Chapter 1

Analyzing American Firms' Market and Nonmarket Strategies in Asia

VINOD K. AGGARWAL[1]

I. Introduction

The Asia-Pacific economies continue to be among the most attractive markets in the world, despite the lingering effects of the regional currency crises of the late 1990s and Japan's continued economic malaise. The track record of the newly industrialized countries, both before and after the crises, China's continued high growth rates, and the widespread regional trend of economic liberalization speak for themselves. But the ups and downs of East Asian markets have forced Japanese, American, and European firms to rethink their strategies. Some firms responded by increasing investments in the region, hoping to snatch up distressed assets that will strengthen their position to profit from renewed growth. Other firms are concerned that excessive reliance on Asia has made them vulnerable. As a result, they have sought to diversify their operations to position themselves in newly emerging markets in Latin America, Eastern Europe, and elsewhere.

This book analyzes the strategic interplay among governments and firms in Asia. By systematically examining the nature of American investment and trade strategies in developing Asian markets across a variety of sectors, and by comparing American firms with European and Japanese firms (in two companion volumes), we hope to understand the factors that affect competitive success.[2]

An important element of firm strategies in Asia is their nonmarket component. Whereas firms must pursue market strategies to position themselves in the global and regional economies, they also interact with governments to secure favorable policies. Firms seek to obtain access to closed or restricted markets for exports and investment, are concerned about regulations on their subsidiaries, and are wary of changing tax policies, among other issues. They often work with both their home and host governments to implement policy changes. At the same time, home and host governments have objectives of their own vis-à-vis both their own and foreign firms, which require firms to negotiate with governments.

From a case selection perspective, our focus on Asia is driven by four key factors: First, East Asian countries provide examples of both extremely high growth rates and markets that have recently suffered severe recession, accompanied by the International Monetary Fund (IMF) and U.S. pressures for liberalization. Thus, a focus on Asia provides an excellent laboratory to analyze shifting firm strategies in times of good and bad economic prospects. Second, developing Asian firms pose a significant competitive challenge to foreign firms in some sectors. Not only do they often have dominant positions in their home markets, but they also have been successful in European and American markets. Third, many Asian firms have close ties to governments. Indeed, the nature of government-business relations is particularly intricate in the Asian context. Most of the newly industrializing countries, both the so-called first and second tier, have actively used industrial policy measures in an effort to bolster their firms' competitiveness. Restrictions on investments, technology transfer, export performance requirements, preferential financing, and a host of other instruments have been commonplace in most of these countries. Fourth, the Asia-Pacific has been one of the most interesting arenas in the world to understand the interplay of different types of institutional arrangements. The mix of different regime forms in terms of bilateralism, regionalism, globalism, and sectoralism is illustrated by the evolution of the recent Information Technology Agreement (ITA). Although this agreement to liberalize trade in a host of information technology products was initially vetted in the Quad group (United States, Canada, European Union, and Japan), it was promoted actively on a sectoral basis in the regional grouping known as Asia-Pacific Economic Cooperation (APEC). It was then globalized in 1996 at the Singapore World Trade Organization (WTO) ministerial meeting and has been accepted by most countries in the world.

This chapter presents the analytical framework and theoretical approach that forms the foundation for the empirical analysis in this volume. My analysis is divided as follows. Section II discusses what I term *positional analysis* -- how market forces, the nonmarket environment, and firm competencies influence firms' choices of trade and investment at the national, regional, or global level. In Section III, we turn to *strategic analysis*, an examination of the choices firms make in response to their market environments, a distributive politics analysis of nonmarket issues, and a transaction cost analysis of organizational forms for market penetration. These elements combine to influence the firm's integrated strategic choice. Once these strategies are formulated, firms can choose from a range of options for implementation. These means of implementation are the subject of the *tactical analysis* presented in Section IV. Tactical analysis considers the market, nonmarket, and organizational tactics that firms pursue to succeed with their chosen strategies. Figure 1.1 provides a roadmap of the analysis that follows in Sections II through IV.

FIGURE 1.1 HERE

As Figure 1.1 indicates, a firm's choice of trade or investment, integrated strategic choice, and implementation efforts can be conceptualized using an analytical model of three "triangles": positional, strategic, and tactical analysis. Each triangle, representing a phase or component of a firm's integrated strategy, includes factors that must be accounted for in its analysis. Moreover, the policy or policies that a firm pursues, along with those with which its competitors respond, can create a cycle of feedback and continued analysis.

II. Positional Analysis: Market Factors, the Nonmarket Environment in Diverse Geographical Arenas, and Core Competencies

Firms operate in both a market and nonmarket environment. Corporate strategists have traditionally focused on the market environment within which firms operate, and on the organization of firms. Traditional market analysis focuses on elements such as an industry's technological profile, the number of major players, the barriers to entry, and so forth. Market analysis of corporate strategy and organization often also covers the internal structures of firms and their implications for competitiveness, the effects of different types of firm organization, the design of incentive systems, and so on.

