operations, these LB-FSAs cannot be effectively transferred as an intermediate output (for example a tangible or intangible asset) or embodied in the final outputs of the organization, to be sold across borders. In contrast, NLB-FSAs are easily transferred and exploited abroad, whether as intermediate outputs or embodied in final outputs. They lead to benefits of integration in terms of economies of scale and exploitation of national differences.

Rugman and Verbeke (1993b) have demonstrated that a firm may actually have several home bases contributing substantially to the development of new FSAs, and improving international competitiveness. More recently, Birkinshaw (1996) has extended this point by research on 'subsidiary initiatives'. It is important to distinguish between the existence of a single home base or multiple home bases, in the pursuit of international competitiveness, because it reflects the impact of the country-specific advantages

(CSAs) of specific locations on strategic behaviour. A single home base implies the dominating impact of one set of national 'diamond' characteristics on the firm's overall competitiveness. In contrast, with multiple home bases, competitiveness both now and in the future depends crucially upon decisions and actions taken in various locations, as well as upon the characteristics of these locations. SOE-based firms need to be in the latter camp; then they can be more 'nationally responsive' to the triad markets.

To the extent that the development and exploitation of NLB-FSAs requires coordination of decisions and actions across borders, a single home base only requires direct, centralized control of all foreign operations. This is unlike the case of a global subsidiary mandate where the 'corporate headquarters' role shifts toward managing a dispersed federation of subsidiaries while ensuring that their strategies are aligned with overall corporate goals. In this case, typical home-base activities are concentrated in the various nations where subsidiaries have received global subsidiary mandates.

## POSITIONING OF ENTERPRISES IN OPEN ECONOMIES

This section bridges the gap between Porter (due to the missing ingredients in his work) and making strategy operational for SOE firms. The missing link discussed here is the nature of truly generic strategies; they are ones which generate efficiency-based rather than shelter-based FSAs. Efficiency-based FSAs can be non-location bound or location bound, where the latter type of FSAs encompass the national responsiveness strategy which is of interest to developing countries.

### Firm-specific Advantages as Generic Strategies

Firm-specific advantages include proprietary know-how (unique assets) and transactional advantages with potential cost-reducing and/or differentiation-enhancing effects. In a number of cases it may be difficult to assess the actual impact of an FSA, in terms of cost reduction or differentiation enhancement. Rugman and Verbeke (1991a) have suggested that in such cases, the contribution of an FSA to a firm's organizational learning should be considered. All strategies that build upon such FSAs or aim to develop new ones can be classified as efficiency based.

In contrast, strategies that do not build upon FSAs to achieve a satisfactory economic performance in terms of survival, profitability, growth or any other goal considered relevant by managers are classified as non-efficiency based or shelter based. If the economic performance of a firm or set of firms does not result from FSAs with cost-reducing, differentiation-enhancing or infrastructure-building characteristics, its performance must result from shelter-based behavior. Many policies in developing countries can lead to such inefficient firm strategies, as is now discussed.

**Shelter-based Strategies**

Shelter-based behavior takes two main forms. Firstly, when firms attempt to impose 'artificial' costs or barriers to differentiation upon (foreign) rivals through government regulation (such as by tariff and non-tariff barriers). Secondly, when firms reduce the market incentives for cost reduction, differentiation enhancement or infrastructure building themselves (for instance by collusive behavior and cartel formation aimed primarily at exploiting the consumer), or limit the potential effects of these incentives (for example by government subsidies). In both cases, such strategies reduce competition and efficiency.

Shelter-based strategies are often pursued in the context of international business and developing countries where firms located in a particular nation may convince public policy makers that protectionist measures will lead to higher output in terms of value added production, or to a special type of public good in terms of the creation of domestic control over strategic sectors, technological spillover effects and so on. This occurs even where such public good may in reality be non-existent, or where shelter leads to a substantial reduction in consumer welfare. Rugman and Verbeke (1991b, 1991c) have demonstrated that such shelter strategies actually subvert policies aimed at achieving a level playing field and fair trade, even in the United States and the EU, let alone in developing countries. In a similar way, recent international economic literature on strategic trade policy is a minor set of mathematical cases under suboptimal conditions with little relevance to reality, and is not the basis for a successful long-run trade policy, as demonstrated by Krugman (1993) and Rugman (1996b).

