A revised version appears as "Lessons from European Strategies in Asia," in Vinod Aggarwal, ed., *Winning in Asia, European Style: Market and Nonmarket Strategies for Success,*(New York: Palgrave, 2001), pp.257-259.

## Chapter 9

# Lessons from European Strategies in Asia

**Vinod K. Aggarwal**

## I. Introduction

Asia has long enticed foreign firms. This region includes many of the world's fastest growing markets, and promises to be a dynamic and fiercely competitive arena for decades to come. The regional currency crises of 1997-1998 complicated but failed to diminish foreign firms' ardor for the region. Both before and after the crises, firms have attempted to devise trade and investment strategies that would give them a competitive advantage over their rivals.

The objective of this volume is to present a novel framework to understand the market and nonmarket strategies that have enabled European firms to win in Asia. From an empirical standpoint, the book explores the political and economic constraints facing firms wishing to enter the Asian region, as well as strategies to secure European governmental support. It also includes a set of case studies of the software, auto, commercial aircraft, banking, and insurance industries to provide a basis for comparing and contrasting how firms in these sectors have attempted to enhance their competitive positions. In many cases, the case study authors have provided valuable comparisons of European firm strategies with American or Japanese firms, thus giving insight into the impact of national origin on competitive success.[1] These sectoral analyses also provide deeper insight into how firms have attempted to build effective relations with governments in the region and their home countries, as well as with regional institutions in Asia and Europe. In doing so, the objective has been to identify the most successful strategies for meeting the unique challenges of Asian markets.

This chapter is organized as follows. Part two begins with a focus on the context within which European firms have operated, concentrating on the economic characteristics of the Asian market and the relative performance of European firms. This section also examines the political institutional arrangements that firms face in both the host and home markets. Part three describes the market and nonmarket opportunities and constraints that prevail in the five sectors covered in this volume. Part four assesses the theoretical and empirical aspects of the strategies and tactics pursued by European firms in Asia. Part five concludes with a discussion of lessons that emerge from the book's analysis and offers directions for future research.

## II. The Political and Economic Context: Competing in Asia

What is the nature of the strategic challenges and opportunities in Asia? In Part two of this book, Shujiro Urata, John Ravenhill, and Cédric Dupont focus on different facets of the political-economic context within which European firms operate in Asia. While Urata is concerned with describing the performance of European firms and the changing Asian market, Ravenhill and Dupont examine the political context of lobbying in Asia and the European Union (EU), respectively.

## The Economic Context

Despite recent ups and downs, the Asian market has been a highly attractive market for investment and trade. As Shujiro Urata notes in chapter 2, much of East Asia has been characterized by phenomenal growth, beginning with Japan in the 1960s. In the 1970s the newly industrializing economies (NIEs), such as Hong Kong, South Korea, Singapore, and Taiwan, experienced rapid growth, followed by a second tier of countries such as Indonesia, Malaysia, and Thailand in the 1980s. This economic growth has been the subject of intensive scrutiny by political scientists and economists. Factors such as macroeconomic policies, education, coherent state policies, and an outward oriented focus are just a few of the factors that have been used to account for this growth. More recently, while some analysts were very critical of the East Asian model in view of the 1997-1998 financial crisis, the rapid recovery of most countries in the region has reinforced the earlier view that these countries have pursued fundamentally sound economic policies. Moreover, the combination of Asian firms facing financial problems and pressures from the IMF to liberalize have created significant opportunities for foreign firms.

In this context, European firms have been drawn to the Asian market. Yet as Urata observes from his empirical analysis, the activities of these firms have been considerably less important in the aggregate than that of American and Japanese firms. For example, in trade, although European exports have kept pace with the overall growth in world trade, in 1998 Asia accounted for less than 5 percent of European exports. By contrast, Europe accounts for just over 15 percent of Asian exports. With respect to foreign direct investment (FDI), although Europeans have increased their aggregate position in Asia, along with the United States and Japan, they have experienced relative declines in FDI flows as intra-Asian investment grew rapidly in the 1990s. More recently, European firms in the aggregate increased their investment, and European banks became leaders in lending to Asia, as Klaus Wallner describes in chapter 8.

What factors account for the generally lower participation of European firms in FDI as compared to their American and Japanese counterparts? Urata argues that both geographical and cultural distance appear to be relevant in explaining patterns of trade and investment. He also comments on a study by the EU and the United Nations Conference on Trade and Development (UNCTAD) that evaluated patterns of European investment. This study identifies several key factors to account for the relative lack of European FDI penetration: the regulatory regime for FDI in Asia, structural characteristics of Asian host countries, transaction costs and economic distance, support from the home government, investment strategies, and preoccupation with regional integration. Of these factors, Urata dismisses the first three, arguing instead that European firms have not had a well formulated strategy particularly as compared to the Japanese and observing that they have been excessively preoccupied with European integration. He also agrees that European government support has not been as forthcoming as in the Japanese case, but he finds this argument to be less compelling. In examining the latter, Urata considers various European efforts to promote economic ties with Asia, and suggests that training programs and information dissemination efforts have yielded some benefits. The most important government-to-government effort, however, has been the Asia-Europe Meeting (ASEM) process—discussed in detail by

John Ravenhill—which brings EU and East Asian officials together in a series of meetings every two years to discuss mutual concerns.