In addition to these two critical factors—the market environment and a firm's organization—a firm's performance also depends on the social, political, and legal context within which it operates: that is, its nonmarket environment.[3] This includes analyses of key issues, relevant interests, availability of information, and existing institutions, and how they relate to a firm's positioning at the national, regional, or global level. For instance, as American firms decide whether or not to enter developing Asian markets, to increase their investments, or to alter their trading patterns, they must consider the nonmarket characteristics of specific country markets. Their strategies must also be sensitive to the broader regional and global international environment, and especially to the roles played by various relevant international institutions.

These elements provide the basis for the positional analysis of the "triangle" of factors depicted in Figure 1.2.

FIGURE 1.2 HERE

As illustrated in Figure 1.2, positional analysis helps firms define their initial choices of proceeding with a strategy of trade, direct investment, partnership with a local firm, or some mix of strategies in Asia. Before we consider the various elements of this analysis in more detail, we consider the importance of the geographical arena.

Geographical Orientation

Before undertaking market and nonmarket firm strategies, managers must consider the appropriate geographic area for their operations. First of all, firms must focus on the market and nonmarket characteristics of the particular country or countries they plan to enter. This "multidomestic" focus suggests that a firm's analysis must be sensitive to the individual characteristics of different target countries.[4] Regarding a country's market, this involves a consideration of existing and potential competitors, suppliers, and the like. An assessment of a country's nonmarket environment focuses on the types of its existing or potential policies regarding investment, including joint venture requirements, export performance demands, local content rules, technology transfer agreements, and multilateral investment initiatives. In addition, both market and nonmarket environments are shaped by previous political bargains or coalitions, historical precedents, and cultural values.

Increasingly, however, firms must look beyond factors at the country level to those of the regional and global environments as well. Theoretical work on global corporate positioning is quite advanced. However, analyses of regional strategies, both from a market and nonmarket perspective, have been given short shrift. From a nonmarket perspective, the proliferation of regional accords such as the Association of Southeast Asia Nations (ASEAN), APEC, and the European Union (EU) is often accompanied by increasingly tight political or institutional ties. In the most advanced integration project, the movement toward a single European market radically altered market calculations and forced many European firms into mergers or alliances. Firms also began to develop a lobbying apparatus as many aspects of policymaking, at both the European and broader international levels, shifted to the European Commission in Brussels.[5] In the Asia-Pacific Asia, APEC, ASEAN, and the Closer Economic Relations (CER) accord have become important arenas for firm influence, while the institutional policies of these accords affect corporate strategies.[6] The development of these regional institutions means that firms cannot focus only on the policymaking in specific countries but must also be aware of and engaged in policymaking at the regional level.

In particular, two areas of policymaking at the regional level can influence the trade and investment strategies of firms: widening and deepening. The process of widening refers to the accession of new members into existing arrangements. The process of deepening regional institutions entails the enhanced coordination of monetary, fiscal, social, labor, foreign, and other policies. These can include trade policies such as regional content requirements, regional patent protection, regional lobbies, and so on. Obviously, efforts to widen and deepen regional institutions can significantly alter regional market and nonmarket conditions.

Firms can, of course, concentrate on becoming globally oriented and competitive. From a global nonmarket perspective, the arrangements reached in the General Agreements on Tariffs and Trade (GATT) and its successor, the WTO, have greatly influenced firm strategies. For example, the liberalization of specific sectors through the GATT—including tariff reductions and the removal of nontariff barriers—has considerably increased global competition. In the aircraft industry, agriculture, steel, electronics, financial services, and other sectors, firms must take into account the new regulations of the WTO. The Uruguay Round introduced a host of new issues that affect firms, including changes in intellectual property protection, and the linkage between trade and investment through the TRIMs (Trade Related Investment Measures) Agreement. Firms have, of course, been a key driving force in setting the agenda of the GATT and WTO, and have lobbied their governments with specific concerns. For example, financial service firms in the United States were instrumental in putting the issue of financial sector liberalization on the GATT Uruguay Round agenda in 1986, and many information technology firms, the entertainment industry, and pharmaceutical companies actively pushed for the institutionalized protection of intellectual property.[7]

At the global sectoral level, arrangements such as the Multi-fiber Arrangement in textiles and apparel or steel voluntary export restraints have long influenced sourcing and production decisions. These arrangements have coexisted uneasily with the GATT and now the WTO, and pressure has built to eliminate such sectoral arrangements.[8] The latest trend at the global sectoral level, however, is the *opening* of markets.[9] Following the creation of the ITA in 1996, APEC ministers in 1997 agreed to consider nine additional sectors for fast-track trade barrier reduction: chemicals, energy-related equipment and services, environmental goods and services, forest products, medical equipment, telecommunications equipment, fish and fish products, toys, and gems and jewelry. Although firms actively lobbied on all sides of this issue to advance their interests, the 1998 APEC meeting in Kuala Lumpur saw a failure to advance this agenda because of Japanese resistance to liberalizing forestry and fishery products. At this point, the whole package of nine sectors has been shifted to the WTO for negotiations.[10]

When assessing geographically-based strategies, it is useful to distinguish production from marketing orientations, both on a market and nonmarket basis. To graphically illustrate the possibilities, we can briefly consider the nine cells in Figure 1.3, with two extreme points labeled to provide some bearings on strategies.

