

# International Transfer Management of Home based Firm-Specific Advantages: Evidence from Japanese MNEs in Emerging Markets

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## INTRODUCTION

The transaction cost-based view of multinational enterprises (MNEs) is generally considered an appropriate analytical framework for firms' initial foreign market entry, and has been expanded to analyze the efficiency of differentiated network-based MNE organizations (Rugman & Verbeke, 1992, 2003). However, criticism from the fields of international management and strategic management has centered on its limitations concerning MNE cost-minimizing behavior on the assessment of firm performance, particularly in technological innovation and value creation in local markets and the global arena (Porter, 1986; Bartlett & Ghoshal, 1989; Birkinshaw, Hood & Jonsson, 1998). Firm-specific advantages (FSAs) or ownership-specific advantages can explain the condition of comparative advantage, where differences in economic productivity make it desirable for firms and nations to specialize in and trade the products and services that reflect their superior capabilities (Dunning, 1980; Rugman, 1981; Kogut & Zander, 1993). FSAs, which include knowledge bundles, proprietary knowledge, and unique assets and capabilities, may be built upon product or process technology,

marketing, and distribution skills, and are always expected to be a critical source of competitive advantage in host markets (Rugman & Verbeke, 1992; Collinson & Rugman, 2008). In the FSA transfer from the home to a local (or host) market, MNEs should focus on not only achieving scope of economy (minimizing communication costs) by sharing knowledge bundles between headquarters and subsidiaries but also by creating value in local markets by allowing subsidiaries to reap the benefits of national responsiveness (Rugman & Verbeke, 2003, 2004).

Previous studies have addressed the importance of striking a balance between these two focuses. However, very few studies have investigated the optimal process of FSA transfer management at the business unit level. There are two main issues related to FSA transfer management. The first concerns how MNEs predict and create value in local markets using transferred home-based FSAs; the second concerns the role of cost minimizing in the value creation process in local markets.

The first issue, originally identified in strategic marketing literature, suggests that identifying key success factors (KSFs) in the competitive market requires providing feedback on the outcomes of the competitive advantage process to the antecedents of advantage (Day & Wensley, 1988; Hunt & Morgan, 1996, 1997). MNEs must analyze differences in performance among competitors to identify the valuable resources in the local market. Firms expect that their home-based FSAs will create great value in the host market as well as in other markets; however, they can never precisely determine the actual achievable value that initially selected home-based FSAs generate in host markets *ex ante*.

The second issue relates to the transaction cost economics (TCE) assumption in communication cost minimization within MNEs, and plays an important role in FSA transfer management. International business (IB) literature suggests that if subsidiaries require very different

resource combinations in terms of critical assets in local competition, the communication costs associated with selective intervention in the various organizationally and technologically separable subsidiaries may be excessive (Rugman & Verbeke, 2003, p. 131). In order to reduce communication costs and avoid self-seeking behavior by subsidiaries, knowledge and technology should be shared among affiliates in differentiated network MNEs. In this sense, home-based FSA transfer and utilization may be more favorable than new FSA development in the host market.

In this study, by conducting explorative case studies on the emerging market entries and expansion stages of two Japanese MNEs, we will explore the dynamic patterns by which MNEs simultaneously achieve value creation and cost minimization in the FSA transfer process. This paper is organized as follows. The next section discusses the main issues between the conventional transaction cost-based view of FSA transfer management and the competitive market perspective that focuses on the dynamic evolutionary process of utilizing resources for value creation. The third section conducts two explorative case studies on Japanese MNEs to explore the dynamic process of value creation, cost minimizing behavior, and FSA transfer management. The final section discusses the findings on the strategic orientation of the two Japanese MNEs concerning their FSA transfers, which were directed toward value predicting behavior at an earlier stage of market entry rather than toward actual value creation behavior at a later stage. We also found that unlike value predicting and creating behaviors, communication cost minimizing behavior was followed by both firms throughout the transfer process.

## THEORETICAL BACKGROUND ON FSA TRANSFERS

### *Transaction Cost Perspective*

In summarizing early works, it becomes evident that the major knowledge in MNEs was developed in the home country when the initial foreign direct investment (FDI) occurred (Rugman & Verbeke, 1992; Dunning, 1998; Cantwell, 2009). In general, the objective of FDIs in the 1970s was the reduction of production costs in the investing country; this has led to more aggressive market-seeking FDIs by transferring home-based FSAs. Rugman and Verbeke (1992, 2003, and 2005) identified a problem with the internalization theory from the perspective of strategic management. The problem is the assumption that an MNE's core FSAs normally originate in the parent company at home market and that these FSAs are usually not location-bound. In order to modify this assumption, they proposed to distinguish FSAs into two types: non-location-bound FSAs (NLB-FSAs) and location-bound FSAs (LB-FSAs). NLB-FSAs can be used in a variety of scales and scopes, can be transferred abroad at low marginal costs, and can be used effectively in foreign operations without substantial adaptation. In contrast, LB-FSAs can benefit a firm only in a particular location.

