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Chapter 1

Analyzing European Firms' Market and Nonmarket Strategies in Asia

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I. Introduction

Despite recent currency crises, most of the Asia-Pacific economies continue to be among the most attractive markets in the world and now appear to be recovering rapidly. The previous track record of the newly industrializing countries, phenomenal Chinese growth rates, and widespread economic liberalization testify to this recovery. But the ups and downs of the Asian market have forced Japanese, American, and European firms to rethink their strategies. Some firms have responded by increasing investments in the region, hoping to benefit from a quick economic recovery and the sale of distressed assets that will leave them well positioned to profit from renewed growth in the region. Other firms are concerned that their excessive reliance on exports to Asia has made them highly vulnerable. As a result,

they have sought to diversify their marketing effort and have attempted to position themselves in newly emerging markets in Latin America, Eastern Europe, and elsewhere. The key focus of this book is to analyze the strategic interplay between governments and firms in Asia. By systematically examining the nature of European investment and trade strategies in Asian markets in a variety of sectors, and by comparing European firms with American and Japanese firms (in two companion volumes), we hope to understand the factors that affect competitive success.

An important element of understanding firm strategies in Asia is the nature of nonmarket strategies.[2] Although firms must pursue market strategies to position themselves in a changing global economy, they also interact with governments to secure policies favorable to them. Firms are interested in securing access to closed or restricted markets for exports and investment, are concerned about regulations on their subsidiaries, and are wary of changing taxation policy, among other issues. In attempting to influence policy outcomes, they often work with both their home and host governments to implement policy changes. And at the same time, home and host governments have objectives of their own vis-à-vis both their own and foreign firms. In addition to understanding the strategies employed by European firms, we hope to shed light on two key questions: Do firms' market and "nonmarket" strategies vary more by industrial sector or by national origin? And how do different governments react to the push and pull from firms of different national stripes?

Our focus on Asia is driven by four key factors. First, East Asian countries provide examples of both extremely high growth rates and markets in severe recession, accompanied by the International Monetary Fund (IMF) and U.S. pressures for

liberalization. As the region recovers from the 1997-98 financial crisis, East Asia provides an excellent laboratory to analyze shifting firm strategies in times of good and bad fortune. Second, many Asian firms pose a significant competitive challenge to foreign firms. Not only do they often have dominant positions in their home markets, but they have been successful in entering 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 (NICs), both the so-called first and second tier, have actively used industrial policy measures in an effort to bolster their firms. 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 forms of governance in terms of regionalism, sectoralism, and globalism. This combination is nicely 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 of countries, 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 discusses the analytical framework and theoretical approaches that form the foundation of the analysis in our empirical chapters. The chapter is divided as follows. Section II examines the nature of *positional analysis* and how market forces, firm competencies, and the nonmarket environment influence the choice of trade,

investment, or some mix, at the national, regional, or global level. In Section III, we turn to *strategic analysis*, consisting of a firm's choices of market strategy, a transaction cost analysis of organization forms of market penetration, and a distributive politics analysis of nonmarket issues. These factors combine to influence the firm's integrated strategic choice. Implementation of this choice based on *tactical analysis* is the topic of Section IV. This section considers the market, organizational, and nonmarket tactics that firms must pursue to succeed with their chosen strategy. Section V reviews the organization of the book and examines the questions explored by the case studies of the software, auto, commercial aircraft, banking, and insurance industries.

Figure 1.1 provides a roadmap of the analysis that follows in Sections II through IV.

FIGURE 1.1 HERE

As indicated in this figure, one can conceptualize the choice of trade or investment, integrated strategic choice, and implementation efforts based on the three "triangles" of positional, strategic, and tactical analysis. In turn, each of these triangles illuminate essential elements that firms must take into account in their analysis. Finally, based on the policies that firms actually pursue (and the policies that potential competitors pursue), a new cycle of analysis may be set in motion owing to feedback from their actions.

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

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. With respect to market analysis, the emphasis has been on such elements as the technological profile of the industry, the number of major players, the barriers to entry, and so forth. In addition to such market analysis, work in corporate strategy and organization has concerned itself with the way firms might be appropriately structured internally to enhance their competitive position. This research includes analysis of the development of different types of firm organization, the design of incentive systems, and so on.