FIGURE 1.3 HERE

Thus, for example, one could invest in China (national), and simply sell domestically. Or, one could sell throughout Asia (regional), or globally. Or, alternatively, one could invest or set up on a regional basis in several countries in Asia through a trading company or production hub, and then sell only in a single country, to the whole region, or worldwide. Finally, globally-based firms could focus on single countries, a region, or on the global market. Firms must make such choices about their location strategy based on consideration of market forces, their core competencies, and the nonmarket environment. I now turn to a discussion of each of these elements individually.

Market Forces

The most popular analytical approach to market-based decisionmaking is that developed by Michael Porter, based on the vast literature in industrial organization.[11] Porter proposed five specific factors, or the "five forces model." These forces are: (1) rivalry among established firms; (2) risk of entry by potential competitors; (3) threat of substitutes; (4) bargaining power of suppliers; and (5) bargaining power of buyers. These forces also provide a basis for the analysis of what firms face in terms of strategy formulation. Reflecting the second half of the well-known SWOT acronym (Strengths, Weaknesses, Opportunities, and Threats), market analysis examines the opportunities and threats posed by the five forces.[12]

The notion of rivalry among firms refers to the classic issue of market structure, that is, whether the market is atomistic, oligopolistic, duopolistic, or monopolistic. The implications of structure come from the ability of firms to pursue strategy autonomously or from the interdependence that arises in a market with few players. The other two elements of the rivalry concept are demand conditions and barriers to exit. The first of these refers to the growth potential of the industry, and the second concerns the impediments firms face in leaving the industry. In a market with high growth potential, rivalry will be less intense since the game is not zero-sum. Competitive firm strategies can coexist with each yielding success. Attention to exit barriers can improve understanding of why firms might resist exiting a relatively poor market, because of the high costs such a move may entail. Exit barriers can also explain why firms might be more willing to take political action to block the entry of foreign competitors.[13]

The analysis of potential competitors is based on barriers to entry. These barriers include such factors as existing brand loyalty, the cost advantages of various production techniques, and economies of scale that arise from large-scale production.[14] Other factors include the need for extensive capital investments, the cost of switching to another product, and access to distribution channels. Each of these barriers poses an obstacle to entry. Over time, however, these barriers tend to erode, as in the example of the effect of the entry of minimills on the steel industry. Governments may also help their own firms overcome barriers by subsidizing their initial efforts at entry.

The third factor—the threat of substitutes—is straightforward. With few substitutes, firms in an industry will face little competition from outsiders. Finally, the fourth and fifth factors—the bargaining power of buyers and suppliers—are part of the downstream and upstream game of market power. If buyers or suppliers are few in number, their oligopolistic position will allow them to secure better prices when interacting with firms in a particular industry.

Each of these five forces can be analyzed in terms of the opportunities and threats it poses. Put most simply, the stronger the market forces in a particular industry (a highly competitive market structure, low barriers to entry, many substitutes, and buyers and supplies with market power), the greater the challenges facing its firms.

Nonmarket Environment

Just as firms must consider the prevailing market forces, so too must they be concerned about their nonmarket environments. As David Baron has argued, they must understand certain key nonmarket issues: the interests of major groups, the institutional setting within which policies are formulated, and the information available to actors.[15]

Issues can include market-related questions as well as nonmarket problems that may have an impact on market activity. In an international context, and particularly in Asia, issues such as environmental and labor standards immediately raise potential nonmarket problems that can affect a firm's market strategy. Actors respond strategically to these issues in various institutional settings through negotiation, sometimes using tactics of "issue-packaging" or issue linkage. The strategic linking of issues may be based on knowledge (substantive links) or power (tactical linkages). Understanding the basis of a proposed issue linkage is crucial to analysis of its future stability and hence affects the formulation of strategy.[16]

Many analysts take a pluralist view of government-business relations, seeing nonstate actors as competing for government attention. More sophisticated approaches to the relationship between state and societal actors focus on the formulation of the interests of state actors. According to this analysis, institutions are not simply arenas for the political activity of governments, firms, and other nonstate actors; the norms, rules, and practices of institutions also influence the interests of major actors. That is, the motivations and capabilities of state actors both by themselves and within international institutions form an essential part of nonmarket analysis and strategy.

The last factor, information, refers to the commonly accepted bank of knowledge about particular issues. The word "information" as used by Baron is potentially misleading. The key component of the issue packaging and negotiation process is more aptly characterized as "knowledge," implying a certain type of theoretical and causal understanding rather than just an accumulation of facts. In this context, knowledge provides a conceptual framework for the formulation of policy and affects the evolution of institutions. From a strategic perspective, the creation of new knowledge may provide a basis for cognitive agreement among different groups, allowing them to supercede zero-sum competition and enter into a mutually beneficial bargaining situation.

Firm Core Competencies

Much has been written about the factors that contribute to a firm's competitive ability. Our focus in this book is primarily on the external factors of markets and nonmarket environments, rather than on corporate organization or management. Regarding a firm's ability to respond strategically to changing market and nonmarket conditions, most analysts focus on the division between a firm's resources and its capabilities.[17] The term "resources" refers to both tangible and intangible factors, ranging from buildings, plants, and so on, to less tangible items such as a firm's reputation, know-how, patents, and the like. "Capabilities" refers to a firm's ability to use resources in a systematic way to advance its interests, based on its structure and control system.