**The Political Context: Lobbying in Asia and the EU**

Although the economic context and market strategies are undoubtedly critical in explaining the success of European firms in Asia, understanding both the host and home environments is essential for the development of nonmarket strategies. John Ravenhill discusses the first of these in chapter 3, focusing on the impact of regional arrangements within the Asian context. The second is addressed by Cédric Dupont in his examination of the political environment in Europe. The strategic approach he presents in chapter 4 provides firms an important roadmap for lobbying in the European Union.

*Regional Arrangements in the Asian Context.* Regional institutions in Asia are much less developed than those of Europe. In focusing on the Association of Southeast Asian Nations (ASEAN), Asia-Pacific Economic Cooperation (APEC), and ASEM, Ravenhill attempts to gauge the extent to which firms should focus on these accords in their lobbying efforts, as opposed to a single-minded concentration on national governments. Beginning with ASEAN, Ravenhill traces the development of these arrangements. He argues that despite the creation of an ASEAN Free Trade Area (AFTA) in 1992, this accord's institutionalization process remains embryonic. The Secretariat is weak, and the only significant avenue of influence for firms appears to be the ASEAN Chambers of Commerce and Industry. Thus, argues Ravenhill, nonmarket strategies in the ASEAN countries are best focused on national member governments rather than the institution itself.

Turning to APEC, Ravenhill notes the close similarity between ASEAN's and APEC's institutional and decision-making structures. He argues that APEC has failed to develop significant independent decision making capabilities, relying instead on relatively ineffective peer pressure and socialization. [2] Finally, he notes that ASEM was developed in response to concerns that European firms were not benefiting from Asian markets as compared to their developed country counterparts. For the most part, East Asian governments saw this as an opportunity to counteract U.S. leverage in Asia. Yet ASEM has had only three official meetings, and business has shown little interest in its dealings. Concluding, Ravenhill suggests that while these institutions may have future promise as a locus of power, in their present state they have little impact on nonmarket strategies. Put simply, firms may wish to focus their limited resources at the level of national governments, at least for the near future.

*Lobbying in the EU.* Regional arrangements in Europe are in sharp contrast to those of Asia. As Cédric Dupont notes, lobbying in the European context is not a simple matter. The complexity of EU institutions poses a challenge to firms that wish to pursue nonmarket strategies. His chapter provides a decision map for firms wishing to negotiate this maze to secure EU support for their activities.

After tracing the evolution of various institutions in Europe, Dupont considers several key elements that influence the choices of firms. First, firms must ascertain whether the Council of Ministers or the Commission share authority in a particular issue area or whether they deal separately with issues. In simple terms, the more developed the legal framework in an issue area, the more important the role of the Commission. Second, firm strategy is based on their aggregate resources; those who are relatively weak are unable to lobby their targets directly. Third, firms with good national connections have the capacity to focus on the Council, or within the Commission can focus on the Commisioner's cabinets. Finally, sectoral cohesion is a key variable: if it exists, even larger firms are tempted to lobby with their counterparts, rather than going it alone. The combination of these factors generates an enumeration of sixteen lobbying strategies and a clear analytical guideline for firms. Dupont also provides a systematic empirical examination of several sectors to demonstrate how firms might in practice go about deciding where to lobby.

## III. Positional Analysis

Before firms can formulate a winning strategy, they must consider not only the broader political-economic context discussed in Part Two, but also the contours of the market in which they operate, their specific core competencies, and the nonmarket factors that affect their business. With respect to each of these three elements, firms must take into account the nature of their activities at the national, regional, or global levels. On this latter score, I suggest in chapter 1 that firms must make decisions about locating their trade or investment operations at the national, regional, and/or global level and also decide on the target market for sales.

To examine the opportunities and threats firms face at these three levels, I suggest in chapter 1 that a good approach to the examination of the nature of markets is Michael Porter's "five forces model."[3] Using this model, the case studies consider the barriers to entry presented by firm rivalry, the potential of new competitors entering the market, threats presented by possible market substitutes, and the bargaining power of suppliers and buyers. The work on firm competencies is also relevant, but considerable debate continues over how one might best examine a firm's capabilities. While this question is less central to the interests of this volume, Gary Hamel and C. K. Prahalad's focus on "core competencies," which entail both tangible and nontangible capabilities, provides a useful entrée into understanding the abilities of firms.[4] Finally, with respect to nonmarket analysis, I consider David Baron's recent work that provides insight into the nonmarket environment of firms.[5] Baron argues that firms must be attentive to possible threats and opportunities arising from the nonmarket environment. Specifically, they must understand the issues raised, the interests of major groups, the institutional setting for policy resolution, and the information available to actors. Because these three sets of factors interact, firms attempting to succeed in the Asian markets must analyze systematically their market, core competencies, and the nonmarket environment in formulating and implementing strategy.