Aside from these two crucial aspects to explain the performance of firms, we must pay attention to the social, political, and legal context within which they operate—in short, their nonmarket environment. With respect to nonmarket forces, the relevant consideration for our purposes is an analysis of issues, interests involved, information, and institutions,[3] particularly based on the firm's positioning, be it at the national, regional, or global level. Thus, as firms initially choose whether or not to enter Asian markets, increase their investments, or alter their trading patterns, they must consider the nonmarket issues involved in their choice with respect to specific countries. At the same time, regional and global issues may affect their strategic initiatives, and the relevant issues and institutions must be incorporated into their analysis.

The elements that we have very briefly considered provide the basis for the positional analysis "triangle" of factors depicted in figure 1.2, which we shall analyze in more detail.

FIGURE 1.2 HERE

As illustrated in figure 1.2, the positional analysis gives firms the initial broad choice of whether to proceed with trade, investment, or some mixture of these in Asia. Before we

consider the various nodes of this triangle in more detail, we consider the importance of geographical arenas.

Geographical Orientation

Whether one undertakes market, firm, or nonmarket analysis, a prior question concerns the appropriate geographical arena. Firms must, of course, focus on the specific country's market and nonmarket characteristics that they plan to enter. This "multidomestic" focus suggests that firms need to consider the individual characteristics of different countries in their analysis.[4] At the market level, this involves a consideration of competitors, suppliers, and the like. At the nonmarket level, the types of policies that can and have been used by Asian and other countries include such things as joint venture requirements, export performance demands, local content rules, technology transfer agreements, and multilateral investment initiatives. In addition, historical political bargains and cultural values entrenched in coalitions in certain countries also affect the environment in which firms interact. Each of these factors must be dealt with on both a market and nonmarket basis.

Increasingly, however, firms must consider not only national arenas of competition, but regional and global ones as well. While the thinking on global corporate positioning is more developed, analysis of regional strategies, both from a market and nonmarket perspective has been given short shrift. From a nonmarket perspective, in a world of growing regionalism that includes regions such as the Association of Southeast Asian Nations (ASEAN), APEC, and the European Union (EU), such developments are often accompanied by region-wide policies. In the most advanced area of integration, the

movement toward a true single European market forced merger of many firms in Europe and altered market calculations. At the same time, European firms also began to develop a lobbying apparatus as many aspects of policymaking, both Europe-wide and internationally, shifted to the European Commission in Brussels. In the Asia Pacific, APEC, ASEAN, and the Closer Economic Relations (CER) accord between Australia and New Zealand have been arenas of firm influence.[5] These arrangements impact corporate strategies and influence optimal policies. This development means that firms cannot simply focus only on policymaking in specific Asian countries and ignore the nature of policymaking at the regional level.

From a market perspective, regional strategies can be crucial. Thus, if production networks are developed on an Asian-wide basis with the intent of targeting global markets, one must undertake appropriate analysis of possible competitors, suppliers, financing, and the like. Or, in trade, firms might choose a global strategy, and incorporate Asia as they would any other region into their strategy.

In terms of trends at the regional level, we can think of two potential policy changes that would influence trade and investment strategies: widening and deepening. The first of these, widening, refers to the accession of new members into existing arrangements. Deepening concerns more intense integration efforts in terms of greater coordination of monetary, social, labor, and even foreign policies. These can include such trade elements as regional content requirements, regional patent protection, regional lobbies, and the like. Both widening and deepening would of course also influence analysis of market strategies at the regional level.

Firms can, of course, concentrate on being globally oriented and competitive. At the global nonmarket level, the arrangements we have seen in the General Agreement on Tariffs and Trade (GATT) and its successor, the WTO, have greatly influenced firm strategies. For example, liberalization of specific sectors through the GATT has led to considerable competition for firms and forced them to become more internationally competitive. This includes both the reduction of tariffs and quotas as well as the removal of other kinds of nontariff barriers. In sectors such as the aircraft industry, agriculture, steel, electronics, financial services, and the like, firms must take into account new regulations and changes in 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 Trade Related Investment Measures (TRIMS) Agreement. The agenda of the GATT and WTO has, of course, been driven by firms who have lobbied their governments with specific concerns. Thus, 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.[6] And many information technology firms, the entertainment industry, and pharmaceutical companies actively sought to develop a set of regulations to protect their intellectual property.