In terms of analysis, the focus is on considering a firm's strengths and weaknesses. Yet there is considerable debate as to which resources and capabilities constitute strengths—and under what conditions—and which constitute weaknesses. Thus, consultants and business school analysts have attempted to direct attention away from the actual products that firms produce to focus on their capabilities and competencies. The most popular work on core competencies, developed by C. K. Prahalad and Gary Hamel, examines firms in terms of their basic sets of competencies, ones that might be transferred to other areas and products. Rather than focusing on specific resources, core competencies focus on a vaguer sense of capabilities including "communication, involvement, and a deep commitment to working across organizational boundaries."[18] Starting from these core competencies, Hamel and Prahalad argue that firms must then go on to develop core products and organize their business accordingly. This view contrasts with the focus on products made by single business units within an organization that operate in a semi-autonomous manner.

There is much debate in this literature on firm-level abilities, but the basic view is that of the firm as one that is capable of managing structural constraints systematically, rather than being at the mercy of Porter's five forces. Indeed, the literature on corporate strategy has evolved from a rather static picture of firms attempting to fit into the environment within which they are operating to a more dynamic perspective in which firms generate and create market opportunities for themselves.

Hamel and Pralahad, for example, speak of strategic "intent" as opposed to strategic fit.[19] In their view, firms draw on their resources and capabilities to affect their market environments and to position themselves dynamically to enhance their profit potential. To complete the picture, we must also add to these market strategies the manipulation by firms of their nonmarket environments.

Positional Analysis and the Choice of Trade and/or Investment in Asia

Our analysis to this point provides a basis for exploring the decision of firms to enter or increase their presence in developing Asia through either a trade or investment strategy, or some combination of the two. This choice of strategy cannot be interpreted or predicted without a specific analysis of the market and nonmarket environment of the industry in question and the position of the firm in that industry. During the crisis period in the late 1990s, however, in several East Asian markets--but by no means all--weakened domestic firms provided obvious opportunity for rapid market entry. This environment favored a strategy of investment, instead of increasing trade. Favorable exchange rates also encouraged foreign investors to increase their presence in Asia. IMF demands on East Asian countries to reduce their barriers to both trade and investment were an additional stimulus for investment and, to a lesser extent, to increased trade (although exports to East Asia obviously suffered from severely low regional demand).

By contrast, both before and after the crisis period, the determinants of a trade or investment strategy were not so clearly in favor of investment, although some barriers have been reduced after the crisis. Under more normal conditions, the choice of strategy involves a more detailed analysis of the firm's core competencies, as well as the market and nonmarket environment for specific industries. The case studies in this volume provide some insights on these types of decisions on the part of American firms from a range of sectors.

III. Strategic Analysis: Markets, Nonmarket, and Organizational Elements

The choice to focus primarily on trade or investment, based on an integrated consideration of market forces, the nonmarket environment, and firm core competencies, provides a first cut at assessing a firm's overall strategy toward the Asian market. However, firms must face several other issues: (1) What is a firm's market strategy with respect to product cost and quality, the transfer of technology, and which specific market segments to enter? 2) What types of opposition or support is the strategy likely to receive from various nonmarket actors, and how should the firm position itself advantageously? and 3) How does a firm organize its regional or country-level trade or investment operations? Figure 1.4 depicts the components that make up the "strategic analysis" triangle.

FIGURE 1.4 HERE

The following conceptual tools can be applied in analyzing these various strategic dimensions.

Market Strategy and Hypercompetition

Richard D'Aveni's work regarding the transformation of markets into states of hypercompetition can help us understand strategic choices in markets.[20] According to his analysis, firms compete in four different *arenas*: (1) cost and quality, (2) timing and know-how, (3) strongholds, and (4) deep pockets. Traditional analysis suggests that firms position themselves in one of these arenas, in cost and quality, for instance, and attempt to secure for themselves a high-cost/high-quality position. As D'Aveni argues, however, these static positioning efforts are ultimately futile—and with improved technology and global competition, this futility is reached with increasing speed. Thus, as markets evolve, firms must not only reposition themselves continually *within* arenas, but also must be prepared to move vigorously into *different* arenas as opportunities (or threats) present themselves.

In the first arena of competition, firms compete on the basis of cost and quality. In an "ideal typical characterization," firms initially begin with a homogeneous product and compete primarily on the basis of price. As price wars escalate, however, firms begin seeking other means of competition. Eventually, each differentiates itself from its competitors using new dimensions of quality and service. Although some firms try to cover the entire market by offering high-priced and high-quality products as well as low-priced and low-quality products, new competitors still have room to enter at either end by using niche or outflanking strategies.

