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TRANSNATIONAL CORPORATIONS IN SOUTHEAST ASIA

An Institutional Approach to Industrial Organization

HANS JANSSON

NEW HORIZONS IN INTERNATIONAL BUSINESS

Transnational Corporations in Southeast Asia

An Institutional Approach to Industrial Organization

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Preface

During many years spent in studying the operations of Western European transnational corporations (TNCs) in Southern and Eastern Asia I have become increasingly aware of the large differences there are between the ways of doing business in Asia and in Western Europe. The differences remain great despite a continual increase in the internationalization of the world's economy and the fact that Europeans and Asians are coming closer to each other all the time. These Asian countries also differ among themselves in their business cultures. Common to all is a rather low level of industrialization. European TNCs, as well, differ in their approach to doing business in the area. Some made heavy investments there, whereas others have simply followed the crowd, their business there being of marginal importance to them. Although the TNCs active in the region have adapted to local conditions, this has not seemed to have meant their losing their European identity and 'going Asian'. The adaptation of such corporations does not usually go so far that their basic framework is markedly changed.

Mainstream theories on the operations of TNCs have tended to be conceived in a somewhat superficial way, the differences between various TNCs in their operations being explained, not by taking precise account of local circumstances and the culture of the firm, but by dealing in a more general way with the industrial environment, the market of the country, matters of technology, and the like. It seems to be expected that some general theory concerned with the behavioural characteristics of all TNCs will be adequate here. Such a theory, to be sure, may suffice for examining Western TNCs in the market environments of the industrialized market economies in which they originated. However, for illuminating the operations of such firms in an Asian environment basically foreign to them and comparing their operations there with those of Asian TNCs, a different type of theory is needed. The dominant business system in Southeast Asia is strongly influenced by the Chinese, Japanese and Korean companies located there. Although these companies have emulated Western business practices in many ways, this has not affected the 'inner core' of these firms appreciably. Thus, there are very basic differences between

European TNCs, even as regards their Southeast Asian subsidiaries, and companies stemming from Eastern Asia directly. In this book an institutional approach will be used to provide insight into the differences alluded to between various firms and markets. This will involve examining the institutional background of Western European TNCs within the very special Southeast Asian context. This aims at providing a deeper understanding of the institutional origin of these companies.

The puzzle of regional and local differences in the approaches taken to business matters has led to my focusing on various theoretical problems that are thus implicated and to my endeavouring to bring together and integrate various theories of TNCs with the hope of developing some unified theory of the TNC as an economic institution. Gaining as thorough insight as possible into the operations of such firms in Southeastern Asia seemed to me of utmost importance in this connection. Whatever the reader's concern it is hoped that this latter aspect will also make the book interesting to a reader primarily concerned with knowing more about the problems in Southeast Asia and about how Western European TNCs can best prepare themselves for doing business in the region.

In a comprehensive empirical investigation of long duration, fruitful and long-term contacts with those TNCs of interest were essential. I am heavily indebted indeed to my interviewees at the subsidiaries of these TNCs in Southeast Asia who have shared their experience with me during my many visits there.

I also want to thank my colleagues at the School of Economics and Management of Lund University who have assisted in the preparation of the book, particularly Sven-Olof Collin, Ulf Elg, Ulf Johansson and Rikard Larsson, whose comments and criticisms have stimulated the reworking of substantial portions of the text. I am heavily indebted to Robert W. Goldsmith, who not only assisted me in correcting my English but also helped me to remove different errors and obscurities in the argumentation.

A grant from the Swedish Council for Research in the Humanities and Social Sciences assisted me in the initial stages of research, while the financial assistance given by the South Swedish Chamber of Commerce (*Stiftelsen för främjande av ekonomisk forskning vid Lunds universitet*) made it possible for me to finalize the book. I wish to express my deep appreciation to Maj-Britt Johansson, who did a valiant and professional job in her typing and editing of the book and Lena Hansson for her professional job of typing certain parts of it.

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The group management of a large transnational corporation (TNC) based in Europe decided to sell out one of its many product lines. No major problems were foreseen in implementing this decision. Indeed, since the firm's global organization was divisionalized according to product type and most of its worldwide subsidiaries belonged to one of these product divisions, the relative independence of which could be seen as representing one of the major advantages of a divisionalized organization of this sort, it was thought to be easy enough for the firm to break out this product-line from the others. However, implementation of this top-level decision was not as easy as had been expected. Protests soon surfaced from unexpected parts of the global organization, namely from several of the Asian subsidiaries. For one of these companies, such a divestment would have meant not only losing more than half its business, and with this a major contribution to its common overhead, but also the local business culture, based on the company's offering an integrated mix of different products, being disrupted. For such multi-product companies, there may be a critical mass concerning the variety that a product portfolio must involve for the company to succeed. Subsidiaries of this sort tend to be linked to product-line companies in a different way than are single-product subsidiaries located in larger and less remote markets. In the case in hand, a compromise was finally reached, the product-line in Europe being sold but that in Asia being kept.

