Alliances and joint ventures

Patterns of internationalization for developing country enterprises

Part one

UNITED NATIONS
INDUSTRIAL DEVELOPMENT ORGANIZATION

Alliances and joint ventures

Patterns of internationalization for developing country enterprises

Part one

UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
Vienna, 2006

Contents

List of figures

The present volume is Part One of a training package developed by the United Nations Industrial Development Organization (UNIDO) on joint ventures for developing country enterprises, support institutions and policymakers. The objective of the complete package is to inform both public and private sector decision makers on the purpose and potential of different forms of joint venture and to assist them in framing and negotiating appropriate agreements that can benefit both the individual enterprise concerned and the economy as a whole. It constitutes one component of a library of UNIDO training material covering aspects of investment promotion and technology transfer.

Part One of the package presents an overview of the broad subject of alliances in their most generic form, and Part Two contains detailed guidelines on how to select the right form of agreement to serve the objectives of a firm and then how to formulate the agreement in a way that serves the objectives of all the parties.

This publication is based on more than 20 years of UNIDO experience in assisting developing countries to formulate appropriate policies and tools at the country level and in assisting individual enterprises to assess and formulate joint venture agreements. It draws extensively on past and current UNIDO publications. It was prepared by a former UNIDO staff member, José M. de Caldas Lima, in cooperation with F. Mithat Kulur. UNIDO would like to thank Professor John S. Henley of the University of Edinburgh Management School for his valuable comments during the drafting stage and his review of the final draft of this volume.

ACRONYMS AND ABBREVIATIONS

3PL	Third party logistics
BPO	Business processing outsourcing
CSR	Corporate social responsibility
EDI	Electronic data interchange
EMC	Export management company
EPZ	Export-processing zone
ETC	Export trading company
FDI	Foreign direct investment
FTZ	Free trade zone
GMN	Global manufacturing network
GPN	Global production network
GVC	Global value chain
LDC	Least developed country
LMW	Licensed manufacturing warehouse
MNC	Multinational corporation
MNE	Multinational enterprise
OBM	Original brand manufacturer
ODM	Original design manufacturer
OEM	Original equipment manufacturing
PTX	Private technology exchange
R&D	Research and development
SME	Small and medium-sized enterprise
SOO	Services offshore outsourcing
TNC	Transnational corporation

Patterns of internationalization for enterprises of developing countries: Alliances and joint ventures

Introduction

The present training package is **addressed to entrepreneurs and policymakers of developing countries**. It deals with issues of internationalization at the enterprise level and the impact of internationalization on economic growth and social development at the national level. Globalization creates an aggressive competitive environment and a scenario of continuing and accelerated change that requires timely and effective responses; it also brings **opportunities, opened by the liberalization of markets and the evolving strategies of multinational enterprises** (MNEs). In particular, it is important to understand and, when possible, to exploit the market entry strategies of enterprises and the way in which enterprises organize and manage their manufacturing activities at the global level, in order to minimize risks and take advantage of cost savings and efficiency gains associated with different locations.

Foreign direct investment (FDI) and other forms of association among MNE operations, such as subcontracting, original equipment manufacturing (OEM), participation in global value chains (GVCs), global manufacturing networks (GMNs), joint ventures and various kinds of alliances have been the movers of technological progress, economic growth and success in international markets for many developing countries. Success stories are widely known and will be highlighted in this work. But it must be emphasized that **success is not an accident and successful experiences cannot be simply transplanted**. MNEs take their strategic and locational decisions on the basis of their stakeholder interests, which include perception of risks, profit expectations and market share. Host countries, on the other hand, have their own set of values and endowments, cultural and social patterns and development policy options. Furthermore, the characteristics of industry competition and factor markets are constantly changing, which adds to the **complexity of the situation** confronting developing countries and their enterprises, in particular those with inadequate capacity-building and insufficient access to information on opportunities for internationalization.

This training package is intended to be an instrument to help firms of developing countries to improve their competitive position and grow domestically and internationally by **linking** with foreign partners, **leveraging** the relationships with those partners and **learning** in order to achieve technological self-sufficiency and innovative capabilities of their own. In that connection, particular attention will be given to joint ventures and alliances, including the motivations of the participating enterprises and the opportunities for partnerships and their negotiation, implementation and management. While the main expected users of this package are developing country entrepreneurs and special focus is given to the subject of alliances and joint ventures, it was decided to **frame the package with a supplementary body of knowledge** based on two considerations, described below.

Firstly, the development of entrepreneurial activities involves issues that are of interest to policymakers. When thinking of technological progress at the enterprise level in developing countries and the contribution of joint ventures and alliances to achieving that aim, **the role and interplay of many enabling factors** must also be considered, such as the following:

- International political and development agendas, related rules and conventions and multilateral and bilateral agreements, and what these mean for a country in terms of constraints and opportunities.
- The country's macroeconomic and policy environment with its institutions and regulatory framework and how they influence entrepreneurial activities and encourage the activities of foreign enterprises.
- The physical and technological infrastructure available in the country, the national innovation system and the mechanisms in place to support technological development and innovation at the enterprise level.

Secondly, the opportunities available to firms of developing countries for internationalization are dependent upon the **business strategies of multinational companies** and the way they manage their global operations.

This training package will therefore bring to both policymakers and managers of enterprises of developing countries not only an awareness of the international development scenario and the competitive forces they have to cope with, but also an understanding of the strategies and behaviour of multinational companies, the opportunities available for growth and internationalization in that context, and how to seize such opportunities. Related to that, the package will enable its users to handle the practical issues associated with the preparation, formation, negotiation and management of the various types of alliances and joint ventures that firms of developing countries may wish to enter into with foreign partners.

The envisaged purpose is to focus on joint ventures and alliances as a path for growth and internationalization for firms of developing countries and at the same time shed light on the variables and conditions under which they have to operate, find their opportunities and make their choices. The package will therefore have two main parts.

Part One presents the international development scenario, the competitive environment and the drivers for global expansion of enterprises. It highlights the patterns of multinational expansion, the various types of inter-firm collaboration agreement, the **global** manufacturing strategies of MNEs and the related challenges and opportunities for developing **countries**.

In this context, Part One presents the **role of GVCs and global production networks (GPNs)** as elements of global operations management by MNEs and as vehicles for technological development of firms of developing countries. Attention is also given to the **role of the Governments of developing countries** in creating suitable locational conditions for MNEs and in providing critical support to domestic enterprises in their path for technological capability-building and internationalization.

Part Two narrows down the subject of inter-enterprise collaborative agreements to the field of **strategic alliances and joint ventures**. It analyses the concept and the features of strategic alliances and highlights the reasons why the partners, usually global players, decide to enter into such cooperation.

It introduces the various types of joint venture that are found in international business operations and focuses on the formation, negotiation and management of equity joint ventures as a form of cooperation between international companies or MNEs on the one hand and domestic enterprises of less-developed or less-industrialized countries on the other. In as much as equity joint ventures represent FDI operations and appear as an alternative to full ownership of domestic subsidiaries by MNEs, the package will also give

insight into FDI, its motives, drivers and impact, including from the perspective of investors' strategies and that of host countries' expectations.

In terms of structure, the package (to be published in two volumes) will have the following basic elements:

(a) A **textbook** part, intended to describe the overall body of knowledge, presented in a comprehensive and flowing way that is easy to read;

(b) A **glossary** of terms and definitions aimed at supplementing the textbook part with further explanations and clarifications on selected terms and concepts;

(c) A set of **reading materials** in the form of short texts taken from current literature, allowing users to deepen their knowledge of topics covered by the package and also to understand better related issues in the real world of business;

(d) A set of **visuals** directly related to the overall content of the training package, in particular to the textbook part, which are intended to support the implementation of training programmes and are addressed to managers and government officials of developing countries concerned with the development and internationalization of their enterprises.

Part One
The international scenario for business and development

I. Overview of international business

A. Evolution of multinational strategies

The strategies and forms of international business have continuously evolved in the last few decades as a result of continuing progress in technology, liberalization of investment flows and increased competition among enterprises.

The strategies of MNEs and the forms of international business have evolved in response to the changing international scenario and the pressure of new competition

The **early decades of the twentieth century witnessed the multinational expansion of European companies** such as Unilever, Royal Dutch Shell, Imperial Chemical Industries and Philips. It was a time when conditions for internationalization were characterized by:

- Slow and costly transportation and communication, and
- Highly differentiated national markets

The phases of multinational expansion
- Early twentieth century: European companies
- 1950s–1960s: Prominence of MNEs from the United States of America
- 1970s–1980s: Emergence of Japan
- Present: Complex global networks

In this context, national subsidiaries of multinational enterprises were given operational autonomy to undertake their own product development, manufacturing and marketing. The role of the parent company would not go much beyond the appointment of senior managers, authorization of major expenditures and collection of dividends from subsidiaries. Some authors describe these companies as "multinational federations".[1]

In the **1950s** and **1960s**, following the emergence of the United States of America as the world's dominant industrial power at the end of the Second World War, the **United States** multinationals, such as General Motors Corporation, Ford Motor Company, International Business Machines, Coca-Cola and Procter & Gamble, took on a prominent role in international business expansion through foreign subsidiaries.

At the early stages of multinational expansion, national markets were highly differentiated and the national subsidiaries of MNEs were given substantial autonomy

Although such foreign subsidiaries were operated with a substantial degree of autonomy and aimed at supplying local or regional markets, the parent companies retained a dominant position with regard to the strategies and operations of the whole group.

Typically, the parent companies would act as the source of capital, technology, innovation, decisions on the introduction of new products and management capabilities. It was the continuing access to the capabilities of the parent company that gave the overseas subsidiaries their competitive advantage in the national markets.

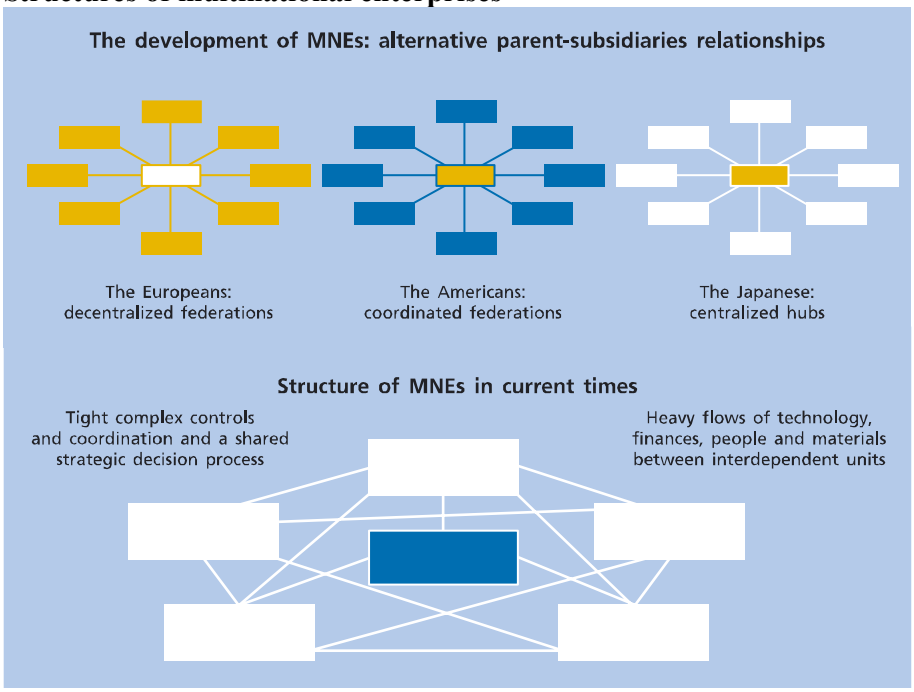
[1] Robert M. Grant, *Cases to Accompany Contemporary Strategy Analysis* (Blackwell Publishing, 2005).

The Japanese multinational expansion of the 1970s and 1980s was characterized by global strategies commanded by home-based headquarters and manufacturing facilities

During the **1970s and through the 1980s, Japanese companies** appeared as leading global players at a time when Western multinationals were following a trend of divestment, rationalization and plant closures in the host country.[2] A characteristic of the Japanese international expansion, which became more conspicuous in a number of manufacturing industries from shipbuilding to automobiles and consumer electronics, was the pursuit of global strategies commanded from a centralized home-based headquarters.

According to those strategies, research and development (R&D) and manufacturing activities were concentrated in Japan, in large-scale operations, producing globally standardized products. Overseas subsidiaries would handle sales, distribution and customer support. While Japanese firms have followed the trend of setting up manufacturing operations overseas, they still keep a strong global integration in their operations.

Figure I
Structures of multinational enterprises



Source: Robert M. Grant, *Cases to Accompany Contemporary Strategy Analysis*, 2005.

Nowadays, MNEs operate within complex networks that bring together the advantages of global integration with those of decentralization and national differentiation

The structures of MNEs are evolving dynamically not only in the relationships with and between subsidiaries but also in a shift towards increased outsourcing

Through the 1980s and 1990s, as a way to respond to increased international competition, multinational companies had to exploit multiple sources of competitive advantage. For that purpose, they evolved into complex structures that:

- Reconciled the advantages of global integration with those of national differentiation, and
- Benefited from forms of decentralization conducive to generating innovation and from the global centralization needed to exploit those innovations more efficiently

From the early forms of decentralized federation, multinational companies became complex structures of globally coordinated and integrated operations, which evolved dynamically not only in terms of the relationship between headquarters and national subsidiaries but also in a shift towards increased

[2] George Stonehouse and others, *Global and Transnational Business: Strategy and Management* (John Wiley and Sons, 2004).

outsourcing of non-core activities and development of GPNs and strategic alliances.

Furthermore, the twenty-first century is witnessing the emergence of "virtual corporations" and "intelligent organizations", the first concept meaning a corporation basically acting as a networking centre that outsources practically all of its operations, and the second concept applying to organizations that seek competitive advantages through organizational learning and knowledge management (see glossary).

B. Multinational business terminology

The enterprises involved in international business are referred to in various ways: transnational corporations, global corporations, MNEs, and so on. Sometimes, the terms are intended to designate a specific type of operation, strategic approach or spatial location, but often such terms are used interchangeably in the current literature. It also happens that the meaning of the terms varies from author to author and even changes over time.

In order to ensure that the users of this training package do not become confused and to provide some clarification of the current terminology, provided below is an overview of the most currently used terms and the notions commonly associated with them. Throughout this package, "multinational enterprise" (abbreviated as MNE) is used as an all-embracing term, encompassing the features that characterize today's international, multinational and global manufacturing and business operations.

Different terms are used to describe the specific types of enterprise involved in international operations; the term "multinational enterprise" (MNE) is often used as an all-embracing one

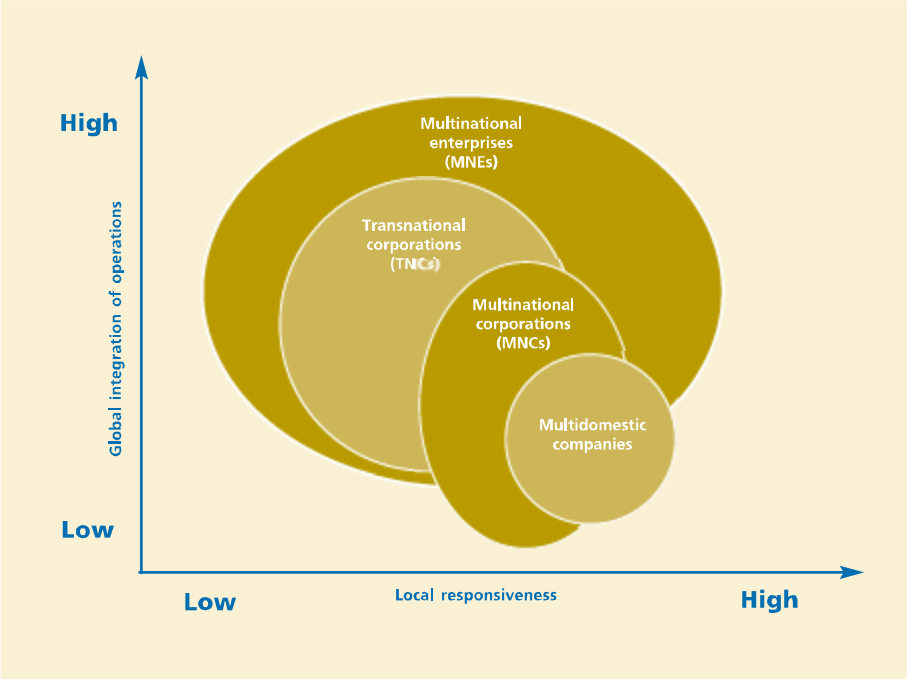
International business and international company. These are terms that imply operations in more than one country and conducting business across national boundaries. They are generic terms and the different types of international operation that bring international companies together can be better characterized by specific terms such as sourcing of raw materials, exporting of products into foreign markets, joint ventures, licensing agreements, outsourcing of products and services, strategic alliances, or even taking equity positions in overseas ventures without significant management involvement.