This distinction between an efficiency-based strategy and a shelter-based strategy is fundamental to strategic management, because each strategy builds upon a different intellectual premise as to what constitutes the source of success. In the case of an efficiency-based strategy, consumer sovereignty ultimately determines whether or not the firm will be successful (except in the case of natural monopolies, few of which exist in an international context). Strong economic performance reflects the successful creation of value for consumers. In contrast, shelter-based strategies reflect behavior that reduces value for consumers.

It is important to distinguish between these two types of strategy because different weapons are used and different rules are followed in each case.

More specifically, SOE firms pursuing a conventional efficiency-based strategy, but faced with shelter-seeking triad rivals, may suffer in the short term, compared with a situation where all competitors are engaged in efficiency-based behavior. In the short term, triad shelter-based behavior will reduce the possibilities for SOE rivals not engaged in such behaviour to exploit their firm-specific advantages or develop new ones. There is a strategic asymmetry in the short term which a national responsiveness policy by SOEs can minimize. In the long term, shelter obviously works against the triad firms that build their economic performance on it. Thus it is always advisable for SOE firms to follow efficiency-based strategies, in both the short and the long term.

Rugman and Verbeke (1993a) have outlined several reasons why shelter-based strategies may fail in the long term, leading to corporate inefficiencies and political dependence. For these reasons, and because of the size asymmetry between SOEs and the triad, it is not useful for SOE-based firms to use shelter as a strategic alternative. Porter's protected market strategy (1986) is both inefficient and irrelevant for SOE managers. Unfortunately, firms from developing countries must compete with triad firms. Managers of firms in developing SOEs must recognize that triad asymmetries exist. Until this is widely understood, much triad, and especially US-based, strategic management thinking will be inappropriate for SOE business. The firm and public policy implications of the asymmetry in power and size of large triad markets versus small developing country markets is explored further in the next section.

## Market Access Issue for SOEs

The brutal reality of global business today is that enterprises in SOEs are in a very weak bargaining position *vis-à-vis* MNEs from the triad. Five major types of enterprises in SOEs must be considered:

- A domestic firms, selling all their output at home
- B local firms, who export a major part of their output
- C local subsidiaries of an MNE, where the MNE exercises head office control
- D local subsidiaries of an MNE, where the MNE operates in a decentralized way, giving local autonomy to the subsidiaries
- E local firms, which become MNEs.

In general, only the last two of these five types of enterprise offer much hope for sustainable development in sovereign SOEs. Yet these are the very types of enterprise structures which are in short supply in developing countries. I know of no example of a type D network-type subsidiary in any developing country, at least in terms of the organizational structure of the largest 500 MNEs in the world, over 85 per cent of which are triad-based. These MNEs tend to develop type D networks across the triad, but not in developing countries.

A similar problem exists for type E enterprises. Other than a few state-owned businesses, especially in the petroleum and mineral resource sectors, only a score of large MNEs come from developing countries. In 2001, only 11 of the Fortune 500 MNEs (which account for over 80 per cent of the world's stock of FDI) were from China, while few others came from other developing countries (see Table 7.1). These Chinese firms have well over 90 per cent of their sales in Asia (Rugman and Verbeke, 2004). One MNE from each of India, Malaysia, Venezuela and Singapore was on the list. Again these are all regionally based. Of the more established newly industrialized countries, Mexico had two, Taiwan two, Brazil four and South Korea six. Overall there were 20 of the world's 500 largest firms from less developed economies (mostly China with 11) and another 15 from the Asian tigers (mostly Korea with 12). But 35 out of 500 is not going to solve the world's poverty problem.

