

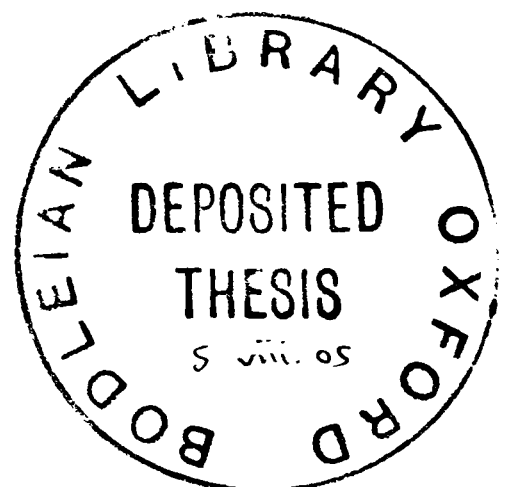
Competitive Advantage, Political Advantage and Shelter in the Textile Industry.

Doctoral Thesis

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Thesis Abstract

The effect of government on competitive advantage theory has only been covered superficially in strategic management literature. This thesis incorporates government into competitive advantage and multinational enterprise (MNE) theory by demonstrating how politically derived firm-specific advantages (FSAs) and competitive advantages may accrue from non-commercial, political sources, to be manifested in commercial enterprises as ‘political competitive advantages (PCAs)’.

The empirical background to this thesis is a study of the global textile industry and the complexity, multidimensional and multi-level nature of the relationship between the wider textile complex and governments. Examples demonstrate the significant impact of governments upon the textile industry, across the globe and over a wide variety of time horizons.

A review of the relevant strategic management and international business core theory forms a base on which the PCA concept is developed. A synthesis of the strategic positioning view (SPV) of competitive advantage, the resource-based view (RBV) and transaction cost/internalization theories is used to develop the PCA concept.

MNEs can derive superior operator surpluses (rents) from complex government externalities that, due to their asymmetrical impact, enable some

profit-centres to gain PCAs. PCAs are non-market-related, chiefly government-derived, political competitive advantages and form a new subset of firm-specific advantages (FSAs). The international business concept of non-efficiency, shelter-based advantages form a subset of PCAs.

An eight-cell PCA analytical framework is developed and operationalized using case studies selected from the world-wide operations of Coats PLC, the world's largest producer and distributor of sewing thread, and one of Britain's oldest MNEs.

This analytical framework enables firms to better understand the significant and dynamic nature of those government externalities that have a major impact upon firm efficiency. The framework can be used to assist practitioners in the search for sustainable reactive and/or proactive (endogenizing) strategies that can enhance PCAs and reduce political competitive disadvantages (PCDs).

DEDICATION

TO

Ute

and to Hester, Millicent, John, Joyce, Abby and Rory

**With grateful thanks to my supervisor
Professor John McGee,**

and to

Dr. Sue Dopson,

Professor Alan Rugman,

Professor Alain Verbeke,

Professor David Faulkner,

Dr. Graham Costello,

and to Dr. Keith Blois, Saliya Jayaratne

and all at Templeton College, Oxford,

**also to all the employees and ex-employees of Coats PLC,
and especially to Jim McLean,**

**to Naomi Bowen for invaluable editorial assistance,
to Templeton College Information Centre and librarians worldwide,
and to my long-suffering patient family and friends.**

*We shall not cease from exploration
And the end of all our exploring
Will be to arrive where we started
And know the place for the first time.
T.S. Eliot, Little Gidding*

Competitive Advantage, Political Advantage and Shelter in the Textile Industry.

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Chapter 1

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1.1. Introduction.

This thesis examines the mechanism by which multinational enterprises (MNEs) derive strategic competitive advantage from political sources.

Research for this thesis began with a simultaneous study of

- i. the theory of competitive advantage and theories of the firm.
- ii. the structure and development of the global textile industry.

The former concluded that, while competitive advantage is recognised as core strategic management theory, the effects of the various levels of government on competitive advantage are only covered superficially in the strategic management literature.

The latter (Bowen, 2001) concluded that in spite of the importance of the textile and clothing industries to the world economy – the ‘textile complex’ employs nearly 20% of the world’s manufacturing labour force (Galli, 1996; Dickerson, 1999) – neither the global industry as a whole, nor the overall role of government in it, has received adequate academic attention.