Although NLB-FSAs are the primary transfers to host markets because of their comparative advantages over local competitors, the value of transferred FSAs (knowledge, resources, and capabilities) may be very limited. Therefore, after initial market entry with NLB-FSA transfer, an MNE may invest in the development of LB-FSAs in foreign markets, leading to national responsiveness to complement transferred NLB-FSAs. The creation of much of the value in a host market largely depends on an MNE's ability to successfully deploy its existing FSAs to the specific circumstances of foreign markets (Rugman

& Verbeke, 2005).

As MNEs globalize their activities, foreign subsidiaries become insiders in the local market, and can therefore access Country-specific advantages (CSAs). In the 1990s, new FSA (LB-FSAs) development in host countries became the strategic imperative necessary for improving MNE competitiveness globally; however, all subsidiaries are not expected to develop their own new FSAs. For example, Bartlett and Ghoshal (1989) identified four generic subsidiary types by using two variables, the strategic importance of the local environment (high or low) and the level of internal resources and capabilities of subsidiaries (high or low). Among the four types, a subsidiary that scores high on both criteria is a *strategic leader*; it will take the initiative to transfer its newly developed original FSAs from the host country to other subsidiaries as well as to the parent company. When FSAs in the host country are developed to respond to specific local opportunities, these FSAs may become location-bound. Because different types of subsidiaries may require access to very different knowledge bundles from other affiliates and outside actors at the locations, different locations bring opportunities to develop distinctive knowledge. However, this may make unified management within a single differentiated network MNE extremely difficult, because communication costs in a single organization with various resources and knowledge bases may be extremely high. Because subsidiaries in emerging markets generally do not possess higher-level resources, they may not be expected to develop new FSAs to increase MNE global competitiveness.

Despite the benefit of LB-FSA development in host markets, MNEs have strong incentive to share knowledge and resource bases (home-based FSAs) between home and subsidiaries in order to minimize communication costs and achieve economies of scope, especially in

emerging markets where the levels of internal resources and subsidiary capabilities are relatively lower than other locations. To build sustainable competitive advantages in host markets, home-based NLB-FSAs are key to the success of initial market entries of MNEs. In this sense, initial selection of NLB-FSAs that should be transferred to host markets may be largely influenced by the desire to minimize transaction and communication costs.

### *Competitive Market Perspective*

The conventional transaction cost perspective on FSAs transfer assumes that the NLB-FSAs that initially selected to transfer become valuable resources that bring competitive advantage into the host market; however, from the dynamic competitive market perspective in strategic management and marketing literature, there are issues with this assumption (e.g., Hunt & Morgan, 1996, 1997; Zollo & Winter, 2002). For example, Collis (1994) stated that the source of competitive advantage is likely to be found in different places at different points in time in different industries; therefore, firms with capabilities will never identify the ultimate source of competitive advantage because of the infinite regress problem. It is difficult for firms to accurately predict the source (s) of competitive advantage in the future. The issue here is whether we can confirm the extended value that NLB-FSAs will actually generate before their transfer and the actual practices in use in the host market (Sugiyama, 2009).

In the framework for diagnosing competitive superiority, Day and Wensley (1988) proposed a dynamic process to identify KSFs in the competitive market. In order to identify KSFs, firms need to provide corrective feedback information regarding the outcomes of the competitive advantage process to the antecedents of advantage. This begins with identifying the differences between ‘winning and losing’

companies as well as high-leverage phenomena in the evolving competitive market. There are a number of differences between successful and unsuccessful companies, including uniqueness of vision or strategy, resources possessed, and other factors such as timing or market fit; these differ from company to company. The evolution of product markets reflects the outcome of numerous market, technological, and competitive forces, each interacting with others to influence the rate of sales growth in the market (Limbkin & Day, 1989). These influences form a critical source of competitive advantage in the market. In general, there may be a gap between the resources currently possessed by a firm and the resource demands of the current business (Priem & Butler, 2001; Mishina et al., 2004), because firms may rely on continuous change to continue to generate competitive advantages in rapidly changing competitive markets (Rindova & Kotha, 2001). When firms face an evolving competitive market environment, they must engage in scanning, searching, and exploration across technologies and markets in order to identify opportunities and sources of competitive advantage (such as knowledge and resources) and fit in with the market (Teece, Pisano & Shuen, 1997; Teece, 2009). This suggests that in rapidly growing markets such as the BRICs, which are attracting increasing numbers of competitors, new entrants, new technologies, and new product proposals, the structural changes in competition make it difficult for MNEs to identify or predict its KSFs in resources or knowledge bundles before its initial market entry.