A Southeast Asian sales subsidiary of another large TNC found itself to be in bad shape. Careful examination of its business revealed negligence in local marketing and service, high employee turnover, frequent changes in the managing directors, and losses for the previous five years. The gravity of the situation was first realized when a large distributor in a nearby country was transferred from this sales subsidiary to another, located in Northeast Asia. It became evident that nearly all the profits the sales subsidiary had reported for the past several years had come from this distributor and not from the local market. This had made the subsidiary complacent, since it had not needed to earn its own profits. A major reason for these serious problems being hidden for so long was that the group had lost much of its control over the subsidiary several years earlier when it had dismantled the regional organization.

This second case illustrates the difficulties a complex worldwide organization can have in controlling its small sales subsidiaries located in remote markets. The group's business operations in Southeast Asia had for the most part been established during the first half of the 1980s through the building up of a market organization consisting of distributors and sales subsidiaries. Business had been managed from a centrally located subsidiary, which had served as a regional office. After the establishment period was completed, this regional function was taken away. This coincided with a change in managing directors and the start of a deep recession in the area. After a period of build-up and support from the group, the subsidiaries had been left to manage on their own.

Both these cases illustrate the fact that subsidiaries in small and distant markets are often organized and controlled differently than are subsidiaries in major European markets. The cases also illustrate the problems which can result from insufficient knowledge at the central level regarding local developments in Eastern Asian subsidiaries. With the rapid growth of business in the area, such problems are becoming increasingly serious and are influencing more and more the global organization of TNCs. In an earlier study (Jansson, 1993), the author found problems of this sort to be typical of those experienced by European TNCs in the extension of their operations into Eastern Asia in efforts to take advantage of the tremendous business opportunities created by the rapid economic developments there. That part of the world is largely unknown territory with exciting strategic and organizational challenges not faced within the traditional markets of Europe and North America. This surge of Asian investment represents a third wave of global penetration, in the sense of the first wave of internationalization having taken the companies out of their home countries into other parts of Western Europe and the second wave involving investment in North America. Their expansion into Eastern Asia made the TNCs global in a more real sense, now operating in all of these major world markets, with one leg at each corner of a triad, so to speak. Due to the present and future importance of these markets, the extension of these TNCs into Eastern Asia represents a major strategic move on their parts. The prophecy of the Pacific Ocean being the economic hub of the future seems well founded. The region will surely increasingly become the home market and the 'backyard' of competitors from both the big dragon Japan herself and from the smaller dragons of South Korea, Taiwan, Hong Kong and Singapore, as well as the 'minidragons' of Thailand, Malaysia and Indonesia.

This third wave of investment poses major strategic and organizational problems for many European TNCs. Important to them is not simply to establish and maintain profitable business operations in the area, based on their existing assets and their competitive advantages gained elsewhere, but also to integrate these new business operations into their global strategies and global organization. The challenge this represents is the focus of the book. This challenge requires that a trade-off be made between local business goals and goals of global integration. How well a TNC meets this challenge is a test of its ability to create a truly functioning 'transnational organization' as described by Bartlett and Ghoshal (1989) or 'multi-dimensional organization' as it is called in this book.

Eastern Asian markets have a strongly local character, one which must be adequately understood in order that operations there can be adequately coordinated with the operations in the TNC as a whole, allowing economies of scale and scope to be taken advantage of. This has introduced new dimensions into the present and future operations of European TNCs, and has had the two following effects.

First, it has made the question of a group's responsiveness to local conditions an important issue. No longer can investments in such regions outside the major markets be seen as being of marginal importance. Rather, the problem of integrating local business units with two major components of the global organization of a TNC, namely its global product divisions and its group management, are viewed as having a significant impact on the group as a whole.

Second, it has highlighted the importance of TNCs expanding into new geographical areas and broadening their perspectives regarding such functions as marketing, production, and purchasing, or such organizational issues as that of the integration of corporate cultures.

Although the prime emphasis is placed here on the organizational problems inherent in this expansion into the local markets of the Southeast Asian region, consideration of these organizational problems is not complete without going into other issues, such as those of the marketing, manufacturing and purchasing strategies these TNCs pursue in this geographical area, and of how the TNCs have established themselves there.