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 pressure has built to eliminate such sectoral arrangements. The new trend at this level is to open markets at the sectoral level. As noted earlier, the ITA was actively promoted in APEC and then became a multilateral agreement at the WTO December 1996 ministerial meeting.

The agreement calls for the phasing out of tariffs on six major categories of equipment, namely computers, some telecommunications equipment, semiconductors, semiconductor manufacturing equipment, software, and scientific instruments. It does not include consumer electronics. In Vancouver at the November 1997 APEC meeting, following up on the information technology agreement, ministers 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. Six remaining sectors—automotive goods, civil aircraft, food, natural and synthetic rubber, fertilizers, and oilseed products—were to be further reviewed for action in 1998. Although firms actively lobbied on all sides of this issue to advance their interests, the 1998 Kuala Lumpur APEC meeting saw a failure to advance this agenda due to Japanese resistance to liberalizing forestry and fishery products. The whole package of nine sectors has since been shifted to the WTO for negotiations.

In thinking about geographical arenas, 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, and simply sell there (national). Or, one could sell throughout Asia, 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 as well, a region, or in the "ultimate" globalization, be "pure global firm." Firms must make such choices about their location strategy based on consideration of market forces, their core competencies, and the nonmarket environment. We next turn to consideration of these elements in seriatim.

Market Forces

The most popular market analytical approach is one developed by Michael Porter based on the vast literature in industrial organization.[7] Based on ideas in this field, Porter proposed five specific factors or the "five forces model." The forces he refers to are (1) the rivalry among established firms; (2) risk of entry by potential competitors; (3) possible threat of substitutes; (4) bargaining power of suppliers; and (5) bargaining power of buyers. The forces also provide a basis for analyzing what firms face in terms of strategy formulation. Drawing on 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.[8]

The notion of rivalry among firms refers to the classic question of market structure, that is, whether atomistic, oligopolistic, duopolistic, or monopolistic. Varying structures directly affect whether firms can pursue autonomous strategies or must take into account the reaction of other firms because of the mutual dependence among actors in the market. The other two aspects within the concept of rivalry are demand conditions and barriers to exit. The first of these refers to the growth potential of the industry while the second concerns the impediments for firms to leave the industry. With greater growth potential, rivalry will be less intense since the game is not zero-sum. Exit barriers help to explain how firms can be

resistant to exit because of high costs. This factor can also explain why firms might be more willing to take political action to resist foreign competitors.[9]

The analysis of potential competitors is based on barriers to entry. These barriers include such factors as existing brand loyalty, cost advantages arising from production techniques, and economies of scale that arise from large-scale production.[10] Other factors include the need for high capital investments, the cost of switching to another product, and access to distribution channels. Each of these barriers poses an obstacle to entry, but over time, these barriers have eroded. For example, in the steel industry, new technologies have allowed minimills to enter the market; in addition, governments may help their own firms overcome barriers to entry by subsidizing their initial efforts.

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—bargaining power of buyers and suppliers—is 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.

As noted, each of these five forces can be analyzed in term of the opportunities and threats that they pose. Most simply, the stronger the forces (competitive market structure, low barriers to entry, easy substitutes, and buyers and supplies with market power), the greater the challenge that firms face in a particular industry.

Firm Competencies

Much has been written about the elements that one must examine to understand a firm's competitive ability. Our focus in this book is primarily on external factors of markets and

nonmarket environments, rather than corporate organization per se. The most popular division is between a firm's resources and its capabilities.[11] Resources, as used by many authors, focus on both tangible and intangible factors. These include such things as buildings, plant and equipment, and more intangibly, reputation, know-how, patents and the like. Capabilities in this context refer to the ability of firms to use resources in a systematic way to advance their interests, based on how the firm is structured and its control systems.

In terms of analysis, the focus is on considering the firm's strengths and weaknesses (part of the SWOT notion). Yet there is considerable debate as to what resources and capabilities constitute strengths (and the obverse, of course, weaknesses). Thus, management consultants and business school analysts have attempted to redirect attention away from the actual products that firms produce to focus on their capabilities and competencies. The most popular work on core competencies, by Gary Hamel and C. K. Prahalad, examines firms in terms of basic sets of competencies that they have developed that might then be transferred to other areas and products. Thus, rather than focus on specific resources, core competencies focus on a more complex set of capabilities that include "communication, involvement, and a deep commitment to working across organizational boundaries."[12] Using these core competencies, they 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 semi-autonomous manner.