In a discussion of autonomous behavior by subsidiaries in FSA development, Rugman and Verbeke (2003) stated that headquarters will recognize the value of autonomous activities only ex post, when a project has had some level of success in terms of feasibility, external interest, sales potential, or profitability increase (p. 133). If this is so,

it seems difficult for MNEs to identify the achievable value of NLB-FSAs ex ante. In IB literature, Johanson and Vahlne (1977, 2009), who proposed the Uppsala model, describe internationalization from a learning and evolutionary process. An insidership in relevant local business network is necessary for successful internationalization. Therefore, MNEs may recognize how valuable transferred home-based FSAs can be after they enter the host market and compete with local players.

By combining the two perspectives mentioned above, we find that the issue facing MNEs is whether initially selected FSAs are more effective in terms of costs and competitive advantage when transferred to host markets. The questions to be considered are as follows: to what extent do firms pursue cost minimization in the transfer process, how do they select FSAs for primary transfer at the initial market entry point, how do they recognize the real achievable value and the limitation of initially transferred FSAs, and how do they respond to it. In order to answer these questions, FSAs transfer management practices must be examined; however, excluding the Uppsala model, this issue has not received considerable academic attention in IB field.

## EXPLORATORY CASE STUDIES

We adopted the comparative representative case study typically employed with the interpretive paradigm in management studies to examine FSA transfer management. Case studies may be exploratory, descriptive, or explanatory (Yin, 1984; 2003). Following Yin's typology (Yin, 1984; 2003), our case studies are exploratory because we have taken an inductive approach in an attempt to develop new concepts concerning FSA transfer management. We conducted a comparative case study comprising multiple experiments on FSA transfer by



Japanese MNEs. Two criteria were used to develop the sample. First, given our focuses on MNEs, the firms were required to operate in at least three separate regions—the United States, the EU, and Japan—in addition to emerging markets in order to qualify as MNEs. Second, the firms also had to be one of the leading firms in their industries, thus restricting the sample to firms with relatively larger market shares in both local and global markets. Samples were also chosen to fill theoretical categories and provide examples of polar types (Eisenhardt, 1989). To meet those criteria, SHISEIDO in China and HONDA motorcycles in Thailand were selected. The case analyses, using both raw and interpreted data, dealt primarily with aspects of resource transfers, knowledge bundles, and capabilities from Japan to overseas subsidiaries. They allowed various kinds of comparisons that redefined and developed new resources. Our case studies produced interesting observed phenomena that can be used to rethink FSA transfer management. Our data sources consisted mainly of semi-structured interviews conducted over several years and archival data such as research papers, case studies, industry reports, and internal documents.

### *Case 1: SHISEIDO in China*

#### *Historical Overview*

SHISEIDO is Japan's largest cosmetics company, ranked fourth in global sales volume in 2013. SHISEIDO entered the Chinese market in 1981. At the time, the company's senior officials identified China as their highest priority because of its potential for market growth and the similarities between Japanese and Chinese consumers. SHISEIDO began by importing cosmetics from Japan and selling them in China. In 1983, SHISEIDO signed a technology cooperation agreement with Beijing (later updated in 1985). In 1987, the two partners began jointly to produce and sell shampoo exclusives in the Chinese market under the

“HuaZi” brand. HuaZi’s success led to the 1991 establishment of the SHISEIDO Liyuan Cosmetics Co., Ltd. (SLC), a joint venture between SHISEIDO and Liyuan Corporation, which, formerly a part of Beijing’s city government, had become a state-owned enterprise.

The SLC company initially produced and sold SHISEIDO’s prestige brands (targeted to China’s highest social class of women). In 1994, SHISEIDO developed the “Aupres” brand, which targeted upper-middle class Chinese women; initially sold only in prestige department stores in large cities, it was subsequently sold throughout the country. In 1998, SHISEIDO established Shanghai Zotos Citic Cosmetics Co., Ltd. (SZC) in Shanghai and began manufacturing and selling products for China’s mass market. SHISEIDO also established a wholly owned research center in 2001. In 2004, SHISEIDO established a holding company, SHISEIDO China Co., Ltd. (SCH), to coordinate all the company’s Chinese operations. In 2006, the locally produced “Urara” brand was launched for the voluntary chain store market, which grew rapidly, reaching 2,400 chain store networks within three years. The Beijing branch is generally responsible for department store business, whereas Shanghai is responsible for the voluntary chain stores. SHISEIDO was estimated to have approximately ¥120 billion in annual Chinese sales in 2012, with approximately 6,000 voluntary outlets and 1,000 sales counters in department stores throughout the country. SHISEIDO’s market share in China was estimated at about 10 to 12%, making the company one of the big three cosmetic companies in China, followed by L’Oreal (15% market share by sales volume) and P&G (13 to 14%).