THE LOCAL PERSPECTIVE

To become acquainted with the problems that the TNCs face in their expansion into Southeast Asia, the local operations of 17 European TNCs were studied in relation to the overall strategy, goals and organizational make-up of the TNCs. The subsidiaries of the TNCs considered were ones in the major ASEAN countries (Singapore, Malaysia, Thailand, Indonesia, and the Philippines), or in Southeast Asia (SEA) as this group of countries will, somewhat improperly, be referred to here.

The subsidiaries in question are ones located far from the group headquarters in Europe. Their remoteness in relation to their groups can be considered both in terms of physical (geographic) distance and in terms of psychic distance, mainly due to dissimilarity in operating conditions. The distance from headquarters, and from industrially mature countries, which is partly physical and partly psychic, involves at least five different aspects:

1. The markets and the market institutions are different.
2. The cultural and social values are different.
3. The level of technology utilized by customers and by suppliers is lower.
4. The infrastructure is often deficient, as seen by European standards.
5. Governments are much more involved in the control of business operations than is usually the case in Europe or the US.

For these and other reasons, the organizational problems in these markets tend to be extreme. Distance creates uncertainty in many ways. The problems that result pose a number of questions. How should TNCs organize the local business operations of such far-off subsidiaries in less industrialized countries (LICs)? How will the organization of the overall group be influenced? How can the interests of national responsiveness/differentiation and those of global coordination/integration be reconciled?

Transactions in markets that are highly remote appear to be controlled differently from transactions in markets nearby. Thus, transactions in remote markets are presumably harder for the TNC organization to coordinate and to integrate with transactions of the group as a whole. It can be assumed to be especially difficult to involve subsidiaries located in remote markets in the long-range global integration of research and development activities with those of production and marketing. Possibilities for the integration of the remote subsidiary's work with that of the group can also be assumed to differ with the function involved, it being easier to integrate production and purchasing in this way than R & D. Production investments aimed at taking advantage of low labour costs tend, for example, to be quite common in SEA.

This book deals with the organization of business activities in this relatively new area of TNC activities, being concerned in particular with those parts of the organization in new and remote markets that are close to customers there – for example, sales companies, manufacturing and R & D units, coordination centres, and various types of regional administrative units. An earlier study showed regional centres to be a vital part of the organization in remote areas (Jansson, 1988).

Although the nucleus of the book concerns the local organization of TNC subsidiaries in SEA, the manner in which these are related to the worldwide organization is also examined. The latter is done in two steps. First, transactions of local units with other group units are focused upon. Second, the partial within-group organization thus considered is related to the global organization of the group in question. Although the transactions involved are studied mainly from the bottom up, those in the top organization are examined as well, for example in strategic centres such as group or divisional headquarters, in part to illuminate the local organization and how it is related to the global organization.

European TNCs have extended their operations to SEA in various ways (Jansson, 1989). To understand how the organization of multinational firms develops, it is important to consider the process of establishment, in the present context that is occurring within distant markets. Research on internationalization processes in transnational corporations in general indicates such corporations to first establish themselves in geographically and culturally proximate countries and to only then proceed to more distant markets. This process is found to emerge in a stepwise manner, starting with agent arrangements and passing on from sales to manufacturing companies. Companies commit themselves through a gradual process of learning. The information and search costs, as well as perceived risks, are higher in international than in domestic investments. (Caves, 1982, pp. 68-73; Johanson and Wiedersheim-Paul, 1975; Johanson and Mattsson, 1987; Lundgren and Hedlund, 1983; Hedlund and Kverneland, 1985; Nicholas, 1986; Jansson, 1989.)

AN INSTITUTIONAL APPROACH TO TRANSNATIONAL ORGANIZATION

An institutional approach is used for illuminating local and regional organization of TNCs in remote markets and the relation of this partial organization to the overall worldwide organization. The conception of institutions emphasized here builds directly on Whitley's (1992, p. 10) definition of business systems: 'as particular arrangements of hierarchy-market relations which become institutionalized and relatively successful in particular contexts'. The particular arrangements of hierarchy-market relations are considered here in the present context as economic institutions and the specific contexts in which they are found as non-economic institutions. A transaction-cost theory is developed to explain behaviour within the economic institution of major interest in the book, the European TNC. This theory expresses very well the main rationale behind TNCs' originating from and mainly operating within Western market economies. The theory involves interpreting organizational behaviour from an economic perspective.