Much debate rages in the literature on firm-level abilities, but the basic view is 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 on how firms generate and create market opportunities for themselves.

This line of argument is best represented by the work of Prahalad and Hamel who speak of strategic "intent"—as opposed to strategic fit.[13] Thus, in their view, firms draw on their resources and capabilities to affect their market environment to dynamically position themselves to enhance their profit potential. To this, we must add the need for firms to possibly manipulate the nonmarket environment in which they operate to advantage as well.

Nonmarket Environment

Just as firms must consider their market environment and analyze the threats and opportunities, so too must they be concerned about their nonmarket environment. Specifically, as David Baron has argued, one must understand the issues that are likely to be raised in this context, the interests of major groups, the institutional setting within which policy resolution takes place, and the information available to actors.[14]

Issues can include both market-related questions as well as nonmarket problems that may impact on market activities. In an international context, and particularly in the Asian context, issues such as the environment and labor standards immediately raise potential nonmarket problems that can impact a firm's market strategy. Actors strategically interact on these issues in various institutional settings. In terms of negotiations and bargaining, it is also useful to think about the notion of issue-packaging or issue areas. These packages are linked issues and may reflect either a knowledge basis or power basis. Understanding the basis of issue linkage is crucial to analysis and the formulation of strategy.[15]

With respect to institutions and actors, whereas many analysts take a highly pluralist view of government-business relations, with nonstate actors simply vying for the attention of the government, more sophisticated understandings of the relationship between state and societal actors focus on the interests of state actors. Thus, in this analysis, institutions are not simply arenas where political activity by firms and other actors take place, with institutions as mere receptacles of interaction. In such a view, and one that is pursued in this book, the motivations and capabilities of state actors form an essential part of nonmarket analysis and strategy.

The last factor, information, refers to what is known about issues. The word "information" as used by Baron is potentially misleading, because the most significant question in understanding the nonmarket environment of issues and issue packagings is more aptly characterized as "knowledge," with implications of theoretical and causal understanding, rather than just an accumulation of facts. Knowledge, in this context, provides a key basis for the formulation of policies and will also impact the evolution of institutions. From a strategy perspective, the creation of new knowledge may provide a basis for cognitive agreement among different groups to go beyond zero-sum conflict.

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

Our analysis to this point, then, provides a way of tapping into the broad choice of whether firms will choose to enter or increase their presence in Asia through a trade or investment strategy, or some combination of the two. The choices that countries will make on this dimension cannot be foreseen in general without a specific analysis of the market and nonmarket environment of the industry in question and the position of the firm in that

industry. But as a general observation, one can note that during the Asian crisis, markets in several countries in East Asia—but by no means all—were characterized by weakening domestic firms that provided obvious targets of opportunities. This made an investment strategy more attractive than one based on increasing trade to countries in recession. Moreover, with exchange rates that were highly favorable to foreign investors, it is hardly surprising that many firms in a variety of industries chose to increase their presence in Asia. Additional impetus for investment (but to an extent, for trade as well), came from the need for countries in Asia to follow IMF policies that called for reductions in barriers to both trade and investment.

By contrast, in a non-crisis situation, both before and after the 1997-99 problems, the determinants of a trade or investment strategy would not be so clearly in favor of investment. Under "normal" conditions, then, the choice of such strategy would involve a more detailed analysis of the firm core competencies, as well as the market and nonmarket environment for specific industries. These tasks from an empirical standpoint are taken up in the case study chapters.

III. Strategic Analysis: Market, Organization, and Nonmarket Elements

Choosing to focus primarily on trade or finance—based on an integrated consideration of market forces, firm core competencies, and the nonmarket environment—provides a first cut into the ultimate strategic choice of a firm's policy toward the Asian market. Firms must, however, face several other issues: (1) what should be the nature of a firm's market strategy with respect to product cost and quality, what technology should be transferred, and which

specific market segments might one enter? (2) how might a firm decide what type of organization of trade or investment activities to pursue? and (3) what types of opposition or support will the chosen strategy receive from nonmarket actors? Figure 1.4 depicts the components making up the "strategic analysis" triangle. In each case, we can employ analytical tools to conduct strategic analysis on these various dimensions.

