The Model of Expansion from Local

Enterprises to Multinational Enterprises

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Abstract

Multinational enterprises (MNEs) are playing more and more important roles in the development of world economic. A relative small set of multinational enterprises account for most of the world's trade and investment (Rugman and Verbeke, 2004). Indeed, the largest 500 MNEs account for over 90% of the world's stock of foreign direct investment (FDI) and they, themselves, conduct about half the world's trade(Rugman, 2000).

The empirical evidence, however, shows that MNEs are more regional than national versus global. "Data on the activities of the 500 largest MNEs reveal that very few are successful globally. For 320 of the 380 firms for which geographic sales data are available, an average of 80.3% of total sales are their home region of the triad, this means that many of the world's largest firms are not global but regionally based, in terms of a balanced geographic distribution of sales across the triad." (Rugman and Verbeke, 2004).

Therefore, it is very significant to study where the regional impact is on multinational management. In this paper, I will discuss the model of expansion from local enterprises to multinational enterprises and how the regional factors affect enterprises operations.

Keywords: Multinational enterprises (MNEs), the triad region, Globalization, regional factors, Expansion Model

1. Fundamental Definitions

Before we go further, we should, first, make a clear definition of MNEs (Multinational Enterprises), globalization, and regional triad.

1.1 MNEs (Multinational Enterprises)

The MNEs is defined as a firm with value-added activities in at least two countries.(Rugman and Verbeke, 2001)

1.2 The triad region

In 1985 Kenichi Ohmae, a Mchinsey consultant in Japan, firstly defined the triad as "a geographic space consisting of the United States, the EU and Japan. However, in this paper, we use a broad triad." (Rugman and Verbeke, 2004)the broad triad consists of NAFTA, the expanded EU and Asia.

NAFTA: North American Free Trade Agreement.

EU: consisted of 25 countries in 2004.

Asia: "in November 2002, China agree to a free trade agreement with the ten members of the association of south east Asian nations (ASEAN), signaling a wide trade ans investment agreement for Asia. In September 2003, India and the ASEAN members agree to forge a free trade area by 2012, while Japan and ASEAN agreed to begin negotiations on far-reaching trade and investment liberalization by 2005." (Rugman and Verbeke, 2004)

1.3 Globalization

The definition of globalization is very critical in this paper. It is a blurred word. There are many definitions for globalization. Such as economic and business school professor defines globalization as "the activities of multinational enterprises engaged in foreign direct investment and the development of business networks to create value across national borders". While other scholar such as Giddens gave a very different definition: "globalization is political, technical and cultural, as well as economic" (Giddens 1999, p.10). Obviously, we can not distinguish regional enterprises from global enterprises based on these definitions. Because the first is too narrow but the latter is too broad. In this paper, we adopt Rugman and Verbeke's (2004) definition of globalization: having sales of 20% or more in each of the three parts of the triad, but less than 50% in any region of the triad.

2. The Empirical evidence of region

Rugman and Verbeke's (2004) have classified the top 500 MNEs into global, bi-regional, host region oriented, and host region oriented. They concluded that only nine of the MNEs are global. Other MNEs are regional. It means that most MNEs do not have a balanced distribution of sales across the three triads. They either focus on one reign or two reigns.

Table 1. Classification of the top 500 MNEs

Type of MNEs	No. of MNES	Percentage of 500	Percentage of 380	Percentage intra-regional sales
Global	9	1.8	2.4	38.3
Bi-regional	25	5	6.6	42
Host reign oriented	11	2.2	2.9	30.9
Home region oriented	320	64.0	84.2	80.3
Insurfficient data	15	3.0	3.9	40.9
No data	120	24		NA
Total	500	100	100	71.9

Data are for 2001.

Source: Braintrust Research Group, the regional nature of global Multinational Activity, 2003 (www.braintruststreseach.com) NA: not available

The data in table 1 told us that MNEs do not easily penetrate the three triads evenly, and intra-regional sales are easier than inter-regional sales. Obviously, there are some regional factors affecting a MNE to become global.

3. The evidence of conflicts among triad regions

The regional focus partly resulted from MNEs regional strategies because some of them merely want to establish a dominant position in their home regional market, but also from the conflicts among triad regions that prohibit MNEs entering these three regions equally.