#### *Initial Market Entry Stage*

The expertise developed in the Japanese market over the last century was used for distribution channel expansion through the use of

sophisticated product brand management skills in the Chinese market. SHISEIDO's business practices in China were consistent with those that had brought the firm success in Japan.

Founded in 1991 to penetrate the Chinese market, SLC expanded its business by narrowing its focus to the department store channel. In addition to imported cosmetics, the Aupres brand, designed exclusively for Chinese women between 20 and 35, contributed to the success and rapid expansion of the department store channels. The company employed "1% marketing" when it launched Aupres in 1994, targeting the wealthiest 1% of the population. Prices were set at levels between those of imported and local brands, making the brand reasonably affordable for its demographic. As a result, the target market grew from 1% to 5% of China's population (Jones et al., 2008). By utilizing SHISEIDO's advanced technologies in cosmetic product development, the firm was able to price Aupres lower than the prices of imported foreign cosmetics (at approximately 100 yuan) despite being of comparable quality, thus closing the gap between expensive imported cosmetics and cheaper domestic ones. To distinguish between the SHISEIDO (a higher line) and Aupres brands, sales counters exclusively for SHISEIDO were set up at high-end department stores when the Aupres brand was launched.

Despite these well-planned marketing strategies, Aupres struggled under uncertain market conditions when launched because most of the targeted customers had never consumed cosmetics, especially those from developed countries such as Japan. SHISEIDO realized that effective customer communication tools were needed to persuade potential Chinese customers that cosmetics would add value to their lives. Aupres eventually became successful, largely owing to SHISEIDO's home-based knowledge transfer—specifically, the

emphasis on hospitality and customer service at sales counters, which were the key factors in their success in Japan. In the early 1990s, the concept of customer service was not well understood in China, even among Chinese beauty consultants (BCs) at sales counters in high-end department stores. A sense of hospitality and the desire to serve customers were the most important qualities SHISEIDO's BCs had to possess. Through face-to-face communication with customers, SHISEIDO's BCs were trained to understand what customers really wanted and expected from them. According to SHISEIDO officials, Aupres was China's first foreign consultation cosmetic brand to feature prices lower than those of the prestige imported brands. SHISEIDO devoted resources to training staff on the corporate ideals of service, starting with basic skills, in order to turn them into effective BCs. The effective transfer of customer service skills to the Chinese BCs was a primary factor in Aupres' success. These advanced and sophisticated BC service skills allowed Aupres to become rapidly perceived as one of the top brands in the Chinese market—a high-end cosmetics brand offering reasonable prices to China's newly rich.

Another key factor was that Aupres' advertising emphasized the brand's development by SHISEIDO, a Japanese cosmetic company, specifically for Chinese women. In the early to mid-1990s, only SHISEIDO among Western and Japanese cosmetic firms focused on developing products exclusively for the Chinese market (in 2007, Japanese company Kanebo developed its "Aqua" brand exclusively for the Chinese market, but no European or American company has followed suit). Consumer recognition of the SHISEIDO and Aupres brands had surpassed 90% and 80%, respectively, by 2007. That Aupres is a Japanese product also had a positive effect, as it represented reliability and advanced technology to Chinese consumers.

In 2007, SLC expanded its department store business. By that year, it was employing 4,100 people (including approximately 3,000 BCs) and operating 21 business offices and six product brands for department stores:

1. Clé de Peau Beauté (a high-prestige brand)
2. Imports of global SHISEIDO products
3. Aupres (an exclusive line for Chinese women)
4. Supreme Aupres (high-class Aupres, also exclusive to the Chinese market)
5. Ipsa (not a part of SHISEIDO; this name is used to avoid using “SHISEIDO” and has 17 sales counters in China)
6. BPI (Beauté Prestige International S.A.)

#### *Local Market Expansion Stage*

SHISEIDO's success in developing department store channels by transferring home-based knowledge of customer service strongly conditioned its future business model strategy in China by the time SHISEIDO decided to expand into the mass market. By the end of the 1990s, managing SHISEIDO's brand image, including in the middle and mass markets, had become a priority. As SHISEIDO developed chain stores and voluntary chain businesses, the firm came to believe that transferring knowledge of customer service and the department store channel business from home enhanced corporate and brand management.

In 1998, SHISEIDO established SZC in Shanghai, which began to offer products for the middle and mass markets. SHISEIDO decided not to expand their sales outlets too quickly because excessive product distribution could have damaged the exclusive brand image the company had developed in China through their department store channel business over the decade. Rapid business expansion always causes brand management control issues.