FIGURE 1.4 HERE

Market Strategy and Hypercompetition

To examine strategic choices in markets, we can draw on the work of Richard D'Aveni, who discusses the transformation of markets to one of hypercompetition.[16] In this view, firms compete in four different arenas: (1) cost and quality; (2) timing and know-how; (3) strongholds; and (4) deep pockets. In traditional perspectives, firms position themselves in one of these—say in the cost and quality arena—and might attempt to secure a high-cost/high-quality position. But as d'Aveni argues, all such static positioning efforts are ultimately (and now, more quickly) futile. Thus, firms must continually reposition themselves not only *within* arenas as the market evolves, but also must be continually prepared to move to compete vigorously in *different* arenas.

The first arena of competition is one in which firms compete on the basis of cost and quality. In this arena, 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 the market at the high or low end with either niche or outflanking strategies.

The second arena of competition, timing, and know-how may be one that firms enter or create in order to escape the unending cycle of price-quality competition present in the first arena. In this situation, a first mover can seize control of the market, but this often requires large investment in a product that can easily be imitated by competitors. 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 to this, 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. This makes it more difficult for imitators to succeed in the market, but they do eventually catch up to the leader. The first mover will then seek a new leapfrog move, and the cycle begins again. In D'Aveni's formulation, it continues until the "next generation leapfrog strategy" is too costly and the cycle thus becomes unsustainable.[17]

In the third arena of competition, strongholds, firms seek an advantage on a playing field that may already have been 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, the entry barriers that they 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 firms' 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 turn to their deep pockets for an advantage. Essentially, the firms with the greatest financial resources try to gain an advantage by bullying their 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, the smaller competitors may develop formal or informal alliances, turn to the government for help, or step aside to avoid competition with the deep-pocketed firm. Eventually, after a series of moves and countermoves, the deep-pocketed firm has exhausted its resources and its deep-pocket advantage is either completely neutralized or substantially diminished.

Organizational Strategy

In attempting to assess how firms are likely to organize their investment or trading activities, we can draw upon a well-developed literature on transaction costs.[18] 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. The fundamental problem that he notes is that in executing contracts in the context of bounded rationality and opportunism, one cannot be sure if one's counterpart will perform as promised. In such cases, if a firm undertakes investments in highly specific assets, it faces a high potential probability of being exploited because these assets cannot easily be transferred to other economic activities without substantial loss.

These ideas on transaction cost problems have been developed by Witold Hinisz in recent work to examine how firms might organize their foreign investment activities. Focusing on the ideas of both the importance of economic and political transaction costs, Hinisz shows the interaction of contractual and political hazards.[19] Specifically, drawing on his own and others' work, he argues that firms are likely to choose majority controlled plants where contractual hazards exist. 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.[20] By contrast, in the face of political hazards that include a fear of takeover by a host government, firms are likely to prefer minority investment stakes where 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. As Hinisz argues and shows empirically, when both contractual and political hazards are high, firms prefer majority owned subsidiaries because their joint venture partners might use the power of the state against them. This work, then, combines market, firm, and nonmarket analysis in an interesting way.

For our purposes, focusing on contractual hazards provides us with some insights on

how firms might organize both their trade and investment activities. Figure 1.5 suggests a possible array of organizational forms that should vary with asset specificity concerns, ceteris paribus nonmarket factors, and hazards.

FIGURE 1.5 HERE

As this chart suggests, for trade, organizational forms will vary from an arm's length trade where contractual hazards are few to trade wholly within a firm where there is great concern about such hazards. 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, these ideas should provide some insights into organizational responses to market and nonmarket factors.

Nonmarket Strategy

In order to systematically assess the supporting and opposing interests involved in a particular nonmarket issue, we can consider the following "distributive politics spreadsheet" in figure 1.6.[21] This approach divides the benefits and costs to each side from supporting or opposing a particular course of action on an issue that may have consequences for a firm.

FIGURE 1.6 HERE

Based on the well-known literature on interest group politics, this figure provides a mode of assessing the likely effective political action that can be generated by groups on each side of an issue. The demand side looks at the incentives for varying interest groups based on substitutes (alternatives to engaging in action on this issue), the overall magnitude

of benefits arising from success in the issue, and the per capita benefits that specifically speak to the motivation of a particular interest group.