Multinational company and multinational corporation. In the earlier days of the 1950s through the 1970s, multinational companies or multinational corporations were regarded as enterprises with operations and control of assets such as factories, mines, sales offices and the like in several countries. The practice of multinational companies was to operate through overseas subsidiaries, which were allowed substantial autonomy in their strategies, aimed at addressing the local conditions, and with little coordination across national boundaries.

The distinction between multinational corporation (MNC) and transnational corporation (TNC) is rather blurred. The term MNC is usually related to earlier forms of multinational operations

Transnational company and transnational corporation. These terms have been applied to businesses and companies with activities across national boundaries that are coordinated, integrated and differentiated in terms of strategies and operations in order to take advantage of or suit market and business conditions and opportunities. The term "transnational" is used in connection with the pursuit of global competitiveness through the configuration, coordination and control of business activities in a way that takes into account both global and local advantages and opportunities.

Figure II
Terminology of international operations (as adopted in this training package)



Multinational enterprise. This term is gaining wide acceptance in the United Nations system, and in particular in UNIDO literature, to designate companies that use the various modes of operation presented so far in the present training package. In general terms, this means that an MNE takes a global approach to foreign markets and production locations, whether through subsidiaries, outsourcing or the integration of GVCs or GPNs. Although the usual notion of an MNE brings to mind the idea of giant companies from industrialized countries, nowadays there exist relatively small companies, which may be owned by nationals of developing countries, that also take global approaches to their operations and use most of the business forms presented above.

Global company and multidomestic company. These terms are sometimes used to highlight and differentiate the geographic focus and the management strategies of companies with international operations. A global company, also called by some authors a "globally integrated company", on the one hand designs products and services intended to be branded and sold on a global scale, and on the other hand integrates operations in different countries to source materials and produce or acquire components that integrate its products and services. A "multidomestic company", also called a "locally responsive company", is one that designs products or services for specific domestic markets and allows substantial independence of its foreign-country operations.

Metanational company. This is a term applied to a newly proposed model of international business intended to go beyond the current transnational, multinational or global forms. According to this concept, an indispensable source of competitive advantage for enterprises in the future should consist of creating three areas of activity: (a) prospecting and identifying new sources of knowledge, competencies and innovative technologies around the world; (b) integrating those scattered capabilities in order to disseminate knowledge inside the company so as to pioneer new products and services; and (c) imparting the innovations into the operations network and using the global operations to leverage metanational innovations rather than just to rely on and propagate home-based concepts and developments. In a metanational company, the headquarters should be regarded as a node in a network and no longer a centre radiating knowledge and technology to the world.

In order to sustain their competitive advantage, MNEs increasingly resort to external sources of knowledge and innovation; this trend is leading to the emergence of the concept of the "metanational company"

To sum up, there are different forms of international business operations and different terms to designate them. Sometimes the terms are intended to convey a specific characterization of the strategies that the companies pursue and the spatial distribution of their operations. But in general, the meaning of the terms currently found in the literature is blurred and varies according to the source. In the present training package, the terms "multinational enterprise" and "multinational business" are used in a generic and all-embracing way. The terms "global business" and "global enterprise" are also used interchangeably. In the following sections, the drivers of multinational business and the operations of multinational enterprises are explored and analysed in detail, thus providing the reader with the full picture of all the above terms and concepts.

The inherent vocation for growth and external competitive pressures drive firms into business expansion and development through international and global operations

C. Global expansion and market entry strategies

1. Globalization drivers

Growth is an inherent vocation of business enterprises and is also imperative for survival. The competitive pressures, and the need to keep and strengthen their position in the market, force enterprises to stay on permanent alert and explore opportunities to achieve an advantage over competitors and expand beyond the limits of the domestic markets.

The expansion of enterprises into the global marketplace becomes a necessity not only because of the confines and limitations of their domestic market, but also because in a globalized world the market share in the domestic market becomes threatened by foreign competitors. Several specific factors drive enterprises to seek business development and growth through international and global operations, namely markets, cost, competitive factors and the international business environment.

2. Market factors

Information and communication technologies, the massive development of international tourism, widespread cultural exchange and the improvement of living standards in a number of developing countries has resulted in the emergence of consumer groups in different countries and regions of the world with comparable educational backgrounds, lifestyles, purchasing power, needs for goods and services and aspirations to high quality. This scenario, combined with the liberalization of international trade and availability of global

distribution channels, opens wide opportunities for enterprises to market their products and services on a global scale.

3. Cost factors

Market leadership compels companies to invest heavily in R&D and innovation to bring about new products or to improve and differentiate existing products. In the car industry for example, the introduction of a new model may represent an investment to the tune of one billion dollars. In the pharmaceutical industry, the cost associated with the successful development of a new drug is of the same order of magnitude. In the consumer goods sector, the cost of promoting a new brand could be as high as $100 million. A single domestic market would not allow companies to achieve the economies of scale necessary to cover such costs, making it necessary to plan operations with the global market in mind.

Globalization drivers

- Trade liberalization and global consumption patterns
- Increased development costs and need for economies of scale
- Pressure of foreign competitors in home markets
- Advances in information and communication technologies

The liberalization of trade and investment flows, which emerged in the 1980s and took an irreversible course, gave impetus to the globalization of enterprises' operations

4. Competitive factors

One of the reasons for enterprises to pursue global strategies is to keep or gain advantage over competitors in foreign markets and also to stave off competition in the home market. Going global creates economies of scale and consequently flexibility to win over competitors in the home market through undercutting prices if needed. On the other hand, an effective strategy to hold a competitor at bay could consist of bringing the pressure of competition into its own home market.

5. The international business environment

The trend towards liberalization of trade and investment flows, which emerged in the 1980s and took an irreversible course, gave impetus to the globalization of markets as well as to the globalization of enterprises' operations. The advances in communication and information technologies also contributed to the globalization process inasmuch as they provided the instruments that made global operations easier and more manageable. Newly emerging markets also recognize the economic benefits, technological progress and growth opportunities that globalization can bring to them, which encourages further and friendlier measures to attract international investors and business enterprises.

D. Globalization of small and medium-sized enterprises

Globalization as a business strategy is not exclusive to enterprises with a traditional international vocation. Many small and medium-sized enterprises (SMEs) also go global nowadays for a variety of reasons, which can be categorized as **proactive motivations** and **reactive motivations**. (See also the case of "born global" enterprises described in subsection I.F.11 below.)

Proactive motivations are the reasons why firms want and decide to go global, i.e., cases where firms feel they have a competitive advantage or sense opportunities abroad

1. Proactive motivations

These are the reasons why companies want and decide to go global. Proactive motivations basically result from the assertion that the company has developed

a technology in the form of a process, a product, a service or a business concept that has a competitive advantage and the potential to win a position in the global markets. This could be the case of enterprises with innovative technologies or unique products with a particular advantage not available from competitors and with potential demand not only in the domestic market but also in foreign markets. Other reasons to go global could be that enterprises have obtained special information about promising customers or market opportunities abroad, or are motivated by incentives of some sort, such as tax benefits granted by foreign Governments. Of course, the major underlying motivation is the quest for increased profit, which means the need for increased output to benefit from economies of scale and the consequent drive to expand business beyond the national boundaries.

Summary: motivations for international business

PROACTIVE	REACTIVE
Quest for profit	Competitive pressure
Competitive advantage	Excess capacity
Market opportunities	Overproduction
Economies of scale	Saturated or declining home market
Tax benefits	

Adapted from *Fundamentals of International Business* by M. Czinkota and others (South-Western Publishing, 2004).

2. Reactive motivations

Reactive motivations are reasons why firms decide to enter foreign markets in order to overcome competitive pressure or declining markets, or to find outlets for overproduction

Enterprises may need to think of entering foreign markets as a reaction to changes in the economy, in the market conditions or in the competitive scenario. For example, if their domestic market share is threatened by the competitive pressure of foreign entrants, they may look to expand sales abroad. This will result in increased production, reduced costs through economies of scale and increased competitiveness also in the home market. Reactive motivations are also typical in such cases as the following: (a) excess capacity, i.e., the available equipment is not fully utilized and part of the economic benefit is lost because of inadequate distribution of fixed costs, in which case expansion abroad will be regarded as a solution; (b) overproduction, which happens in periods of economic downturn and leads enterprises to seek foreign outlets for their excess inventories; and (c) saturated or declining domestic markets, for example because of changing consumer tastes or displacement of current products by new innovations, in which case the life cycle of the "outdated" products can be extended through selling them in foreign countries where they could be appropriate to local conditions and needs.

E. Patterns of expansion

1. Considerations with respect to internationalization

For many companies, internationalization is undertaken as a step-by-step process; they move into deeper levels of international commitment as they gain experience and confidence

Foreign markets versus domestic markets: distinctive elements

- Political, social and cultural factors
- Local and relevant international laws
- Geography and natural conditions
- Infrastructure and manpower

For many companies, the internationalization process is undertaken with caution as a step-by-step process involving an approach that includes strategic planning and risk minimization. In

principle, companies will choose the markets and the entry modes that appear more familiar and less risky and will afterwards move into deeper levels of international commitment as they gain experience and feel more confident about foreign business.

Once aware of business opportunities abroad or having recognized the need to expand into foreign markets, the ensuing internationalization has to be undertaken methodically and competently, otherwise it may end up in failure and cause irreversible waste of resources. First of all, internationalization requires management commitment because it also requires the sustained allocation of valuable staff resources, market and competition analysis and financial investment.

Furthermore, business operations in foreign markets confront companies with problems very different from those arising in the domestic market, which are well known and more easily solved.

Business operations in foreign countries confront companies with problems that are very different from those arising in the domestic environment

Foreign markets, as compared to domestic markets, usually mean significant differences in various areas that companies have to consider, including the following:

- **Political, social and cultural factors** may have a bearing on the practical ways of conducting business and on the characteristics and the acceptance of a company's products by local consumers, bearing in mind their social and cultural values, beliefs and attitudes
- **Local and relevant international laws** determine what managers can and cannot do and determine relations with the labour force, the level of taxation in the foreign country, the taxation of foreign earnings in the home country, and the extent or the security of operations in certain countries
- **Geography and natural conditions** and their impact on business should be assessed; the difficulty of access to landlocked countries or geographical obstacles like mountains or deserts may represent burdensome additional costs and risks
- **Infrastructure and** manpower, for example the availability or absence of roads, ports, telecommunications and skilled labour, are also important elements that influence the distribution and manufacturing costs and the ability to manage operations

2. The evolutionary process of expansion

As highlighted above, companies will move with caution from the domestic market into international markets according to prudent patterns of expansion, which are illustrated in figure III below. The expanding circles depict the various levels of internationalization and the different axes, the various aspects, motivations and ways of implementation of the internationalization strategy. The speed at which a company moves forward is not necessarily the same along each axis; it depends on the internationalization strategy and the resources available to go preferentially one way or another.

At the early stages of internationalization, companies may confine themselves to export operations and resort to intermediaries; as experience grows, they may decide to do more themselves

The axis of international expansion

- Impetus for international business
- Internal versus external operations
- Mode of operations and commitment
- Extent of geographic diversification

Axis A: impetus for international business. This impetus could be a passive response to unsolicited orders, in which case the company would prefer

countries representing a low business risk, or it could represent an active search for opportunities and higher levels of internationalization (and risk), which could be motivated by positive experiences derived from passive responses.

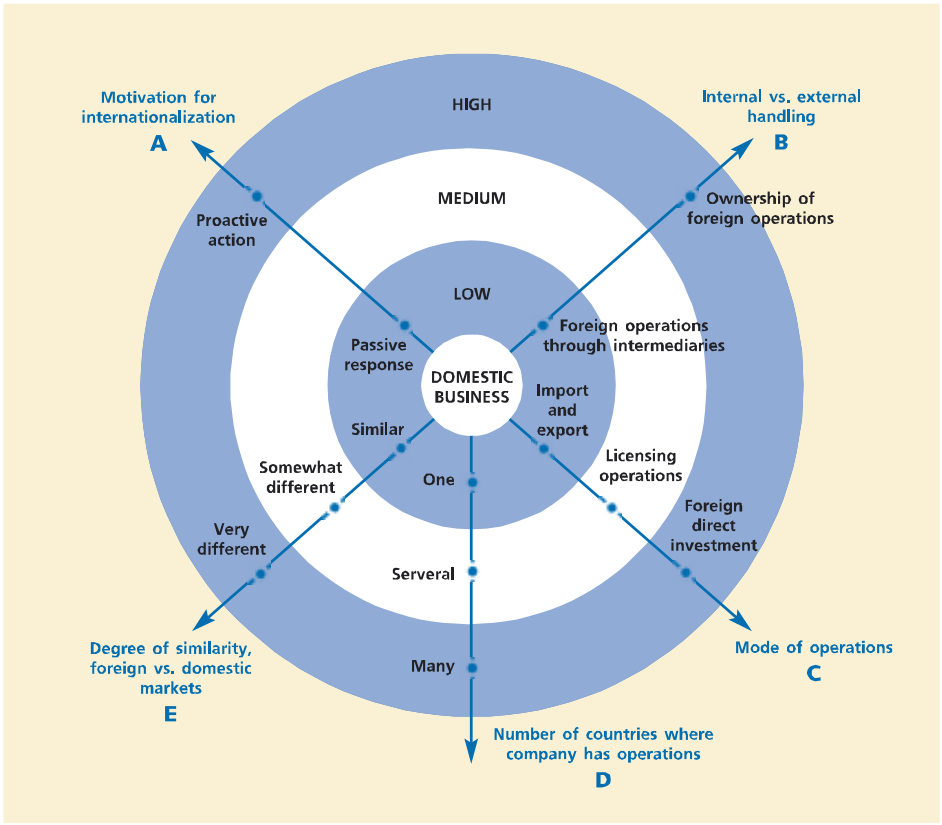
Axis B: internal versus external handling of operations. At the early stages of internationalization, companies usually rely on intermediaries who are well acquainted with the foreign market. As success and experience grows, companies may decide to take their foreign operations into their own hands.

Axis C: mode of operations and commitment. As a rule, at the early stages of internationalization companies opt for lower-risk operations such as export and import. As they learn and become more confident about foreign markets, they may go into deeper levels of commitment and assume greater risk, for example through licensing operations, joint ventures and FDI.

Axes D and E: geographic diversification. At the beginning, companies will tend to internationalize operations into one or a few countries, preferably neighbouring countries or countries belonging to the same regional or trade block, with close cultural and business affinities. At a later stage, operations can expand into a larger number of countries with diversified business environments and competitive conditions.

In order to minimize risks, international expansion may start in neighbouring countries, countries with cultural and business affinities, or countries belonging to the same trade block

Figure III
Patterns of international expansion



Adapted from John D. Daniels and others, *International Business: Environments and Operations*, 2005.

F. Foreign market entry strategies

In the present section, the various strategies used by companies to expand their operations into foreign markets will be explored in more detail. As mentioned above, they usually go by steps, in a way that minimizes risks, at least at the early stages of internationalization, and allows for deeper degrees of commitment as the learning and the experience grows. In figure III, this is illustrated by axis C.

Except perhaps for exporting activities, the various foreign market entry strategies result in the establishment of linkages with local producers in the targeted countries, providing them with opportunities for learning and thereby improving their capabilities, competitiveness and ability to become internationalized themselves.

Attention to these aspects is one of the main purposes of the present training package and they will be given the relevance they deserve when dealing with the management of global operations and in particular with GVCs and GPNs.

1. Exporting

Export intermediaries can be **international agents** (working for a commission); or **international distributors** (purchasing the products to sell in their own name)

Exporting is the simplest and least risky way for a company to start its global expansion. It can be done **directly**, when the company develops its own relationship with customers in foreign markets, for example by establishing sales offices in those markets; or it can be done **indirectly**, through international intermediaries.

On the one hand, **direct exporting** represents deeper commitment and possibly higher risks than the **use of intermediaries**; but on the other hand, it allows for faster learning on how to do business abroad, helps to establish more productive relationships with customers and induces further internationalization and growth.

The use of **intermediaries** becomes necessary when a company is willing to export its products but does not have sufficient experience of international business, is unable to find the appropriate marketing channels and has difficulty in identifying and targeting foreign customers. Intermediaries can provide the expertise and the range of services that are needed to bring to fruition the business relationship between the company and its foreign customers. These **services** may include:

Balancing the exporting option
- Less risky and less complicated
- Profits do not have to be shared
- No direct contact with customers
- Lack of control of field operations

Intermediaries can provide the expertise and the range of services that are needed to bring to fruition the business relationship between the company and its foreign customers

- Knowledge about the local market, competitive conditions and existing sales networks
- Business contacts on behalf of the company with potential local customers
- Evaluation of reliability and credit worthiness of local customers
- Transportation services and other necessary assistance for distribution and logistics
- Handling of official documentation and assistance in administrative and financing matters

There are different types of intermediaries, which are described below.

