Going International: Export Myths and Strategic Realities—Executive Summary[1]

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1. What are the Issues?

It is generally accepted that Australian manufacturing firms don't export enough. Further, it is assumed that this is because they are not competitive. It is as if, in people's minds, exporting is synonymous with international competitiveness. In fact though, Australia does have world competitive manufacturing firms, such as Boral's brick and Burns Philp's yeast businesses, with extensive overseas sales. They just don't export much from Australia. This paradox was recognised, but not resolved, in *The Global Challenge*.[2]

Paradoxes exist because the way we think about the problem is either wrong or incomplete. Once that has been corrected, what previously looked like a paradox is seen as normal. The importance of the paradox is that it implies a threat to current policy, where it is based on an incomplete or incorrect model, and the opportunity to refocus policy by resolving the paradox and correcting the underlying model. A major objective therefore, of this study, is to change the way we think about the problem.

The classic SWOT framework for analysis, which directs attention to an analysis of a firm's Strengths, Weaknesses, Opportunities and Threats, highlights another way in which much of the discussion about the internationalisation of Australian manufacturing industry has been incomplete or at least unbalanced. The existing debate has concentrated on the weaknesses and threats, with some discussion of the opportunities, but minimal consideration of the strengths.

In contrast, we begin with the strengths. We extend the analytical framework of *The Global Challenge* which focuses on firm strategy, to include the firm's structure and management processes, and in particular the close fit required among these three factors for sustained high performance. Within this extended framework, successful Australian international manufacturing firms are found to be capitalising on their competitive advantage by pursuing multi-domestic strategies

1. Report to the Australian Manufacturing Council.
2. Australian Manufacturing Council, 1990, *The Global Challenge: Australian Manufacturing in the 1990s*, p. 134.

of producing in the countries in which they sell, rather than acting as strategic exporters.

To understand these strengths, so that where possible Australia can build on them and, where this is not possible, develop alternative strengths, the first two terms of reference ask:

> Is the extent of internationalisation and the process and pattern within manufacturing industries different from other countries, and if so, in what ways?
>
> What are the factors driving the differences in Australia, and what are the likely scenarios for the ownership, structure and performance of Australian industry?

The third asks to what extent the existing strengths will contribute to the external account deficit:

> What are the implications of these scenarios for the Australian economy, particularly the external account?

We find that Australia's existing successful international manufacturing firms and their current strengths are unlikely to offset the external account deficit. These firms' strengths are as specialist solutions to particular market opportunities in the less traded goods sectors. It is unlikely that collectively they are also solutions to very different market opportunities in the traded goods sector.

So the question becomes where does Australia find different firms with strengths in the traded goods sectors. We identify three options. The first, although it lies outside the scope of this report, comprises foreign-based manufacturing firms who can bring such strengths into Australia. The second is emergent Australian firms which are developing such strengths, are currently too small to be strategic exporters, and whose development should be promoted. The question then becomes what general policy agendas bear on developing the strengths and maximising the opportunities of the emergent firms. We make explicit the assumption that while policy can be made in a vacuum, it can only be successfully implemented by firms whose competitive advantage fits the policy agenda. The third option takes as its starting point the activity itself instead of the type of firm—the large, one-off, high value-added project such as an aluminium smelter, pulp mill, or petro-chemical plant.

Finally, in addressing the last of the terms of reference, namely:

> What, if any policy changes are required to maximise the benefits of the process of internationalisation for Australia?

we partition the general policy agenda into four parts. The first involves supporting the existing strengths of Australia's top international manufacturing firms, while recognising they are not collectively the ball carriers for increased exports and job creation. Two or three of them may, however, have significant rôles to play. The second relates to building on emergent strengths and opportunities. We identify the general policy settings necessary to stimulate and develop them and explore areas that may have significant potential for manufactured exports. The third deals with a major factor which currently limits the attraction of investing in the "mobile links", such as aluminium smelters and pulp mills, of resource-anchored value chains. As long as the investment decision remains fragmented, involving many different and unknown types of risk, firms will give such options low priority. Instead, they will concentrate on investment opportunities where they already understand and can manage the risks associated with the negotiating and contracting process. One critical policy agenda is therefore to reduce the fragmentation and complexity of the investment decision so that a firm is faced with "no more than one risk at a time". Finally, we note, but do not explore, the rôle of the foreign multinational enterprises (MNEs) which might choose Australia as a location for subsidiaries or joint ventures to provide a production platform for one family of products from within their global portfolio.