SHISEIDO began to find tremendous opportunities in China's middle-mass market in around 2000 that could not be addressed by department store channels. The company thus introduced the "Za" brand (which was not marketed under the SHISEIDO brand name) as an instant strategy at the early entry stage. Soon after its initial mass-market entry, SHISEIDO was confident that it brought great value to the Chinese market and executed a channel strategy, steadily expanding its network of smaller stores offering high-quality customer service. After 2000, China's middle-mass cosmetics market continued to grow rapidly. To maintain the appropriate level of customer service and the effectiveness of the SHISEIDO cosmetics experience, the company developed its own exclusive distribution network of qualified small local stores (partners) all over China as exclusive SHISEIDO distributors for middle-mass market products. The Chinese market is so large that most manufacturers find it difficult to build their own exclusive direct distribution network channels. Some of the pioneers among China's SHISEIDO mass-market marketers disagreed with the strategy of investing in the development of an exclusive distribution network by turning small mom and pop stores into qualified SHISEIDO distributors, as these marketers had already developed distribution channels through major local intermediaries in some key regions. However, the new CEO, Shinzo Maeda, made an executive decision to develop the voluntary chain store network because a lower level of channel control power was necessary to effectively transfer customer service knowledge to each small store. SHISEIDO's management team remains confident that customer service knowledge is their most critical source of competitive advantage in the Chinese market.

Transferring tacit knowledge such as customer service skills outside of a firm to partner distributors requires that much time and

investment be devoted to training and managing individual stores into qualified retailers, especially for a foreign prestige brand like SHISEIDO. In our interviews, almost all respondents from SHISEIDO's China business division recalled that the success of China's SHISEIDO's department store business in the late 1990s was key in building trust in SHISEIDO's middle-mass business strategy among distributors who needed to learn customer service knowledge from SHISEIDO. In other words, the success achieved by the department store business by pursuing higher customer service quality provided local store owners with a strong motivation to learn customer service skills from SHISEIDO.

While SHISEIDO decided to invest in its own voluntary chain network with high customer service quality, other major competitors in China, such as L'Oreal, P&G, and Estée Lauder, spend approximately 20 to 30 times more than SHISEIDO on mass advertising. The strategy followed by most competitors is to gain brand name recognition by pouring funds into mass advertising such as TV commercials in order to entice consumers to ask for and purchase their brands. One of SHISEIDO's senior managers in the China business division called these strategies an "air battle." By contrast, SHISEIDO focuses on offering high-quality outlets and customer service at their stores, in what may be called a "ground battle." SHISEIDO prioritizes investment in knowledge transfer and maintaining service quality at its stores, thus fostering and improving personnel development, customer information control systems, and the relationships and exchanges between customers and sales staff at each local store.

SHISEIDO established SCH, a holding company, as the company's head office in China to expand its voluntary chain businesses. In 2006, SZC put locally produced brand Urara on the market. Urara was

exclusive to voluntary chain store channels, just as Aupres was to their department stores. As a result, SHISEIDO's Chinese voluntary chain store business has grown rapidly, with 2,400 retailers networked across China in 2007 and 6,000 in 2012. For SHISEIDO, the most difficult part of the Chinese market's specificity was the great physical distance between the head office and local stores, which weakened service quality controls. In its channel construction, which has expanded to over 6,000 stores and is still growing, SHISEIDO emphasized quality and high standards, screening applicants and selecting only those deemed suitable to be store owners. SHISEIDO attracted infrequent cosmetics users by improving customer service and sales promotions at the point of sale, made possible through independent store owners' trust in SHISEIDO's business strategy.

#### *Case 2: HONDA's Motorcycle Business in Thailand*

Amano and Shintaku (2010) claim that HONDA's motorcycle business accounted for only 14.1% of HONDA's total sales in 2008; it has strong growth potential, however, especially in many developing countries, even after the 2008 financial crisis, particularly compared with the automobile business in the triad market. HONDA's total motorcycle production was 10.1 million units in 2008, 74.4% of which were manufactured in Southeast Asia. From 2007 to 2008, HONDA's sales growth ratio in the Asian market was 13.4%, with declining markets in Japan, Europe, and North America.

#### *Initial Market Entry Stage*

HONDA established Asia HONDA Motor in Thailand in 1964. In 1965, HONDA founded Thailand HONDA with a joint holding company and started manufacturing motorcycles in 1967. Following HONDA's philosophy, the company established local companies and on-site production wherever demand existed: in Malaysia in 1969, Indonesia in



1971, the Philippines in 1973, and India in 1984. HONDA's Asian market developed rapidly based on expected future demand growth. Thailand has become a center of HONDA's ASEAN motorcycle market.