In order to escape the unending cycle of price-quality competition present in the first arena of competition, firms focus on a second arena of competition, timing, and know-how. First movers who undertake a large investment may seize control of the market. Often, however, their products are easily imitable. To prevent imitation and maintain its control of the market, the first mover often creates barriers to market entry and develops its product in such a way as to make imitation difficult. Eventually, however, competitors do succeed in entering the market and learn to imitate the first mover's product. In response, the first mover may use a strategy of leapfrogging innovations in which new products are developed from large technological advances, entirely new resources, and know-how. While this again impedes the efforts of imitators, eventually they will again catch up to the leader. Again, the first mover will likely attempt a new leapfrog move, and the cycle begins again. According to D'Aveni, it continues until the "next generation leapfrog strategy" is too costly and the cycle becomes unsustainable.[21]

In the third arena of competition, firms seek an advantage on a playing field already leveled by price-quality competition and rapid innovation. They do this by creating strongholds to exclude competitors from their regional, industrial, or product market segments. As discussed by industrial organization theorists generally and Michael Porter in his analysis of five forces, entry barriers that firms create serve to insulate them from the price-quality and innovation-imitation cycles. Yet, in contrast to this somewhat static view of barriers, in hypercompetition, such barriers provide only short-term relief, and are rarely sustainable in the long run. Competitors are likely to build war chests in their own strongholds and then fund their entry into the strongholds of others. Usually, the attacked firm will respond by defending itself and then counterattacking in the initiating firm's stronghold. In the long run, these attacks and counterattacks weaken the stronghold of both firms until no stronghold remains.

In the fourth arena of competition, firms use their "deep pockets" to their advantage. Essentially, firms with the greatest financial resources try to gain an advantage by bullying smaller competitors. Such bullying often includes wearing down and undercutting smaller competitors, who have fewer financial resources and therefore cannot endure in the market as long as the deep-pocketed firm. In response, smaller competitors may develop formal or informal alliances, turn to the government for help, or seek to avoid competition with their powerful competitor. Eventually, after a series of moves and countermoves, the deep-pocketed firm exhausts its resources and its advantage is either substantially diminished or neutralized.

Nonmarket Strategy

When firms pursue a market strategy, they often must deal with nonmarket actors such as labor or environmental groups, or governmental regulatory or deregulatory policies. The "distributive politics spreadsheet" presented in Figure 1.5 provides a schematic breakdown of the supporting and opposing interests involved in a particular nonmarket issue. The figure describes the costs and benefits that accrue to each party from supporting or opposing a particular course of action on an issue that may have consequences for a firm.[22]

FIGURE 1.5 HERE

This figure, based on the well-known literature on interest group politics, provides a means of assessing the likely effectiveness of political actions of groups on each side of an issue. Turning first to the demand side, we can observe the incentives of varying interest groups based on three factors: (1) substitutes, which refers to alternatives available to a particular interest group to engaging in action on the issue at hand; (2) overall magnitude of benefits, which refers to the total benefits that would result from success on an issue; and (3) the per capita benefits, which represents the motivation of a particular interest group based on the direct benefits that its members will receive.

The supply side column presents the power capabilities of the actors in question, focusing on their numbers (how many groups or individuals can be involved), the coverage in terms of relevant political jurisdictions, and the resources that can be brought to bear on the issues. The last element, the cost of organizing, reflects the problems of overcoming collective action in view of the possibility of free riding and information dissemination.

This analysis can be conducted for both the supporting and opposing side on any issue. The definition of the issue-area(s) involved, as well as which groups or individuals should be considered relevant political actors, depends on the problem that is being addressed and the geographical arena in which the interaction occurs. Once defined, this analysis of distributive politics offers a window on a firm's calculations regarding which markets to enter and which integrated market and nonmarket strategies to apply.

Organizational Strategy

The well-developed literature on transactions costs helps to illuminate the organization by firms of their investment or trading activities.[23] In examining contracts and organizational forms, Oliver Williamson emphasizes the importance of bounded rationality, opportunistic behavior by actors, and the problem of highly specific assets to construct predictions about governance structures. According to Williamson, the fundamental problem of contracts is that, given the nature of bounded rationality and opportunism, one cannot be sure that one's counterpart will perform as promised. In such cases, a firm that undertakes investments in highly specific assets is highly vulnerable to exploitation because these assets cannot be transferred to other economic activities without substantial loss.

Witold Henisz has recently applied concepts of both economic and political transaction cost dilemmas to examine how firms might organize their foreign investment activities.[24] Henisz explores how the interaction of contractual and political hazards affects firms' choices. Specifically, he argues that where contractual hazards exist, firms are likely to choose majority controlled plants. These contractual hazards include a high need to invest in specific assets, a concern that technology might be inappropriately used or exploited by a joint venture partner, and free-riding on brand name or reputation.[25] By contrast, in the face of political hazards—which include, for instance, a fear of take-over by a host government—firms are likely to prefer minority investment stakes in which they might be able to use the skills and political standing of their venture partners to mitigate such hazards. The interaction effect of contractual and political hazards turns out to be empirically interesting. Henisz argues convincingly that when both contractual and political hazards are high, firms prefer majority-owned subsidiaries because their joint venture partners might well use the power of the state against them. Henisz's work combines market, firm, and nonmarket analysis in an interesting way.

For our purposes, focusing on contractual hazards provides insight on how firms might organize both their trade and investment activities. Figure 1.6 presents an array of possible organizational forms that vary according to asset specificity concerns and nonmarket factors and hazards.