1.2. Thesis Methodology.

This section sets out some of the key research concepts and principles guiding the development of this thesis and outlines the thesis research path and process.

It is generally agreed that a greater awareness of the researcher's own subjective paradigm leads to better research. All human beings are guided by highly abstract principles (Bateson, 1972, p.320). These principles combine beliefs about ontology (What kind of being is the human being? What is the nature of reality?), epistemology (What is the relationship between the inquirer and the known?), and methodology (How do we know the world, or gain knowledge of it). It is this "net" of ontological, epistemological and methodological premises that may be termed a paradigm (Lincoln and Guba, 1985; Guba and Lincoln, 1994). Paradigm is here defined in accordance with Kuhn (1970, 1991), as "the source of methods, problem field, and standards of solution accepted by any mature scientific field at any given time" (Kuhn 1970, p.103); and, as "universally recognised scientific achievements that for a time provide model problems and solutions to a community of practitioners" (Kuhn, 1970, p.viii). A paradigm has also been defined as a "modus operandi of scientists" (Burrell and Morgan, 1979, p.23).

In the face of so many philosophical uncertainties, this researcher takes a traditional positivist position with regard to the search for objective truth (Popper, 1961, 1968, 1972). Once the existence of such concepts as external reality or universal truths is denied, there is no need to continue the search. If, as some of

the post-modernists would claim, there is no truth outside the text, then epistemology and the theory of knowledge and most of twentieth-century philosophy are redundant (Warnock, 1996). This researcher believes that the search for objective truth is worthwhile, and that occasionally, although not commonly, these objective truths, albeit with a necessarily subjective interpretation, can contribute to the advancement of the human race and of the universe as we know it.

In the social sciences, in particular, it is important to be aware of the constant dangers of subjective prejudice and to ensure that the research methodology and research development is discussed and evaluated with colleagues and others in order to reduce subjectivity.

Smith (1989) states that research should proceed logically through six stages – description; classification; comparison; estimation; establishment of association; and determination of cause and effect (Smith, 1989). However in the social sciences the strict determination of cause and effect, where an experiment can be repeated until the results are the same every time, is rarely possible. Research into human actions etc often involves dynamic situations and constantly shifting contexts. In such research cause and effect are very difficult to establish and there are no easy solutions to limit the likelihood of error, although research methodologies seek to improve validity.

An early choice is usually made between qualitative and quantitative research methodologies as the prime methodology to be employed. Some of the core features of the choice are discussed below.

1.2.1. Quantitative Research.

Quantitative research attempts to measure statistically the relationships between two or more variables and has a 'rigorous' approach to hypothesis testing. The aim is to determine the relationship between an independent variable and one or more dependent variables in a population. The relationship between variables is measured using statistical techniques such as correlation, relative frequencies, or differences between means. Quantitative research designs are either descriptive (subjects usually measured once) or experimental (subjects measured before and after a treatment). Descriptive quantitative research using statistical techniques can establish only correlation and not strict causality. Strictly speaking, the determination of strict cause and effect is limited to scientific experimentation where every time an experiment is repeated the results are the same. This type of experimentation, common in the physical sciences, is rarely possible in social sciences where human actions are usually involved in dynamic situations and constantly shifting contexts.

In social sciences quantitative researchers often use the questionnaire as their key instrument in measuring the degree to which one concept can be regularly associated with another. The quantitative researcher develops a number of hypotheses which, if validated, support a theory. A questionnaire is designed with multiple choice questions to aid statistical analysis. The researcher seeks to persuade a statistically significant number of relevant people to complete the questionnaire and then analyses the data in order to determine the correlation between selected independent and dependent variables. A perfect correlation

would be where constant repetition produces exactly equal and predictable results, thus implying experimental verification beyond doubt. Typically however association is the highest claim made by social science researchers as a surrogate for causality. Quantitative researchers sometimes cast doubts on the "scientific" nature of qualitative research, since they claim that case studies are basically anecdotal and any insights derived from them have no claim to general validity, since the insights must be, by their very nature, strongly contextual.