The Thai government enacted a protective policy for the domestic motorcycle industry after HONDA and other Japanese motorcycle firms entered the Thai market. In 1971, the Thai Industry Ministry imposed a 50% local components policy, increasing it to 70%; in 1977, it imposed a total import ban on all finished motorcycle products to protect the Thai motorcycle industry (Higashi 2006; Mishima 2010). Because of these policies, all major Japanese motorcycle firms (i.e., Suzuki, Yamaha, Kawasaki) operating in Thailand decided to make a series of large investments in Thailand and develop an entire industrial infrastructure from scratch with the long-term expectation of future demand. They had no other option given the high uncertainty of Thailand's future market growth.

From 1967 to the mid-1980s, HONDA's primary mission in the Thai market was to develop a fundamental industrial infrastructure for the motorcycle business, especially manufacturing capabilities and local supply chain systems, in order to produce a high-quality product on a mass production basis. To achieve a high standard of local production, HONDA started to transfer their home-based manufacturing capabilities such as inventory control, process management, and specific skills to the local production facility by dispatching skilled veteran Japanese personnel to Thailand. Some of the main required machine tools were also sent. To develop a local supply chain, major Japanese suppliers who made relatively large-scale heavy components developed their own manufacturing sites in Thailand. The rate of local Thai content in finished products reached 75% in 1974 (Mishima, 2010).

Despite the transfer of home-based manufacturing capabilities, the

Thai market remained weak, with 100,000 units sold in 1974. Japanese manufacturers enjoyed a 90% market share, but producing 100,000 units was insufficient for local profitability, as the minimum annual production scale for one company is usually at least 200,000 to 300,000 units. In 1986, Thailand's total market volume reached 340,000 units, with HONDA holding a 34% market share, compared with 39% for Yamaha and 20% for Suzuki (Mishima, 2010).

#### *Local Market Expansion Stage*

From the early 1980s to 1985, Thailand's motorcycle market did not grow as much as expected because of the economic recession caused by the second global oil crisis and, as Mishima (2010) points out, the Japanese motorcycle manufacturers failed to offer products that appealed to Thai consumers. HONDA's marketing efforts had failed to develop the local market's potential. In 1988, HONDA established its first product development unit in Bangkok, Honda R&A Thailand (HRA-T), to develop locally adapted production models (Demizu, 2011). HRA-T was established not only for production development and engineering but also as a local market research unit. Mishima (2010) observes that collecting intensive local market data and analyzing Thai consumer needs allowed HRA-T to develop locally adapted models, leading to a 51% market share, with 500,000 units sold in 1996. As a result, HONDA's local production grew to 728,000 units in 1995, exceeding the minimum production scale. This marketing experience revealed to HONDA that local product development capability could be the key success factor for not only the Thai market but also all other ASEAN markets.

The 1997 Asian financial crisis crucially influenced all ASEAN markets. From 1996 to 1998, sales in the Thai market declined by a third, from 1.4 million in 1995 to 580,000 in 1998. Until the mid-1990s,

nearly all production models for the ASEAN markets were developed at the Japanese headquarters (Amano & Shintaku, 2010) and then modified locally based on analyses of local customer preferences (Demizu,2011). In 1997, HONDA decided to enhance the function of the local product development unit and established Honda R&A South East Asia Thailand (HRS-T). HONDA headquarters decided to transfer all its product development functions (from market analysis and product design to finished goods manufacturing) to the local market to be able to respond to local market conditions as quickly as possible. HONDA gradually moved increasing numbers of locally designed production models previously designed at headquarters, and raised its total number of production models through HRS-T.

According to Demizu, there were 22 Japanese-developed models and only one locally developed model in 2000; by 2006, however, there were three Japanese and 34 locally developed models. HONDA Thailand developed its capacity to design and manufacture finished products locally by enhancing its local parts and component supply system and initiating local product qualification tests and evaluations. In 2002, minor modifications to the surfaces and appearances of product designs were transferred to local subsidiaries. By 2004, appearance design was also being conducted locally; by 2006, all basic architectural product design, including appearance and frame design, had become part of HRS-T's operation. Road testing was also transferred to Thailand, to make it consistent with the nation's road conditions. Motorcycles are the means of transportation for many working-class Thais, and road conditions are often poor. Many roads in both suburban and rural areas have not been properly paved; thus, travel, undertaken more often for work than for leisure, tends to take longer. Thailand also tends to be warmer and more humid than in Japan. HONDA has attempted to test

local characteristics such as usage, weather, and traffic conditions and has prepared verification facilities for testing motorcycles in order to provide locally adapted products more effectively.