The case studies provide valuable positional analyses of several key sectors in which European firms have competed in Asia. Trevor Nakagawa observes that with the global proliferation of the personal computer and client-server architecture, the market dynamics in the software industry changed dramatically, leaving European software producers behind. Whereas they had succeeded in meeting the specialized needs of local clients with proprietary hardware designs, the new global software market has been marked by extremely rapid growth, increasing returns, open standards, network externalities, and pressure for compatible standards. In this international context, European firms' core competencies were not suited to the packaged mass-market software, and U.S. firms, with both cost and quality advantages, rapidly acquired dominant market shares in both Europe and Asia. However, many European firms found ways to leverage their local expertise by specializing in the lucrative service and systems integration business. However, these firms largely opted out of producing software, preferring to rely on the pervasive U.S. products.

Both Asian host and EU home governments provided important nonmarket contexts for software development in Asia. On the one hand, Asian countries have attempted to promote their own software production through provision of venture capital, the creation of "Software Parks," the organization of standards consortiums, attempts to cope with software piracy, and liberalization efforts to woo foreign firms. Meanwhile, European governments and the EU have created a variety of long-term IT consortia to promote the software industry and bolster the competitive abilities of European firms. Yet as Nakagawa notes, the relatively modest success of these projects seems to be explained by a tendency to focus on large established companies that often lack an export orientation. In short, the combination of these positional factors has left European firms in a relatively difficult position, with the notable exception of SAP.

The Asian auto market has proven highly attractive to foreign firms. As Nick Bizouras and Beverly Crawford note, rapid economic growth in developing Asia, and particularly in China, provide a contrast to the saturated markets in developed countries.

With respect to the market, local Asian suppliers are relatively weak, and consumers are in a relatively poor bargaining position in view of the high demand for autos. There is little threat of substitutes because local public transportation and trains cannot meet the demand for travel in rapidly growing economies. In terms of competition, Japanese firms have dominated most Asian markets, with the exception of China, thus making it the last open frontier. The auto market faces tremendous pressure for consolidation, with transnational mergers such as DaimlerChrysler and other cross holdings increasingly becoming the norm. Moreover, as competition increases, firms have been tempted to subcontract and source globally to reduce costs. Yet this market strategy works against success in China. Their research suggests that local allies are essential in the Chinese market because of an active, interventionist Chinese state that promotes technology transfer and the interests of its own local suppliers. This factor is particularly important in light of the devolution of power in China from the center to the regions. In response, firms must invest in nonmarket capabilities on a broad basis, including ties to local and regional government officials, if they wish to succeed in gaining market access. Those companies that have already developed core competencies in negotiating with authoritarian governments (such as Volkswagen in Eastern Europe) have a competitive advantage in China.

In their case study of Airbus, William Love and Wayne Sandholtz highlight the overriding importance of positional analysis in an industry characterized by high risk, enormous capital investment, and international competition. For Airbus, the Asia-Pacific market is attractive for its rapid growth and for the relative equality of its playing field. The absence of indigenous aircraft manufacturers leaves Boeing as Airbus's only competitor. Because no regional market alone is large enough to provide the large economies of scale necessary for a profitable aircraft industry, Airbus and Boeing compete globally. Failure in the key Asian market could thus have been fatal for the more recently arrived Airbus. Another important element of the market is the high cost and the technology-intensive character of aircraft development and production. Aircraft producers must invest heavily in design, modeling, systems integration, and testing, and must carefully shape their aircraft to meet the specific needs of clients. At the same time, since each airplane model has an extremely long lifetime of production and sales, there is intense pressure to make designs flexible, so that an existing model can be stretched or shortened through modifications in the fuselage section. This is particularly important in Asian markets, because Asian carriers in the coming decades are expected to demand increasingly larger aircraft with greater seating capacities at a faster rate than U.S. or European airlines. Regarding nonmarket factors, the support of home governments has proved extremely important to both Airbus and Boeing. Neither company made a profit over its first two decades of business, but relied instead on government subsidies, grants, export financing, military contracts, tax exemptions, and other tools.

Klaus Wallner describes the financial services industry as facing significant formal and informal barriers in Asian markets. As a result, the foreign market share of Asian financial services markets is very small, with most foreign firms serving compatriot firms in the region. In the casualty industry in Japan, for example, foreign firms had only 3 percent of the market at the beginning of 1999, a figure that had not changed significantly in the 1990s. Asian markets tend to be highly segmented as a result of a history of tight regulation and protection of local, state-connected firms and banks. The economic crisis, while slowing down investment and business in the short-term, has had positive effects for foreign financial services firms in Asian markets. The restricted nature of their involvement kept them largely out of harm's way, and the failure or downsizing of many local banks or security houses presented an opportunity to hire locally connected and skilled employees. Most importantly, the fallout from the crisis generated pressures regionwide for liberalization of financial services, including for the reform of informal banking and corporate networks in South Korea and Japan, and the lowering of formal entry barriers in China.