2. What Did We Do?

A range of international databases, such as Vernon's Harvard/CEI comparative multinational enterprise program, and the comprehensive IUI survey of Swedish multinational manufacturing firms, was used to compare the behaviour of Australian firms with their international counterparts. Specifically, we considered the effects of firm size and industry (tradeability), and patterns of location, mode of entry and structure and control systems. The analysis was then checked against the current strategic thinking of nine of Australia's top international manufacturing firms, not only to cross validate the individual findings, such as the effect of firm size, but also to ensure that the findings held together and explained overall firm behaviour. This analysis was based on publicly available data which was then corroborated by in-depth interviews with key executives on "how they compete and win".

This comparative analysis addressed the first two terms of reference about the pattern and direction of development. Three activities were undertaken to assess the implications of these patterns for the Australian economy under the third term of reference. First, while the multi-domestics export relatively little, they do in fact export "invisibles" in the form of management systems and proprietary technology. This flow was modelled and projected to 1999 to determine its monetary contribution to the external account. Second, we examined the "third wave" scenario, in which exports would be stimulated by the current overseas investment. Finally, we explored the potential of Australian manufacturing industries to export under different policy environments. This was simulated using a re-specified ORANI model.

3. What Did We Find?

As with firms elsewhere, there is a high correlation between increasing size and internationalisation. A firm with a specific competitive advantage is likely to grow large, exhaust the opportunities in its domestic market, and seek to use its specific advantage internationally. Successful firms in small countries can really only reach significant scale by expanding offshore. But size in the local market still appears to be a prerequisite for the ability to undertake investments abroad.

When a firm grows big enough and goes international, it must make a number of decisions. These include whether to export or produce in the overseas market, which overseas markets to enter, whether to acquire or undertake greenfield development, what risks it can afford to take, and how to restructure the firm from a domestic to an international business.

- The first decision, on where to produce, is dominated by industry effects. Many of the Australian Top 20 manufacturing firms are concentrated in the less tradeable sectors, where exports from Australia typically constitute a low proportion of overseas sales.

- The next question is where to locate. The answer tends to be, begin with a neighbour. For all but the U.K. and Australia, neighbour is defined geographically, like the U.S. for Canada. In contrast, the U.K. went to the "Empire", and Australia appears to have chosen New Zealand, the U.S. and the U.K. Initial ventures into South East Asia in the 1970s by many of the Top 20 were sold off in the 1980s.

- The choice of greenfield investment or acquisition reflects the basis of a firm's competitive advantage. If this is embedded in proprietary technology, the tendency is to build greenfield sites. On the other hand, if it can be grafted onto an existing organisation, the tendency is to make acquisitions. Australian firms follow the same strategies.

- Going international potentially exposes a firm to many new kinds of risk. The firms interviewed have adopted a common rule of thumb—"one risk at a time" for a new major investment project. Risk here means for them project-specific areas in which they lack and would need to develop managerial skills. Essentially, the firms believe that they can cope with only one source of competitive, if temporary, disadvantage at a time. For the most part Asia is seen as entailing more than one dimension of significant "risk", while the U.K. and America may present only one. Some firms claim that they have now learned enough about operating overseas to try Asia soon.

- Finally, the structure and control processes adopted by Australian multi-domestics reflect the domestic environment in which they evolved and learned their distinctive competencies, in the same way U.S. and European firms both show characteristic, and different, patterns of international structures.

On balance, we find that that the Australian firms behave in a way that is similar to their foreign counterparts. The problem, namely that many don't export, is common to their industry counterparts in the less tradeable sectors. History, and in particular the domination, by foreign firms, of the traded goods sectors in Australia, partly explains the concentration of Australian firms in these less traded industries.

Although Australian multi-domestics do not export in the conventional sense, they do export invisibles in the form of managerial expertise, either as management processes and procedures, or embedded in proprietary technology. Modelling the value to the external account of the invisible export of this managerial expertise, using both a base and optimistic case, we estimate the annual contribution of invisible exports to be around $1.5 billion per annum within 10 years' time and possibly higher. While this figure is substantial in itself, it will not make a significant contribution to the external account, by comparison with the current account deficit.