Export management companies* (*EMCs). These are firms that, because of their knowledge of the markets and expertise with export operations, perform international business services to manufacturing companies, either as **international agents** or as **international distributors**. As a rule, export management companies operate in focused geographic areas or particular countries they are acquainted with.

When operating as international agents, EMCs develop the business contacts abroad, the sales strategies and the export operations, and receive a commission (which depends on the volume of sales).

As international distributors, EMCs purchase the products from the manufacturing company and sell them in their own name, thus assuming greater risk but having the opportunity of taking greater profits.

Export trading companies (ETCs). These are major intermediaries, operating on a large scale not only in geographical terms but also in terms of the scope of operations, which can include imports, exports, counter-trading, investments and manufacturing.

Export trading companies operate on a large scale and in a wide range of operations, including imports, exports, counter-trading, investments and manufacturing

Historically, trading companies are associated with the European expansion overseas in the sixteenth century. Governments would give them exclusive trading rights against tax payments or **royalties**.

In modern times, the most common illustration of trading companies is the case of the Japanese *sogoshosha*, which played a crucial role in the internationalization of Japanese manufacturing companies at the early stages of their expansion into foreign markets.

Other countries, such as Brazil, the Republic of Korea and Turkey, have also created trading companies within their export promotion policies, as the operational arms of national companies willing to export their products. Even the United States has enacted legislation aimed at facilitating the creation of export trading companies in order to provide SMEs with the proper intermediaries and services that would improve their export performance.

2. International licensing

Licensing can be an effective way for a company to expand its operations abroad and take advantage of the opportunities offered by foreign markets. It represents a deeper level of commitment to internationalization and higher risks compared to export operations, but does not entail as much commitment or risk as FDI.

Pros and cons of licensing

- No need for significant investment
- Some control of field operations
  but
- Income mostly depends on licensee
- Licensee is a potential competitor
- Risk of losing intellectual property

Broadly speaking, under a **licensing agreement**, the company, or **licensor**, allows a foreign firm, designated as a **licensee**, to use its know-how and other intellectual property assets, such as **patents and trademarks**, for the manufacturing and sale of the company's products. In exchange for the rights granted by the licensor, the licensee has to pay a compensation called a **royalty**, usually established as a percentage of the sales of the licensed products.

Under a licensing agreement, the licensor allows the licensee to use its know-how and other intellectual property assets for the manufacturing and sale of a product

The **licensing agreement** sets out the rights and obligations of both parties, for example the scope of the licence, the technical assistance to be provided by the licensor to the licensee if needed, the level of royalties that the licensee is

obliged to pay to the licensor, the duration of the contract, the countries where the licensee is allowed to sell the licensed products, the consequences of termination, etc. All these aspects will be dealt with in detail in the sections related to international negotiations and those dealing with joint ventures. What is relevant in the present section is to present the licensing option as a strategy to enter foreign markets and highlight its main features as compared with other entry strategies.

With the licensing option, the company does not need to invest in the foreign country, nor does it face any problems associated with the regulatory environment in the foreign country. It does not need to involve itself in costly market studies or worry about involvement with foreign customers. All these are tasks for the licensee to handle.

As a rule, a licensing agreement results from a long process of confidence-building between the licensor and the licensee; in many cases, it emanates from a previous business relationship

But there are also **risks in licensing**. The company will have to transfer to the licensee its manufacturing know-how and proprietary rights, which are the very foundations of its competitive advantage.

As a rule, a **licensing agreement** is the result of a long and methodical process of confidence-building; in many cases, the licensing agreement happens as a result of a long-term relationship, mutual acquaintance and trust built upon a commercial and export relationship between the company and the licensee of many years.

The licensee is a potential competitor in the future and an untrustworthy licensee could bring substantial damage to the company through unlawful use of the company's technology. By the same token, when considering the licensing option, the company has to think about the legal and institutional environment in the intended foreign country with regard to such aspects as intellectual property protection, contract laws, judicial practice and enforcement of contractual obligations, foreign exchange regulations and assurance of timely remittance of royalties.

3. International franchising

In a franchising agreement, the franchisee is allowed to adopt and replicate a certain business concept, model, image and standards owned by the franchisor

In certain fields, franchising has been an effective way for companies to internationalize and expand their operations globally. In some respects, franchising can be regarded as a certain form of licensing but in current business practice, licensing and franchising are substantially different and distinct concepts.

In a typical licensing agreement, the licensee manufactures a certain product based on the licensed technology, pays a royalty to the licensor for the rights granted under the licensing agreement and sells the licensed products according to its own managerial and marketing strategies. In other words, the licensee is in principle an already established company; the licensed product adds to the range of products manufactured by the licensee and does not necessarily change the configuration of the licensee's business.

The franchisee will have to make the investment to set up the franchised business, but benefits from a well-established brand and from the franchisor's assistance

In **franchising**, it is the whole business concept that is the subject of a **franchising agreement** whereby the owner of the concept, or **franchisor**, allows another company, or **franchisee**, to replicate the business according to the same concept, model, image and quality standards.

Classic fields where franchising has been widely used are fast food chains, hotel chains, car hire companies and retailing; but in recent years, franchising activities have become increasingly popular and have expanded to many business fields, big and small.

To illustrate, take McDonald's or Kentucky Fried Chicken in the field of fast food. The franchisee will have to (a) provide for the investment that is needed to set up the franchised business; (b) adopt the franchisor's trade mark(s), logos, symbols, colours, architectural designs, staff uniforms, etc., which make the business instantly recognizable; and (c) offer the same kind of products and the same way of delivering them as the franchisor, with a high degree of standardization and quality requirements.

What characterizes franchising?
- Franchisee provides for investment
- Franchisee adopts business model, including trademarks and logos
- Franchisor provides franchisee with know-how, licences and training

The franchisor, for its part, will provide the franchisee with the licences required to use the know-how, trademarks and other proprietary elements; it will also make available to the franchisee all technical assistance, training of personnel, product specifications, etc., that are needed to conduct the franchised business according to the required methods and standards.

4. Management contracts

Management contracts represent situations where a company with experience in specific business areas or industrial sectors makes its personnel available to perform general or specialized management functions for another company.

For supplier companies, management contracts represent a profitable way to expand internationally, without the risks that are usually associated with direct investment

In countries where effective managerial capacity in certain fields is scarce, management contracts represent a viable way of accessing the necessary skills that otherwise would be difficult to find locally.

For the supplier companies, management contracts represent a profitable way to expand internationally, without the risks inherent to direct investment, and provide the opportunity to learn about the local environment and market opportunities for other possible ventures in the future.

As a rule, management contracts are concluded for periods of three to five years, possibly subject to renewal, and the remuneration for the supplier comprises two components: one a fixed fee, in principle commensurate with the services or personnel provided by the supplier; and the other based on volume or profit, which can be regarded as an incentive fee.

For some developing countries, management contracts represent a viable way of accessing needed skills that would be difficult to find locally

Management contracts are typical in a number of fields, private and government-owned, where the patterns of competition (for example hotel operations) or the technical complexities involved (for example the management of an airport) require in-depth experience and expertise and a combination of skills that the owner of the facility does not have available.

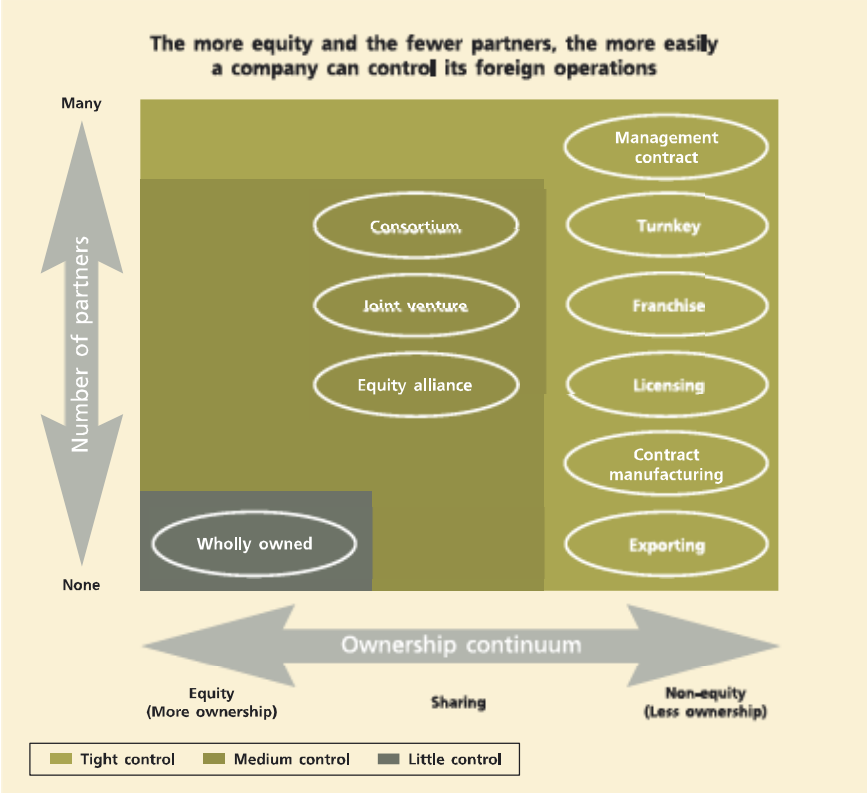
Management contracts may also appear in connection with turnkey operations, as will be described in the relevant section below.

Two additional points can be mentioned in connection with management contracts:

Franchising and management contracts may have similar features; but in a management contract the management of the facility is external to the owner

Firstly, for developing countries that need to resort to management contracts, a point of concern is that they should also be taken as an opportunity for learning so that, over a certain period of time, local capacities can be built up and the managerial functions assigned to the supplier can be partially or totally phased out. The mechanisms for learning and the timing of the phasing out can be the subject of appropriate provisions in the management contract.

Figure IV
Complexity of control as related to collaborative strategy



Adapted from John D. Daniels and others, *International Business: Environments and Operations*, 2005.

Secondly, in some fields, as illustrated by the case of hotel operations, the management contracts may resemble a franchising situation inasmuch as they involve distinctive business models with a globally recognizable brand name associated with them. The difference between the two situations is that, in a franchising contract, the management of the facility is done by the franchisee itself as the owner of the franchised facility, while in a management contract the management of the facility is external to the owner, that is, it is provided by the supplier's expatriate personnel.

5. Turnkey operations

In a turnkey contract, one client company contracts another company to build and deliver, ready to operate, an industrial plant or infrastructure facility

Turnkey contracts represent a form of international operation, often involving large-scale complex projects, that may provide opportunities for smaller firms of the host country to serve as subcontractors and suppliers.

In a turnkey contract, one client company contracts another company to build and deliver a ready-to-operate industrial plant or infrastructure facility, such as a power plant, a highway or a port. In such cases, the client can be a government agency.

There are various reasons why a turnkey contract might represent the preferred option for the client as compared with other project implementation modalities, for example when the client itself takes responsibility for the coordination and management of the project activities.

Industrial or infrastructure projects are complex undertakings, involving the mobilization and articulation of many different disciplines and a variety of suppliers. These could include various engineering branches (mechanical, electrical, civil), manufacturing and supply of equipment, management of the project implementation activities, commissioning and start-up operations, etc.

With a turnkey contract, the risks associated with possible delays, defective deliveries from different suppliers, cost overruns and performance failures are borne by the turnkey contractor.

Reasons for turnkey contracts

- The client lacks project management capabilities
- The contractor takes responsibility for the overall project
- The client avoids the risks of delays and cost overruns

Typical turnkey contractors are construction companies, industrial-equipment manufacturers or engineering and consulting firms, who assemble and coordinate other players and take responsibility for the overall project.

Some turnkey operations are associated with or lead to management contracts, e.g. when the client needs to outsource the skills for the operation and maintenance of the plant

Turnkey operations conducted in developing countries give the opportunity for local firms to act as subcontractors in areas where competencies may exist, for example selected engineering tasks, manufacturing of non-proprietary equipment and metal structures, civil works, etc. Furthermore, the linkage of local firms with international turnkey contractors will help to leverage their capabilities and pave the way for their own internationalization.

It should also be noted that some turnkey operations are associated with or lead to management contracts. This could be the case when the client has the plant or the infrastructure facility built and commissioned under a turnkey contract, and then needs to enter into a management contract to obtain the skills for the operation and maintenance of the facility, at least for a certain period until local capabilities can be built up and made available.

6. Equity alliances

The present training package revolves around the issues related to international business and inter-enterprise collaboration arrangements at the global level, which currently might be designated as "joint ventures", "collaborative agreements", "international alliances", "strategic alliances" and so on. Sometimes, these terms are used in a generic way and interchangeably, but they may also carry a specific meaning and a sharper characterization, which will be clarified throughout the package when necessary.

Features of equity alliances

- Equity alliances usually take the form of minority equity ownership
- They range from loosely bound relationships to well-structured agreements
- Investors seek collaboration on design, engineering and markets

Equity alliances solidify other forms of inter-firm collaboration arrangements such as joint R&D or supplier-buyer contracts for engineering and parts

There are many reasons why firms collaborate, for example to gain market knowledge and benefit from the distribution potential of a local firm, to gain access to other companies' technological capabilities and to share costs and risks in forward-looking R&D programmes. A more exhaustive picture will emerge in Part Two of the present package, mostly focusing on strategic alliances and joint ventures.

Inter-firm collaboration arrangements can range from loosely organized alliances to tightly structured contractual agreements, as in the case of joint ventures.

In this context, **equity alliances** can be referred to as a form of collaborative arrangement in which at least one of the collaborating companies takes an ownership position in the other partner company; in some cases each party takes an ownership of the other party, for example by buying some of each

other's shares or by swapping some shares with each other.[3] Typical equity alliances have been found in the automotive industry, but they have also been found in other industries from electronics to the airline industry. Through equity alliances, and even in cases of minority ownership (which are more usual), MNEs seek a certain measure of control of companies that are important to them for such purposes as sharing designs; engineering and parts; ease of market entry; and development of new products and systems. A motivation for equity alliances may also be to solidify other inter-firm collaboration arrangements, such as **supplier-buyer contracts**, which, within the framework of an equity alliance, are more difficult to break, mostly when the ownership is large enough to secure a management position in the partner company. In a generic sense, equity alliances could be regarded as a certain form of joint venture; but, as will be seen below when dealing with the concept of equity joint ventures, these are substantially different entities.

In plain language, the term "joint venture" means any undertaking through which the parties join efforts to achieve a common aim; but the term "joint venture" also carries a specific meaning and character

7. Joint ventures

The term "joint venture" is not used consistently in international business practice. Plainly speaking, the term "venture" means an undertaking involving chance, risk or danger; and the term "joint venture" means a "joint undertaking". Parties to international business transactions tend to use the term "joint venture" to describe various kinds of their joint efforts to achieve a common aim, and as a result the term then appears as synonymous with other kinds of collaborative agreement. For example, the concept of equity alliance presented above could fit this broad definition.

For the purpose of this training package, a "joint venture" is a long-term association of two or more companies, which contribute with assets for the creation of a new legal entity—the joint venture company

The **joint ventures** that are the subject of this study are of a specific character. They will be covered **in depth** in Part Two of the present training package; therefore the purpose of this section is simply to provide some highlights on the joint venture option as a form of foreign market entry strategy.

A **joint venture** is a long-term participation of two or more companies in an enterprise in which each party contributes with assets, has equity participation and shares risk. In some instances, parties do not even provide a time limit for the duration of their contract. Sometimes, the assumption under which joint ventures are established is that the parties will jointly run an undertaking for as long as the venture is viable.

There are different reasons for the establishment of a joint venture by international companies in developing countries, such as:

- The interest of foreign investors to minimize capital outlays or risks of entry by using the local partners' assets
- Lack of knowledge of the local institutional and legal environment, access to local borrowing, the goodwill associated with the perception that the joint venture is a local company
- In specific or strategic sectors, the country's laws may not allow full ownership of operations by foreign nationals
- In addition to the above reasons, for the local partners there is the willingness to take advantage of the association with the foreign partner in order to obtain access to the technology, international brands, product development and managerial techniques

[3] John D. Daniels and others, *International Business: Environments and Operations* (Prentice Hall, 2004).

Possible reasons for joint ventures

- *Host country*: policies restricting full foreign ownership of companies
- *Foreign investor*: minimize investment risk and obtain access to partner's assets and skills
- *Local partner*: access to technology, specialized services, brands and markets

Joint ventures, in the sense given to the term for the purpose of this training package, imply most often the creation of a new legal entity by incorporation of the partnership that was established through the joint venture agreement. The new incorporated body has an existence of its own, and is sometimes called an "incorporated joint venture" or "equity joint venture", in contrast to the "contractual joint ventures" or "consortiums" that are described below. Moreover, the joint venture agreement very often consists of a package of various contracts, for example, transfer of technology contracts and various other types of supply and service contracts, which usually are associated with the formation of an incorporated joint venture. The joint venture agreement also sets the rules that govern the managerial issues, as will be seen in Part Two of this package.