The supply side considers 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, speaks to the problems of overcoming collective action in view of the possibility of free riding and information dissemination. Such an analysis can be conducted for both the supporting and opposing sides on any issue. The definitions of what issue or issue-areas are involved, as well as which groups or individuals should be considered relevant political actors, depend of course on the problem that is being addressed, and particularly on the geographical arena in question.

Integrated Strategic Choice

I have argued that firms must make strategic decisions about the arena in which to position themselves; but they must also decide where to locate within a particular arena. As an example, a firm needs to make a decision as to whether to concern itself with the cost/quality decision at the national or regional level. The success of this policy from a market perspective will depend on the likelihood of entrants, be they domestic or global. This factor could potentially be controlled through market actions and organizational strategies, thus moving the firm to a position on the cost/quality dimension to prepare the firm for severe competition, even from potential global competitors. Alternatively, firms may try to insulate a national level playing field or regional arena through nonmarket protectionist actions. The investment decision in market competitiveness versus

investment in political strength is one that firms must make on an ongoing basis. To take another example, firms in the telecommunications industry, faced with deregulation and new competition, have tried to position themselves globally through setting standards (through the Comité Consultatif International Téléphonique et Télégraphique [CCITT] in the International Telecommunication Union [ITU]) as well as engaging in buyouts in other countries, alliances, and the like. This involves positioning oneself for timing (standard setting) as well as in the cost/quality and strongholds arenas.

To get a better handle on integrated choice, we can briefly consider some examples of how firms combine market and nonmarket strategies. Faced with nonmarket problems such as Japanese banking regulations, European banks worked with their governments to pressure the Japanese to provide reciprocal access to their markets while introducing new types of products to enhance their competitiveness. Similarly, while European firms in the auto industry have attempted to design products that will be attractive to Asian markets, they have also increasingly turned to their home governments to lobby the Chinese in an effort to secure contracts and investment projects in this giant market.

At the broader regional level, the U.S. efforts in APEC and the discussions about a possible East Asian grouping have stimulated broad concern among European firms. In response, these firms helped to push the agenda for meetings between the European Community (EC) and Asian countries in the Asia Europe Meeting (ASEM). This group came together in March 1996 (and has met every two years since then) with twenty-five countries in attendance: fifteen EU members, seven ASEAN members, South Korea, Japan, and China. Of particular note is an agreement to set up an "Asia-Europe Business Forum" to promote greater two-way trade and investment between Asia and Europe. European firms

with strong competitive positions in key industries such as power generation equipment and telecommunications infrastructure have been especially interested in encouraging a dialogue in this area. Finally, we can view Airbus's efforts in Asian markets as both a market and nonmarket response to both market and nonmarket factors. The European consortium has made efforts to compete with Boeing by lobbying European home governments, the European Community, Asian governments, and even the U.S. government. At the same time, Airbus has attempted to enhance the appeal of its products through technological advancements, and specific interfirm alliances in the Asia-Pacific region.

To sum up: these examples provide an illustration of the types of issues that firms have faced and are likely to face increasingly in the Asian region. As they attempt to enhance their competitive position, they are likely to draw upon an array of specific market and nonmarket strategies. The lessons they learn from similar efforts by firms from other countries should prove instructive.

IV. Tactical Analysis: Implementing Strategy

To implement a dynamic strategy successfully, firms must focus on three different tasks. The first is to undertake market strategies through the development and use of their capabilities. A second task involves executing nonmarket strategies, both as an adjunct to their market strategies as well as to create strategic competitive space for a longer-term market strategy. And finally, firms must utilize and restructure their organization to fit with their dynamic market and nonmarket strategies and to position themselves for new opportunities. The necessary tasks are depicted in figure 1.7.

FIGURE 1.7 HERE

Market Tactics

With respect to market strategy implementation, we can focus on three elements of firm tasks: research and development (R&D), production, and marketing. In positioning themselves in various arenas (say cost/quality and timing/know-how), firms must decide how best to compete. Thus, if a decision is pursued to compete with other multinationals using know-how, it is self-evident that emphasis might be placed on R&D. Thus, for example, Japanese firms have located their design centers for automobiles in the Los Angeles area to take advantage of the superior resources in that region and to market autos better in the U.S. market. To take another example, European firms who are focusing on China face the problem of marketing their products to compete with the many other contenders in that increasingly crowded market as firms from many countries attempt to tap into the large domestic market. Or, in choosing to use production networks across a number of Asian countries, European firms must decide where to conduct R&D and choose an appropriate market to lower their costs without excessively sacrificing quality.

