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Global competition and global markets: some empirical results

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Abstract

The purpose of this paper is to develop and test a model that relates the profit rates of multinational firms to market share, other firm characteristics, and industry effects where the relevant geographic markets are defined at the global level. We test the proposition that market share and industry fixed effects can explain profitability variation for a sample of multinational firms. The most important finding is that market share has a positive and statistically significant effect on profit rates for a sample of *Fortune Global 500* firms. Moreover, the *Fortune Global 500* firms exhibit strong industry effects. While there are a number of explanations for a positive market share effect and strong industry effects, a common interpretation is the presence of rivalry among these firms.

Keywords: Global markets; Industrial organization; Market structure; Firm strategy and market performance; Multinational firms; Profitability; Oligopoly

1. Introduction

The increasing importance of multinational firms and international trade in manufactured goods leads naturally to the question of whether the relevant geographic market for many manufacturing industries is now global rather than national. With some notable exceptions, much of the previous empirical work building on the structure– conduct–performance paradigm has made use of data that follow national geographic market definitions. This paper is motivated by

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our interest in whether it is meaningful to define manufacturing markets globally.

Hout, Porter, and Rudden (1998) suggest that multinational firms compete in two types of industries: multi-domestic industries in which firms pursue independent strategies in each of a number of foreign markets, and global industries in which firms compete with other multinational firms in the world market at large. Our hypothesis in this work is that global industries are sufficiently important so that competitive interaction among firms takes place at this level of industry definition.

Richard Caves (1989: p. 1244) summarizes the need for research regarding the consequences of global competition as follows: "Discussions in the field of business strategy have focused on 'global competition' in which international rivals pursue strategies that treat the world's sub-markets as interdependent. Yet systematic empirical research on international oligopolistic behavior is quite limited." The transaction cost explanation for the existence of multinational firms suggests that such firms will tend to be present in industries with concentrated sellers (Caves, 1996, Chapter 4). Global oligopoly is thus a phenomenon likely to coincide with the growth of multinational enterprise.

The potential importance of global competition is also suggested by the growth in international trade in manufactured goods. While merchandise trade relative to GDP has increased for most industrial countries during the past three decades, the trend is dampened by the increasing importance of services as a component of GDP. As pointed out by Feenstra (1998: Table 2), merchandise trade relative to merchandise value-added has increased sharply for most industrial countries during the recent past. This increase is due in part to falling trade barriers and lower transportation costs, but is also related to what Feenstra calls the "disintegration of production", with substantial importing of intermediate inputs. The importance of global vertical production chains also suggests the importance of the study of global competition.

The purpose of this paper is to develop and test a model that relates the profit rates of multinational firms to firm characteristics and industry effects, where markets are defined at the global level. The research addresses important public policy issues related to the effectiveness of global competition in restraining oligopolistic pricing behavior of firms that may face little price competition from domestic rivals. Moreover, the findings are relevant to firms concerned about the strategic actions of rivals operating on a global scale. The paper utilizes a methodology similar to that used by Schmalensee (1985), developed further by Rumelt (1991) and Brush, Bromiley, and Hendrickx (1999), which relates profit rates to individual firm characteristics and industry fixed effects.

Our data set of international firms was gathered from the *Global Fortune 500* for the years 1989–1992. We know of no prior research regarding global competition that employs data similar to those contained in the *Global 500*. We note, however, that prior studies using US data have consistently found that industry effects are important in explaining cross sectional variation in profit rates. The two major findings reported in this paper are: (1) firm market share in the total global market