8. Consortiums

Consortiums are short- or medium-term arrangements involving various companies that decide to join forces to implement a project; upon project completion, the consortium is dissolved

In some sources,[4] **consortiums** are identified as "joint ventures where more than two organizations participate", and in the classic literature the term "contractual joint venture" is often used as another way of describing consortiums. But in a more currently accepted concept, the term "consortium" is used to designate short- to medium-term alliances that are set up to implement time-limited projects.

Typical cases of consortiums appear in civil engineering, construction and equipment supply industries, where contractors decide to join forces for a limited period of time in order to jointly build a plant or an infrastructure facility. The channel tunnel between the United Kingdom of Great Britain and Northern Ireland and France was build by a number of construction companies, which formed a consortium called TransManche Link. The consortium was dissolved on completion of the project.

Illustrative cases of consortiums

- For ***infrastructure projects***, needing involvement of different contractors
- For costly research and development projects, e.g. in ***pharmaceuticals***
- In the ***aircraft industry***, European-wide projects, e.g. Airbus consortium

Consortiums are also found in industries where costs and risks associated with R&D lead multiple companies to form partnerships in order to achieve a common objective. Examples include the pharmaceutical industry, where a new drug can cost $800 million to develop and bring to market; the formation of the Airbus Industries consortium for the European production of commercial jets; and consortiums for the creation of new generations of computer chips or the development of advanced wireless communication systems.

9. Contract manufacturing

Contract manufacturing can be regarded as a form of market entry strategy or a modality of outsourcing used by MNEs as an element of their global manufacturing strategies

Contract manufacturing can be included among the forms of market entry strategy that have been described above; it can also be regarded as a modality of

[4] For example, Daniels and others, op. cit.

outsourcing, to be presented in chapter II, which is devoted to manufacturing strategies of MNEs.

(a) Contract manufacturing as a market entry strategy

Through their own learning and innovation efforts, many contract manufacturers have improved their capabilities are becoming "original design manufacturers" and "original" design manufacturers

Through contract manufacturing, a company willing to enter a foreign market can contract a domestic enterprise to manufacture the product intended to be sold locally. This way, the contracting company will not need to set up its own facilities in the targeted country, thus avoiding the burden and risks of investment; however, it can keep control of its product and technology through the provisions of the contract and through the supply of the product specifications and other inputs such as materials, components and technical assistance.

As an example,[5] in a bid to get a footing in the potentially vast automotive market in China, in 2002 Toyota entered into an agreement with China's First Automotive Works aimed at the local production of a number of car models. Under the contract, Toyota, which had no equity participation, contributed with management expertise, technology, marketing assistance and cash, while First Automotive provided manpower, factories and equipment.

(b) Contract manufacturing as a form of outsourcing

As an element of their global manufacturing strategies, MNEs widely use contract manufacturing as a form of outsourcing components, systems and products, which they design, have assembled or manufactured by a contract manufacturer and sell on a global scale.

Many firms in Asia have prospered as contract manufacturers, most visibly in the fields of information technology and consumer electronics. In the process, through their own learning and innovation efforts, many of them are becoming original design manufacturers (ODMs) and original brand manufacturers (OBMs), in a pattern of development and internationalization that will be further highlighted in chapter II.

The case of Flextronics, the world's biggest contract manufacturer, is a good example. It has 20,000 employees and 2.5 million square feet of manufacturing capacity in Malaysia. It makes Sony Ericsson handsets, Hewlett-Packard printers, Xerox copiers and products for dozens of other companies. Flextronics has 7,000 of its staff engaged in R&D activities following a trend that is common to other contract manufacturers, which aim at affirming themselves as ODMs and OBMs.

10. Full ownership and wholly owned subsidiaries

To avoid risks and gain competitive advantage, MNEs increasingly resort to GVCs and GPNs to the detriment of wholly owned subsidiaries

A mention of **wholly owned subsidiaries** is warranted here for the sake of comprehensiveness in the enumeration and characterization of foreign market entry strategies of MNEs.

As we have seen in section I.A, the traditional strategies in FDI operations of MNEs involve wholly owned subsidiaries directly linked to the headquarters.

Such structures may be found in business fields where total control of the subsidiary business is a strong requisite, either for reasons such as the protection of intellectual property, because of a deeply rooted corporate culture, or because control by the headquarters is critical to the success of international marketing activities. However, as also explained above, the current trend is against full ownership by MNEs in their FDI operations. Among the factors supporting this trend are the risks inherent to legal restrictions in host countries; volatility in the

[5] Czinkota and others, *Fundamentals of International Business* (South-Western Publishing, 2004).

political or economic environment; and the fact that, in the context of international competition on the one hand and liberalization and globalization of markets on the other, MNEs increasingly resort to the less risky and more beneficial outsourcing within coordinated GVCs and GPNs.

11. The case of "born global" firms

Born global firms do not follow the traditional incremental approach to internationalization; they are typically export-oriented from the time of their creation

The concept of "born global" was first introduced in a survey for the Australian Manufacturing Council in 1993 by the consultants McKinsey & Company. The survey showed that two main types of exporters could be identified: (a) firms that had built a solid base in the home market over the years and had been driven to exports as a strategy for growth according to the classic patterns of multinational expansion; and (b) firms that were export oriented practically since their creation, as though they viewed the world as their marketplace from the outset and saw the domestic market as a support for their international business.[6]

A distinctive aspect of born global firms is that they do not follow the traditional approach to internationalization by incremental stages. On the contrary, they have the ability to address their products and services to the global market almost from their creation.

Many born global firms are SMEs. They are found in different sectors, including high technology, and are typically directed towards international niche markets.

Empirical studies have shown that many born global firms become global exporters from the start because of the international experience of their founders or because of the management's commitment to internationalization.

Increasing numbers of people with international experience, international networks and niche markets all over the world explain the emergence of born global firms

An explanation for this emerging pattern seems to be the pervading flows of information, the increasing number of people with international experience and the global market conditions with a growing number of international networks and niche markets. Before the born global concept was introduced, other authors had documented the existence of firms that were internationally oriented right from the beginning and used different terms to describe them,[7] examples of which are given below.

High-technology start-up firms. The characteristic of high-technology start-up firms is that such firms are founded by a group of people from several countries, who follow a strategy directed towards international niche markets. As developers of high-technology products, these firms have a natural vocation to be international right from the beginning.[8]

International new ventures. International new ventures[9] are regarded as business organizations that, from the inception, seek to derive significant competitive advantage from the use of resources and the sale of outputs in multiple countries. This category includes (a) firms that operate both as exporters and importers *(*new international market traders)*;* (b) firms that gain their competitive advantage by servicing a few customers with a highly specialized demand in a relatively small

---

6 Erik S. Rasmussen and Toge Koed Madsen, "The born global concept", paper for the 28th European International Business Academy Conference, 2002.

7 Ibid.

8 Vijay Jolly, Matti Alahuta and Jean-Pierre Jeannet, "Challenging the incumbents: how high technology start-ups compete globally", *International Journal of Strategic Change Management*, vol. 1, pp. 71-82.

9 Benjamin M. Oviatt and Patricia P. McDougall, "Toward a theory of international new ventures", *Journal of International Business Studies*, vol. 25, No. 1, pp. 45-64.

part of the world *(*geographically focused start-up firms); and (c) firms that are active both in reacting to the opportunities to place their products in the global markets and in accessing resources from multiple countries.

II. Global manufacturing strategies of multinational enterprises

A. The drivers of change

The opportunities for internationalization of firms of developing countries is very much dependent on the dynamics of international business and in particular on the business strategies of MNEs. With that in mind, the present section will analyse the approaches taken by MNEs in the management of their global manufacturing operations, the changing patterns of their behaviour and the underlying drivers of change, and the implications for developing countries at the enterprise and policymaking levels.

The opportunities for internationalization available to firms of developing countries are associated with the business strategies of multinational companies in their global operations

1. Technology, innovation and competition for markets

The evolving routes for innovation

- *Traditional:* inside the firm, resources are aimed at market leadership
- *Current situation:* innovation in cooperation with other firms because of costs and risks
- *Ongoing trend:* outsource innovation from dynamic firms in order to stay ahead and to shorten time to market

Technology is a critical source of competitive advantage; companies must keep innovating in order to stay ahead of competitors or they will lose their position in the marketplace. "Innovate or die" is not just a metaphor, it is a reality of the current business environment. It is disturbing to think that, of the top names in the *Fortune* 500 list for 1985, less than half were still there by 1995.[10] For smaller firms, the death rate is still higher. Reports in 2005 have said that Polaroid, which once marvelled the world with its instant photography technology, was unable to survive the assault of digital photography and might eventually fade into oblivion. Conversely, Kodak, a long time leader as a manufacturer of conventional cameras and film also faced the threat of digital technology, but managed to react to it successfully by decisively going digital and entering the lucrative printing business, reversing its fortunes from a situation of decline into becoming the market leader in the United States of America in the field of digital photography.

"Innovate or die" is not just a metaphor, it is the reality of the competitive business environment these days: as a trend, MNEs are increasingly outsourcing innovation

In order to survive the competitive pressures and grow, firms resort to cost-reduction strategies, such as subcontracting, contract manufacturing, outsourcing materials and other inputs, or taking advantage of locational benefits. But most of all, they must invest substantially in R&D and innovation. Sometimes, this might be accomplished using a firm's own resources, which gives ownership of the technology created and consequent market dominance; in other cases, R&D is done in association with other firms, even competitors, when the development costs and the uncertainties about the results are too high and represent excessive risk for one single organization. Another situation, a growing trend in the practice of MNEs, is to outsource innovation, either subcontracting R&D to suit their product development targets, or adapting new products developed by other firms and commercializing them under their own brand.

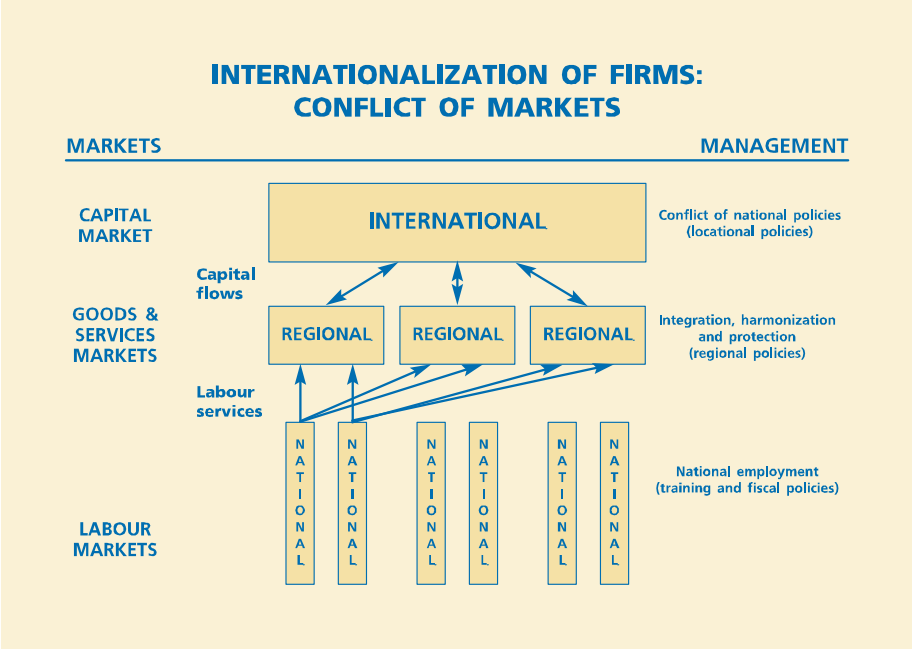
Capital markets, labour markets and markets for goods and services have substantially different characteristics and move at different rates; this has profound implications for the strategies of MNEs

[10] Steve Brown and others, *Strategic Operations Management* (Butterworth Heineman, 2005).

2. Conflict of markets

As illustrated in figure V,[11] there are three types of market, all of which have substantially different characteristics and move at different rates, resulting in profound consequences for strategies of MNEs. At the top of the diagram, a single block represents the capital market, which is very closely integrated (capital has a high mobility as compared to other production factors); in the middle, regional markets for goods and services (for example, regional blocks such as the European Union and the North American Free Trade Agreement) are shown; and at the bottom, labour markets, which are essentially national and immobile, are given. These markets move at different rates, as does the globalization process.

Figure V
Conflict of markets as a driver of internationalization



Source: Peter Buckley, "FDI and growth for developing countries: MNEs and challenges of the 'new' economy", keynote speech and paper, UNIDO General Conference, 2003.

Capital markets are international and very closely integrated as a result of the high mobility of financial flows; labour markets are essentially national and immobile by nature

The implication for the strategies of MNEs is that they can raise capital at the lowest possible cost and disburse it wherever they like; they can gain economies of scale in markets for goods and services and thus achieve long production runs and reduce costs within key markets; and they also have the opportunity to place their labour-intensive stages of production in labour markets that provide both cheap costs of labour in relation to productivity and also flexibility of operations.

3. Volatility of the world economy

The reaction of MNEs to the volatility of the world economy is to build as much flexibility as possible into their operations through both locational and ownership strategies

The world economy is uncertain and increasingly interconnected; events or crises happening in one place may have immediate reverberations on a global scale. This volatility is one of the major reasons for the changing strategies of MNEs. Their reaction is to build as much flexibility into their operations as possible and there are two key areas where flexibility is essential.

The first key area is the **locational strategy**. In order to minimize risks, MNEs avoid concentrating their offshore activities, foreign investment operations or

[11] Keynote speech and paper presented at the UNIDO General Conference in 2003 by Peter Buckley.

outsourcing in a single country; by the same token, they can easily move from one location to another, according to changing conditions and perceived comparative advantages. This is true not only with regard to the investments of MNEs in developing countries but also in respect of their operations in industrialized countries.

The other key area is the **ownership strategy**. The traditional hierarchical, vertically integrated MNE is giving way to a much more network-like firm. Instead of FDI through wholly owned subsidiaries, MNEs increasingly operate abroad through other forms of collaboration, such as joint ventures, subcontracting, licensing, or other kinds of non-equity arrangement.

4. Liberalization policies in developing countries and competition for FDI

Liberalization policies in developing countries regarding FDI were induced by international trade negotiations and also by the positive correlation between FDI and growth

Drivers of changing strategies of MNEs
- Technological change, innovation and competition for markets
- Conflict of markets: capital vs. labour and regional blocks
- Liberalization policies in developing countries; competition for FDI
- Advances in information and communication technologies

Since the early 1980s, a trend has emerged in developing countries to abandon the former import-substitution regimes and increasingly adopt liberalization policies with regard to investment and trade operations of MNEs.

On the one hand, the liberalization trend was induced by the pressure of multilateral trade negotiations as well as regional and bilateral trade agreements linking developing countries to industrialized countries. The conditions associated with the structural adjustment programmes supported by international financial institutions also compelled the adoption of liberalization policies in countries that entered into such programmes. On the other hand, this trend also resulted from the recognition of the positive correlation between FDI and growth.

The perceived advantages of FDI led Governments of developing countries to compete among themselves to attract foreign investors. This is certainly a major element for the locational flexibility enjoyed by MNEs in their global operations.

5. Advances in information and communication technologies

The advances in the area of information and communication technologies made it possible for MNEs to manage and control complex worldwide operations

The technology advances in the area of information and communication technologies is another important driver of changing strategies for MNEs, by allowing them to manage and control their global supply chains, manufacturing, warehousing and distribution operations and networks of suppliers, subcontractors and subsidiaries. Different mechanisms have been developed, for example electronic data interchange (EDI) to link suppliers, manufacturers, customers and intermediaries; call centres and e-commerce, to process orders and serve customers on a worldwide basis; and the Extranet, to link companies with their suppliers and subcontractors so that they can organize production and deliver their inputs when needed. Multinational enterprises and software developers alike have been actively implementing and putting to use information technology packages to manage their operations by using the Internet. The new trend is that of private technology exchange (PTX), which allows online collaboration, as well as time and cost reductions, among the elements of value chains and production networks.

Example

Walmart has 14,000 suppliers throughout the world connected to its inventory ordering system, processing transactions worth more than $217 billion. One could ask whether such a business could be implemented without the information and communication tools that came into being with the technology revolution of the past two decades.

(***Source***: John D. Daniels and others, ***International Business: Environments and Operations*** (Prentice Hall, 2004)).