Organizational Tactics

With respect to tactics, having chosen an appropriate form of trade or investment in light of transaction costs considerations, firms must internally restructure their management and firm organization to succeed in the market arena they have chosen. Wholly owned subsidiaries require knowledge of sourcing partners and personnel who understand local markets and who can deal with host governments. Some of these tasks could be shifted to a

local partner in a joint venture. In such cases, however, skill in organizing and managing joint ventures with respect to contracting, financing, and control will be necessary. With respect to trade strategies, firms must again organize themselves to compete effectively. The failed effort by Sears to compete with Japanese trading companies illustrates the problems of operating in highly competitive markets and the need for organizational skill and learning.

With respect to nonmarket strategies and tactics, firms must develop skill in interacting with governments, nongovernmental organizations, and other interest groups. This aspect of developing an integrated strategy and implementing one successfully has often been neglected by firms who concentrate only on market issues and attempt to outsource nonmarket tasks.

Nonmarket Tasks

Eight implementation elements for dealing with nonmarket problems are lobbying, grassroots activity, coalition building, testimony, political entrepreneurship, electoral support, communication and public advocacy, and judicial strategies.[22] For the most part, these are self-explanatory. Some may be less obvious. Grassroots activities refer to efforts to generate broad scale public support, with the objective of influencing office holders. Another notion that might be more opaque is political entrepreneurship. This tactic involves the active role of attempting to set a political agenda of relevance to the firm. Examples include efforts to open markets in Japan, putting intellectual property issues on the GATT agenda in the Uruguay Round, and promoting arrangements such as NAFTA. In most cases, entrepreneurship of this type involved coalition building with like-minded firms as well as

the host of other tactical efforts to secure success in this agenda setting process.

V. Layout of the Book

How have European firms fared in Asia? To examine this issue, contributors to this volume examine the strategies of European firms in different industries. To provide a context for this discussion, in Part II of the book, three authors provide a systematic economic and political analysis of the constraints and opportunities facing European firms.

In chapter 2, Shujiro Urata provides an analysis of recent trends in aggregate trade, FDI, and strategic alliances in Asia. Urata finds that European investors have not kept up with their U.S. and Japanese counterparts in terms of the growth in total stock of foreign investment in East Asia. European investors have focused on a few specific countries in Asia, with over 60 percent of European FDI going to the ASEAN-4 and over half of this amount ending up in Indonesia. To explain this uneven performance, Urata reevaluates the factors identified by a 1996 EU-UNCTAD report on impediments to investment in Asia including regulatory regimes, structural characteristics of the economy, transaction costs, government support, investment strategies, and preoccupation with regional integration. He concludes with a discussion of European efforts to overcome such barriers and prospects for increasing investment.

In chapter 3 John Ravenhill outlines the nonmarket context in Asia by focusing on the implications of Asian regional integration efforts for firm strategies. Ravenhill provides a brief summary of the recent evolution of the three major regional groupings in which a number of East Asian countries participate: ASEAN, APEC, and ASEM. In emphasizing the fledgling and weakly institutionalized nature of these groupings,

Ravenhill explores the issue of the appropriate level at which firms might most successfully lobby for market access and benefits.

As a complement to Ravenhill's emphasis on the external Asian nonmarket environment, in chapter 4 Cédric Dupont focuses on the internal domestic lobbying environment within the EU. He devises a decision map to examine potential firm strategies for lobbying in the EU. In particular, Dupont focuses on the appropriate target for lobbying, the most profitable route, and the organizational form likely to yield the highest return. He then turns to an examination of European firms' experiences in a variety of sectors to provide an empirical complement to the analytical structure that he develops.

Part III of the book turns to an examination of European firm strategies in five sectors: software, autos, commercial aircraft, banking and insurance (the final two are covered in a single chapter). Chapter 5, by Trevor H. Nakagawa, explores the performance of European software firms. He finds that European firms have been slow to enter Asian software markets, and in fact have been steadily losing market shares to U.S. firms in their own domestic markets. Nakagawa shows that despite significant aid from their governments, fragmentation and specialization along national, environmental, and functional divisions have hindered European software firms. After exploring the market and nonmarket factors that account for this relatively poor European performance, Nakagawa then considers the cases of three European firms that have been much more successful than the European norm: Systems, Applications, Products (SAP) in Enterprise Resource Planning software, Micro Focus in Common Business-Oriented Language (COBOL) development tools, and Synon in the development of Computer Aided

Software Engineering (CASE) tools. In analyzing the success of these firms, he is able to provide insight into the combination of market and nonmarket strategies that have allowed them to succeed.