## IV. Strategic and Tactical Analysis

Armed with the positional analysis of markets, firm competencies, and the nonmarket environment in different geographical contexts, firms are positioned to undertake a set of strategies and implement them to succeed in Asian market. Because strategic and tactical analyses are deeply interrelated and frequently overlap in the case studies, we can examine these two aspects together in discussing our findings.

### Strategic and Tactical Analysis: Review of the Theory

To review briefly, strategic analysis refers to how firms respond to and attempt to manipulate market forces. Efforts to develop market strategies have been analyzed from many perspectives. Particularly helpful is the work of Richard D'Aveni, who argues that firms compete in four different *arenas*: cost and quality, timing and know-how, strongholds, and deep pockets.[6] In the cost and quality arena, firms begin with a homogenous product and compete for market share through price differentiation. As price wars escalate, they must shift their focus to quality and service to gain market share. Timing and know-how refer to the ability of firms to seize control of the market, based on such classic concepts as first mover advantages (or disadvantages) and the innovative character of their products. Strongholds are crucial because they may provide firms with the ability to exclude competitors from particular regional, industrial, or product segments. But in a dynamically changing market, such barriers are likely to erode quickly and firms must seek new strongholds. Finally, the deep pockets arena focuses on the ability of firms to utilize their superior financial resources to discourage weaker competitors.

Organizational strategy considers how firms restructure to compete in light of their positional analysis and choice of market and nonmarket strategy. While this is not a central focus of the volume, key issues include how to organize to compete in trade and investment, based on considerations of transaction cost factors. For example, with respect to investment, should firms attempt to create wholly owned subsidiaries or would a minority owned operation suffice? Market forces and strategies will clearly affect this decision. For example, might a minority owned operation use the home firm's technology to become a competitor down the line? Often, however, a more critical question concerns the nonmarket environment in which firms are operating, including political hazards.

At the level of nonmarket strategy, firms must engage in calculations about their possible supporters and opponents on issues of critical importance for success. These include questions about the demand side (what benefits will different actors receive from success on an issue) and on the supply side (who will be able to generate political action?). These considerations will often influence a firm's decision on market strategy. VW, for example, aggressively pursued local suppliers in China, in large part to ensure it would receive political support from key officials in China.

Turning to tactics, firms must assess their abilities to execute market and nonmarket strategies and build competencies in this area as needed. Market tactics refer to firms' decisions regarding R&D, production, and marketing as they strive to compete in various market arenas. Organizational tactics involve the internal restructuring of their management and organizational structure. Finally, nonmarket tactics concern policies that might be pursued to advance both market and nonmarket strategies. These include lobbying, grassroots activity, coalition building, testimony, political entrepreneurship, electoral support, communication and public advocacy, and judicial strategies.[7]

**The Case Studies: Devising and Implementing Strategies for Asia**

How have firms strategically positioned themselves to win in Asian markets? In the software industry, European firms that had been positioned to compete in national European markets quickly found themselves at a severe competitive disadvantage with the advent of the PC. As a result, U.S. producers were the first to dominate the rapidly growing packaged software segment, which places a premium on the development of low cost, high quality products with short product cycles. The link to hardware producers proved to be a crucial advantage in this market segment, and network externalities reinforced this lead. However, Nakagawa's research suggests that the proliferation of PCs in corporate Europe created a new market opportunity in enterprise resource planning and inter-enterprise software where European local expertise could be leveraged into a comparative advantage. This new demand allowed firms such as SAP and BAAN to leverage their strength in devising customized solutions and services by creating complex standardized packages for multiple industrial users.

To implement their strategy, these firms successfully built alliances in Asia with local and global partners, provided technical training to customers through developing partner academies, and willingly personalized their global solutions across sectors. All of these tactics played to the strength of European firms who had expertise in service and meeting customized demands. A second key niche in Europe arose from the complexity of languages, organizational cultures, and differences in legal and accounting systems. Here, too, firms were able to build on their previous competencies in meeting the needs of large firms. These opportunities have helped to drive large firms such as Olivetti and Groupe Bull to undertake radical restructuring and reorganization to focus on services, components, and telecommunications. Although other European multinationals were the first clientele for these firms, many firms like Sterling and Micro Focus chose to focus on producing packaged software for a global market niche. Their ability to succeed in Asia, however, still remains an open question as suggested by the example of Synon and recent demise of BAAN in late 2000.

From a nonmarket perspective, many European software firms have utilized national and EU funding and support to develop reusable and standardized software products. As noted, however, this has not easily translated into success in Asia. Still, the policies of many Asian governments toward IT industries in general has made for a favorable market and nonmarket environment. This has led to a more nurturing environment for firms with tax breaks, relocation incentives, pre-competitive research grants, and assistance in locating and training qualified local personnel. The variation in openness can be seen in the success that European and other nationals' firms have had in Taiwan and Singapore—which sought to become regional hubs—as opposed to the difficulty they have faced in penetrating markets in Japan and South Korea. In Japan, for example, SAP has successfully advanced its market penetration through a joint venture with Fujitsu and other European firms as an entrée into other Asian countries. European firms that have succeeded in Asia have recognized, however, that a U.S. presence is often necessary. Thus, as Nakagawa notes, in many cases the consolidation of activities and alliances is an essential component of successful entry into Asian software markets.