B. Implications for operational strategies of multinational enterprises

Intense competition for consumers' preferences drives firms to continuing innovation, product differentiation, high quality and low prices

The operational strategies of MNEs, which policymakers of developing countries need to dissect and understand, are influenced and shaped by several interrelated elements. Firstly, the intense competition for consumers' preferences and market position—which means continuing innovation, differentiation, product quality and also low prices; secondly, the liberalization of trade and FDI regimes—which results in decreasing transaction costs and gives MNEs substantial flexibility in the spatial location of their operations and in the dynamic distribution and re-distribution of manufacturing and services according to convenience; thirdly, the mobility of capital and the propensity of MNEs to shift from more "closed" and vertically integrated operations to more "open" structures where outsourcing and locating non-core operations offshore is becoming the prevailing rule; and fourthly, the advances in information and communication technologies, which give MNEs the tools and skills to process data and the ability to effectively coordinate and manage complex networks of suppliers and customers worldwide, thus responding quickly and flexibly to changes in demand and playing to their advantage with location, differences in costs, infrastructure, manufacturing capabilities and trade and investment regimes. This scenario has, moreover, made possible the fragmentation of manufacturing activities. The following sections will analyse in more detail the way MNEs organize and manage their global operations.

Vertical integration, insourcing, offshoring and outsourcing, subcontracting and contract manufacturing

Vertical integration of operations allows for better consolidation and control of operations but offshoring and out-sourcing may provide for more competitive and flexible conditions

Under the pressure of competition and with the flexibility created by the openness of developing countries to trade and investment flows and the coordination and control possibilities offered by the advances in information and communication technologies, MNEs can organize their operations in a way that better suits their interests and strategies.

Vertical integration used to be the traditional approach to companies' operations, characterized by ownership of the entire production and supply chain, including R&D activities, as intrinsic to their culture and core capabilities. Vertical integration has the advantage of allowing for the consolidation of all processes for a specific product or product line, but involves risks and shortcomings that, in the present conditions of competition, companies may not wish to take. One risk is that vertically integrated

Alternative operational strategies
- Vertical integration—own supply
- Insourcing—company owned
- Offshoring—operations abroad
- Outsourcing—third party supply

manufacturing facilities may have difficulty in coping with changes in demand, either quantitative or qualitative, and the consequent missed opportunities or financial losses. Another shortcoming of vertical integration is that many of the elements of a production and supply chain can possibly be obtained from outside sources with better quality and price, which also explains why enterprises increasingly resort to offshoring and outsourcing operations.

Insourcing represents a step between vertical integration and outsourcing. It consists of establishing shared service centres within a company so that different areas of the business can benefit from such services in an efficient, streamlined, standardized and cost-effective way. With the insourcing approach, companies achieve efficiency gains by relocating and concentrating in one specific structure resources that otherwise would be dispersed, uncoordinated and inefficient; skills can be retained and assets exploited, resulting in lower unit costs for the insourcing business.

There are cases of companies' activities that, through the insourcing approach, have become viable business units that evolved into self-sufficient independent firms with international outreach.

Offshoring has been used by MNEs as a cost minimization strategy; it takes advantage of low labour costs, availability of cheap materials and components, and the proximity of markets

Offshoring, literally speaking, means to move a business process to a foreign location. Offshoring became attractive as a cost-minimization strategy of MNEs, which set up production facilities in foreign countries, for example in Asia, Mexico and Eastern Europe, to take advantage of low labour costs, availability of cheap materials and components and proximity to markets. Offshore manufacturing became popular in the 1960s and 1970s in the electronics industry, when Western companies, one after another, set up facilities in Asian countries, namely the Republic of Korea, Singapore and Taiwan Province of China. Subsequently, as wages rose in those countries, offshore manufacturing shifted to lower-cost countries, such as China, Indonesia, Malaysia, Thailand and Viet Nam. Offshoring, as characterized above, can be regarded as synonymous with FDI, but it can also be perceived as a form of outsourcing, which is the case when the offshore elements are provided by independent firms.

Through outsourcing, a company can concentrate on what it does best and take advantage of the lower costs, expertise and innovation capabilities that the provider can offer

Outsourcing can be defined as a way of having inputs supplied to a firm by a third party. Outsourced inputs can be of a different nature, for example inventory management, call centres, human resource services, inventory control, supply of components or the provision of full-scale manufactured products. Through outsourcing, a company or organization can concentrate on what it does best and also take advantage of the expertise that the provider has accumulated and will possibly keep improving.

A decision to outsource must balance considerations of an economic and a strategic nature such as:

- Costs of outsourced products versus in-house production
- Quality and reliability of supplies from outside sources
- Capability (or lack thereof) for in-house production
- Vulnerability resulting from possible supplier coalitions
- Loss of intellectual property and innovative capabilities

- Danger of suppliers becoming competitors

Offshoring and outsourcing benefits
- Cost reduction of product or service
- Access to technology and innovation
- Focus on company's core business
- Increased flexibility of operations
- Outsourcing—third party supply

Too much or too little vertical integration can result in competitive disadvantages, so these kinds of decision should be addressed from a strategic perspective.

Outsourcing is sought not only by big MNEs; small businesses also turn to outsourcing as a way of improving flexibility and accessing needed skills that are not available in-house

Outsourcing is not only sought by big companies; small businesses increasingly turn to outsourcing for a variety of reasons. In some cases, it is a question of cutting prices and surviving the pressure of competition; in other cases, the reason is to find skills that are needed but not available in-house, for example software programming, graphic design and advertising. Small businesses may also find outsourcing attractive because of the flexibility it provides. With a relatively small staff, they can quickly expand in periods of peak work by sending orders overseas and then shrink again in the off-season period.

It should be pointed out that not all outsourcing is successful, particularly when the client is a small business, is located a long way away from the outsourcer, does not have an on-site manager and possibly faces substantial time differences and language barriers, as could be the case, for example, if one firm is in the United States and the other is in India.

Big companies may also encounter potential problems with outsourcing. Loss of operational control of operations has been found to be one of the biggest concerns. Cultural barriers and long-term dependency may also be regarded as potential problems that companies take into account when taking a decision to "make or buy".

Both subcontracting and contract manufacturing are forms of outsourcing; while there are subtle distinctions between the two concepts, they can be regarded as practically the same

In section I.F, the concept of contract manufacturing as a modality of outsourcing was introduced, whereby a company arranges for components, systems or products of its own design to be assembled or manufactured by another company, usually referred to as a contract manufacturer.

Subcontracting is also a form of outsourcing and the concept can currently be regarded as practically the same as contract manufacturing. A subtle distinction between the concepts is rooted in the historical development of outsourcing activities. At earlier stages, the term "subcontracting" was more in use in connection with the outsourcing of simpler operations or the manufacturing of components according to the requirements of the main contractor.

There are two main types of subcontracting: "capacity subcontracting", the more traditional form, and "specialist subcontracting", which is identical to contract manufacturing

As defined by UNIDO, subcontracting is an economic relationship where one entity, the main contractor, requests another independent entity, the subcontractor or supplier, to undertake the production or carry out the processing or assembly of a material, component or part, or to provide an industrial service in accordance with the main contractor's specifications.
(Source*: UNIDO, 2003, *"International subcontracting versus delocalization: a survey of the literature and case studies from the SPX network".)

The term "contract manufacturing" has a stronger connotation, with the outsourcing (or "subcontracting") of more complex systems or equipment, where the manufacturer is required to have a higher level of expertise and in some cases design capabilities as well.

The growth of industrial subcontracting has led to the development of two main types of subcontracting relationship, defined below.

***Capacity subcontracting*.** The first type of subcontracting relationship is that of capacity subcontracting, which corresponds to the more traditional concept. In such a situation, the main reason for subcontracting is the fact that the main contractor does not have enough capacity to undertake the manufacturing of the specific component, part or material.

In other words, the main contractor has reached the capacity limit in its production process and, in order to meet the market demand for its product, is required to use a subcontracting specialist at least for a temporary period of time.

***Specialist subcontracting*.** This modality corresponds closely to the concept of contract manufacturing. In this case, the main contractor relies upon the services of a subcontractor who has specialized equipment or machinery and skilled labour to undertake complex and precision tasks.

As a recent trend, MNEs are outsourcing innovation not only through research contracts but also by acquiring complete designs that are commercialized under their brand names

This may involve either finished products, specialized components or supplies that require a higher level of technical expertise that the main contractor does not possess or cannot meet.

Outsourcing of innovation is becoming a trend that shows how far the strategies of MNEs are evolving in their search for external sources of competitive advantage. Innovation is outsourced not only through research contracts, but also by acquiring complete designs from the dynamic, innovative firms in Asia and simply commercializing the devices under their own brand names. This is becoming common with brands like Dell, Motorola and Philips, and for equipment ranging from laptops and high-definition televisions to MP3 music players and digital cameras. While this trend is most conspicuous in the electronics sector, outsourcing and offshoring innovation is spreading into many other fields of the economy.

Described below are a few illustrative examples. In early 2005, Boeing entered into a deal with HCL Technologies of India to develop critical software for the operation and navigation of the 7E7 Dreamliner jet; leading pharmaceutical companies such as GlaxoSmithKline and Eli Lilly are involving Asian biotechnology companies in joint research activities in order to cut the extremely high costs of bringing new drugs to the market; and Procter & Gamble intends to increase the contribution of outsourcing and offshoring (now at 20 per cent) for new product ideas.

C. Global supply chains, global value chains and global production networks

1. The concept of supply chains and value chains

The terms "supply chain" and "value chain" are often used with the same meaning in the current literature; but there is a distinction, which highlights the value added along the chain

An overview of major textbooks and academic literature has shown that the terms "supply chain" and "value chain" are used interchangeably and with practically the same meaning. Some works contain only one of the terms and not the other; other works contain both terms but without a clear elucidation of the distinction between the

Supply chains and value chains

- *Supply chains*: flow of all a firm's activities from extraction of raw materials to final distribution of goods
- *Value chains*: the supply chain involves a sequence of "value activities" that create a product of value to customers

underlying concepts. The book *International Business: Environments and Operations*,[12] for example, contains a glossary with the following definitions:

Supply chain. The coordination of materials, information and funds, from the initial raw material supplier to the ultimate customer.

Value chain. The collective activities that occur as a product moves from raw materials through production to final distribution.

These definitions do not provide much help if we look for a distinction between the terms, which in fact exists and is highlighted by some sources and authors.[13] According to these, the concepts of "supply chain" and "value chain" can be differentiated as follows:

A typical supply chain involves three inter-related levels of intervention: material management functions; information processing functions; and functions for the transfer of funds

A supply chain encompasses all the activities associated with the flow and transformation of goods from the raw material stage through to the end users, as well as the associated information flows; it includes systems management, operations and assembly, purchasing, production scheduling, order processing, inventory management, transportation, warehousing and customer service.[14] This concept, in a way, embraces the above definitions of supply chain and value chain.

A value chain is a concept introduced by Michael Porter in 1985[15] to underscore the idea that every business is a collection of activities to design, produce, market, deliver and support its product, in a sequence that he termed the "value chain". The activities are called "value activities" and through them the firm creates a product of value to its customers. In monetary terms, the difference of the total value of a product to customers is higher than the total cost of the value activities and the difference represents a higher profit margin for the firm and a lower cost for the customers.

To underscore the conceptual distinction between the terms **supply chain** and **value chain**, a ***supply chain*** refers to the flow and processing of physical inputs along the chain; a **value chain** refers to the underlying idea that each node of the chain has outputs that, in accounting terms, bring an added value to the manufacturer.

The problem firms face is how to transform supply chains into value chains, i.e. to meet or exceed the customer's expectations at the lowest cost, thus achieving a higher profit

Figure VI illustrates a typical supply chain network for a manufacturing or service organization. It shows three interrelated levels of intervention: (a) the material management functions, from receiving and storing the raw materials and components, to processing and manufacturing functions, to distribution and delivery to customers; (b) decision-making functions and related information-processing functions, including orders from customers, orders to suppliers, and planning and control process; and (c) functions related to the transfer of funds, which are assumed to be a form of working capital and must be regarded as an important element in the supply chain.

---

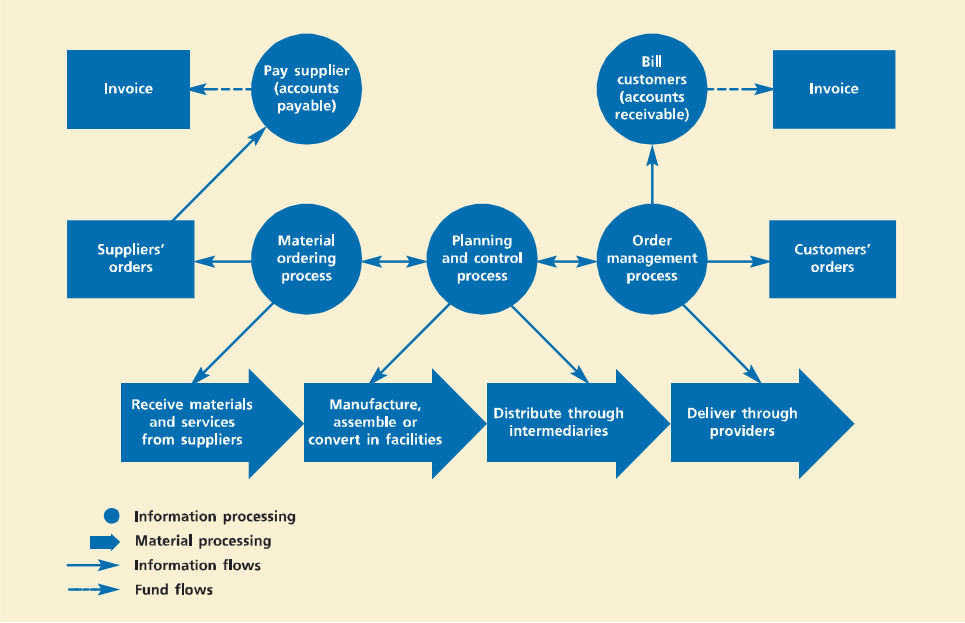
[12] Daniels and others, op. cit.

[13] For example, Ralph G. Kauffman and Thomas A. Crimi, "A best-practice approach to transforming global supply chains". Paper presented at the 89th annual International Supply Management Conference, April 2004.

[14] Monczka and others, *Purchasing and Supply Chain* Management (Thomson South-Western, 2002), quoted by Kauffman and Crimi, "A best-practice approach …".

[15] Michael E. Porter, *Competitive Advantage: Creating and Sustaining Superior Performance* (New York, Simon & Schuster, 1985).

Figure VI
Illustration of a supply chain network



Source: Amitabh S. Raturi and James Evans, *Principles of Operations Management* (South-Western Publishing, 2005).

The need for supply chains, whether through vertical integration, offshoring, outsourcing, purchase or a combination thereof, is inherent to any firm. The problem firms face is **how to transform supply chains into value chains,** which means meeting or exceeding the customer's expectations at the lowest cost and achieving success in terms of profitability.

Supply chains and value chains are the real source of competitive advantage and companies today no longer compete on products but rather through supply chains and value chains.

Both value chains and supply chains can span the enterprises of a local economy, a supra-national regional economy and the global economy. For this training package, the importance of the value chain concept derives from the influence these chains have in the innovation possibilities of the firms of developing countries when they participate in global operations of multinational enterprises. That is why the terms GVC and GPN are more currently used in this context.

2. Global production networks

The "production network" concept reflects the fragmentation of knowledge-intensive activities in some value chains and the possibility of such activities being performed in different locations

The GVC concept is increasingly complemented by that of GPNs of specialized independent enterprises, capturing complex relationships and interrelations between firms that are of a systemic nature. The **production network** concept reflects the process of accelerated fragmentation of knowledge-intensive activities in some value chains. Through modularization, technological knowledge acquires the characteristics of a standard commodity, allowing design and other knowledge-intensive technologies to be separated from the whole value chain system and to be performed in different geographical locations.

Leading MNEs are playing a key role in organizing and controlling these global production systems, benefiting from locational differences in costs, infrastructure, capabilities in manufacturing, marketing and logistics, and in trade and investment regimes.

In a GPN, brand leaders pursue cost reduction, product differentiation and time-to-market strategies through outsourcing volume and low-margin production

In a GPN, brand leaders such as International Business Machines, Compaq or Dell, acting as flagship firms, allow suppliers to be independent but demand high performance from them. Brand leaders pursue cost reduction, product differentiation and time-to-market strategies through outsourcing volume and low-margin manufacturing and related support services.

Triangle manufacturing[16] appears in this connection as a strategy adopted by some contract manufacturers, which take orders from the leading flagship firms and shift part or all requested production to other factories (wholly owned, joint ventures or independent), which form their own supply chains and production networks. The triangle is closed when the finished goods are shipped to buyers.

The growth, strategic direction and ownership position of participants in GPNs depend markedly on the strategy of the flagship company. Where final markets do not need customized inputs, the flagship companies will prefer to purchase inputs on an arm's-length basis on the global markets, as they do for many primary commodities. But where a market demands more customized inputs, they often choose long-term relationships with reliable suppliers who meet their requirements. When needed, the flagship companies will help these suppliers to reach the desired standards. Sometimes, MNEs prefer to internalize production in their value chains, for example when their discrete competencies are involved, or where the transaction costs of helping suppliers are too large.