Table 7.1 confirms that the focus of international business is in the triad of the United States, EU and Japan. This has been the situation for the last 20 years. These three blocs are the home base of 85 per cent of the world's largest 500 MNEs, and these MNEs conduct the majority of all their

*Table 7.1 The world's largest 500 multinational enterprises*

| Country | 1981 | 1991 | 1996 | 2001 |
|---|---|---|---|---|
| United States | 242 | 157 | 162 | 197 |
| European Union | 141 | 134 | 155 | 143 |
| Japan | 62 | 119 | 126 | 88 |
| Canada | | 9 | 6 | 16 |
| South Korea | | 13 | 13 | 12 |
| China | | | 3 | 11 |
| Switzerland | | 10 | 14 | 11 |
| Australia | | 9 | 5 | 6 |
| Brazil | | 1 | 5 | 4 |
| Others | 55 | 48 | 11 | 12 |
| Total | 500 | 500 | 500 | 500 |
| Triad Total | 445 | 410 | 443 | 428 |

*Source:* Adapted and compiled from various annual publications of the *Fortune 500* by *Fortune* magazine.

business within their home regions of the triad (Rugman and Verbeke, 2004). In other words, developing countries are not significant players in the FDI game. No amount of wishful thinking or misguided state intervention will change this fact in the near or medium-term future. Therefore the logic of public policies which attempt to develop type D and E enterprises is flawed.

Enterprises in developing SOEs are usually of types A, B and C. Type B firms are the classic resource-based or cheap-labour exporting firms. In all sectors they face declining terms of trade and ever more limited market access to the triad. Again, future prospects are not good, unless niche areas can be found. Despite efforts at trade liberalization through the GATT/WTO process, and preferential treatment for developing countries in such agreements, it is clear that most economic activity is conducted by FDI rather than trade. Multilateral rules for 'deep integration' via FDI have not been developed and the 'shallow integration' achieved by tariff cuts at the GATT/WTO has not helped developing countries bridge the efficiency and managerial gap to the triad leaders. Type C firms are often resource-based or labour-intensive subsidiaries of MNEs. Little transfer of technology takes place and upgrading of skills and managerial practices is minimal. Branch plants are not associated with R&D and rely on the parent's managerial and marketing know-how. Finally, type A firms are often small or medium-sized enterprises and their growth is limited by the relatively small domestic market and its slow growth rate.

Against this gloomy background for business enterprises in SOEs, what prospects are there for development? I do not believe that there is any significant evidence that conventional proposals to tinker at the margins with technology transfers and so on will work. Instead, enterprises in SOEs need to choose between two corporate strategies:

1. become niche suppliers and develop global marketing skills
2. become network partners of MNEs and develop managerial skills.

In option 1, it is necessary for an indigenous firm to find and exploit a niche of no particular interest to a potential rival MNE. Just as the MNEs have the threefold skills of research, production and marketing, so the SOE enterprise also needs to develop these three skills in the niche area. Marketing skills are the most difficult to learn, especially global marketing skills.

With option 2, modern management skills are the critical factor. Managers in developing countries will need MBA-type skills, plus deep practical experience of different countries and cultures, in order to become entrepreneurial network partners in an MNE's decentralized federation. The possibility of doing this is explored at greater length in the 'flagship/five partners' model of international competitiveness (Rugman and D'Cruz, 2000).

## COMPARATIVE STUDIES OF BUSINESS STRATEGY IN DEVELOPING COUNTRIES

Lall (1987) argues that technological capabilities can be classified into the following three categories:

- Investment capabilities: the planning, entrepreneurial and financial assessment skills required to start up a project.
- Production capabilities: the engineering and manufacturing skills to operate, maintain and upgrade the plant.
- Linkage capabilities: the ability to develop networks and maintain supplier–buyer relationships.

The model of the East Asian Tigers has been to use cheap labour and low-technology exports as a basis for shifting competitive advantage towards higher-technology indigenous production. This has been furthered by selected government-determined industrial policies, improving international competitiveness. In this context, the successful development of Korea and Singapore was noted by Porter (1990), although the contribution of government-led industrial policies is still controversial, especially after the Asian financial crisis of 1997–98 undermined the East Asian Tigers.