The lucrative but highly competitive Chinese market provides a key battleground for auto firms. Although by the mid-1990s the Japanese had made inroads in most of Asia, China was still a relatively untouched market. The key challenge for all firms was to develop both market and nonmarket strategies in view of the many nonmarket hazards in China. To understand this integrated strategy, Biziouras and Crawford compare the entry and relative degrees of success of two key European auto firms, Peugeot and Volkswagen, in the Chinese market. Both VW and Peugeot entered the Chinese market in the mid-1980s with joint venture arrangements with Chinese manufacturers, and both firms signed additional agreements in the early 1990s. By the end of that decade, however, VW had emerged much more successful.

With respect to market strategy and tactics, several key decisions gave VW a significant edge over Peugeot. First, based on previous experience in Europe and Latin America, VW worked actively to set up an extensive local production network of suppliers in China. While this was in response to the nonmarket constraints of state restrictions on imports, this strategy had important market benefits as well. It gave VW flexibility in responding to market demands, and allowed it to meet pressures for domestic content. Second, VW created a broad distribution network of 400 centers, creating an important stronghold against competitors. Moreover, its service network of two hundred service stations—as compared to Peugeot's of less than one hundred—

allowed VW to develop a reputation for good customer service. Third, VW introduced new models in response to changing demand, while Peugeot was slow to react. Fourth, VW hired Chinese managers to work with its German managers in pairs, while Peugeot relied on expatriate French managers. VW also created training institutes for workers and promoted its best workers into management positions. Fifth, VW developed a significant R&D facility to produce cars with the latest technology that met market demand in Asia, with the objective of using its Chinese production facilities to export to Southeast Asia.

VW recognized the need to pursue simultaneously an active nonmarket strategy in view of the complexity of the Chinese state. In marked contrast to Peugeot, VW executives were in China constantly. Moreover, VW relied heavily on the German federal government as well as support at the state (*Laender*) level. VW's development of local production and creation of an R&D center also increased its influence with regional and central government officials. In view of the ongoing decentralization of economic decisionmaking power to regions, VW's close ties to Shanghai officials proved critical in securing support, both political and financial, in the form of loans and a host of preferential policies.

Unlike European software firms, the European aerospace consortium Airbus successfully competes head-to-head with an American firm, Boeing, for market share in Asia. Sandholtz and Love discuss a number of specific market strategies that have given Airbus a strong regional presence. Its imitation of Boeing's "family concept"—using the same wings, fuselage, and/or cockpits for many plane designs and making relatively smaller production adjustments related to length and size—has allowed it to reduce production costs. Indeed, Airbus has gone even farther than Boeing in this direction. This strategy has also helped it increase market share due to the greater number of products available, the speed with which different planes can be delivered, and the reduced training requirements for pilots. Moreover, some of its aircraft products such as the A330/340 allow it to meet both the demand for thin, long haul markets and high-volume regional service. Airbus has also excelled at introducing advanced technology, including fly-by wire, cockpit automation, and composite materials. In addition, Airbus has also bested Boeing with respect to delivery time, although the latter is now becoming increasingly competitive with shorter production lead times. On pricing, Airbus has often undercut Boeing, leading the latter to complain about government subsidies to Airbus.

Airbus has fared less well on other dimensions. While it initially succeeded in displacing sales of the MD-11 because of its range problems, its A340 now faces trouble from the Boeing 777 because of the A340's slower speed, narrower cabin, and inability to meet range guarantees. The 777 has also given Boeing an advantage in responding to Asian demands for high average seating capacity, and its decision to enlist three Asian airlines in designing the 777 has stood it in good stead. To meet this challenge, Airbus has moved forward with the A380, a double decker jumbo launched in late 2000. It has also moved to improve its after-sales service, which lagged behind Boeing in the cost of spare parts and speed of delivery. Finally, with respect to operating costs, Boeing and Airbus appear to be tied. For example, while its A340 is seen to have lower operating costs than the 777, the opposite is true with its A330.

Although Airbus would not have succeeded in Asia without a strong market strategy, it has complemented this effort with a variety of nonmarket strategies and tactics. One key approach has been the use of subcontracting and co-production. With activist Asian states seeking technology transfers and jobs, and with state owned airlines as customers, such arrangements have been an essential element of Airbus's success. Examples include the technical advice given to the Indonesians on their turboprop commuter plane, the subcontracting of components for Airbus planes, and training centers in several Asian countries. Still, these efforts have not always guaranteed orders, and collaborative efforts have sometimes fallen through. As a consortium of nationally-owned European aerospace companies, Airbus has benefited from diplomatic pressure on the part of their home governments to encourage Airbus purchases. Strategies include the offer of landing rights for Asian airlines, concessionary financing, and unrelated links to trade concessions. The most controversial issue has been launch aid from home governments. After considerable conflict with Boeing, an agreement was reached in 1992 to limit direct government support to 33 percent of the total cost of programs. Airbus and Boeing, backed by their home goverments, have both accused one another of market interference through bribes and government pressure.