Factor markets include all the inputs that enterprises need, from information and capital to skilled and unskilled labour, components, physical resources and infrastructure

Integrated global factory is a term gaining currency[17] to describe the complexity of the functional relationships and spatial distribution of the global operations of MNEs. Figure VII illustrates the complexity of the picture, the configuration of which is dynamically changing according to the changing characteristics of industry competition and **factor markets** (see glossary), as well as the policy environment of developing countries where MNEs implement their operations.

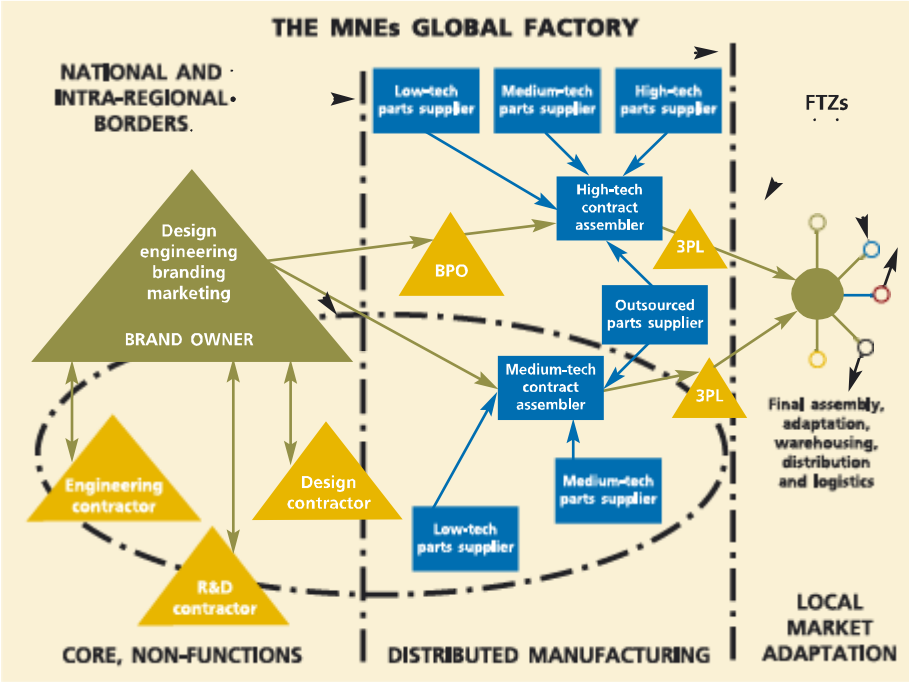
Alliance capitalism is a term used to designate the parallel modes of market entry in multifaceted patterns of intra-firm cooperative arrange-ments with equity and non-equity modalities

Adding to the complexity of the picture, the global strategies of MNEs assume parallel modes of market entry and servicing in multifaceted international patterns of inter- and intra-firm cooperative arrangements described as **alliance capitalism** (see glossary), which includes different types of cooperative arrangement such as joint ventures, strategic alliances, co-production and marketing, joint R&D, contract design and manufacturing with equity and non-equity modalities.

[16] UNIDO, "Inserting local industries into global value chains and global production networks: opportunities and challenges for upgrading", 2004.

[17] Frank L. Bartels, "Outsourcing markets in services: international business trends, patterns and emerging issues", paper presented at the 2005 Outsourcing Trend and Development Conference (Shenzhen, China, 8-9 June 2005); see also keynote speech and paper by Peter Buckley, UNIDO General Conference, 2003.

Figure VII
Integrated global factory



Source: Frank L. Bartels, "Outsourcing markets in services: international business trends, pattterns and emerging issues", paper presented at the 2005 Outsourcing Trend and Development Conference; and Peter Buckley, "FDI and growth for developing countries: MNEs and challenges of the 'new' economy", keynote speech and paper, UNIDO General Conference, 2003.

D. Corporate social responsibility

In the past 20 years, there has been a radical change in the relationship between business and society, with companies recognizing that improving their own impact and addressing wider social and environmental problems is crucial in securing their long-term success. Increasingly, high-profile companies are implementing corporate social responsibility (CSR) processes (see glossary), such as public commitment to standards, community investment, continuous improvement, stakeholder engagement and corporate reporting on social and environmental performance.

CSR is now being discussed and debated in the public policy sphere. The United Kingdom has a Minister for Corporate Social Responsibility; in 2001 the European Union published a Green Paper on promoting a European framework for CSR; and the United Nations Global Compact is bringing together companies and United Nations entities to address CSR.

The basic drivers of CSR are:

- **Values:** a value shift has taken place within businesses where they feel a responsibility not only for wealth creation but also for social and environmental issues
- **Strategy:** being more socially and environmentally responsible is important for the strategic development of a company
- Public **pressure:** pressure groups, consumers, the media, the State and other public bodies are pressing companies to become more socially responsible

Over time, CSR has gathered strength and strategic importance within companies as it is seen as a way of creating sustainable value

Companies are often driven by one of the above CSR drivers, but see a shift into other spheres over time. For example, for companies that have been subjected to high-profile campaigns, such as Royal Dutch Shell and Nike, the main driver of change has been public pressure. Over time, CSR has gathered strength and strategic importance within companies as it is seen as a way of creating sustainable value. However, in the main, it has been public pressure centred in three key areas that has driven the CSR agenda. These comprise the environment, labour standards and human rights, and it is no coincidence that these are included in the 10 principles of the United Nations Global Compact.

CSR has primarily been of concern to MNEs, but it also concerns SMEs, both as suppliers to international companies and markets, and as recipients of donor-led programmes

Although CSR has primarily been the concern of MNEs, it is increasingly involving SMEs, both as suppliers to international companies and markets and as recipients of support through donor-led programmes to encourage economic development. CSR is affecting SMEs in developing countries through direct supply chain relationships, and as the result of developments in legislation and international standardization and certification. CSR represents a change in the commercial environment in which SMEs operate and can be regarded in terms of its net effect on society. For some critics, CSR may result in a protectionist effect, by imposing inappropriate cultural standards or unreasonably bureaucratic monitoring demands on small business. In such cases, the net effect on the communities concerned would be a reduction in their welfare.

From another perspective, CSR offers opportunities for greater market access, cost savings, greater productivity and innovation to SMEs, as well as broader social benefits such as education and overall community development.

E. United Nations Global Compact

The United Nations Global Compact contains 10 principles that call for CSR in such areas as human rights, labour practices, protection of the environment and ending corruption

The United Nations Global Compact is rooted in the Universal Declaration of Human Rights; the International Labour Organization's Declaration on Fundamental Principles and Rights at Work; the environmental principles contained in Agenda 21, adopted at the United Nations Conference on Environment and Development; and the United Nations Convention against Corruption. The 10 principles of the United Nations Global Compact are set out below.

Human rights

The Secretary-General asked world business to:

1. Respect the protection of international human rights within their sphere of influence.
2. Make sure their own corporations are not complicit in human rights abuses.

Labour

The Secretary-General asked world business to uphold:

3. Freedom of association and the effective recognition of the right to collective bargaining.
4. The elimination of all forms of forced and compulsory labour.
5. The effective abolition of child labour.
6. The elimination of discrimination in respect of employment and occupation.

The environment

The Secretary-General asked world business to:

7. Support a precautionary approach to environmental challenges.
8. Undertake initiatives to promote greater environmental responsibility.
9. Encourage the development and diffusion of environmentally friendly technologies.

Corruption

The Secretary-General asked world business to:

10. Work against all forms of corruption, including extortion and bribery.

III. Opportunities for developing countries

A. Basic requisites for technological development

As a rule, successful cases of technological progress in developing countries are related to FDI operations and to linkages between local companies and MNEs

Global production systems can create opportunities for producers in developing countries to upgrade their technological and industrial capabilities and to integrate themselves into the global economy. The process mostly involves linking firms of developing countries with global players, so that the firms acquire new technology and skills and leverage those acquisitions in ways that maximize the benefit of the new relationship.

Technological and industrial development is possible even for countries that have a low starting point, as illustrated by the encouraging and inspiring achievements of the countries of South-East Asia. However, each country has its own set of endowments and constraints and will have to find the path for development that suits its particular conditions. Whatever the options, there are unavoidable common prerequisites and decisive factors for success, which are enumerated below.

Elements for technological growth of enterprises of developing countries

- **Imported technological inputs**: linkages with foreign partners; participation in global chains
- **Own technological effort**: willingness to grow; investment in R&D, innovation and learning
- **Government support**: enabling policies; technological infrastructure; and supporting institutions

In order to take full advantage of the links with foreign partners and grow technologically, developing countries' firms have to make a consistent effort of **innovation and learning**

Imported technological inputs. The contribution of foreign inputs has been acknowledged as a critical factor for technological progress of firms of developing countries and the economic growth of the recipient countries. Those inputs can be channelled through different kinds of linkages, for example technology acquisition through licensing or through FDI with its spillover effects and backward linkages with local suppliers; joint ventures, with the consequent upgrading of local partners; OEM (see glossary) arrangements; and participation in value chains.

Own technological effort. In order to take full advantage of the linkages with foreign partners, firms of developing countries have to undertake a conscious, purposeful and consistent technological effort to learn from their foreign partners and move up the technology ladder from basic assembly operations to their own designs and own brands, towards internationalization and market leadership. The technological effort can occur everywhere in the enterprise, not only in R&D activities but also in the context of shop-floor operations and in managerial strategies; it can also draw substantially from outside sources such as suppliers and customers and from the institutions that form the **national innovation system** (see glossary), as well as from specific government support services.

The role of Governments is indispensable, both to create conditions to attract foreign investors and to assist domestic companies in their learning and internationalization efforts

Government policies and support. The role of the Government is crucial in the development process, both at the macro level and at the enterprise level. Foreign investors and partners are only willing to operate in a country or establish cooperative arrangements with local enterprises if the Government is able to create the legal, institutional and infrastructural conditions that inspire confidence and make foreign operations in the country competitive and profitable.

In addition, domestic firms might not be able to succeed in their own efforts to acquire technology without government policies and institutions aimed at supporting their learning and internationalization. Indeed, only Governments can coordinate the many elements to form a coherent strategy for industrial and technological development. Where this has been done effectively in some East Asian economies, the results have been spectacular.

B. Technology development through value chains: linking, leveraging and learning

Technology development at the level of the firm in the context of developing countries is the result of a process of **innovation and learning** (see glossary), which usually starts by importing technology for production purposes and grows over time into the capability to improve existing technology and create new technology.

There are different ways of accessing technology and capturing technological knowledge, for example through licensing, OEM, joint ventures and alliances, and through participation in value chains and GPNs.

In all cases, the concept of **linking, leveraging and learning** (see glossary) captures what firms—and also countries—have to do to foster their technological development.[18]

Linking: connecting with outsiders to acquire needed technologies and skills

Leveraging: going beyond arms-length transactions to squeeze as much as possible out of the new relationships with outsiders

Learning: making the many efforts to master technological processes and consciously building the foundation for improving existing technologies and creating new ones

Linking to GVCs and GPNs gives firms of developing countries the opportunity to upgrade their capabilities and integrate into the global economy

Linking to GVCs and GPNs brings to firms of developing countries opportunities to upgrade their technological and industrial capabilities and to integrate into the global economy. It can provide better access to markets and to knowledge of leading players and represents a platform to learn and create new capabilities. Local enterprises need to possess high technological capabilities in order to be included by a flagship firm in its GPN. Once selected, participants can benefit from the opportunities to form and develop networks, which is the core of the strategy adopted by a flagship firm to raise the competitiveness of its network. Furthermore, the inclusion of an enterprise from a developing country in a GVC puts great pressure on that enterprise to meet demanding quality, reliability and logistic standards and induces the firm to improve its efficiency in individual activities and move to higher levels of technological capabilities, competitiveness and growth. Over time, and as a result of the **leveraging and learning** that comes from the participation in GVCs and GPNs, firms of developing countries will be able to upgrade their operations in different ways and directions, as illustrated in figure VIII, by changing the mix of activities and moving to the upper links of its value chain; or by innovating four kinds of innovation can be distinguished (see glossary): **process**

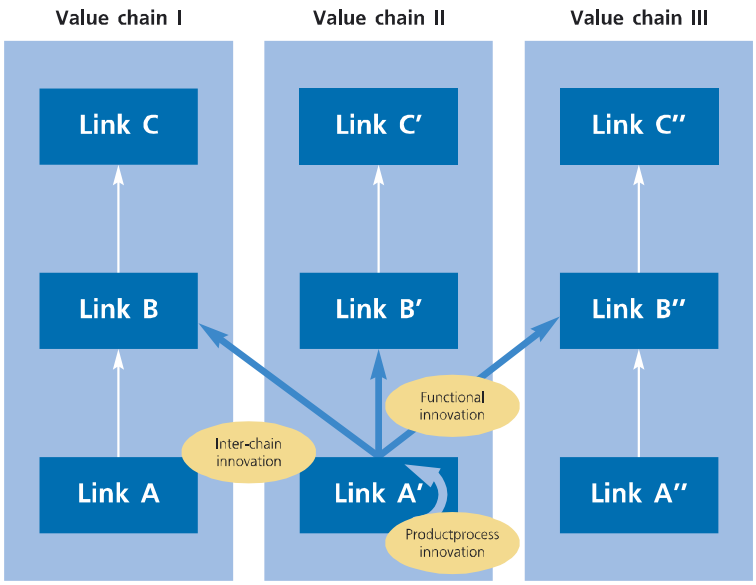
To be eligible for participation in GVCs and to be included by flagship firms in their GPNs, enterprises of developing countries need to have substantial capabilities in place

[18] UNIDO, *Industrial Development Report: Competing through Innovation and Learning*, 2002 (United Nations publication, Sales No. 02.II.B.13).

innovation (improving the efficiency of internal processes), **product innovation** (improving products through quality, price performance and differentiation), **functional innovation** (raising value added by changing the mix of activities conducted in the firm), and **inter-chain innovation** (moving into a new, more profitable, value chain).

Over time, and as a result of **leveraging and learning**, firms can upgrade operations and move into higher links of the value chain or into new and more profitable value chains

Figure VIII
Innovation trajectories in value chains



Source: UNIDO, *Inserting local industries into global value chains and global production networks: opportunities and challenges for upgrading*, 2004.

C. Development pathways and the role of Governments

1. Development pathways

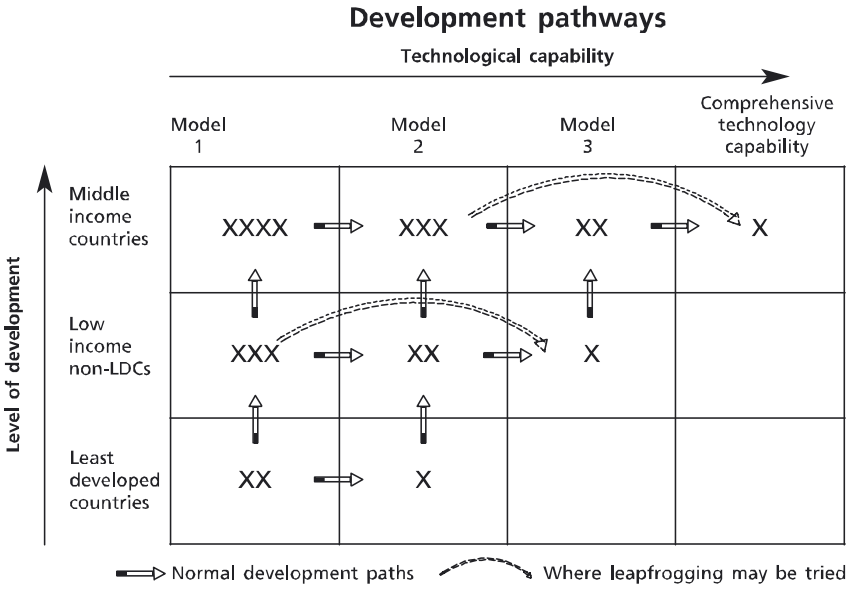
Different countries have followed different development pathways, depending on the overall conditions, government options and capabilities at the firm level

In order to be selected to participate in GVCs and GPNs, firms of developing countries need to possess significant technological capabilities, which means that they must have already gone through a certain process of building up their capabilities. Different countries and their firms start from different levels of industrial development and technological capabilities; no matter what level a country or firm starts from, there is scope for building, upgrading and further developing their capacities, according to pathways that depend on the overall country conditions and level of development, government policy options and technological capability at the firm level.

Figure IX provides an illustration of usual technology development pathways following three typical models, which are described below. For least developed countries (LDCs) with a low level of development and technological capability, a possible option could be based on **trade, aid and import-substitution strategies**, and an effort at the level of the firm to improve the efficiency of operations, upgrade technology and achieve acceptable quality standards for the products (model 1 in figure IX). Low income non-LDCs with an intermediate level of technological capability and infrastructure may be able to attract FDI, to set up export-oriented activities in the country, or to establish **subcontracting** and **OEM** (see glossary) arrangements with local companies

(model 2). At a more advanced level of development and capability, developing countries and their enterprises have the conditions for active participation in GVCs and GPNs and use that participation to achieve comprehensive technological capability (model 3).