Less tangible and direct, but still clearly significant, contributions flow to the economy from the multi-domestics based in Australia. These firms are not only demanding "leading-edge" users for other firms (in the manufacturing and service sectors), but also leaders in the transfer of technology and best practice back to their Australian operations. There is no current prospect of their shifting domicile, but nor does the experience of any other country offer insight on this issue. The top management teams of MNEs domiciled in other countries are normally within a few hours' distance of a major market. By contrast, Australian MNEs have largely concentrated in "neighbours" at great distance and in other time zones. The one factor that arose in a number of interviews as a possible limit to further international growth, or as an influence on head office location and corporate structure decisions, is the constraint that may result from the effects of dividend imputation on the relative returns to foreign and domestic shareholders.

The above discussion analyses the existing patterns of business. Some people claim that the current pattern of high levels of offshore investment represents a temporary phase in the fledgling international operations of Australian manufacturing companies. This "third wave" hypothesis argues that once established in the international environment, these firms will expand production at home and export from Australia. Unfortunately, the evidence provides little support for this belief.

Finally, we show that, contrary to earlier findings, Australian manufacturing exports may gain substantially through microeconomic reform, in particular, the removal of manufacturing protection. A major boost to manufacturing exports would also come from the introduction of international best practice to Australia's manufacturing sector. These new and different findings resulted from modifications to the ORANI model, which is widely used to simulate the impact of proposed policy interventions. Previous reform simulations used a version of the model that only allowed four manufacturing industries to export, in order to stabilise its behaviour. As a consequence, previous runs of the model had over-estimated the impact of micro reform policy initiatives on the mining industry, whose export behaviour was relatively responsive, and under-estimated the impact on the manufacturing sector, where exports had been artificially constrained. In the analysis presented here, the "over responsiveness" of the mining sector has been adjusted and the range of manufacturing industries which can export has been expanded. As a result, we find a significant change in the composition of the manufacturing sector with cut-backs in traditional areas and expansion of the export-oriented sectors.

4. What Do We Conclude?

Essentially, Australian manufacturing firms parallel the process and pattern of internationalisation of their foreign counterparts. Taken as a group, Australia's Top 20 manufacturing firms look different because, with some important exceptions, they are predominantly in the less traded sectors of manufacturing. The issue is not that Australian manufacturing firms don't export because they are uncompetitive, but that there are few Australian manufacturing firms of large scale in the industries that generate exports. Typically, the multi-domestics are internationally competitive, but, with some important exceptions, are not in exporting industries. While the value of their rôle in strengthening overall competitiveness is unquestioned, their direct monetary contribution to the external account will remain small given their strategic focus on overseas production. What is needed are competitive firms in the tradeable industries that export.

At the macro level, our ORANI runs suggest that export prospects are better than generally believed for manufacturing industry overall, and specific areas within it, in a changed policy environment. Manufacturing exports would gain substantially through microeconomic reform, particularly the removal of manufacturing protection as contained in the May 1990 and March 12, 1991 assistance reduction programs. A major boost to exports would also come from the introduction of international best practice to Australia's manufacturing sector. This would be complemented by the government's initiatives to benchmark Australian industry.

It is important to remember though that simulations only indicate what potentially might happen. In reality, it is actual firms that respond to policy. Therefore the key issues revolve around identifying which types of firms will be successful in different (exporting) industries.

The firms that are already successful overseas, the multi-domestics, may seem to be the obvious target, because they have the scale to make a substantive contribution to the external account, and to take the risks, and the international presence that reduces the risk. But as a group they will not provide the solution, although two or three may have a rôle to play. Their competitive advantage lies in different industries and cannot easily be generalised.

The new ball carriers will be either emergent Australian firms or large scale foreign players. Importantly, the former must already exist. Very few firms that start now will do anything significant for exports or the external account by the year 2000. With both a limited number of growth options and potential players, policy can direct such government development expenditures as are made away from those areas with poor prospects towards those in which there are both relatively good prospects, and an already emerging cluster of firms. Some of these firms may already export, but are probably small. A study is needed to identify in which of the high potential areas those possible future strategic exporters already exist.