While quantitative research aspires to establish scientific levels of causality or at least correlation, it has weaknesses as a research methodology when applied to research where the interest is in exploring human action etc. In order to promote statistical analysis, questions tend to be simple and closed-ended, often forcing the respondents to choose between a number of answers that may not accurately reflect their views. Questionnaires have difficulty analysing dynamic business situations and give an impression of simplicity that fails to reflect context and complexity. Access to a statistically sufficient population of relevant respondents is often very difficult if not impossible. Responses to questionnaires are often low, forcing researchers to relax the purity of the methodology and accept a level of verification that is more akin to qualitative than quantitative research. Respondents may be asked to choose acceptance or rejection of a statement on a Likert scale of 1-5. Responses may be very judgemental and subjective, hence more qualitative in character than quantitative.

Historically, many areas of academic research have utilised quantitative methods. In general, the emphasis of such research is on what is observable and

accessible, with researchers focusing primarily on those areas that are most suited to this approach. While researchers continue to place a strong emphasis on quantitative methods, the use of qualitative research methodologies has been growing. Osborne (1994) identifies the early 1980s as a time when greater disenchantment with the limits of logical-empirical research methodologies began. Increasingly questions emerged about the focus of inquiry, together with the exploration of methodologies that emphasized discovery, description and meaning, rather than prediction, control and measurement. A new raft of qualitative research methodologies has grown in popularity including phenomenology, ethnography, grounded theory, and hermeneutic phenomenology (Denzin and Lincoln, 2000).

1.2.2. Qualitative Research.

‘Qualitative’ implies an emphasis on processes and meanings that are not measured in terms of quantity, amount, intensity or frequency. “Qualitative researchers stress the socially constructed nature of reality, the intimate relationship between the researcher and what is studied, and the situational constraints that shape inquiry” (Denzin and Lincoln, 1994).

Qualitative and quantitative research have the same ends. They both “think they know something about society worth telling to others, and they use a variety of forms, media and means to communicate their ideas and feelings” (Becker, 1986, p.122).

Much of the early literature spent time trying to justify qualitative research and trying to give it an equal validity to that claimed by quantitative research. The idea that qualitative research methodology comes a poor second to quantitative research has now been largely dismissed, as the unique, rich, contextual and dynamic nature of the associations established by qualitative research are better appreciated. “Where only statistics, experimental designs and survey research once stood, researchers have opened up to ethnography, unstructured interviewing, textual analysis, and historical studies” (Denzin and Lincoln, 1994).

Instead of trying to test qualitative research using quantitative methodologies, different sets of verification criteria are being generated that in many cases challenge the traditional research paradigms and give rise to different styles of research, different epistemologies and different forms of representation (Becker, 1986, pp.134-135).

Bryman (1989) suggests that qualitative research has seven distinguishing features:

- i. There is a strong accent on interviewees’ interpretations of events.
- ii. It develops the context of the environment being researched in some depth.
- iii. It tells a story through time as events unfold.
- iv. It tends to be low on the structuring of issues and strong on developing theory after, rather than prior to, the interviews (cf. grounded theory, Glaser and Strauss, 1967).
- v. It employs a number of information sources that can be cross-checked, notably interview transcripts, press clippings, and perhaps the minutes of board meetings.

- vi. It is a valuable instrument for identifying an organisation's culture.
- vii. Through the closeness of the interviewer to the subject of the research, a close understanding of what matters most can be more easily determined.

One solution to the problem of analysing social science qualitative data, from a positivist viewpoint, is “content” analysis, but this exemplifies the conflict inherent in adopting quantitative approaches to analyse qualitative data.

By using “grounded theory” the need to convert the data to facts and figures is avoided and the researcher concentrates on themes and patterns. Grounded theory is holistic, inductive, subjective, iterative and thematic. Theory emerges from the data and is grounded in it. Steps in grounded theory analysis are: familiarisation, reflection, conceptualisation, cataloguing concepts, recording, linking, and re-evaluation (Glaser and Strauss, 1967; Turner, 1981).