Finally, Wallner examines Asian banking and insurance markets. As noted in the positional analysis, nonmarket factors in the form of regulation have strongly limited the breadth of the market, making products relatively homogenous. This key market characteristic reduces firms' space for strategic maneuvering. In many cases, then, smaller and medium-sized firms have limited their activities to meeting the needs of firms from their own countries who have invested in Asia. The exception has been in the banking industry, where firms have engaged in a combination of market and nonmarket strategies to curry favor with large firms and government related entities that would otherwise not be profitable. The objective of these strategies has been to develop relationships with an eye to developing long-term investment banking or bond flotation business. In some cases, they have also pursued successful organizational tactics such as strategic alliances. In 1997, for example, the Swiss Bank Corporation allied with Long-term Credit of Japan to develop a common range of services in the Japanese market. From a nonmarket perspective, Wallner's research suggests that European banks faced much tougher going, because they did not have government backers from the EU with the same political clout as those of Japanese or American firms.

In his case study of the Japanese casualty insurance industry, Wallner finds that European firms have fared significantly worse than American firms, accounting for a meager 0.3 percent versus 2.4 percent share, respectively. The latter have used pressure from the U.S. government to press for market liberalization and have been able to make inroads into the market. Moreover, once having entered, American firms have successfully prevented other foreign firms from encroaching on their market segments.

## V. Strategic Lessons

Firms attempting to penetrate Asian markets, either through trade or foreign direct investment, have faced significant market and nonmarket obstacles. In the sectors that we have examined, firms responded by using a variety of market, nonmarket, and organizational strategies. In many cases, similar strategies were applied successfully in various sectors; in others, their effectiveness has been limited by specific sector characteristics. In this section, I discuss general lessons from the case studies and suggest directions for future research.

To get a sense of the types of generic strategies that appear to be successful in Asia, we must consider two types of challenges faced by firms: market and nonmarket. As we have seen, firms respond to each by undertaking both market and nonmarket strategies. We can combine these two categories of problems and responses (see figures 9.1 and 9.2) to generalize about the types of responses that seem effective. Figure 9.1 reviews the individual market and nonmarket strategies that have proven successful in responding to market conditions across various sectors.

**FIGURE 9.1 HERE**

**Responses to Market Challenges**

Examination of strategic problems in Asia typically focuses on the market problems and opportunities posed by rapid economic and population growth. Analysts have advised firms to seek economies of scale, divide production globally according to labor costs, and the like. But the possibility of using nonmarket responses to gain market share and profits in Asia has been given relatively short shrift. Yet firms that focus only on market strategies have frequently been outmaneuvered by their competitors. Without an integrated market and nonmarket strategy, firms will not adequately respond to market and nonmarket challenges.

*High Start-Up Costs.* Firms in many sectors have faced high start-up costs. The most extreme example of this is in the aerospace industry, but firms in the automobile, software, and financial sectors have also had to cope with this challenge. In the cases of Airbus, Volkswagen, and SAP, effective market responses included cost sharing efforts with partners, subcontracting, and co-production. For example, by shifting risk to local producers as well as devolving production regionally, VW achieved significant market presence. This strategy also proved effective in the nonmarket sense. Nonmarket strategies include lobbying for home government subsidies and aid, as in the case of Airbus and several European software companies, or lobbying for financial assistance, tax breaks, and other incentives from host countries. For example, VW benefited from its government relations in Germany and China, where it secured a key position as a privileged firm, giving it access to state assistance and loans, as well as guarantees with respect to entry by other foreign firms into the Chinese market.

*Barriers to Entry.* Barriers to entry and aggressive competition have been common challenges for firms attempting to succeed in Asia. The most effective firms have addressed these issues by seeking allies and creating joint venture operations. VW, Airbus, SAP, and European financial firms have all employed such strategies with success. VW and SAP were particularly aggressive in creating partnerships with local firms. VW went on to build an impressive network of distributors and service stations that created a significant barrier to entry for other firms.

In this area, nonmarket strategies have proven especially effective. For example, Airbus has been able to use home country lobbying to secure purchases of its aircraft, with home governments linking these purchases to landing rights, technical assistance, and concessionary finance. Similarly, VW effectively cultivated the support of the German government, whereas the efforts of Peugeot fell short. This difference is all the more striking in light of the efforts of the European Commission to develop common policies. It is also worth noting that the lobbying by European governments, as compared to that of others, has not always borne equal fruit. In the insurance industry, for example, lobbying by European governments was considerably weaker than that of the American and Japanese governments on behalf of their firms. In many cases, of course, Asian host countries have attempted to attract investment by liberalizing and increasing transparency—even without prodding from an investor's home government.