The success of regional and bilateral agreement and the failure of multilateral agreements, such as the Organization for Economic Cooperation and Development's (OECD) multilateral agreement on investment (MAI) and the lack of progress at the World Trade Organization (WTO) in setting new agendas for trade and investment liberalization, are signal of the problems of globalization and the power of closed regional/triad blocs. (Rugman 2001,P3)

Triad regions are attempting to stimulate intra-trade and investment and be against "outsiders" by setting up regional policies and regulations. They adopted nontariff barriers to trade and investment to limited access to their internal markets and/or give preferential access to certain partners I return for reciprocal advantages. Examples of nontariff barriers include rules origin, discriminatory health and safety code used to keep out agrricultural products, new environmental regulations in European Union and the North American Free Trade Agreement, exempted sectors from the principle of national treatment (such as culture, education, health, etc), poorly administrated anti-dumping and countervailing duty laws, and so on. Many U.S. restrictions are aimed at Japanese and European competitors, and vice versa.

Exports in the broad triad
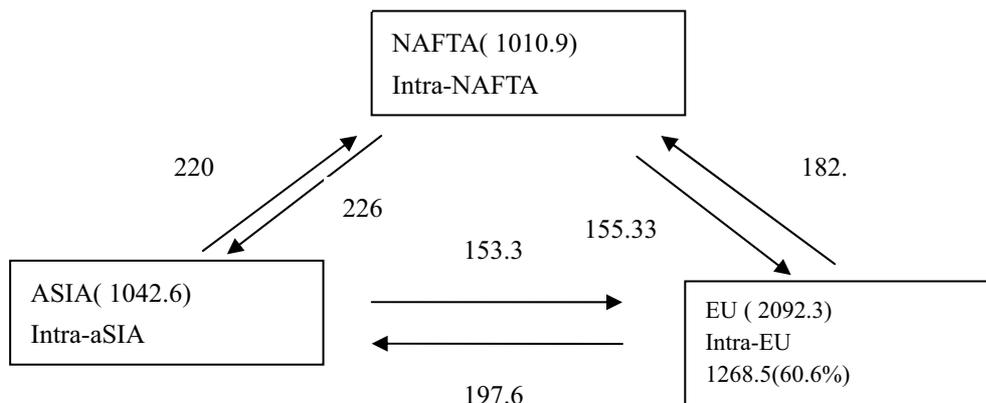
Note: Data are for 1997, in US$ billion.
Source: International Monetary Fund, Direction of Trade Statistics

For example, according to data for 1997, the triad's export total was US$ 4,145.8 billion, with 60.6 per cent of the EU exports of US$ 2,092.3 being internal, at US$ 1,268.5 billion. The EU exports only 8.7 per cent to NAFTA (US$ 182.1 billion) and 9.4 per cent to Asia (US$ 197.6 billion).   NAFTA exports 15.4% per cent of its total to the EU (US$ 155.3 billion) and 22.4 per cent to Asian (US$ 226.0 billion).   Asia exports 21.1 per cent of its total to NAFTA (US$ 220.0 billion) and 14.7 percent to the EU (US$153.3 billion).

4. Expansion Models of MNEs

When a company decides to become a multinational company, how will it expand abroad in terms of region? Totally there are four models it can adopt.

Model 1

Home Country	→	One Region (Home Region)	→	Bi-Regions (Host Region)	→	Global (Three Regions)
		Step 1		Step 2		Step 3

Model 2

Home Country	→	One Region (Host Region)	→	Bi-Regions (Other Host Region or Home Region)	→	Global (Three Regions)

Model 3

Home Country	→	Bi- Regions	→	Global (Three Regions)

Model 4

Home Country	→	Global (Three Regions)

Many MNEs adopted Model1. It will need three steps to become a global company from a local one. MNEs will build upon the strong home base diamond characteristics of the Unite States, the European Union, or Japan and use the appropriate triad market as a staging ground for activities in other markets.(Rugman, 2001) But the great majority of MNEs sales are from its home traid. The home triad region sales weighted averages are as follows: (Rugman and Verbeke, 2004)

(1)   home region oriented (320 firms) :80.3%

(2)   bi-regional (25 firms): 42%

(3)   host region oriented(11 firms): 30.9% ;and

(4)   global (9 firms) :38.3%

In this process, they carefully analyze costs, revenues, factor conditions, growth potential, political risk, cultural factors, and environmental issues.

The problem is that why most MNEs adopted Model 1 instead of other Models. This is also told us that there is some regional factors rather than global factors affecting MNEs's operation. Up to now, there are only nine global companies. The study shows that only consumer electronics and high-value-added goods with low transport costs can approach being global. (Rugman 2001, P2)

5. Regional Factors affecting MNEs operations

The analysis above has showed that a MNEs's manager should not think merely in terms of the nation-state-global market dichotomy, he should think about triad regions and regional factors. Here I will divide regional factors into internal factors and external factors.