FIGURE 1.6 HERE

Regarding trade, organizational forms will vary according to the level of concern regarding contractual hazards. Where hazards are perceived to be few, parties are likely to transact at arm's length. Where concern about such hazards is high, firms may choose to organize different operations internally, to ensure compliance. Similarly, for investment, contractual hazards could be mitigated by higher levels of ownership, albeit with the negative costs involved with maintaining a bureaucratically organized firm. Although our primary focus in this book is not on firm organization and structuring, this model provides some insights into firms' organizational responses to market and nonmarket factors.

Integrated Strategic Choice

Firms must make strategic decisions about their positioning with respect to arenas, as well as their positioning within a specific arena. For example, a firm must decide whether or not to concern itself with cost/quality at the national or regional level. From a market perspective, the success of its strategy will depend largely on whether or not there are other entrants, perhaps at the global level. This factor could be controlled through market actions and organizational strategies, thus moving the firm to cost/quality competitiveness in preparation for any competition, even potentially from global competitors. Alternatively, firms may try to insulate the national or regional arena through nonmarket protectionist actions. The decision between investing in market competitiveness versus investing in political activity is one that firms must make on an ongoing basis. To take a concrete example, firms in the telecommunications industry, faced with deregulation and new competition, have tried to position themselves globally both in respect to setting standards (through the CCITT in the ITU) as well as engaging in buy-outs in other countries, alliances, and the like. This has involved positioning themselves for timing (standard setting) as well as in the cost/quality and strongholds arenas.

IV. Tactical Analysis: Implementing Strategy

In order to implement a dynamic strategy successfully, firms must focus on three different tasks. The first is to implement their market strategies through the development and use of their capabilities. The second involves executing nonmarket strategies, both as an adjunct to their market strategies and to create competitive space for a longer-term market strategy. Finally, firms must utilize and restructure their organizations to fit their dynamic market and nonmarket strategies and to position themselves for new opportunities. These tasks are depicted in Figure 1.7.

FIGURE 1.7 HERE

Market Tactics

There are three basic firm tasks in implementing market strategies: research and development (R&D), production, and marketing. When positioning themselves in various arenas (for example, in cost/quality and timing and know-how), firms must decide how best to compete. Thus, if the strategy chosen is to compete with other multinationals using know-how, it is self-evident that emphasis is placed on R&D and therefore a critical question is where such activities might best be pursued. Japanese firms, for instance, have located their design centers for automobiles in the Los Angeles area to take advantage of that region's superior resources and to market autos for the U.S. market more effectively. Or, in choosing to use production networks across a number of Asian countries, European firms must decide where to conduct R&D, and must choose an appropriate market for production to lower their costs without excessively sacrificing quality.

Nonmarket Tasks

Nonmarket problems require a carefully formulated, strategic response. Elements of such a strategy can include lobbying, grassroots activity, coalition building, testimony, political entrepreneurship, electoral support, communication and public advocacy, and judicial strategies. For the most part these are self-explanatory. Grassroots activities refer to efforts to generate broad public support in order to influence office holders. Political entrepreneurship means an active effort to shape a political agenda to benefit the interests of the firm. Examples of this tactic include negotiations for more open market policies in Japan, putting intellectual property issues on the GATT agenda in the Uruguay Round, and the promotion of liberalized trade arrangements such as NAFTA. In most cases, entrepreneurship of this type will involve the building of coalitions with like-minded firms as well as various other tactical efforts to affect the agenda setting process.

Organizational Tactics

Having chosen an appropriate form of trade or investment in light of transaction costs considerations, firms must structure their organization and management to succeed in their chosen market arena. Wholly-owned subsidiaries require knowledge of sourcing partners and personnel who understand local markets and who can deal with host governments. In the case of a firm that enters with a local partner in a joint venture, some of these tasks could be shifted to the local level, to take advantage of its local network and expertise. In such cases, however, skill in organizing and managing joint ventures with respect to contracting, financing, and control are essential.

Similarly, with respect to trade strategies, firms must organize themselves to maximize their competitiveness. Sears' failed effort to compete with Japanese trading companies illustrates the challenges of operating in highly competitive markets, and the need for organizational skill and learning.

With respect to nonmarket strategies and tactics, firms must develop their abilities to interact with governments, nongovernmental organizations, and other interest groups. Firms that concentrate only on market issues and attempt to outsource nonmarket tasks often suffer as a result of their neglect of this aspect of their integrated strategy.

V. The Layout of the Book

American firms, for the most part, have been successful in competing in developing Asian markets. The contributors to this volume provide us with insightful analyses of a host of examples of successful strategies—both of the market and nonmarket variety, along with organizational strategies and tactics.

In Chapter 2, Shujiro Urata provides an analysis of recent trends in U.S. trade and foreign direct investment in Asia to sketch the context for the case studies that follow. Urata finds that historically U.S. trade is more important than FDI as a percentage of U.S. global trade and investment in developing Asia. He attributes the more central role of trade as opposed to FDI as being driven by U.S. interest in investing in other richer countries, by the restrictions faced by U.S. firms in Asia, and by the lack of U.S. familiarity with the market. Examining more recent data, he finds that U.S. FDI did increase since the mid-1990s, and that the returns on investment on FDI in Asia have been greater than comparable investment elsewhere, thus suggesting continued U.S. increases in investment in the region.

