Understanding strengths and weaknesses of international business in home country

Life, Home

International business grew substantially in the second half of the twentieth century, and this growth is likely to continue. The internationalenvironmentis complex and it is very important for firms to understand this environment and make effective choices in this complex environment (Buckley, 2005). International business is different from domestic business because the environment changes when a firm crosses international borders.

Typically, a firm understands its domestic environment quite well, but is less familiar with the environment in other countries and must invest more time and resources into understanding the new environment (Dunning, 1998). When a business tries to expand internationally, one has to seriously consider different aspects of the economy of such country. First consideration is the level of economic development. Secondly, the business must clearly understand the type of market a country has, for example free-market, centrally planned or mixed.

Clearly the level of economic activity combined witheducation, infrastructure, and so on, as well as the degree of government control of the economy, affect virtually all facets of doing business, and a firm needs to understand this environment if it is to operate successfully internationally (Pauly, L. & Reich, S. , 1997). Another consideration is the political environment existing in the country. The political environment refers to the type of government, the government relationship with business, and the political risk in a country.

Doing business internationally thus, implies dealing with different types of governments, relationships, and levels of risk (Murtha T. P. and Lenway S.

A. , 1994). The characteristics of a firm's home country have been shown to be key determinants of the firm's competitive capabilities in international markets (Porter, 1990). Home country or location advantage is strongest for firms that perform value-added operations in their home country and export goods to foreign markets. Examples of this in media industries include the producers of recordedmusicand most television programming.

A large domestic market and other technical and economic advantages allow the creation of a variety of content that can be successfully and profitably exported to smaller international markets. The impact of location advantage weakens, however, as firms shift increasing amounts of their value-added process to foreign subsidiaries (Cantwell, 1990) or if foreign competitors gain access to their home market. As location advantages decline, ownership advantages—based on home-country resources—may continue to influence the firm's competitiveness in international markets (Daniels, J. D. , and L. H, 1997).

As location advantage declines, Foreign Direct Investment theory (FDI) suggests that firms may be able to maintain competitive ownership advantage by leveraging abundant resources and favorable institutional structures in their home country that may not be available to competitors in other countries (Dunning, 1996). Business may be viewed positively as the engine of growth, it may be viewed negatively as the exploiter of the workers, or somewhere in between as providing both benefits and drawbacks.

Specific government-business relationships can also vary from positive to negative depending on the type of business operations involved and the relationship between the people of the host country and the people of the home country. To be effective in a foreign location an international firm relies on the goodwill of the foreign government and needs to have a good understanding of all of these aspects of the political environment. A particular concern of international firms is the degree of political risk in a foreign location.

Political risk refers to the likelihood of government activity that has unwanted consequences for the firm. These consequences can be dramatic as in forced divestment, where a government requires the firm give up its assets, or more moderate, as in unwelcome regulations or interference in operations. In any case the risk occurs because of uncertainty about the likelihood of government activity occurring. Generally, risk is associated with instability and a country is thus seen as more risky if the government is likely to change unexpectedly, if there is social unrest, if there are riots, revolutions, war, terrorism, and so on.

Firms naturally prefer countries that are stable and that present little political risk, but the returns need to be weighed against the risks, and firms often do business in countries where the risk is relatively high. In these situations, firms seek to manage the perceived risk through insurance, ownership and management choices, supply and market control, financing arrangements, and so on. In addition, the degree of political risk is not solely a function of the country, but depends on the company and its activities as well—a risky country for one company may be relatively safe for another (Chamberlain S. L. and Tennyson S. 1998).

The cultural environment is one of the critical components of the international business environment and one of the most difficult to understand. Nationalcultureis described as the body of general beliefs and values that are shared by a nation. Beliefs and values are generally seen as formed by factors such as history, language, religion, geographic location, government, and education; thus firms begin a cultural analysis by seeking to understand these factors.

Firms want to understand what beliefs and values they may find in countries where they do business, and a number of models of cultural values have been proposed by scholars. The most well-known is that developed by Hofstede in1980. This model proposes four dimensions of cultural values including individualism, uncertainty avoidance, power distance and masculinity. The competitive environment can also change from country to country. This is partly because of the economic, political, and cultural environments; these environmental factors help determine the type and degree of competition that exists in a given country.

Competition can come from a variety of sources. It can be public or private sector, come from large or small organizations, be domestic or global, and stem from traditional or new competitors. For the domestic firm the most likely sources of competition may be well understood. The same is not the case when one moves to compete in a new environment. For example, in the 1990s in the United States most business was privately owned and competition was among private sector companies, while in the People's Republic of China (PRC) businesses were owned by the state. Thus, a U. S. company in the PRC could find itself competing with organizations owned by state entities such as the PRC army.

This could change the nature of competition dramatically. In the theories linking the competitiveness of firms with the characteristics of their home environment no distinction is made between different types of such characteristics. Rather, all of them are assumed to provide similar bases for the creation of competitive advantage. Likewise, domestic firms are assumed to have favorable access to all of them vis-a-vis foreign firms investing in the country.

However, there are a number of reasons to expect that home country characteristics would differ in terms of their importance as the bases for competitive advantage and that there will also be considerable variation in terms of the liability of foreign firms in accessing them, with some displaying more similarity between foreign and domestic firms than others. For example, foreign firms often stand in a considerable disadvantage in acquiring local information and knowledge.