Internal factors are the factors that MNEs can control, such as MNEs strategy and structures.

5.1 Strategy

The MNEs need different competitive strategies if they are in the different markets position in the various regions. "a leadership role in one market may require different patterns of decisions and actions than the role of a (perhaps ambitious) junior player in other market. These differential roles should then be reflected in the deployment of specific combinations of non-location-bound and location-bound FSAs in each region."(Rugman and Verbeke's, 2004)

5.2 Structure

MNEs strategy, intra-regional or inter-regional sales, and upstream or downstream activities will determine MNEs's structure. A good MNEs structure should serve MNEs regional strategy, and maximize FSAs in that region.

Regional headquarters are an important regional component in MNEs organizational structure. The other elements are organizational physiology and psychology. These regional elements "may increase the difficult of managing multidivisional (M-form) companies, as performance evaluation should be differentiated for units operating in the various regions, even within similar businesses, given the enormous differences in environmental circumstanced faced by the affiliates in each region". (Rugman and Verbeke's, 2004)

External factors is the factors that MNEs can not control but will affect MNEs's operation and management, such as social , political and economic factors.

When MNEs decide to venture into other regions from home triad region, they may face a liability of regional foreignness, including several additional risks that were absent in the host region and may be of an economic, cultural, administrative or geographic nature.

5.3 Regulations and policies

Government regulations and policies differences are major factors affecting MNEs's operation. Inter-triad business is likely to be restricted by government-imposed entry barriers. The EU and the US are likely to fight trade wars and respond to domestic business lobbies seeking shelter in the form of subsidies and/or protection. Moreover, there are significant health care and political differences between Triad regions, but far fewer within them. therefore, most of the advantages of standardization that can often be achieved within the home triad region may be lost or transferred into disadvantages in host triad regions.

5.4 NGOs

The nongovernmental organizations also challenged the MNEs. The NGOs are new and powerful actors on the stage of international business. (Rugman, 2001). NGOs have defeated the OECD's multilateral agreement on investment (MAI).

5.5 Environmental protection

Over the past decade the number of trade disputes arising from such environmental regulations and coalitions has increase sharply. Environment disputes are a global problem but are resolved regionally (Rugman, 2001). For example, in NAFTA triad region, they signed North American Agreement on Enviromental Cooperation(NAAEC), which created three surveillance and enforcement mechanisms to constrain national environmental regulatory activity that affects trade.

5.6 Culture

Culture differences have a great influence on MNEs operations. Culture differences lead to different demand conditions. A commodity that is best seller in home region may be rejected in other triad region. For example, the car designs that are popular in one area of the world are often rejected by customers in other geographic areas

5.7 Rivalry

Competitions vary in three triad regions. A MNE which is the biggest company in its home region may be a very small one in the host region. Obviously, this needs the MNEs's subsidiary to adopt different strategy and structure

from its parent company. Another disadvantage for newcomers is that they will cost much time and money to satisfy local regulations and policies.

6. The implications of studying regional factors

The purpose of MNEs going abroad is to pursue low cost or differentiation competitive advantages. In order to achieve their targets, MNEs must carefully deal with:

How they transfer country NLB and LB FSAs (firm-specific advantage) to regional NLB and LB FSA.

How they take advantage of regional-specific advantages

What entry model they should adopt when they decide to touch triad region.

6.1 How they transfer country NLB and LB FSAs (firm-specific advantage) to regional NLB and LB FSA.

MNEs should design strategies on a regional basis. They are responsive to local consumers, rather than global and uniform. Therefore, they also should analyze their location-bound and Non-location-bound FSAs in term of region. It means MNEs should extend the concept of NLB and LB FSAs across national borders to geographic region, namely regional bound. While new regional-bound FSAs need regional integration. "Hence regional integration creates both a threat and an opportunity for MNEs as they need to complement the conventional bundles of non-location-bound FSAs and location-bound FSAs with a set of region-bound FSAs." (Rugman and Verbeke's, 2004)

FSAs (firm-specific advantage): there are two types of FSAs: non-location-bound (NLB-FSAs) and location-bound ones(LB-FSAs). The former are defined as FSAs that can be exploited globally and lead to benefits of scale, scope or exploitation of national differences.   While location-bound FSAs can be defined as FSAs that benefit a company only in a particular location (or set of locations), and lead to benefits of national responsiveness. (Rugman and Verbeke, 1992)

Obviously, NLB-FSAs can be transferred abroad at low marginal costs and used effectively in foreign operations without substantial adaptation in view of firm. But whether NLB-FSAs can be transferred abroad successfully also depends on the permission of host country or region. So we should find what factors the host country or region will consider when they permit a foreign company to operate in it.

location-bound FSAs are effective in one location but will be ineffective in other locations. But Location-bound FSAs depends on the definition of location. Location can be referred as a sub nation, a nation, a triad region or two triad regions. Therefore we should detect what factors affecting LB-FSAs's effectiveness.

