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Regional integration and the international strategies of large European firms

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ABSTRACT

From the perspective of regional economic integration we decompose international strategy into regional integration strategy and three types of global strategy (global sales, global production, and pure global integration). Using 1100 firm-year observations we find that 60% of the largest European firms pursue a regional integration strategy. We also find that global strategies vary. We examine the firm specific factors that affect global strategies. In general, R&D capability determines a global production strategy, whereas firm size and managerial capability determine both a global sales strategy and a pure global integration strategy.

1. Introduction

Today an unresolved issue is whether large firms can pursue a 'global' or a regional strategy. By global we mean an extension of home country domestic strategy to a global context, assuming that the world is flat such that there is homogeneity in production and consumption patterns. By regional we mean sales or asset dispersion within each of the broad triad regions of the E.U., North America and Asia. Today firms are required to report their sales and assets across these broad geographic regions.

A great deal of ambiguity and misunderstanding remains in the literature as to when and how a global strategy can be used (Bartlett & Ghoshal, 1991; Zou & Cavusgil, 1996). The literature on global strategy recognizes some of the complexities of globalization and of global strategy itself but it also generates confusion about when to use it. In addition there is now ambiguity in the empirical support for global strategy, especially in light of recent finding that regional strategy is now being used by many large firms (Rugman & Verbeke, 2004, 2005). In this paper we provide new empirical work which helps us test the relative importance of global and regional strategies across large European firms. To facilitate this we first develop a new framework combining the firm-specific and country-specific factors that determine global or regional strategy.

The early literature of global strategy is a simple extension of domestic competitive strategy. Hout, Porter, and Rudden (1982) suggest using a portfolio approach in order to leverage a competitive edge in different countries to achieve a synergy effect across different products and markets. Levitt (1983) proposes that the best global strategy is to standardize a product for a global market in order to produce a high quality product at a low cost. Hamel and Prahalad (1985) argue that global

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strategy requires product varieties by sharing core competencies in proprietary assets across product lines. A large related literature emphasizes strategic flexibility in order to gain a comparative advantage (Kogut, 1985) and coordinate independence across countries (Porter, 1986). On the other hand, Bartlett and Ghoshal (1989) suggest a transnational solution that focuses on balancing pressures for integration and responsiveness. In addition, Ohmae (1985) and Yip (1989) focus on how industry and external environments drive globalization. Kobrin (1991) gives special attention to intra-firm resource sharing and learning across borders within a firm's network.

Recent studies on the nature of regional strategies question the existence of global strategy itself in both theory and practice (Ghemawat, 2007; Rugman & Verbeke, 2004). The empirical evidence suggests that globalization is not uniform across economic space due to the segmentation of manufacturing process carried out in different locations (Rugman, 2005). Therefore, the strategies of multinational enterprises (MNEs), which are embedded in the causes and consequences of globalization, may not be uniform (Buckley & Ghauri, 2004). In summary, the new regional literature demonstrates that the world's largest MNEs operate regionally (Rugman, 2005; Rugman & Verbeke, 2004) or semi-globally (Ghemawat, 2001, 2007) rather than globally. Small and medium size MNEs also show a regional orientation (Johanson & Vahlne, 2009; Lopez, Kundu, & Ciravegna, 2009). This recent evidence suggests that new empirical work linking economic integration with the strategies of MNEs needs to decompose integration into regional integration and global integration.

A related problem is that the existing literature does not tell us what motivates a firm's global (or regional) strategy. Several determinants could be the driving force for such a strategy, including firm size (Levitt, 1983), proprietary assets as core competencies (Hamel & Prahalad, 1985), managerial skills for coordination and integration (Bartlett & Ghoshal, 1989; Kogut, 1985; Porter, 1986) and external factors (Ohmae, 1985; Yip, 1989). Future research needs to focus on whether these or different drivers exist in regard to using global or region strategies. We can address these questions by classifying strategies into two broad building blocs, firm specific advantages (FSAs) and country specific advantages (CSAs). This classification will help us test the determinants of global and regional strategies.

Here we will compare the extent of the regional integration of Europe's largest firms to three types of global integration, namely global production (integrating upstream activity globally), global sales (integrating downstream activity globally) and pure global integration (integrating both upstream and downstream activities globally). We empirically test the consequences of globalization (or regionalization) based on the extent of an MNE's international sales and assets.

Using regional integration as a reference strategy, it is found that MNEs choose a global production strategy when they possess FSAs in R&D; they choose a global sales strategy when they have FSAs in growth orientation and in firm size and managerial capability; and they choose a pure global integration strategy when they have FSAs in firm size and managerial capability. However, the majority of large MNEs pursue a home region integration strategy. We also find that home CSAs determine which strategy is used.

The rest of the paper is organized into four sections. In Section 2 we examine the international and regional activity of large European MNEs and categorize them into four types of international strategy based on the perspective of economic integration. In Section 3 we discuss our data and methodology. In Section 4, we present empirical results from a multinomial logit regression analysis that we use to find the firm-level and country-level factors leading to global or regional integration strategies. Finally we conclude with a discussion of future research issues in Section 5.

2. Theory and evidence of regional integration and MNE strategy

2.1. Regional integration

Regional integration has been an integral part of the international economic system since the 1960s. As of 2008, more than 230 regional or bilateral trade agreements and about 1950 bilateral investment treaties exist worldwide. In addition, several regional trade agreements have expanded their membership and economic size over time, which has affected the activities of MNEs (Fratianni & Oh, 2009; Oxelheim & Ghauri, 2004). More than 50% of world trade and 40% of foreign direct investment (FDI) are generated from within a firm's home region triad (North America, Europe and Asia-Pacific). In fact, regional integration, or so-called new regionalism, has gone beyond preferential tariff reduction toward deeper integration, and FDI is now as much a central part of new regionalism as trade was in old regionalism (Ethier, 2001). Thus, macro economic and institutional factors provide favorable environments for MNEs that operate within their home region. Several studies have used a gravity equation modeling in their country-level analysis (e.g., Brenton, Di Mauro, & Lücke, 1999; Fratianni & Oh, 2009; Hejazi, 2009) and shown that regional integration leads to regional bias in both trade and FDI.

Applying the gravity concept to MNEs, Ghemawat (2001) suggests that firms should analyze not only opportunities in foreign countries, but also the costs and risks that arise from operations in these countries. These costs and risks arise from the four dimensions of distance: cultural, administrative/political, geographic and economic. However, Ghemawat's dimensions are to be used for an industry- and country-level analysis rather than a firm-level analysis.

At the firm level, Kobrin (1991) suggests that the greater the intra-firm resource flows, the greater is the level of transnational (global) integration. However, this simple type of globalization has been re-evaluated and challenged due to the asymmetry existing in CSAs and the complexity of economic (regional) integration, as the benefits of FSAs and CSAs are likely enhanced by geographical proximity (Buckley & Ghauri, 2004). Thus deeper economic integration may increase intra- and inter-firm resource flows within an economic cluster or a regional bloc.