Wignaraja (1998) finds that the acquisition of technological capabilities by export-oriented firms in Sri Lanka over the 1977–91 period is a mixed bag. Although these firms do not develop new process-centred R&D, or inter-firm linkages, they do upgrade their production capabilities to best practice levels. This has helped to increase and maintain the exports of Sri Lankan garment firms. Wignaraja actually examines firms in three sectors: garment, electronics and light engineering. Across these sectors, the firms tend to acquire investment capabilities 'typically at the simpler end of the technological spectrum' (Wignaraja, 1998, p. 192).

Similarly, few production capabilities are transferred, as Sri Lankan firms concentrate on process modification rather than new product development. Finally, the firms 'display little evidence of inter-firm linkages or linkages with technology institutions and universities' (Wignaraja, 1998, p. 206). The failure of Sri Lankan firms to develop new indigenous products has linked them to a cheap-labour, export-led strategy, making them vulnerable to external changes, such as the abolition of the WTO's Multi-Fibre Agreement (MFA) in 2004.

There would appear to be obvious parallels between the Sri Lankan focus on cheap garment exports under the MFA and the Caribbean banana exporters' reliance on the EU protocol, which has been found to violate WTO procedures. The failure to diversify into other value added production and service activities in Sri Lanka and the Caribbean makes both regimes dependent upon resource-based exports within the quasi-protectionist WTO regime and the EU respectively. As movement towards government trade liberalization takes place following the November 1999 Seattle meetings of the WTO, these SOEs will become more vulnerable to world market forces. However their over-reliance on resource-based exports and their ability to exploit semi-protectionist institutional arrangements is their own choice. International trade and investment liberalization should not be held up by such histories of inefficiency and missed opportunities to develop. Instead SOEs of this type will need to follow the models of Chile and Mexico, absorbing major adjustment costs in order to restructure and reinvest in new, globally efficient businesses.

Barclay (1998) is the first work using the modern theory of international business (IB) which assesses empirically the contribution of FDI to the developing Caribbean economies of Trinidad, Barbados and Jamaica. Based on a full sample of FDI in these three economies, the work is supplemented by expert interviews with managers of foreign-owned MNEs in this area. The findings are also relevant to the smaller economies of the Pacific and Africa, and possibly to the emerging economies of Eastern Europe. All these economies are similarly preoccupied with the benefits and costs of FDI, and most of them lack Barclay's understanding of modern theory.

Barclay includes all the MNEs involved in FDI in the Caribbean in her study. This totals 139 foreign MNEs (in Jamaica, Barbados and Trinidad and Tobago) 25 of which operate in more than one of the three countries. She sent out questionnaires, and also conducted interviews with a large number of managers and other stakeholders. Barclay uses this impressive and comprehensive database to test the modern theories of FDI as they apply in the Caribbean. Of particular interest are her findings on the robust nature of internalization theory (Rugman, 1981) and the eclectic paradigm (Dunning, 1980). She also finds that a version of the 'double diamond' model (Rugman and D'Cruz, 1993) is a very useful explanation of FDI in these three Caribbean countries. Barclay's (1998) is one of the most detailed and rigorous studies published in the field of international business and it sets new standards for research work on the economics of developing nations.

The application of strategic management thinking to the economic development experience of East Asia is well known. As demonstrated by analysts of Asian business systems such as Amsden (1989), Whitley (1992), Gerlach (1992) and Rugman and Boyd (1999), the 'group' system has been the predominant and successful mode. In Japan it is the *keiretsu* system; in Korea, the *chaebol*; in China and the overseas Chinese economies of Singapore and Hong Kong, it is a looser family or clan system of enterprise control.