*Market Responsiveness.* Firms that were willing to adapt their products to the demands of local Asian markets using local R&D and product differentiation were particularly successful. Moreover, the use of local suppliers—through subcontracting, for instance—combined with the hiring and promotion of local managers gave firms such as VW a significant advantage over its competitors. Software firms such as SAP and Synon have succeeded in Asia by customizing packaged products for large enterprises and working with local firms and governments. SAP has created a ready supply of skilled labor by establishing training centers in Asia, which allow it to better service its customers. As compared to other European software firms, which have relied on existing competitive advantages in services and skill in customization based on their previous experiences in Europe, SAP has been willing to look beyond its existing core competency that had been developed in the home market. From a nonmarket perspective, firms have been able to secure or take benefit from subsidies and tax incentives to improve their market responsiveness. For example, the EU helped to subsidize research in software as noted with respect to start-up costs, and host governments have attempted to entice firms in software to locate in Asia through a host of incentives. In many cases, firms may be able to lobby for various types of financial aid (as in VW's case in China) to enhance their competitive position.

*Network Externalities.* In some industries, such as software and autos, the penetration of Asian markets depends on developing novel designs and new products. In an environment with network externalities, simply locating in low cost areas or where the company has been located for historical reasons may be insufficient. For this reason, European software firms have located elements of their operations in Silicon Valley or other areas with high concentrations of firms that would stimulate innovation, encourage partnerships, and give them access to capital markets. Similarly, European auto firms have located design operations in Los Angeles to benefit from the high degree of expertise in that region. Although responsiveness to local market and nonmarket demands is a crucial element of firm strategy in Asia, locating in the presence of other firms to encourage the stimulation of network externalities can also be important for overall global and regional success. Firm efforts to secure aid from governments to encourage training of their employees or adoption of new products has also been an effective nonmarket strategy. For example, by working with the Singaporean and Taiwanese governments, SAP has been able to expand demand for its products and create externalities by promoting adoption of their products by governments and large enterprises alike.

*Economies of Scale.* With costs declining rapidly in response to large scale production in many industries such as software, autos, and aircraft, developing a global market for products is essential. Thus, from a market perspective, many software firms have sought to locate in Silicon Valley, not only to benefit from network externalities, but to secure business customers to increase the scale of their production. This issue is obviously central in aircraft, where the high capital costs and falling costs with longer production runs makes it imperative to sell globally. Thus, Airbus has sought large numbers of customers before committing to the A380. Similarly, in autos, longer production runs significantly reduce costs, giving VW a significant incentive to use China as a production base to sell more widely in Southeast Asia. From a nonmarket perspective, VW, Airbus, and SAP were able to benefit from various EU, European government programs, as well as Asian host promotional programs, thus allowing them to achieve economies of scale to reduce costs and make them more competitive with other firms. VW, for example, received tax exemptions, policy-oriented loans, and priority in using foreign funds and listing in stock and bond markets, which allowed it to build larger plants and achieve scale economies.

**Responses to Nonmarket Challenges**

In Asia, state intervention in the market is the norm—rather than the exception. While the so-called East Asian model has been criticized in the aftermath of the economic crises, this propensity of governments to manage markets has not disappeared. Thus, firms must be able to respond to and lobby governments, regional organizations, and even the World Trade Organization (WTO) as a crucial element of their strategy. Figure 9.2 illustrates the strategic responses to nonmarket challenges.

**FIGURE 9.2 HERE**

*Local Content Requirements.* Many countries have imposed local content requirements on firms, forcing them to source locally for a portion of their production. Free trade agreements also generally impose some kind of regional content requirement to prevent firms from simply exporting goods to a country with low barriers and then shipping them to the partner country with higher barriers to avoid duties or other market impediments. In response to these requirements, VW in China developed local R&D facilities and encouraged the use of local managers. In that case, this strategy was an effective response to both market and nonmarket concerns. As noted above, local managers and production increased VW's capacity for market responsiveness. From a nonmarket perspective, firms can also lobby governments to alter the domestic content requirements imposed by governments or regional arrangements. They might also push for participation in regional arrangements such as the Association of Southeast Asian Nations (ASEAN) members auto accords. More globally, firms in the software industry have been particularly active in promoting the development of the information technology agreement (ITA) to liberalize trade in these products. European firms have also taken an interest in developments in the Asia-Pacific Economic Cooperation forum (APEC), as well as pushing their governments to actively participate in arrangements such as the Asia-Europe Meetings (ASEM) to keep abreast of and maintain control over these developments.

*Highly Regulated Markets.* Although local content requirements can be met relatively easily with market responses, other types of barriers are often less amenable to market strategy. In such cases, nonmarket strategies, particularly the lobbying of host governments and help from home governments, may be required. Firms with experience in dealing with activist governments or authoritarian regimes may have developed significant competencies to deal with regimes such as the highly interventionst Chinese government. VW had been involved in producing in Eastern Europe for some time, and was well prepared to address this type of nonmarket concern. VW was also adept at cooperating with its local suppliers to lobby for aid and other benefits, a strategy Airbus has also used in Asian markets.

When faced with nonmarket constraints, firms in the insurance, auto, and aerospace industries have all sought help from their home governments. However, in the insurance industry, European firms appeared to have fared worse then their Japanese and American counterparts because of the greater leverage the U.S. and Japanese governments have in China. By contrast, in the auto and aerospace sectors, VW and Airbus succeeded in attracting significant assistance in both locating plants and in selling products.