In Chapter 3, Fukunari Kimura discusses the challenges that American accounting firms faced in entering the Japanese market and their strategic responses. The highly country-specific nature of accounting laws and accountant qualification regulations presented significant nonmarket obstacles to the entry of U.S. accounting professionals, and the market environment was characterized by individualistic and small-group relationships with clients. However, by actively supporting international standardization and pursuing strategic alliances with the Big Four Japanese firms, U.S. firms were able to get a foothold in the large, underserved Japanese accounting services market.

In Chapter 4, Kun-Chin Lin describes the learning curve that the U.S. chemical industry experienced in its first decade of serious commitment to Asian markets. The size of the Asian export market, fluctuations in demand, and increasing competition from local producers made the chemical industry realize that Asia could not be marginalized and indeed, was a central part in their global operations. U.S. chemical companies shifted away from their initial strategy of high-volume, low-margin commodity products to higher-margin specialty products, and established cooperative industry associations in the region to promote cohesion and self-governance.

In their discussion of the automobile industry in Chapter 5, Beverly Crawford and Nick Bizouras review the decade from 1985-1995, when North American and European faced huge challenges due to competition from Japan and overcapacity, leading to gluts in domestic markets. During this period, economic growth in Asia led to explosive growth in automobile demand, but here, U.S. and European manufacturers could not leverage their strengths against dominant Japanese automakers who had already spent decades establishing sales and production networks. However, U.S. automakers began to acquire significant positions after 1997, and they argue that the Asian financial crisis provided the opportunity for U.S. firms to bargain for liberalization while increased asset valuation at home enabled them to acquire large stakes in struggling Japanese and Korean firms.

In Chapter 6, Takahiro Yamada reviews the experience of U.S. telecommunication firms in Japan, using the experience of AT&T as a prototypical example. Although the deregulation of the huge Japanese telecommunications market presented a window of opportunity for AT&T, it was unable to convert its initial strategy of arms-length, minority investments in local firms into an established foothold due to unforeseen market circumstances.

Trevor Nakagawa discusses the approach to Asian markets of the U.S. software industry in Chapter 7. Both the market and nonmarket environments have been relatively favorable to U.S. firms, especially in the largest market, Japan, where U.S. software firms were poised to profit from the growing popularity of PC-based computing and their strengths in packaged software while their Japanese competitors were still wedded to producing customized software for mainframes. The growth in Internet-based applications and urgent E-commerce security demands that required sophisticated U.S. software led to favorable government policies towards this industry.

In Chapter 8, John Ravenhill provides the final case study of the U.S. electronics industry in Asia. Here, the U.S. faced formidable challenges from Japanese competitors that had already made significant inroads into electronics markets around the world through superior product design and lower prices. U.S. participation in the electronics industry in Asia has traditionally been for extra-regional production for shipment to third markets. Asian governments were eager for the jobs provided by labor-intensive manufacturing, but the realization of technological transfer and R&D activities in the host country proved more difficult to secure.

The concluding chapter assesses the variety of market, nonmarket, and organizational strategies that American firms have pursued. Based on the theoretical framework, it also draws more general lessons about the combination of strategies that have allowed firms to successfully penetrate Asian markets in the face of changing market and nonmarket conditions.

[1] For comments on earlier versions of this chapter, I would like to thank David Baron, Cédric Dupont, Ralph Espach, Ed Fogarty, Elaine Kwei, Kun-Chin Lin, Trevor Nakagawa, and John Ravenhill.

[2] *Winning in Asia, European Style: Market and Nonmarket Strategies for Success* edited by Vinod K. Aggarwal and *Winning in Asia, Japanese Style: Market and Nonmarket Strategies for Success*, edited by Vinod K. Aggarwal edited by Vinod K. Aggarwal and Shujiro Urata. All three books are being published by Palgrave (New York). The case studies include an examination of software, financial services, aircraft, autos, chemicals, telecommunications, and electronics.

[3] See Baron (2000) for a good overview of nonmarket strategies.

[4] Bartlett and Ghoshal (1989).

[5] Dupont (2001).

[6] For discussion of such influence efforts, see Ravenhill (2001a). For background on APEC, see Aggarwal and Morrison (1998) and Ravenhill (2001b).

[7] Aggarwal (1992).

[8] See Aggarwal, Keohane, and Yoffie (1987).

[9] For a discussion of the dangers of this approach, see Aggarwal and Ravenhill (2001).

[10] Aggarwal (2000).

[11] Porter (1980).

[12] It is worth noting that other analysts have criticized Porter's approach for being excessively structural and unresponsive to firm strategies. This debate, similar to the "Great Man" versus "Forces of History" argument in both political science and history, concerns the plasticity of

structural forces as opposed to the initiative that firms might take to mold the factors themselves.

[13] See Aggarwal, Keohane, and Yoffie (1987).

[14] See Bain (1956).