A major reason for utilizing transaction-cost theory in this context is that it is of an institutional character. A theory regarding corporations of the type operating in different institutional environments around the world does well to consider the institutional aspect. Indeed, this is the major way of analysing the transnational or international dimension in such a company. The large differences in institutional set-up between industrialized and LICs makes an institutional approach to multinational organizations particularly fruitful. The differentiation of subsidiary control, for example, that is achieved in such a company is assumed to depend on the mixture found of external economic and non-economic institutions. Marketing, purchasing, production, and the organization of these activities are adapted to such environments.

Another advantage of basing the study on transaction-cost theory is that this makes it possible to integrate theories of the organization of international business with theories regarding specific international business disciplines or functions, for example theories on marketing, purchasing and production. This will be developed later on in the book.

Using transaction-cost theory implies a competitive perspective. Strategies of TNCs in LICs such as those in SEA are different from those of the uninational (domestic) firms there. Generally speaking, the TNCs are technologically superior and are backed and influenced by an extremely large organization outside the host country. The strategies employed often originate outside the country and are transplanted there through the local market company. Local strategies tend to be coordinated with global strategies (Jansson, 1993). The present investigation focuses on sales companies, since they are more common and are the preferred mode of organization in the markets that were studied. So as to create a broader perspective, a comparison is made with production companies (production centres) and with agencies. In this way, the main stages of foreign involvement can be related to each other. The organization locally is also explained in light of the transnational organization of the firm. This approach seems fruitful in view of the fact that the influence of the TNC organization on competitiveness has changed within recent years.

The integration of the different activities of a TNC is of central importance today to the TNC's competitive strength. Dunning (1988a, pp. 172-3) reviews changes in the patterns of TNC activity found over the last 15 years and how these in turn have influenced ownership advantages:

1. The country-wise base has been broadened. First European TNCs, then Japanese TNCs and most recently TNCs from developing countries have become more international. The competitiveness of these companies is based on different ownership advantages than earlier TNCs had.
2. The degree of foreign involvement has grown. This has increased the advantages attaining through common governance.

As these first two points indicate, TNCs are based today in a variety of different countries. In addition, they are generally multi-product and are highly diversified geographically.

3. The forms of involvement have also been broadened. The 'new' TNCs are more willing to use other contract forms, such as joint ventures.
4. Uninational firms have become more competitive in certain industries previously dominated by TNCs.
5. Major advances in international transport, in the acquisition and interpretation of information, and in communications technology have very much facilitated international operations, making common governance easier.

An important result of these developments is that ownership advantages are increasingly based on firm-specific characteristics and less on country-specific factors. This has more to do with efficiency in reducing the transaction costs of integrative activities and what activities units have in common than with the appropriation of rents from proprietary assets for single or segmented activities. Global competition is increasingly affected by hierarchical advantages (efficiency). Dunning (1988a, p. 211) has summarized this, stating:

> We have suggested there is some reason to suppose that intra-industry production is the last stage in the evolvement of international economic transactions which begins with inter-industry trade and one-way asset transfer based on country-specific ownership advantages of single-product MNEs. Inter-industry production or intra-industry trade follows, and then finally – where there are advantages of the common governance of plants located in different countries – we get intra-industry production, based on firm-specific transaction-cost economizing advantages of multi-product MNE oligopolists from different countries.

Institutions

As already discussed, the main reason for basing the present study on transaction-cost theory is institutional, since the theory expresses well the main rationale behind TNCs originating from and mainly operating within Western market economies. This matter is elaborated upon in a quotation to be presented, which takes up how one major non-economic institution – culture – influences the economic institution of major interest here, namely the Western TNC. The quotation indicates how transaction-cost theory highlights and captures the dominant orientation, the basic beliefs, the values and behaviour, and 'soul' of this Western market-oriented economic institution.

> As the Western culture derives its main orientations from the Judeo-Christian or Greco-Hellinist traditions, order, symmetry, linearity, and individuality are the bases of an epistemological framework. Organisations are the systemic hierarchy of individual parts. As such, their efficiency and efficacy can be analysed down to the smallest unit i.e. individual. The unit's individual outcomes can be aggregated to obtain the results of the whole outcomes. As the organisation compares and contrasts the efficacy of different units, the systematic allocation of resources among them becomes of prime concern. In fact, the Western economic concept is mainly built on allocation of resources or allocative efficiency. On the other hand, if organisations are regarded as symbiotic relations of heterogeneous parts mutually benefiting all concerned, the precise demarcation of contributions is not possible and will not be attempted. Instead, measurement will be based more on the totality of the system than on individual parts. The results of these divergent views can be observed in the ways the American and Japanese organisations