MNEs should redefine their location-bound and non-location bound FSAs in terms of region. Some location-bound FSAs in their home country may still be LB FSAs in region (such as Process 1 in table 2) or may not (such as Process 2). While some NLB FSAs in their home country may turn into LB FSAs in region (such as Process 3) or may still be NLB FSAs (such as Process 4).

Table 2.

Table 2 also can interpret why many MNEs adopt Expansion Model 1: home country---home region—other region. Obviously, more location-bound and non-location-bound FSAs in home country are effective in home region than host region due to external factors.

6.2 How can MNEs take advantage of regional-specific advantages?

When MNEs are in home country, they have Country-specific (or locational) advantages (CSAs), "which state that some benefits are associated with locating certain activities in particular countries. These benefit may arise from (a) structural market imperfections such as government regulation(Rugman et al, 1985) and (b) the potential to economize on

transaction costs by reducing risks and to benefit from local opportunities(Rugman 1990)" (Rugman and Verbeke, 1992).

when MNEs operate in a region, MNEs' managers set up strategy or business structure based on regional-specific advantages not Country-specific advantages. So they should think regional regulations rather than country's regulations. And they should think regional transaction cost, risks and benefits from regional opportunities. Home region commonly have similar regulations with home country. So MNEs can have more regional-specific advantages in home region than host region. Certainly, they not only reduce transaction costs but also reduce risk because they are more familiar with home regional market than host region.

6.3 What entry model should they adopt when they decide to touch triad region.

MNEs have relative benefits associated with different entry models (e.g., exports, licensing, joint venture, FDI and other forms of investment) when serving foreign markets. (Rugman and Verbeke, 1992). But some time what MNEs think is how they can enter a region rather than how efficiently they enter. A related point is that inter-block business is likely to be restricted relative to intra-regional sales by government imposed barriers to entry. For example, the E.U. and the United States are likely to fight trade wars and be responsive to domestic business lobbies seeking shelter in the form of subsidies and/or protection. Cultural and political differences among members of a single triad region may remain, but these will mostly be less significant than across triad regions, Rugman (2000). Value added through aggregation, in the sense of exploiting similarities across coutries (Ghemawat, 2003), can be achieved in the home region but appears difficult across regions. **(**Rugman and Verbeke's, 2004**)**

7. Case studies

We have tested that many MNEs are more regional than global. Next, I will analyze the strategy and structure of a specific MNE, Wal-Mart, and how the regional factors affecting Wal-Mart's strategy and structure.

7.1 Background of Wal-Mart

Wal-Mart is the world's largest retailer. Sam Walton found the first Wal-Mart store in Rogers, Arkansas in 1962. Wal-Mart's international expansion began in 1992, when it entered into a joint venture with Cifra S.A., a successful Mexican retailer. In 1998, it acquired a controlling interest in Cifra and officially changed the company'sname to Wal-Mart of Mexico. Since 1992, it has also expanded into eight other international markets: Argentina, Brazil, Canada, China, Germany, South Korea, Puerto Rico, and the UK. In the year ending of 2002, its revenue was almost $218 billion.

7.2 Regional-based Wal-Mart

Wal-Mart is a regional, not a global business. There are two arguments to back up this conclusion.

First, most its stores located in NAFTA triad region. For example, at the beginning of 2002, Wal-Mart had a total of 3,989 stores. A total of 3,609 of its stores are in the NAFTA region, with 2985 in the domestic US market, 458 in Mexico and another 166 in Canada. Only 380 are truly "international"—outside Wal-Mart's home triad region, only about 10 percent of its stores.

7.3 Distribution of Wal-Mart Stores

Locations		No. of stores	Percentage of Total
NAFTA 3609 (90.47%)	U.S.	2985	74.9%
	Mexico	458	11.48%
	Canada	166	4.09%
Other regions		380	9.53%
Total		3989	100%

Second, although Wal-Mart became the largest company in term of sales revenues in 2001, its most revenue came from NAFTA. For example, Wal-Mart's revenue was almost $218 billion for the year ending in 2002, ahead of General Motors and Exxon Mobil. But about 83.7percent is from United Stated and only16.3 percent is from international sales. The NAFTA market stands at an estimated 94.1 percent, and only 5.9 percent was from EU and Asia regions.