*Subsidies.* As we have seen, host countries in Asia have been highly interested in securing investment in the software, auto, and aircraft sectors. European firms such as SAP, VW, and Airbus have all actively developed local partnerships to benefit from such aid. By working with local firms that are eligible for such subsidies, these firms have been able to advance several market and nonmarket objectives simultaneously. Subsidies by home countries also have been helpful. Synon, for example, became an innovator in the design of computer-aided design engineering (CASE) tools. Its global strategy benefited from favorable UK science and technology tax policies as well as European development funds. Such home country subsidies have, of course, been very controversial at times, leading to sharp conflict among governments. The best example is the ongoing conflict between Airbus and Boeing that has engaged the United States and EU to define limits on start-up aid and efforts to subsidize production and sales.

*Protectionism.* Despite ongoing liberalization, many Asian markets restrict access in many areas. Firms often are not able to export directly to these countries, or even secure needed parts. In the case of autos and the financial services industry, we have seen how firms have coped with such protectionism by engaging in foreign direct investment. Thus, VW and Peugeot recognized the need to directly produce in China. VW's local sourcing strategy allowed it to overcome import restraints, and proved useful in addressing a host of other challenges. In the banking sector, European banks sought to penetrate protected markets for financial services by engaging in nonprofitable or high-risk bank lending to develop goodwill with potential customers. Nonmarket strategies with respect to protection have been particularly significant. In software, firms were active in pushing the ITA agreement through—first by lobbying actively in APEC, and then in the WTO. In autos, VW used its privileged position to discourage liberalization by China, and its management board even called for a delay in China's accession to the WTO unless it was granted safeguards to protect domestic infant industries such as the auto industry.

*Standards Consortia.* In sectors where standards are particularly important, such as the software, banking, and insurance industries, the setting of standards can prove to be a key determinant of market success. In software, involvement in standards consortia has been an essential market strategy. Partnering with firms in Asia served SAP in good stead, and SAP was also able to work directly with Asian governments in various joint research centers that could be instrumental in setting standards. Other European firms have found that unless they locate in the United States and "become more American," they may face the danger of being left out of the development of new standards. From a nonmarket perspective, in cases where home industry was in danger of being left behind by increasing foreign firm market share (as in the software industry), the European Commission has taken the initiative to encourage a consortium of firms. Its objective has been to avoid duplication of effort, provide venture capital funds and to encourage the development of common standards in order to help European firms position themselves vis-à-vis their American competitors. As we have seen, however, these efforts in dynamic sectors have not always produced the desired result.

## Future Avenues for Research

This book has provided a framework for examining how firms can succeed in Asian markets. Positional analysis has given us insight into the diversity of different sectoral environments, and a focus on strategic responses to market and nonmarket challenges has provided us with insight into winning strategies for Asia. The broad set of sectors covered by the case studies provides a spectrum of experiences from which we can draw in generalizing about optimal market and nonmarket strategies.

What types of research and further investigation will allow us to better understand the development of firm strategies for Asian markets? First, while the case studies have given us insight into comparative strategy, the focus of this book has been the experiences of European firms. More detailed analysis of the strategies employed by American and Japanese firms in penetrating Asian markets would help us to advance our understanding of the role played by different home governments as well as the unique characteristics of firms of different nationalities.

Second, while our analysis has considered a range of sectors, it would be useful to consider what patterns might hold and what new lessons might emerge from studies of the behavior of firms in other areas. For example, do firms in the telecom or chemical industries—both of which are highly regulated by governments—pursue significantly different strategies than firms in electronics or autos?

Third, firm strategies may change over time, in response to both changing market environments as a result of the Asian crises and to evolving bilateral, regional, and international arrangements. Will progressive liberalization in Asia as a response to the recent crises and as a result of pressures from international financial institutions create a significantly different regional environment? These questions have been important to our analysis, because we have been able to examine firm strategies before and after the Asian crises. Still, while many changes continue to take place in Asia, we submit that the long-term implications of these changes are better understood and predicted using the integrated market-nonmarket framework we present in this volume.

Two companion volumes to this book—*Winning in Asia, American Style* and *Winning in Asia, Japanese Style*—which focus on the strategies of both American and Japanese firms, will address these ongoing questions. In view of the complexity of business-government interaction in Asia, however, this field should remain a fertile ground for years to come.

---

1. As noted in the introduction, two companion volumes systematically explore the strategies of American and Japanese firms in the region.

2. See also Aggarwal and Morrison (1998) for a discussion of the weakness of APEC decisionmaking apparatus.

3. Porter (1980).

4. Hamel and Prahalad (1994).

5. Baron (1999, 2000).

6. D'Aveni (1994).

7. See Baron (1999, 2000) for discussion of these nonmarket tactics.

## References

Aggarwal, Vinod K. and Charles Morrison, eds. (1998). *Asia-Pacific Crossroads: Regime Creation and the Future of APEC.* New York: St. Martin's 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,* 3nd edition. Upper Saddle River, NJ: Prentice Hall.

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

Hamel, Gary and C. K. Prahalad (1994). *Competing for the Future.* Boston: Harvard University Press.

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