From the viewpoint of internalization theory, all three systems can be explained by a transaction-cost approach. If internal markets for capital, labour and intermediate products (such as knowledge) are less than perfect, then there is an economic rationale for the firm (or 'group' system in this institutional context) to replace the market. The first writer to apply this Coase–Williamson type thinking to the group system in East Asian countries was Nathaniel Leff (1976). The interesting variance from internalization thinking, which argues that international market imperfections lead to the MNE (Rugman, 1981) is that the groups result from imperfection in internal domestic markets rather than in international ones. The international aspect, in terms of management strategy, comes into play as these groups (in small open economies such as Korea, China or even Chile) seek access to triad markets. This takes us back to the critical strategic issue of asymmetry in market access for SOEs, relative to triad-based MNEs.

I shall now turn to an evaluation of the literature on the economic contribution of MNEs to developing countries. This will help us to make generalizations about the appropriate role of strategic management thinking as it relates to public policy, based on the empirical evidence cited above in this section.

## MNEs AS ECONOMIC ORGANIZATIONS IN DEVELOPING COUNTRIES

A basic premise is that the theory of the MNE applies equally well to MNEs based in developing countries as to those based in the triad. It has been demonstrated elsewhere (Rugman, 1981) that the MNE is explained by internalization theory. Although this statement was made for large triad-based MNEs, it is just as appropriate for the MNEs based in SOEs.

The MNE is a producer of goods and/or services, it employs local workers, it may or may not use local capital, and it markets its output mainly in the host nation. Yet all of these purely economic activities are the result of normal, cost-conscious business decisions; they are not directly related to the economic goals or political aspirations of the host nation. Nor should they be. The MNE is an economic organization, not a social agency. It owes no allegiance to the host nation, or to the home nation for that matter. Its only interest as a good corporate citizen is in keeping a good business partnership with stakeholders such as local consumers, producers and (in today's regulated world) political figures.

Multinational enterprises in SOEs have the same responsibilities to their shareholders as their counterparts in the United States, Europe or Japan. The MNE is obliged to operate in an efficient manner, that is to maximize profits subject to relevant local cost conditions. It can use its internal market to exploit a firm-specific advantage abroad, and it cannot neglect the risks of alternative contractual arrangements when it makes a foreign investment decision. If the host nation chooses to impose regulations on the MNE, this forces the firm to consider alternative locations in order to minimize costs.

The social and political objectives of the host nation, as reflected in its controls and regulations on the MNE, may sometimes force the MNE to an alternative site or cause it to cancel or postpone its foreign investment. To this extent there is a potential conflict of interests between the nation-state and the MNE. Yet the MNE is a regulation taker, not a regulation maker, and its dependence on the whim of local political leaders will make it risk averse in its choice of location. Thus political risk and perception of social, cultural or psychic distance are the major elements in the information cost set of the MNE.

It can be hypothesized that the key firm-specific advantage of MNEs in SOEs lies in resource management. The full array of management skills starts with the choice of cost or niche strategy, but also expands along the value chain to include production and global marketing skills. The traditional reliance on extraction of minerals or harvesting of agricultural products is not enough to generate an FSA. Rather these are country-specific advantages (CSAs), or location factors, in the terms of Dunning (1980). This new FSA builds upon the efficient utilization of technology required for resource-based industries, and links it to sales and marketing skills. Thus the largest set of MNEs is in the resource sector or in a cluster related to this sector. The core skill of the MNE lies in its ability to assemble a package of FSAs in resource management and to use them for worldwide sales, overcoming obstacles placed in the way of distributing these resources. Such obstacles are usually put in place by government regulations, tariffs and non-tariff barriers, effective tax rate differentials and other market imperfections. To match this, market access (and overall marketing and management skills) is critical to the success of firms in developing countries.