Grounded theory methodology implicitly involves generating theory and doing social research as two parts of the same process. Grounded theory studies share similarities with other modes of carrying out qualitative research and the sources of data are the same. The major difference is in its emphasis upon theory development. Researchers can aim at various levels of theory but, regardless of the level of theory, there is an explicit mandate to strive toward verification of the resulting hypotheses (statements of relationships between concepts). This is done throughout the course of the research project, rather than assuming that verification is only possible through follow-up quantitative research (Strauss and Corbin, 1994).

Research into business studies usually involves the study of dynamic human actions and attitudes within dynamic and often turbulent contexts. Pettigrew points out a bias in the study of the social sciences in general, and of organizations in particular, towards change as the unit of analysis with the focus on a single event or a set of discrete episodes, somehow separated from the immediate and more distant antecedents that give those events meaning and substance. Pettigrew argues that the way to counter this bias is to encourage a form of longitudinal research which is both contextualist and processual in character (Pettigrew, 1985, 1990).

The analytical cornerstone is “the view that theoretically sound and practically useful research on change should explore contexts, content, and process of change together with their interconnections through time. The focus is on changing, catching reality in flight, studying long-term processes in their contexts and a return to embeddedness as a principle of method. Context refers to the outer and inner context of the organization. Outer context includes the economic, social, political, and sectoral environment in which the firm is located. Inner context refers to the structural, cultural, and political environment through which ideas for change proceed. The research challenge is to link the content, contexts, and processes over time in order to explain the differential achievement of change objectives” (Pettigrew, 1990).

In an attempt to improve the level of validity achieved by qualitative research, the technique of triangulation is commonly employed.

1.2.3. Triangulation.

Triangulation involves the comparison of the results from two or more different methods of data collection (Denzin, 1989). Commonly triangulation involves the combination of qualitative and quantitative methodologies. It is hoped that the qualitative methods will reveal inadequacies in quantitative measures or show that quantitative results are at odds with observed behaviour. Opposing evidence can indicate relationships that may not be immediately apparent in qualitative or highly contextual data, while quantitative data may provide a counterbalance to otherwise rich but incorrect impressions in qualitative data (Morgan and Smircich, 1980; Morgan, 1983; van Maanen, 1988; Shipman, 1988; Patton, 1990; Cresswell, 1994).

However triangulation can also be employed in qualitative research where quantitative data is absent. Robert Yin's methodological analysis of case studies contains important lessons for other types of research (Yin, 1981, 1984, 1994). Where possible, triangulation, using several different methods in combination, can protect the researcher from the pitfalls of any one method (Denzin, 1989; Denzin and Lincoln, 1994, 1998, 2000).

In this thesis, desk research, secondary sources, informal interviews and case studies are combined. Importantly, triangulation here involves interviews taken from two or more data sources i.e. from different members of the group that shared the same or similar experiences. The researcher looks for patterns of convergence to develop or corroborate an overall interpretation.

Triangulation is generally accepted as a means of ensuring the comprehensiveness of a set of findings. It is more controversial as a genuine test of the truthfulness or validity of a study. The latter test relies on the assumption that any weaknesses in one method will be compensated by strengths in another.

1.2.4. The Research Path and Process.

The research methodology employed in this thesis is generic to business studies and strategic management (Easterby Smith, Thorpe and Lowe, 1991).

The thesis research design consists of nine work blocks:

- 1.2.4.i. Pre-thesis research.
- 1.2.4.ii. Selection of core concepts.
- 1.2.4.iii. Formulation of thesis propositions.
- 1.2.4.iv. Selection of methodology.
- 1.2.4.v. Interview process to test propositions.
- 1.2.4.vi. Generation of PCA theory.
- 1.2.4.vii. Operationalization of the theory using an eight-cell PCA analytical framework and the development and selection of case studies.
- 1.2.4.viii. Thesis write-up.
- 1.2.4.ix. Conclusions.

1.2.4.i. Pre-thesis Research.

After a necessary period of pre-thesis research and preparation (Eisenhardt, 1989), a potentially interesting gap in the literature is identified.

Propositions are formulated in order to focus and set limits to the research (Mintzberg, 1978). The definition of the research questions and propositions, within the broader fields of strategic management and international business research, serves to specify the kind of organizational approach and the kind of data required. In an interactive process, data is collected, propositions are formulated and tested, and a theory is postulated. In this thesis, in a second stage, case studies are identified, selected and written up.