5. What Do We Recommend?

There are four different policy agendas. The first relates to the multi-domestics, for whom the overall policy recommendation might be characterised as “benign neglect”. We note that these firms have emerged in an environment that was unprotected and meet most of Porter’s notions of rivalry and competition. The outcome has been the development of a number of internationally competitive manufacturing firms. One major area of policy does warrant attention—the impact of tax imputation on investment decisions by multi-domestics.

The second agenda, although it lies outside the scope of this report, comprises foreign-based manufacturing firms who can bring world best practice into Australia. The question is why they should choose Australia as a location for subsidiaries or joint ventures to provide a production platform for one family of products within their global portfolio.

The third agenda is concerned with capturing the mobile link in a resource-anchored value chain. Two examples are the aluminium smelter and the pulp mill. Both are complex decisions. The economic viability of such projects depends on the supply and pricing of inputs largely vested in state governments while many of the national policy concerns, such as income tax and increased exports, are the responsibility of federal government. The states may not be motivated to move on such projects because they would bear many of the costs and gain few of the benefits. In addition, these projects confront the interested firm with multiple risks. Since all of the firms that could take on such a project have alternative investment opportunities that do not involve such complex contracting problems, it is not surprising there has been a failure to add value to our natural resources. The government has to manage the complexity of contracting because with so many component parts, and therefore risks, there is no incentive for firms to pursue such projects over other investment opportunities. The viability of such projects would then be a function of Australia’s comparative advantage with respect to factor costs.

Just as a firm needs a close fit between its strategy, structure and management processes, so too, a government needs to establish the structure and management processes to support a strategy of value-added resource exports. Without a clear structure to coördinate state versus federal conflicts, and clear management processes, such as environmental approval processes, such strategies will remain just visions of what might be. It should be recognised that, while any one issue such as resource security can be overcome, it is putting the whole package together which is the formidable challenge. This cannot be off-loaded onto the firm but is the central responsibility of government. But in a number of areas government can simplify this problem by making the contracting a part of the private market. For example, in the case of the aluminium smelter, this might involve privatising the electricity supply.

The fourth agenda is the development of emergent strategic exporters. The ORANI simulation provides strong evidence that both microeconomic reform (May 1990 and March 12, 1991 assistance reduction programs) and the move to best practice would have major positive impacts on manufacturing exports. As such, we endorse the current initiatives in both areas. In this context, we recognise how little is known about the dynamics and timing of economic change. By their nature, ORANI-type simulations point to the direction of change but cannot predict the speed with which such change may occur.

This points to two implications. First, macro-economic models identify industries which have potential but it is individual firms which finally respond to new opportunities. Second, the emergence of strategic exporters will be delayed if there are delays in any other aspects of the microeconomic reform process (e.g. transport and power sectors) relative to the tariff reduction program. Alternatively, the gains could be realised more quickly if the government were to implement the whole range of microeconomic reforms as a coördinated package.

In addition, government policy should be to encourage, and certainly not to inhibit, the emergence of strong large firms in the highly traded industries. For example, trade practices regulations should define the market in wider terms than simply Australia. Indeed, in those sectors which are highly tradeable and in which protection is low, a firm’s share of the Australian market should be irrelevant. Similarly, government procurement policy should, in the structure of its contracts, encourage the emergence of scale-efficient firms.

Finally, the government makes a large number of development expenditures, such as applied research grants. These should be directed towards areas in which there are already-established firms that can be the platforms for producing and marketing the resultant products. If firms that can take up and develop the patents do not already exist, little can be done after the ideas have been generated to earn a return on the research investment. The government’s recent policy initiative—establishing coöperative research centres which strongly encourage the active sponsorship of firms in collaboration with research institutions—is an example that could be emulated more widely.

In conclusion, we re-emphasise the central significance of firms of sufficient scale to be able to take the risks involved in becoming international, whether by exports or by investment overseas. Australia is, and will remain, a relatively small country at the periphery of the global economy. Without the benefits of a large domestic market or an easily accessed large neighbourhood market, we should not be surprised that many of our most successful manufacturing firms have favoured multi-domestic strategies as they emerged as global players. It would be a mistake to confuse international competitiveness with the existence of Australian strategic exporters.