Figure IX
Illustration of technology development pathways



Source: *Innovative Technology Transfer Framework Linked to Trade for UNIDO Action*, 2002.

2. Historical overview of the role of Governments

The above illustration of possible development pathways also reflects the experience and the success stories of some developing countries, with particular relevance to the transformation of East Asian countries in the last few decades. In all cases, government policies and support (differently designed and implemented from country to country) played a crucial role in the upgrading and internationalization of domestic enterprises. Some examples are given below.

Taiwan Province of China

In the case of Taiwan Province of China, the development policy focused on the creation of a strong national innovation system to support SMEs in their upgrading and internationalization

The **approach to capacity-building** was through development of national technology systems. The Government used the policy process to link and adjust its technological infrastructure to technological changes occurring in the global economy and to the needs of the large number of indigenous and export-oriented SMEs extant in Taiwan Province of China. The **policy focus** was based on efforts to build up strong links between the national technology and innovation system, the country's SMEs and the international economy. **Public institutions** included:

- An investment promotion agency (for the identification of suitable industries and technologies)

Examples of pathways to building capability in East Asian countries

- Through development of national technology systems (*case of Taiwan Province of China*)
- Through linked learning between large domestic firms and large MNEs (*case of the Republic of Korea*)
- Through linked learning of SMEs participating in GVCs (*cases of Malaysia and Singapore*)

- A science and technology institute (for acquisition, reverse engineering and diffusion)
- An export-marketing agency (to provide firms with relevant information on markets)
- An agency to support clustering (to link larger firms to clusters of smaller firms)

The development strategy of the Republic of Korea was based on links between large domestic firms and MNEs, together with institutional support to allow high-speed technological learning

Republic of Korea

The **approach to capacity-building** was through linked learning between large firms and large MNEs. The Government used the policy process and technological infrastructure to promote high-speed technological learning and large-scale indigenous conglomerates. The **policy focus** was on building a relatively small number of large indigenous national firms that could compete with developed country multinational corporations. The firms also relied on the Government's restrictions on foreign capital to ensure that FDI, licensing agreements and technical assistance agreements hastened the building of technological capabilities at the enterprise level. The **role of institutions** was through a very solid institutional framework, including state-owned banks, by which the Government allocated performance-based promotional privileges, such as subsidized credit, to a small number of entities that became very large conglomerates.

Initially, Malaysia and Singapore gave priority to attracting FDI; subsequently, they re-oriented policy in order to promote participation of SMEs in GVCs and GPNs

Malaysia and Singapore

The **approach to capacity-building** was through linked learning of SMEs participating in GVCs. The Governments of Malaysia and Singapore used the policy processes and the technological infrastructure to promote linkages between indigenous SMEs and the GVCs of multinational corporations. The **policy focus** was initially on the development of infrastructure facilities and the human capital base, together with an incentive system and an institutional framework necessary to attract multinationals from developed countries. Subsequently, in order to create an indigenously-owned industrial base, the Governments restructured the policy process to promote the participation of indigenous SMEs in the GVCs of multinationals located in each of the countries. **Public institutions** included:

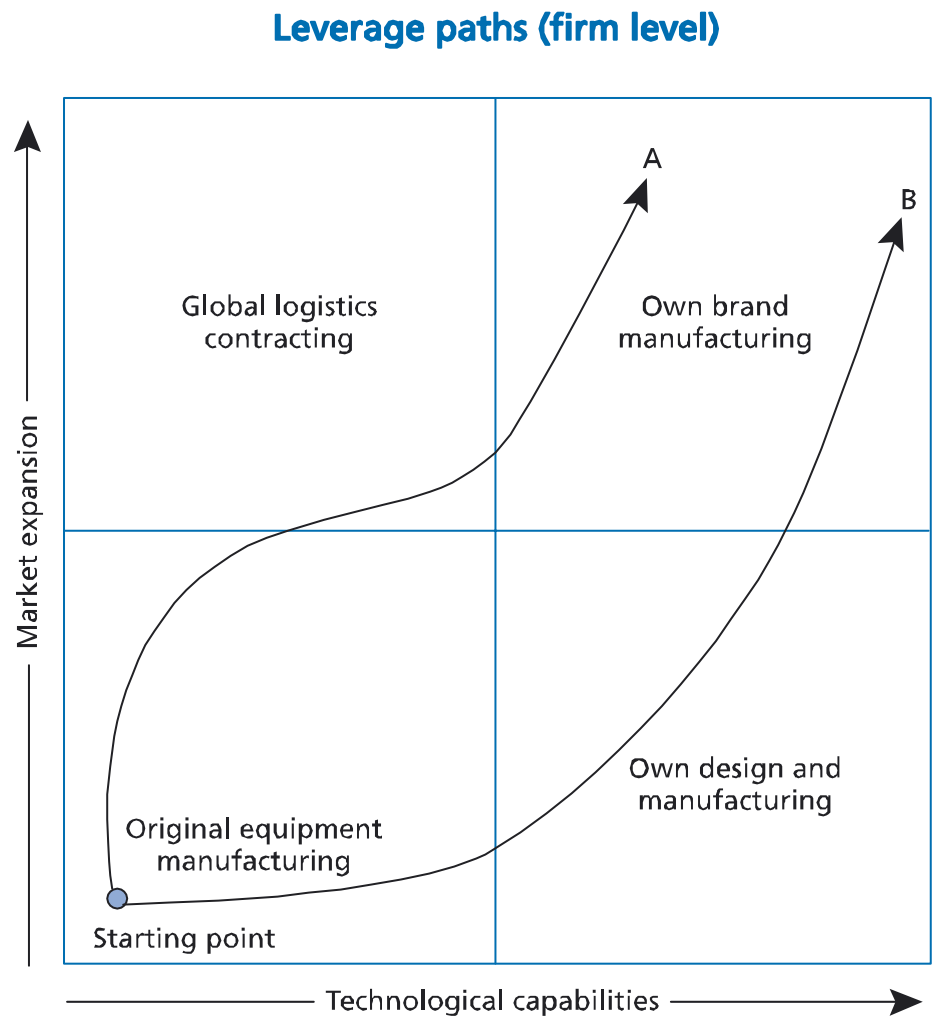
- Investment promotion agencies (which searched worldwide for firms and industries to provide investment)
- Agencies responsible for industrial estates
- Export-processing zones (EPZs)
- Licensed manufacturing warehouses (LMWs)

Figure X illustrates how Asian firms managed to **learn and innovate** within GVCs and how they moved from OEM to technological leadership and OBM. Two kinds of leveraging strategies were used, namely **market expansion** and **technological capabilities**. OBM, usually the most profitable segment of a GVC, requires both market and technological competencies. Path A in figure X represents a trajectory along which many of the activities entailed in OEM, all of them initially accomplished domestically, along with key activities, are relocated to production facilities in third countries, giving rise to **triangle manufacturing**. Capability enhancement is centred on mastering the complexity of the logistical functions required when sourcing and combining inputs from a number of different producers and locations. Path B, by contrast, focuses on capability enhancement through expanding functional responsibilities, from OEM to including some responsibility for design, leading the enterprise to then market its own designs under its own brand.

Through innovation and learning within GVCs, Asian firms moved from OEM to technological leadership and OEM

Triangle manufacturing is used by contract manufacturers as a strategy to relocate their own production to third countries and form their own supply chains and production networks

Figure X
Experience in Asia at the level of firms



Source: UNIDO, *Inserting Local Industries into Global Value Chains and Global Production Networks: Opportunities and Challenges for Upgrading*, 2004.

Review of concepts and issues

Alliance capitalism and the integrated global factory

The concepts of the **integrated global factory** and **alliance capitalism**, which were introduced in section II.C above, portray the intricate mechanisms used by MNEs in their global operations. On the one hand, such models and strategies represent the reaction to competitive pressures, increasing uncertainty, volatility and perception of risk. (As mentioned above, many big enterprises have been unable to survive the "turbulence" of the new economy.) On the other hand, the flexibility that MNEs can afford in their modes of entry and operations management, is the result of external factors such as (a) the advances in the field of information and communication technologies, which made possible the coordination and handling of GVCs and GPNs; and (b) the new policy approaches of developing countries. The developing countries understand the growing importance of FDI and the linkages with foreign enterprises as major drivers for their development and growth. They consequently compete among themselves for eligibility in the location decisions of MNEs, for example through liberalization of their foreign investment regimes, low wages, lax environmental standards or tax incentives.

D. Issues for developing countries

Developing countries compete among themselves for FDI and for inclusion of their firms in GPCs (global production chains) and GPNs of MNEs

The preceding sections provided a picture of the present development scenario, showing how the development scenario shapes the behaviour and the strategies of MNEs, bringing to light the opportunities and benefits that developing countries and their firms can have as a result of MNEs' operations and underscoring the crucial role of Governments in the process.

In the present section, the complexity of FDI in current times will be reviewed, together with the corresponding issues that confront developing countries.

For MNEs, in their quest for lower costs, better quality and faster distribution of goods to markets, the location factor in FDI-related decisions will be influenced by the answers to questions such as the following:

The development strategies that have been effective in Asian countries during the 1970s and 1980s may not work for other developing countries in the 1990s and onwards

- Are there domestic firms able to participate in the investor's network and bring added value to its operations?
- Where would it be best to locate the various production segments of the value chain in order to maximize the difference between manufacturing value-added and the locational cost structures?
- What kind of control modalities should be established with each node of the production network, i.e. should the option be for full ownership or for another form of collaboration, such as outsourcing, a strategic alliance or a joint venture?

For **Governments of developing countries**, there are challenges and also opportunities as a result of the present structure and features of global manufacturing operations and the changing locational decisions of MNEs

according to the changing characteristics of industry competition and factor markets.

The Asian experience briefly presented above is an important guiding light for policymakers of other developing countries, who may wish to emulate it and achieve the same kind of performance; but the strategies that have been effective during the 1970s and 1980s will not work in the same way in the 1990s and onwards. While in former times MNEs were using East Asian firms for manufacturing and assembly operations under subcontracting or OEM arrangements (which eventually led to their present technological level of self-sufficiency and innovative capability), nowadays MNEs increasingly rely on turnkey suppliers for technology-intensive segments of their value chains. In this situation, latecomer firms from developing economies may be at a disadvantage vis-à-vis East Asian firms; and developing countries may be further marginalized in the global economy unless they can upgrade their industrial sectors and innovation systems so that domestic producers can achieve systemic efficiency.

Understanding the features of international operations of MNEs is essential for developing countries to capture FDI or integrate their firms into GVCs and GPNs

Questions related to location decisions of MNEs

- Availability of factor markets and capable domestic firms
- Comparative assessment of locations' cost structures
- Decision on control modalities for each possible location

Understanding the features of international operations of MNEs is essential for developing countries if they are not to be sidelined in the race for development. Operations management of MNEs is characterized by flexibility in the choice and change of partners for their networks and value chains as well as in what concerns the market entry and exit decisions.

Policymakers of developing countries need massive and continually updated information and business intelligence to anticipate and take advantage of MNEs' strategies and moves

Again, it is worth highlighting the role of information and communication technologies, which made it possible for MNEs not only to manage dynamic relationships and spatially dispersed operations but also gave them the tools to collect vast amounts of data, leading to information and knowledge about technology and markets and their trends, improving their forecasts and reducing the costs of change with respect to the location or relocation of their international manufacturing operations.

For developing countries, such tools have the same relevance, mutatis mutandis. The prospects for countries that are on the wrong side of the digital divide—those that lack capacity and have a low level of skills in usage of information and communications technologies—are terrible. The availability of information and communication infrastructure is indispensable to bring in foreign investors or allow for the participation of domestic enterprises in GVCs or GPNs. Furthermore, policymakers of developing countries also need massive and continually updated information and business intelligence to learn about the relative differences in factor conditions (see glossary) and costs among countries and within regions, and to anticipate the moves and direction of changes being made by MNEs with respect to their production and subcontracting networks. They also need information and intelligence in order to decide which policy measures, adaptive structures and incentives would achieve the inclusion of domestic firms in such networks.

Value chain and production network analysis is also an important tool for strategic policymaking. it helps to better understand (a) the structure of a specific value chain and identify the characteristics of its leading firms and the ways they might wish to incorporate developing country producers into the chain; (b) what type of work is allocated to developing countries and firms in the chain and whether such work can sustain their jobs and income; and (c) what are the strategies and policies that can help developing countries to successfully leverage their participation in GVCs and GPNs to enhance productivity and obtain welfare gains.

In order to customize and shape policy instruments, developing countries should identify strengths and weaknesses through needs assessment and diagnostic exercises

In general terms, recommended policies for developing countries are on two levels, as described below.[19]

At the industry level

Efforts should be focused on medium- and high-technology manufacturing activities. This calls for productivity enhancement through skills and technology upgrading and through setting up backward linkages to the local industries and forward linkages to markets.

At the national economic level

Developing structural factors that allow industrial upgrading is crucial. This includes public investment in enhancing physical and knowledge infrastructure and utilities, in the provision of technology extension services, in setting up EPZs and industrial and technology parks and in providing financial incentives (tax relief, loans and so on). Equally important are the reform of labour laws and of institutions and government structures.

In order to give shape and focus to the general policy prescriptions and adjust them to the specific country conditions, it is also recommended that **needs assessment** and **diagnostic exercises** should be implemented in order to identify the strengths and weaknesses at the different levels of intervention (such as policy, institutions, infrastructure, industries and resources), to adjust the policy instruments as needed and to decide on the most suitable development pathways.

[19] UNIDO, *Inserting Local Industries into Global Value Chains and Global Production Networks: Opportunities and Challenges for Upgrading*, 2004.

Summary of Part Two: strategic alliances and joint ventures

Part Two of the present training package, which will deal more specifically with strategic alliances and joint ventures, will be issued as a separate volume. A summary of Part Two, giving perspective to the subject and highlighting how it is outlined and dealt with, is provided below.

Part One of this training package presents the international development scenario, the drivers for global expansion of enterprises, the global manufacturing strategies of MNEs and the opportunities available to developing countries and their firms through participation in GVCs and GPNs. In the process, Part One also provides an overview of the main types of collaboration agreements that MNEs can establish with firms in countries where they intend to set up business or manufacturing operations, or to outsource components, materials or equipment.

In Part Two, the subject of inter-enterprise collaboration is narrowed down to the field of **strategic alliances** and **joint ventures**.

In many works, terms such as "joint venture", "collaborative agreement", "international alliance", "strategic alliance" and so on, are used in a generic and interchangeable way. This sometimes confuses readers, who struggle to understand the meaning, scope and characterization of the different forms of collaboration. To some extent, Part One has already clarified much of the confusion. Clarity is further pursued in Part Two, which will be structured and developed along the following lines.

Firstly, the **difference between strategic alliances and joint ventures** will be explored. On the surface, strategic alliances and joint ventures seem to represent similar forms of inter-firm collaboration; but there are essential differences between the two concepts.

In order to clarify the distinction between these collaborative forms, focus is brought to such aspects as (a) the motivations and aims of the parties; (b) the nature of the resources allocated and how they may evolve over time; (c) the predictability and stability, or conversely the instability, of the relationship; (d) the aspects of collaboration versus competition and rivalry; and (e) the managerial approaches required.

Secondly, **issues related to strategic alliances** will be presented. This covers the main reasons why enterprises decide to form strategic alliances, touches upon the subject of mergers and acquisitions as a possible alternative, and dwells upon issues related to knowledge flows and learning, the costs and risks of alliances and the organizational and managerial complexities that must be understood and dealt with. Attention is also drawn to the fact that, while **traditional joint ventures** are formed between a multinational enterprise from an industrialized country and a local partner in a developing or less-industrialized country, usually to expand the market for existing products; **strategic alliances**, in contrast, mostly involve partners in industrializing countries with the purpose of creating new products, technologies and services.

Thirdly, **conceptual aspects** of joint ventures will be reviewed. Having clarified the distinction between strategic alliances and joint ventures, one question related to the concept and terminology remains to be untangled, because the term joint venture can be applied to different forms of collaboration, namely:

- **Contractual joint ventures** (or consortiums). These usually have a limited duration. Typical cases of consortiums appear in the field of civil engineering, construction, building and equipment supply industries, where contractors decide to join their forces to build jointly a plant or an infrastructure facility. As a rule, the consortium is dissolved upon completion of the project.
- **Cooperative joint ventures** (or mixed joint ventures). Cooperative joint ventures, also referred to as mixed joint ventures, are joint ventures between an international company and a developing country Government. They have distinctive features as compared with equity joint ventures. The fact that one of the partners is the Government (or a government agency or government controlled company) allows for the negotiation of conditions that would not be achievable under the legislation applicable to private business transactions.
- **Restructuring joint ventures**. For the sake of completeness, Part Two also introduces restructuring joint ventures. These mostly happen between MNEs in the context of their restructuring strategies and are therefore not of such great interest for developing countries. Restructuring joint ventures have been used creatively in cases where a company wishes to separate itself from a non-core, underperforming business and another company is willing to acquire it for a number of reasons, such as access to technology, brand names or distribution networks in markets which it intends to enter or in which it wishes to improve its position.
- **Equity joint ventures**. An equity joint venture is a long-term participation of two or more companies in an enterprise in which each party contributes with assets, has equity and shares risk. The assumption under which these joint ventures are sometimes established is that the parties will jointly run an undertaking for as long as the venture is viable. Equity joint ventures in the sense given to the term for the purpose of the present training package most often imply the **creation of a new legal entity** by incorporation of the partnership, which is itself established through the joint venture agreement.