The automobile industry, for its part, has seen intense, global competition among European, Asian, and American firms. Among European producers, there have been sharp differences in success, thus providing a ready study of the market and nonmarket factors that are instrumental for auto firms to compete effectively. Chapter 6, by Beverly Crawford and Nick Biziouras, examines the efforts of Peugeot and Volkswagen (VW) in one of fastest growing markets in Asia—China. As they demonstrate, VW implemented a carefully formulated integrated market and nonmarket strategy and was able to establish a strong market position in China, while Peugeot eventually sold its production facilities. They argue that Peugeot's failure can be attributed to inadequate customization of product for local needs, inability to develop a strong distribution network, and failure to cooperate with local authorities. By contrast, VW succeeded with a strong distribution network, first-mover advantage, and the use of local management talent and local components suppliers. Therefore, the VW approach illustrates at least one winning combination of market and nonmarket strategies for success in the Chinese auto market.

Chapter 7, by William Love and Wayne Sandholtz, explores the efforts of Airbus to counter Boeing’s success in Asia. As the fastest growing market in the world and facing no indigenous competitors, Asian markets were a key Airbus target. Indeed, Airbus did succeed in penetrating Asian markets using a strategy that emphasized both market and nonmarket factors. From a market perspective, Airbus sought to develop customer goodwill by lending aircraft and pilots to Asian airlines and focusing on

efficient, high-capacity, technologically advanced planes to deal with the limited supply of landing spots at airports in most Asian countries. From a nonmarket perspective, Airbus relied on "launch aid" from national governments, entered into subcontracting relationships with governments to encourage purchase by their flagship airlines, and pushed European governments to offer technical and developmental assistance to governments whose airlines chose Airbus.

Chapter 8, by Klaus Wallner, examines European service sector firms in Asia. Specifically, he focuses on the strategies and performance of European banks in Southeast Asia and European casualty insurance providers in Japan. Wallner finds that European banks faced greater difficulty in deploying European governmental pressures on their behalf, in marked contrast to American and Japanese banks. However, he shows how, through a combination of direct market and nonmarket strategies, European banks were able to develop their relationship with Asian clients to raise their prospects of securing the corporate bond and investment banking business. By contrast, in the casualty insurance business, European firms were unable to compensate for their relative lack of success in securing government support by deploying market strategies in the face of a highly regulated Japanese insurance market.

The conclusion (Part IV) of the book assesses how European firms have penetrated Asian markets in the face of changing market and nonmarket conditions.

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1. For comments on earlier versions of this chapter, I would like to thank Cédric Dupont, Kun-Chin Lin, Trevor Nakagawa, and Ralph Espach.

2. See Baron (1999) and (2000) for an excellent discussion of nonmarket strategies.

3. These categories are taken from Baron (2000).

4. Bartlett and Ghoshal (1989).

5. See chapter 3 by Ravenhill in this volume.

6. See, for example, Aggarwal (1992).

7. Porter (1980).

8. 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" vs. "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.

9. See Aggarwal, Keohane, and Yoffie (1987).

10. See Bain (1956).

11. Hill and Jones (1995).

12. Prahalad and Hamel (1990), p. 82.

13. Hamel and Prahalad (1989).

14. Baron (2000), pp. 11-15. The four I's noted here provide a useful but limited first cut to understand the nonmarket environment as I discuss in the following paragraphs.

15. See among others, Haas (1980), Stein (1980), Oye (1979) and Aggarwal (1996).

16. D'Aveni (1994).

17. D'Aveni (1994), p. 22.

18. See Coase (1960) and Williamson (1985, and 1996), among others.

19. See the excellent work by Henisz (1998), who draws upon Oliver Williamson's work

on economic transaction costs and work by Douglass North (1981, 1999) on political transaction costs to examine organizational form choices for direct foreign investment in the context of possible expropriation.

20. Klein and Leffler (1981) and Hienisz (1998).

21. See Baron (2000) for discussion of the “distributive politics spreadsheet.”

22. See Baron (2000) for a discussion.

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