[15] (2000) The four Is noted here provide a useful but limited first cut to understand the nonmarket environment, as I discuss in the following paragraphs.

[16] See among others, Haas (1980), Stein (1980), Oye (1979) and Aggarwal (1998).

[17] Hill and Jones (1995).

[18] (1990), p. 82.

[19] (1990).

[20] (1994).

[21] D'Aveni (1994), p. 22.

[22] See the discussion in Baron (2000).

[23] See Coase (1960), Williamson (1985) and (1996), among others.

[24] See the excellent work by Henisz (2000), who draws on Oliver Williamson's work on economic transaction costs and work by Douglass North (1981) and (1999) on political transaction costs to examine organizational form choices for direct foreign investment in the context of possible expropriation.

[25] Klein and Leffler (1981) and Henisz (2000).

References

Aggarwal, Vinod K. (1992). "The Political Economy of Service Sector Negotiations in the Uruguay Round," *The Fletcher Forum Of World Affairs*, vol. 16, no. 1 (Winter), pp. 35-54.

——— ed. (1998). *Institutional Designs for a Complex World: Bargaining, Linkages, and Nesting* (Ithaca, N.Y.: Cornell University Press .

——— (2000). "The Wobbly Triangle: Europe, Asia and the U.S. after the Asian Crisis." In *After the Asian Crises: Perspectives on Global Politics and Economics*, ed. Maria Weber (London: Macmillan), pp. 173-198.

Aggarwal, Vinod K., Robert Keohane, and David Yoffie (1987). "The Dynamics of Negotiated Protectionism," *American Political Science Review*, vol. 81, no. 2 (June), pp. 345-366.

Aggarwal, Vinod K. and Charles Morrison, eds. (1998). *Asia-Pacific Crossroads: Regime Creation and the Future of APEC* (New York: St. Martin's Press).

Aggarwal, Vinod K. and John Ravenhill (2001). "Undermining the WTO: The Case Against 'Open Sectoralism," *Asia Pacific Issues*, No. 50 (February).

Bain, J. E. (1956). *Barriers to New Competition* (Cambridge: Harvard University Press) .

Baron, David (1999). "Integrated Market and Nonmarket Strategies in Client and Interest Group Politics," *Business and Politics* 1 (1) (April).

Baron, David (2000). *Business and Its Environment,* 3rd edition. (Upper Saddle River, NJ: Prentice Hall).

Bartlett, C. and S. Ghoshal (1989) . *Managing Across Borders: The Transnational Solution* (Boston: Harvard University Press). Coase, Ronald (1960). "The Problem of Social Cost." *Journal of Law and Economics* (October), p. 186.

D'Aveni, R. (1994). *Hypercompetition: Managing the Dynamics of Strategic Maneuvering* (New York: The Free Press).

Dupont, Cedric (2001). “Euro-Pressure: Avenues and Strategies for Lobbying the European Union.” In *Winning in Asia*, *European Style: Market and Nonmarket Strategies for Success*, ed. Vinod K. Aggarwal (New York: Palgrave).

Haas, Ernst (1980). "Why Collaborate? Issue-linkage and International Regimes," *World Politics*, Vol. 32, No. 3, pp. 357-405.

Hamel, Gary and C. K. Prahalad (1989). “Strategic Intent,” *Harvard Business Review* (May-June), pp. 63-76.

Hill, Charles and Gareth Jones (1995). *Strategic Management Theory: An Integrated Approach* Boston: Houghton Mifflin.

Henisz, Witold Jerzy (2000). “The Institutional Environment for Multinational Investment,” *Journal of Law, Economics and Organization*, 16(2): pp. 334-364.

Klein, Benjamin and Keith B. Leffler (1981). “The Role of Market Forces in Assuring Contractual Performance,” *Journal of Political Economy* 89, pp.615-641.

North, Douglass C. (1981). *Understanding the Process of Economic Change*. (London: Institute of Economic Affairs).

North, Douglass C. (1999). *Structure and Change in Economic History*, 1st edition. (New York: Norton).

Oye, Kenneth (1979). "The Domain of Choice." In *Eagle Entangled: U.S. Foreign Policy in a Complex World*, eds. Kenneth Oye, Robert Lieber, and Donald Rothschild (New York: Longman), pp. 3-33.

Prahalad, C. K. and Gary Hamel (1990). “The Core Competence of the Corporation,” *Harvard Business Review* (May-June), pp. 79-91.

Porter, M. E. (1980). *Competitive Strategy.* (New York: Free Press).

Ravenhill, John (2001a). “Nonmarket Strategies in Asia: The Regional Level.” In *Winning in Asia, European Style: Market and Nonmarket Strategies for Success*, ed. Vinod K. Aggarwal, (New York: Palgrave).

——— (2001b). APEC and the Construction of Pacific Rim Regionalism (New York: Cambridge University Press).

Stein, Art (1980). "The Politics of Linkage," *World Politics*, vol. 33, no. 1, October.

Williamson, Oliver E. (1985). *The Economic Institutions of Capitalism: Firms, Markets and Relational Contracting* (New York, The Free Press).

Williamson, Oliver E. (1996). *The Mechanisms of Governance* (New York, Oxford University Press).