Fourthly, **highlights on FDI** are given. Because equity joint ventures can be regarded as a form of FDI, it was decided that Part Two should include a section that would give perspective to the investment decisions of MNEs in foreign countries in general and in developing countries in particular. Underlying realities and motivations will be highlighted. While for MNEs there is a quest for opportunity advantage—which is facilitated by the mobility of capital, the liberalization policies of developing countries and the regionalization of markets—developing countries seek the positive correlations between FDI and growth and the positive effects and impacts associated with FDI in such areas as employment generation, poverty alleviation, technological upgrading, export promotion, spin-off effects and economic development and growth in general.

Fifthly, the package describes the **formation, negotiation and management of equity joint ventures**. This is a core element of Part Two and is intended to provide detailed insight into the issues that are relevant to the partners, including their motivations and interests, and to the host country, namely the impact on the local economy.

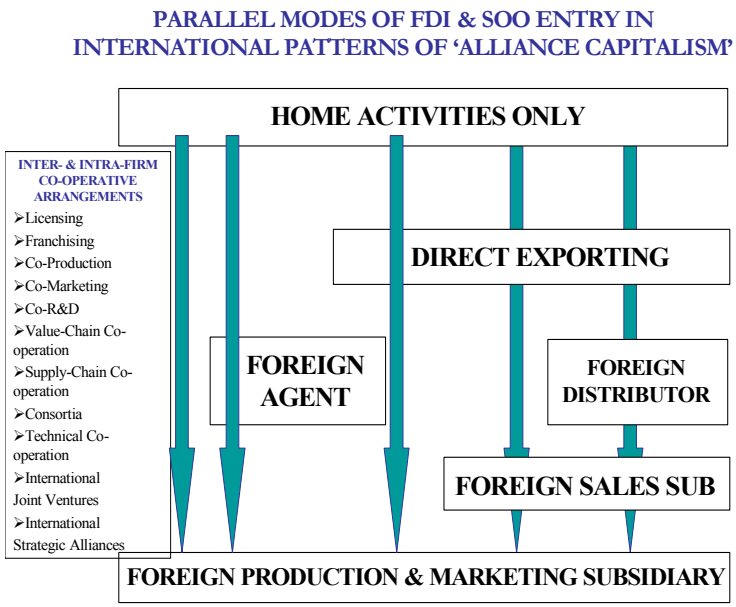
As much as possible, Part Two of the package draws on empirical data collected by UNIDO in its surveys on FDI and covers, among other things, various aspects such as the following:

- Questions to be considered before forming a joint venture (selecting and screening prospective partners, developing a business plan, due diligence, etc.)
- The time frame of the path leading to the joint venture formation
- The project evaluation and feasibility study
- The host country legal environment and related implications
- The development of a joint venture relationship
- Negotiation and drafting issues (and in this connection, the cross-cultural aspects in the negotiation process)
- The joint venture agreement and its main clauses
- The management of a joint venture and the related issues
- The ancillary agreements (the joint venture as a vehicle for cooperation between the partners, for example technology transfer, equipment and material supplies, management assistance, etc.)

Annex
Glossary and definition of terms

Alliance capitalism[a]

The term alliance capitalism was created to designate the multifaceted pattern of foreign direct investment (FDI) operations involving simultaneous collaboration with competitors and rivalry (in different economic spaces) with strategic and alliance partners, as well as participation in dense networks of technology suppliers. In practice, this means that the former patterns of FDI, with more predictable modes of market entry in sequential time and place, have been replaced by parallel modes of market of entry and servicing through intricate systems of industrial sourcing, technology, production, marketing and servicing, which involve offshoring and outsourcing modalities of joint ventures, strategic alliances, co-production and marketing, joint research and development, contract design and manufacturing with equity and non-equity cooperative arrangements. This reality is illustrated in the figure above (which is also included in the set of visuals accompanying this training package).



Buyer-driven value chains

(See also "producer-driven value chains")

In this kind of value chain, large buyers with core competencies in branding and marketing are the driving actors in setting up the value chain. They organize, coordinate and control production, designing and marketing activities to target consumer markets in developed and developing countries and in the countries with economies in transition. These chains are typical for **labour-intensive** industries and are highly relevant to developing countries (for instance, agro-food industries, textiles, garments, footwear, toys and furniture). The buyers, usually producers of branded products, are keen to maintain control of the marketing channels and the value of the brand and to prevent copying

[a] John H. Dunning, *Alliance Capitalism and Global Business* (London and New York, Brunner-Routledge, 1977), taken from Frank L. Bartels, "Outsourcing markets in services: international business trends, patterns and emerging issues", paper presented at the 2005 Outsourcing Trend and Development Conference (Shenzhen, China, 8 and 9 June 2005) and Peter Buckley, "FDI and growth for developing countries: MNEs and challenges of the 'new' economy", paper presented at the UNIDO General Conference, 2003.

through protecting intellectual property. The strong market position is the result of global brands and brands for a specific market or region.

Competitiveness

For an enterprise, competitiveness refers to the capacity to create and sustain cost and/or product advantages to gain or maintain a strong position in the markets for its products and a high level of profitability. In general, the advantages are based on the ability of a firm to successfully define its scope, to manage and coordinate the core functions and operations within the enterprise, as well as relationships with suppliers and customers, and to be aware of market demand characteristics and respond to them appropriately.

OECD defines competitiveness of a country as the degree to which a country can, under free and fair market conditions, produce goods and services which meet the test of international markets, whilst simultaneously maintaining and expanding the real incomes of its people over the long term.

The European Commission attempts to encompass entities other than countries in the definition of competitiveness as the capacity of businesses, industries, regions, nations or supra-national associations exposed to international competition, to secure a relatively high return on the factors of production and relatively high employment levels on a sustainable basis.

Corporate social responsibility

There are various definitions of CSR. According to the World Business Council for Sustainable Development, CSR can be defined as "the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large".

The European Commission has said that being socially responsible means not only fulfilling legal expectations, but also going beyond compliance and investing "more" into human capital, the environment and relations with stakeholders.

For Business for Social Responsibility, CSR means operating a business in a manner that meets or exceeds the ethical, legal, commercial and public expectations that society has of business.

Factor conditions; factor markets

Factor conditions include all the inputs that enterprises need to conduct and sustain a business and production process. Typically, this includes human resources (skilled and unskilled labour); physical resources (weather, waterways, minerals and agricultural products); knowledge (education system, research and development, industrial knowledge); capital resources (availability of debt and equity capital); and infrastructure (roads, ports, energy and communications). Flexible and responsive factor markets are vital to building and deploying industrial capabilities. Clear and supportive rules of the game induce enterprises to make long-term investments in innovation and learning.

According to Michael Porter, four conditions are important for competitive superiority: (a) factor conditions; (b) demand conditions; (c) related and supporting industries; and (d) firm strategy, structure and rivalry. He represented these conditions in a framework called the "Porter diamond",

which is a useful tool for understanding how and where globally competitive companies develop.[b]

Global supply chains and global value chains
(See also "buyer-driven value chains" and "producer-driven value chains").

The terms **value chains** and **supply chains** (and global value chains and global supply chains when the terms are used in association with globally organized operations) are currently used interchangeably and encompass the sequence of related and dependent activities that are needed to bring a product or service from conception, through different phases of production, to delivery to final consumers and after sales services, and finally to disposal or recycling. But the term **value chain** in particular is a concept introduced by Michael Porter in 1985[c] to underscore the idea that every business is a collection of activities to design, produce, market, deliver and support its product, in a sequence that he terms a "value chain". The activities are called "value activities" and through them the firm creates a product of value to its customers. In monetary terms, the difference of the total value of a product to customers is higher than the total cost of the value activities and the difference represents the margin to the firm.

Innovation and learning

For developing countries and their firms, the development of competitive capabilities requires a conscious effort of innovation and learning, a process that involves the ability to draw on skills and inputs from others—suppliers, customers and also competitors—in order to deploy new production and management technologies, upgrade them over time and ultimately create new technologies.

Innovation and learning are interactive processes that work best in networks of efficient enterprises, institutions and markets. Enterprises in developing countries generally start the innovation and learning process by importing new technology; they then invest in building their capabilities to master the tacit elements, adapt to local conditions and keep advancing technologically by developing new processes, products and services as a source of competitive advantage.

Innovation and value chains[d]

Innovation global value chains can involve improving capabilities in production; developing new capabilities outside production (design and marketing skills); diversifying customers and market destinations; and developing a capacity to introduce new products. In this connection, four kinds of innovation can be distinguished:

Process innovation consists of improving the efficiency of internal processes, such that these are significantly better than those of rivals, in individual links in the chain (for example cutting the cost of inventories or lowering the amount of scrap) and between the links in the chain (for example, more frequent, smaller and less timely deliveries).

---

[b] Michael E. Porter, *The Competitive Advantage of Nations* (New York, Simon & Shuster, 1990).

[c] Michael E. Porter, *Competitive Advantage: Creating and Sustaining Superior Performance* (New York, Simon & Shuster, 1985).

[d] UNIDO, *Inserting Local Industries into Global Value Chains and Global Production Networks: Opportunities and Challenges for Upgrading,* 2004.

Product innovation consists of improving all products through quality and price performance and through time to market, or differentiating by introducing new products faster than one's rivals. This involves changing new product development processes in individual links in the value chain and in the relationship between different chain links.

Functional innovation implies raising value added by changing the mix of activities conducted in the firm.

Inter-chain innovation assumes moving to a new more profitable value chain, where higher rents can be captured (for example, Taiwan Province of China firms moved from the manufacture of transistor radios to calculators, to televisions, to computer monitors, to laptops and now to Wireless Application Protocol telephones).

Intelligent organization

Organizations are confronted with increasing complexity and speed of change in the global business environment and with new forms of competition that require fast adaptation and response. To deal with the challenges, organizations have to become "intelligent", that is, able to take advantage of the dispersed knowledge of their members and to learn more quickly than competitors about their internal and external environment. The development of an **intelligent organization** is based on organizational learning and knowledge management. Effective intelligent organizations have been concerned with the creation of organizational knowledge by taking advantage of their core competencies in terms of **explicit knowledge** (codified and documented) and **implicit knowledge** (tacit knowledge, based on individual experience). Knowledge management in an intelligent organization has to be based on a culture and a set of values cutting across the organization's different layers and encouraging questioning and creativity, freedom of speech, access to and sharing information in a spirit of teamwork, trust and a sense of common purpose. The knowledge management should be supported by an efficient organizational infrastructure, including information and communication technology that facilitates the diffusion of knowledge within the organization as well as organizational and individual learning.

Linking, leveraging and learning

The concept of "l**inking, leveraging and learning**" captures what firms—and countries—have to do to foster their technological development.

Linking means connecting with outsiders to acquire needed technologies and skills; this includes the identification of partners with whom capability enhancement is feasible.

Leveraging means going beyond arms-length transactions to squeeze as much as possible out of new relationships with outsiders; the leveraging phase requires a strategic choice and specifies the means of knowledge acquisition (how do we get what we want?).

Learning means making the many efforts to master the processes of technologies and consciously building the foundation for improving current technologies—and creating new ones. Different forms of learning are feasible—learning by doing; learning by interacting; learning by monitoring; and learning by formal training. The choice will depend on the type of linkage and leveraging involved. The learning process is difficult and complex and it lies at the heart of the arduous process of industrial innovation and development.

National innovation system

A national system of innovation may be defined as a network of public and private institutions, located within national borders, whose activities and interactions enable the generation, importation, simulation, notification, fusion and economical use of knowledge. In a national system of innovation there is an interaction between five main subsystems: productive (including public and private firms performing their activities in the country); scientific and technological (encompassing diverse institutions such as research centres or technology diffusion organizations); education and training (educational organizations at the various levels and training institutions); financial (including banking, insurance and, in general, all the organizations that provide financial support for launching innovative endeavours); and the administrative-regulatory system (public institutions that lay the groundwork, define the rules of the game and provide the incentives for innovative activities).

Original equipment manufacturing

Original equipment manufacturing (OEM) involves contract manufacturing by a local firm for foreign multinational enterprises, which sell the products under their own brand names. In a typical OEM relationship, multinational enterprises provide the local firm with the specifications of the products and often assist with selecting equipment, training engineers and providing advice on technology and management for OEM. All this gives the local firm an opportunity for learning and technological upgrading. The assimilation of foreign technology is a point of departure for making one's own technological advances through research and development and innovation, redesigning existing products and developing new ones, creating own brands, competing in foreign markets, further acquiring advanced technologies and skills and becoming a global player.

Producer-driven value chains
(See also "buyer-driven value chains" and "global value chains")

In this case, key producers in the chain control vital technologies, which are of crucial importance for positioning in the final product market. They coordinate these value chains and take responsibility for helping the efficiency efforts of their suppliers and customers. These chains are typical for medium- and high-technology industries, such as automobiles, electronics, telecommunications and the like.

Supply chains, see "global supply chains"

Value chains, see "global value chains"

Virtual corporation

The concept of a "virtual corporation" is associated on the one hand with the trend of firms tending to outsource as many as possible of their functions, and on the other hand with the possibilities opened up by the information and communication technologies that made possible the management and control of complex networks of spatially dispersed operations. At its limit, a virtual corporation subcontracts almost all of the organization's activities, including design, manufacturing and marketing, and does not need to have a large number of regular employees to be a major player. However, it can be argued that such a virtual corporation may degenerate into a "hollow corporation" that loses the capability to evolve and adapt to changing circumstances. In a more realistic

approach, virtual corporations rely extensively on outsourcing and collaborative networks but remain centred on a core business with highly integrated design activities and relations with customers.

Bibliography

Buckley Peter. FDI and growth for developing countries: MNEs and challenges of the new economy. 2003.
Keynote speech and paper presented at the United Nations Industrial Development Organization General Conference.

Doz, Y. L. and G. Hamel. Alliance advantage. Boston, Harvard Business School Press, 1998.

Folta, Paul. Cooperative Joint Ventures. China Business Review Online, Jan-Feb 2005. (http://www.chinabusinessreview.com/public/0501/folta.html).

Fundamentals of international business. *By* Michale Czinkota *and others*. South-Western Publishing, 2004.

Gay, Charles L. and James Essinger. Inside outsourcing: an insider's guide to managing strategic sourcing. Nicholas Brealey Publishing, 2000.

Global and transnational business: strategy and management. *By* George Stonehouse *and others*. John Willey and Sons, 2004.

Grant, Robert M. Cases to accompany contemporary strategy analysis. Blackwell Publishing, 2005.

International business: environments and operations. *By* John D. Daniels *and others*. Prentice Hall, 2004.

Kauffman, Ralph G. and Thomas A. Crimi. A best-practice approach to transforming global supply chains. April 2004.
Paper presented at the 89th annual International Supply Management Conference.

Pinnels, J. R. International Procurement Contracts: an Introduction. Programme for Development Cooperation at the Helsinki School of Economics, 1991.

Rasmussen, Erik S. and Tage Koed Madsen. The Born Global Concept. December 2002.
Paper for the European International Business Academy Conference.

Sparks, Debra. The global rush to find partners. *BusinessWeek.* (New York) 25 October 1999.

Transnational management: text, cases, and readings in cross-border management. *By* Christopher Bartlett *and others*. McGraw-Hill, 2003.

United Nations Industrial Development Organization. Corporate social responsibility: implications for small and medium enterprises in developing countries. 2002.

_____. Industrial development report: competing through innovation and learning (Sales No. 02.II.B.13). 2002.

_____. Innovative technology transfer framework linked to trade for UNIDO action. 2002.

_____. Inserting local industries into global value chains and global production networks: opportunities and challenges for upgrading. 2004.

_____. International subcontracting versus delocalization: a survey of the literature and case studies from the SPX network. 2003.

_____. Outsourcing Trend and Development Conference. Outsourcing markets in services: international business trends, patterns and emerging issues (IWPS 002/05). 2005.

Index

Printed in Austria
V.05-91195—June 2006—1,000

UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
Vienna International Centre, P.O. Box 300, 1400 Vienna, Austria
Telephone: (+43-1) 26026-0, Fax: (+43-1) 26926-69
E-mail: unido@unido.org, Internet: http://www.unido.org