Recent management research on the role of MNEs in emerging markets has examined the role of 'groups' in Korea, Chile, India, Indonesia and other countries (Ghemawat and Khanna, 1998). The theoretical basis for this work goes back to the pathbreaking article by Nat Leff (1976) on the nature and organization of groups in East Asia. Taking this on board, and testing it across Korea, is work by Khanna and Palepu (1997). In this study the Korean *chaebols* are found to have emerged due to the market imperfections which existed in South Korea in the 1960s when it was an emerging economy. These imperfections existed in the markets for labour, capital and intermediate goods (such as knowledge). Business groups offer risk-diversification benefits in response to such market imperfections.

This thinking is a straightforward application of internalization theory, as proposed also in Rugman (1981). It is also found in Khanna and Palepu (1997) that the *chaebol* is an efficient organization form and that it has been an engine for the economic development of South Korea. Their findings are also broadly consistent with Amsden (1989) and Whitley (1992), who note that large business groups dominate in the emerging markets of Asia.

Business groups exist not only in Korea, but also in Chile, Indonesia and South Africa. The role of business groups in Chile and India is discussed in Khanna and Palepu (1999a, 1999b). The role of business groups as agents for risk diversification and intermediation has not declined over the 1987–97 period in Chile, nor over the 1990–97 period in India. One interpretation is that, despite movements towards both deregulation (in primary markets) and trade liberalization, many market imperfections remain in these economies, maintaining the need for intermediation by business groups.

One basic part of this work is the finding that the institutional context matters. Economic development does not just depend on economics. The successful business enterprise to emerge will be embedded within the social, political and cultural context of their countries and regions. The profits of MNEs in SOEs are in line with those of MNEs from other home nations such as the United States, Japan and Europe (Rugman, 1981). The distinctive feature of MNEs in SOEs is that they are resource intensive, but their embodiment of this country-specific advantage does not permit them to earn excessive profits.

In the process of operating as MNEs, the firms provide indirect economic benefits to the home country. The economic impact of US multinationals has been studied by many authors. One of the earliest comprehensive studies is that of Bergsten et al. (1978). Frank (1980) extended this work. A similar study by Langdon (1980) examined the impact of Canadian MNEs on developing nations. One of the indirect economic benefits of MNEs occurs in the form of substituting for free trade, which is otherwise denied by tariffs and related market imperfections. In this manner MNEs help the balance of payments. Similarly, there are indirect effects on employment, tax revenues, industry structure, competition and so on. These effects can only be measured by a social benefit cost analysis; yet as I have argued elsewhere (Rugman, 1980), such an analysis itself confuses equity with efficiency considerations.

Internalization theory predicts that the MNEs are transferring their newest technologies overseas through affiliates (where the risk of dissipation is reduced) and using licensing or joint ventures only at a later stage in the life of the technology, when it is becoming a more standard product. Internalization theory also predicts that the newer technologies will go first to developed countries, since they may well be inappropriate or costly to adapt in developing countries. Only at a later stage is it profitable for MNEs to transfer technology to developing nations; yet such transfers do indeed take place and the MNEs' internal market achieves this worldwide transfer of technology without any help from governments (Rugman, 1981).

Traditional economic-based public policy towards MNEs confuses efficiency and equity objectives. The governments of other advanced, and most developing, nations also fall into the same trap, so the North–South debate is in many ways a dialog between the deaf. All governments have a propensity to favour protective devices such as tariffs, quotas, exchange controls, export subsidies and so on for some particular pressure group within their society. In this world of government-imposed market imperfections, the MNE is an organization with enough market power to bypass most of the regulations imposed by governments. Its success in arbitraging the imperfections of national markets is remarkable. The emergence of MNEs in developing SOEs is entirely predicable given the imperfect nature of today's world economy.

Multinational enterprises in developing SOEs are responsible for some alleviation of the loss of world welfare that might otherwise be experienced by the continuation and even extension of protective measures and restrictions by most nations. The MNE is not a complete substitute for free trade, but it is an organization with a remarkable degree of adaptability. The creation of internal markets by MNEs to some extent makes up for the closed markets imposed by restrictive government policies. These efficiency aspects of MNEs represent the underlying focus for their strategic management.