The revenue of Wal-Mart in 2002

500 Rank	Company	Region	Revenues (US$ bn)	F/T Sales	Percentage Intra-regional	North American Percentage of total sales	Europe Percentage of total sales	Asia-Pacific Percentage of total sales
1	Wal-Mart	North America	219.8	16.3	94.1	94.1	4.8	0.4

Data are for 2001

Source: Braintrust Research Group, the Regional Nature of Global Multinational Activity,2003(www.braintrustreseach. com)

7.4 How do Regional Factors affect Wal-Mart strategy and structure?

Wal-Mart is NAFTA-base business. The locus of its business model strategy and structure is regional and home-based. Its success can be attributed to a scale strategy based on cost reduction, steadily generating its "always low prices" formula and increased physical growth of market share(Alan M Rugman,The regional solution: Triad strategies for multinationals, Executive briefing/international business)

One of Wal-Mart's NLB FSAs is its brands. Wal-Mart is "the world's strongest brands". Each week, about 100 million customers visited a Wal-Mart store somewhere in the world. The company employed more than 1.3 million associates.

But Public outcry against the company is growing stronger. Recently the store has faced censure for paying its employees substandard wages and for hiring illegal aliens(Bob Batchelor , Will Wal-Mart Last Forever (http://www.nybooks.com/articles/17647)) Wal-Mart has to adopt a better strategy to "use its power to become a corporate revolutionary, utilizing its influence to set new merchandising standards as the country continues its shift to a service economy"(Bob Batchelor, Will Wal-Mart Last Forever (http://www.nybooks.com/articles/17647)). It should pay employees better,

One of its LB FSAs is innovation in purchasing and distributing goods, cross-docking. In this logistic system, goods trucked to a distribution center from suppliers are immediately transferred to trucks bound for stores—without ever being placed into storage Cross docking and companion innovations led to lower inventory levels and lower operating costs, which Wal-Mart translated into lower prices(Michael Hammer, Deep Change How Operational Innovation Can Transform Your Company, Harvard Business Review, April 2004, online version.)

But in host region, if the transportation industry are not so developed that cant not back up the cross-docking system, Wal-Mart will can not transfer this LN FSAs into host region.

7.5 Strategy

"Wal-Mart used a "saturation" strategy for store expansion. The standard was to be able to drive from a distribution center to a store within a day. A distribution center was strategically placed so that it could eventually serve 150-200 Wal-Mart stores within a day. Stores were built as far away as possible but still within a day's drive of the distribution center; the area then was filled back (or saturated back) to the distribution center. Each distribution center operated 24 hours a day using laser-guided conveyer belts and cross-docking techniques that received goods on one side while simultaneously filling orders on the other."(Wal-Mart stores, http://mba.tuck.dartmouth.edu/pdf/2002-2-0013.pdf)

Wal-Mart was also aware of the power of customers. Wal-Mart defined its core customers and catering to their needs. One of Sam Walton's wisest decisions was to locate many of his earliest stores in towns with populations of fewer than five thousand people, communities largely ignored by his competitors. This strategy gave Wal-Mart a near monopoly in its local markets and enabled the company to ride out the recessions of the 1970s and 1980s more successfully than its then larger competitors such as K-Mart and Sears.Wal-Mart has also been skillful in providing products that appeal to women with low incomes(Bob Batchelor , Will Wal-Mart Last Forever (http://www.nybooks.com/articles/17647)).

7.6 Structure

Wal-Mart's structure and management system is based on region. Each store constituted an investment center and was evaluated on its profits relative to its inventory investments. Store-level data on sales, expenses, and profit and loss were collected, analyzed, and transmitted electronically on a real-time basis. The data could be analyzed by region,

district, store, department within a store, or even at the level of an item within a department(Wal-Mart stores, http://mba.tuck.dartmouth.edu/pdf/2002-2-0013.pdf)

Conclusion

Most of MNEs are home regional -based companies rather than global companies. One of important reason is influence of regional factors. Home regional factors can bring more advantages than host region's. And MNEs can easily transfer FSAs into regional FSAs. Therefore, MNEs should follow home country—home region—host region model. MNEs's manager must "think regional and act local", and design regional strategy and organization structure that develop triad-based internal know-how capabilities and organizational competences.

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