The nature of competition can also change from place to place as the following illustrate: competition may be encouraged and accepted or discouraged in favor of cooperation; relations between buyers and sellers may be friendly or hostile; barriers to entry and exit may be low or high; regulations may permit or prohibit certain activities. To be effective internationally, firms need to understand these competitive issues and assess their impact. An important aspect of the competitive environment is the level, and acceptance, of technological innovation in different countries.

The last decades of the twentieth century saw major advances intechnology, and this is continuing in the twenty-first century. Technology often is seen as giving firms a competitive advantage; hence, firms compete for access to the newest in technology, and international firms transfer technology to be globally competitive. It is easier than ever for even small businesses to have a global presence thanks to the internet, which greatly expands their exposure, their market, and their potential customer base.

For economic, political, and cultural reasons, some countries are more accepting of technological innovations, others less accepting. In contrast, foreign firms are perhaps standing on a more equal basis with domestic firms regarding accessing general services provided on the market. Governments often create such variation across country conditions artificially, by denying access of foreign firms to certain resources but treating them equally to domestic firms, with reference to others. Resources may also differ in terms of the ability of MNEs to compensate for their liability in accessing them by internal transfer.

As part of an international network, foreign affiliates can access some resources elsewhere and can supplement some local resources by those available in other geographic areas (Nohria and Ghoshal, 1997). However, this ability is likely to apply to some resources more than to others. For example, if foreign firms have less favorable access to the local labor market, and hence are unable to attract the best available employees, they might be able to compensate for this, in part by employing expatriates.

Likewise, foreign firms are often disadvantageous in their ability to raise capital locally, arising from lack of information of the market on the participant and vice versa. They may, and often do, compensate for this liability by raising capital elsewhere. However, they may not be able to apply similar compensation mechanisms to other resources, for example local customers. Nachum (1999) identifies four possible outcomes in the struggle for competitive advantage. If firms are dominant enough in their domestic market to erect effective barriers to entry by foreign firms, both location and ownership advantages are sustained.

If they are unsuccessful in preventing other firms from gaining home country entry, their advantage may decline but they may maintain their ownership advantage through foreign investment. In this instance, they will face a significantly more competitive marketplace because they no longer have sole access to home-country resources. If firms fail to buttress their ownership advantage through foreign investment and remain focused on their domestic market, they may lose competitive strength and enter decline.

Finally, if foreign firms succeed in accessing the resources of the advantaged country through foreign investment, they may succeed in undermining the competitive power of domestic firms. Sources of home country advantage are varied and differ from industry to industry. Financial resources such as capital markets, institutional investment capability, and a strong domestic economy frequently provide competitive advantage. Sound governmental, technical and legal infrastructures and human resources, such as a skilled and available workforce, may play important roles.

Cost advantages due to technology or the easy availability of raw materials are factors in many industries. One potential home country advantage that has been studied by marketers but has drawn relatively little attention from economists is the impact of national image on consumer behavior in international markets. Casual observations of the national patterns in industries may be interpreted as an indication of a variation across location characteristics in facilitating the creation of competitive advantages.

For example, about 90% of the world's 100 leading management consulting MNEs emerge from a single country – the US. In contrast, in engineering consulting the world's 100 leading firms originate from 6 countries and the dominant one accounts for only 30% of the total (Nachum 1999). This variation might be attributed to differences across location attributes in terms of their accessibility to foreign firms and the ability of the latter to compensate for their liability by relying on the MNE internal network.

The recognition that the home country environment is critical in shaping the competitive advantages of firms has underlain a number of theoretical conceptualizations of the sources of the competitive advantages of MNEs. Researchers in organization theory, adopting an institutional approach, have argued that firms develop their capabilities in relation to their particular environment, and hence possess resources that match the distinctive institutional characteristics of their home country.

Porter (1990) conceptualized the home environment as the critical environment that shapes the nature and type of competitive advantages of national firms. He used this conceptualization to explain why the leading global players often emerge from one or very few home countries. FDI theory implies that firms originating from location-advantageous countries would develop strong competitive advantages based on the resources abundant in their home countries (Dunning 1993), and will become dominant global players in the industries in which their home country is comparatively advantageous.

The literature is replete with attempts to illustrate empirically the association between the competitive advantages of firms and the institutional characteristics of their home countries and to show that firms originating from the same nationality share similar sets of competitive advantages (Fiegenbaum A. and Thomas H. , 1990). These studies show that the practices of firms are, in some sense, selected by the immediate environment in which they operate, and that the home environment is the most important one.

A fundamental assumption underlying this link between the competitive advantages of firms and their home country environment is that national firms enjoy favorable access to the resources of their home countries, which is denied from foreign firms investing there. It is also one conceptualization of the favorable access that national firms have to the resources of their home country, resulting from reasonable and unreasonable preferences of local customers and suppliers and from discriminatory policies of national governments.

Attempts to examine the extent to which firms can tap into location advantages of foreign countries via investing there (Thomas and Waring 1999) have generally concluded that such ability is limited. Domestic firms were found in these studies to enjoy an advantage stemming from their familiarity with the local environment and the system in which they have been operating since their establishment.

It is argued that if an advantage can be accessed via investment in a foreign country, it would not provide an exclusive advantage because the possibility of accessing it would be equally available to all firms (Kauser, S. and V. Shaw, 2004). Moreover that it is the governance system that creates the country-specific advantages those national firms enjoy, and hence merely operating in a host country is not enough to access these advantages. Implicit here is the notion that the same set of country conditions has different value for national firms and for foreign firms investing in a country.