## SUMMARY AND CONCLUSIONS

Readers of this chapter will be struck by the operational paradox of national responsiveness. The asymmetrical strategic framework suggests that SOE managers can rarely achieve success in the triad markets without being nationally responsive, whereas triad managers, on average, can get by without national responsiveness when doing business in SOEs. The reason of course is that triad managers can choose a cost or differentiation strategy and beat the average competitor on a triad basis, virtually ignoring the marginal impact of the SOE economy which is of relatively trivial economic size. A successful triad business rolls out the product across various regions in sequence and it treats an SOE as a minor end-of-production line region. The GATT/WTO reinforce this strong single-diamond, home-base, strategic vision.

None of this is as easy for SOE managers doing business in the triad. While they still need to beat the average competitor on cost or differentiation margins, they also need to overcome discretionary entry barriers to the triad market. Such entry barriers can arise when discriminatory measures are introduced by triad governments, often at the behest of triad-based private sector rivals. Examples are the petitions for the use of WTO trade law remedies against alleged subsidies of Caribbean bananas and related agricultural products.

SOE firms will find it becomes essential to develop a strategy of national responsiveness. Indeed an SOE firm that lives by the Porter cost or differentiation strategy alone will invite retaliation by its triad rivals, and if triad firms lose home market share to a firm from a developing country, then the application of punishing trade laws becomes almost inevitable (Rugman and Anderson, 1987).

A related issue is whether the competitiveness of SOE companies is weakened or enhanced by relocating critical value-chain activities to the triad. Porter (1990) would argue that the core competitive advantage of an SOE company must be drawn from the SOE cluster of the home-base diamond. While it would be theoretically simpler if this could occur, in practice we observe that virtually all SOE resource-based, manufacturing and service companies rely on access to the triad market for the success of their business; for example on average the great majority of sales of resource-based and labour-intensive products occur in triad markets. Given this dependence on the triad markets, the contingent location of production and distribution in the triad, instead of in SOEs alone, can never weaken the performance of SOE firms, given that the alternative is to lose access to the triad market and go out of business.

This is why the neoclassical economics framework of social benefit cost analysis to evaluate FDI process is of limited value from the viewpoint of strategic management. The correct counterfactual is not investment, jobs, R&D spillover, profits or other economic attributes in the triad as opposed to the SOE. Instead, it is a competitive business operating in a home cluster, or across the oceans (in both cases with the majority of sales in the larger triad market), versus no SOE business at all.

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Multinational companies maintain production and marketing operations in different countries. In each country, the business may oversee multiple offices that function through several branches and subsidiariesSubsidiaryA subsidiary (sub) is a business entity or corporation that is fully owned or partially controlled by another company, termed as the parent, or holding, company.Â  Setting up production in other countries, especially in developing economies, usually translates to spending significantly less on production costs. Though outsourcing is a way of achieving the objective, setting up manufacturing plants in other countries may be even more cost-efficient. Due to their large size, MNCs can take advantage of economies of scale and grow their global brand. âž¢ Host country focus strategy. âž¢ Hybrid international strategy. 4. SWOT analysis of MNEâ€™s. 5. Advantages of MNEâ€™s.Â  Structure of multinational enterprises. MNEâ€™s have three different and unique structures (transnational corporations,2011). Horizontally integrated MNEâ€™s: Horizontal integration is a plan where a company manages its production units in different countries to manufacture identical products.Â  Emerging markets is a concept used to define a developing country. It is a country, which is rapidly progressing towards industrialization and globalization (Financial Times) E.g.: India and China are the most attractive emerging market for any business. Developing countries on the rise: 1950 2007 2050. China China India. Developing Country Enterprises. (Alliances and Joint Ventures). Prepared for UNIDO by J. M. de Caldas Lima.Â  The strategies and forms of international business have continuously evolved in the last few decades as a result of continuing progress in technology, liberalization of investment flows, and increased competition among enterprises. The early decades of the twentieth century witnessed the multinational expansion of European companies, such as Unilever, Royal Dutch Shell, ICI and Philips.