In the late 1990s, HONDA and other Japanese firms were faced with new competitive conditions in Thailand because Chinese imitators started to export their semi-finished components to Vietnam, Indonesia, and other ASEAN markets on a knock-down assembly basis. Cheap and affordable quality Chinese products were claiming larger shares of the ASEAN markets, especially in Vietnam. China was one of the countries where HONDA aggressively conducted technology transfers for motorcycles in the 1980s. When HONDA entered the Chinese market, there were hundreds of fiercely cost-competitive local motorcycle companies. HONDA struggled with this cost competition, its market share decreasing to 8.4% by 2008. China became the only national market in which HONDA's motorcycle business failed to develop or sustain a competitive advantage.

Even in ASEAN markets, HONDA's competitive advantage seriously declined in the late 1990s, as Chinese products were overwhelmingly more affordable than HONDA's motorcycles. Furthermore, as HONDA failed to recover its Chinese market share, the invasion of the ASEAN markets by Chinese manufactures represented a new near-term threat to HONDA (*Nikkei Sangyo*, June 16, 2004; Amano & Shintaku, 2010). HONDA Thailand developed ten new higher quality models based on home-based technologies and product development capabilities. For example, the Wave was introduced in December 2001, priced at 40,500 baht (US \$980), and the Dream 125 was launched in April 2002, priced at 37,500 baht (US \$910) while the products of competitors with Chinese-manufactured components were priced at 23,650 baht (US \$550). HONDA's products cost local customers almost twice as much as

Chinese ones did.

To compete with Chinese competitions in the Thai market, HONDA decided to redesign a whole value chain, from product design and the supply chain system to the assembly lines. Both Japanese and select local suppliers had developed and improved their manufacturing capabilities with HONDA's technical assistance, making a series of relationship-specific investments to develop manufacturing lines and thus cut costs to 30% of the total cost of production. These tightly managed, long-term relationships with selected suppliers may lead both the principal firm and its suppliers to invest in fixed and inflexible assets specific to the relationship, which could help build competitive advantages based on the characteristics of Japanese manufacturers. HONDA has transferred the capacity to build relational assets with selected suppliers to refine and redesign the supply chain network in the ASEAN region as a whole to minimize its ongoing production costs.

HONDA's Wave 125 was released in 2001, priced substantially higher than similar Chinese models. In June 2002, the Wave 100 was launched, priced at 29,800 baht (US \$723) ; it was the first motorcycle in the Thai market that cost less than 30,000 baht. Its cylinder capacity was reduced to under 100cc, and it used many local parts. In 2003, HONDA strengthened its lower-priced model lineup with the Wave Z, priced at 27,500 baht (US \$667). To keep its price low, not only were Thai-made components used but Chinese-made components as well. Of course, the Thai-made components were intensively used to establish cost competitiveness; the motorcycles' local content ratio reached 96.8% in 2003. Ever since, Thailand has remained one of HONDA's parts and components export centers, supplying other ASEAN countries. HONDA has therefore protected the Thai market from Chinese competitors through its locally adapted, high quality, and competitively priced

products, enabled by transferring home-based organizational capabilities for product development and supply chain management.

HONDA also decided to intensively invest in enhancing its distribution channel networks (Amano & Shintaku, 2010) and maintenance service networks overseas, as they have in Japan, in order to create clear advantages over their Chinese and Indian competitors, who tend not to emphasize customer relationship development (*Nikkei*, March 8, 2004; *Nikkei Sangyo*, July 6, 2007). The number of units sold in the Thai market rose from 580,000 in 2000 to 1.27 million in 2003. The Wave 100 alone sold 800,000 units in 2003. In 2007, HONDA held a 70% share of the Thai market, with over 1.2 million units in annual production.

## DISCUSSION AND IMPLICATIONS

Figure 1 summarizes the findings of our case studies of Japanese MNEs. It shows that the FSA transfers in the two cases were directed at value prediction at the initial stage and then gradually moved to value creation in subsequent stages. Initially, a lack of information on evolutionary competitive markets caused both MNEs to fail to identify the key resources and capabilities in the host markets. Instead, they “predicted the value” in their initial entry. SHISEIDO initially transferred its home-based FSAs and subsequently enhanced the initially transferred FSAs with additional investments when developing a new distribution channel for the middle-mass market. SHISEIDO clearly came to recognize the value of the transferred FSAs generated in China at the local market expansion stage. In contrast, HONDA transferred other bundles of home-based FSAs during the local market expansion stage because it also recognized that the initially transferred FSAs had limited achievable value creation in the host market. Throughout the transfer process, communication cost minimization was

displayed by both firms. Our case data indicate that MNEs tend to avoid the immediate development of new location-bound FSAs in host markets in order to minimize communication costs between headquarters and subsidiaries.

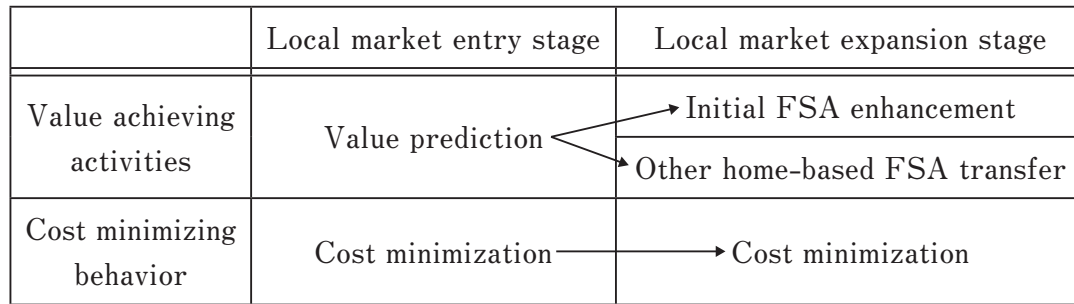


Figure 1. Two-stage process model of FSA transfer management

In SHISEIDO's Chinese market entry and expansion, the firm initially transferred its home-based FSAs, relative to brand marketing on a channel basis, when it entered the Chinese market fully. These are business resources that SHISEIDO accumulated over a long period in Japan. SHISEIDO initially developed the Aupres brand exclusively for Chinese customers and subsequently launched the Urara brand for voluntary store channel development. The quality of face-to-face service at sales counters (a home-based FSA) was transferred through the BCs' hospitality training. As a result, SHISEIDO achieved rapid growth in the Chinese market. A series of FSA transfers involved value predicting and cost minimizing in the earlier stages. Although the FSA's effect on value creation had been uncertain, SHISEIDO successfully transferred its excellence in the Japanese market to its China operations. It is important to note that SHISEIDO did not confirm the achievable value of its initially selected FSAs but, rather, confirmed that they generated great value in the Chinese market only after learning to adapt to the competition; SHISEIDO was then able to use the FSA transfers with additional investments when developing new distribution channels for the China's middle-mass market. In the early

stages of transfer, SHISEIDO decided to use its FSAs in a cost-oriented manner; in the local market expansion stage, additional investments enhanced the initially transferred FSAs when SHISEIDO recognized their ability to create value ex post.

For HONDA, production manufacturing capabilities were first transferred as NLB-FSAs. The FSAs able to produce high-quality products (generally much higher than what most mass-market consumers expected) accumulated in Japan were transferred. This home-based FSA transfer shows that HONDA had not adapted its operational capabilities in product development and production to local markets. This was a relatively low-cost transfer because HONDA did not develop new location-bound FSAs from scratch. In the late 1980s, HONDA realized the need to provide the capability to adopt products locally for Thai consumers and thus develop the local motorcycle market. Therefore, a local product development function was established and gradually enhanced by transferring other home-based FSAs. In the mid-1990s, HONDA encountered new competitors in ASEAN markets (including Thailand) offering cheaper products manufactured by Chinese companies. Facing this new competition, HONDA transferred other FSAs from Japan to complement the initially transferred home-based FSAs. At that time, HONDA realized that the FSAs already transferred were insufficient to achieve the desired level of value in the mass market.

HONDA therefore decided to reconstruct its regional supply chain network to use affordable locally produced parts and components for locally designed products and to offer lower-priced models not only for the Thai market but also for other ASEAN markets. This operational capability to construct and maintain the local supply chain network and product development was acquired in the Japanese market as part of



their home-based FSAs. Here, HONDA displayed other home-based FSA transfers during the local market expansion stage to engage the local competition.

## CONCLUSION

This study was founded on two premises. The first was that there are dynamic competitive market effects on the management of FSA transfer and development. The second was that FSA transfer management should be able to balance cost minimization and value creation. Two case studies were conducted on Japanese MNEs to examine the management practices of FSA transfer, focusing on the stage model of transfers. Previous studies on FSAs assumed that all NLB-FSAs automatically become the source of competitive advantage in every host market; however, our findings indicate that firms must take time to identify the resources that are most suited to dealing with the competition in each country's market. It is not easy to predict which home-based FSAs will achieve the expected value in a host market ex ante; therefore, MNEs focus on "value prediction" at the initial market entry stage. It is important to note that, despite the uncertainty of value creation with initially transferred FSAs, our findings indicate that, throughout the transfer process, MNEs tended to focus on minimizing communication costs by sharing resources and knowledge bases with headquarters in order to win the battle of the local market competition.

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