In a thesis where validity depends partly on a deep and verifiable knowledge of context and events, a period of pre-thesis research and preparation is necessary and important. Pre-thesis research and preparation consisted of simultaneous studies of the structure of the global textile industry, recent developments in the theory of the firm and the history and development of Coats PLC. The effect of government on MNE competitive advantage was identified as a potentially interesting gap in the literature.

This thesis lies within the overlapping fields of strategic management and international business (Coase, 1937, 1960, 1988; Chandler, 1963, 1986; Ansoff, 1965, 1984; Caves, 1971, 1982, 1988, 1996; McManus, 1972; Caves and Porter, 1978; Bower and Doz, 1979; Doz, 1979, 1986b; Rugman, 1979, 1981a, 1986, 1996a, 1996b; Teece, 1980, 1981, 1986; Porter, 1980, 1985, 1990, 1996, 1998b; Rumelt, 1981, 1982, 1984, 1991; Wernerfelt, 1984; Ghoshal, 1987; Lipsey and Dobson, 1987; Ohmae, 1989; Rugman and Verbeke, 1990a, 1992a, 1993d, 1995b, 2001; Williamson, 1991; Rumelt, Schendel and Teece, 1991, 1993; Ketelhöhn, 1993; Peterlaf, 1993; Mintzberg, 1994; Markusen, 1995; Rugman and Hodgetts,

1995; Dunning, 1997; Toyne and Nigh, 1997; Bowman and Faulkner, 1997; Mintzberg, Ahlstrand and Lampel, 1998; Jones, 1998; Grant, 1998a; Thompson and Strickland, 1998; Segal-Horn, 1998a; Segal-Horn and Faulkner, 1999; Pitelis and Sugden, 2000; Rugman and Brewer, 2001).

Strategic management has not reached a level where predictive models are possible. The uniqueness of firms and customers, and the dynamic and irrational nature of consumer perceptions, result in levels of complexity that have so far resisted the discovery of immutable laws. Especially noteworthy are longitudinal studies of organizational change that demand a deep and fine-grained contextual study (Wall and Williams, 1970; Romanelli and Tushman, 1986; Barley, 1990; Pettigrew, 1990; Huber and Van de Ven, 1995; Bognor, Thomas and McGee, 1996). Generalisations are difficult and exceptions continually disprove the rule, but we can group similarities and differences by using common analysis frameworks (Porter, 1991).

This thesis extends current strategic management, competitive advantage, resource-based and internalization literature, to encompass firm-specific advantage derived from political, non-commercial sources, termed here *“political competitive advantage (PCA)”*.

The global textile industry is used as the background and context of the thesis. The brief introduction into the global textile industry in chapter 1, the industry-level examples of government effects on the textile industry in chapter 3, and the firm-level Coats case studies in chapter 5, are all extracted from a much

wider, pre-thesis, study of the global textile industry, part of which has been deposited at Templeton College, Oxford as working papers (Bowen, 2001).

In addition to academic journals, magazines, newspapers, internet, and U.S. and U.K. government sources, the following specialised textile sources of quantitative and qualitative data are of particular note:

a. The Textile Institute (TI), Manchester is recognised as the most important global textile institute and brings together textile companies and interested individuals throughout the world. The TI provides an extensive network of contacts and its information centre and library are indispensable for textile research.

b. Since 1985 the journal *Textile Outlook International* (ISSN 0268-4764) has been the standard journal on the international textile industry and contains very useful quantitative and qualitative data. Its managing editor, Robin Anson, has been extremely helpful both in supplying data and in assisting in the location of appropriate and reliable data sources. Formerly published by the Economist Intelligence Unit, since 1992 *Textile Outlook International* has been part of Textile Intelligence Ltd, which publishes over 30 in-depth research reports covering global sectors of the textile industry, including man-made fibres and non-wovens, the geographical regions and key global issues including internationalisation and sourcing.

c. The textile consultancy firm *David Rigby Associates (DRA)* is recognised as one of the leading international textile consultancies. Founded in 1979, DRA specialises in textile strategy, marketing and technology and its

associates, and in particular the Chairman David Rigby, are a mine of quantitative and qualitative data. While much of their work is for private clients and not publishable, DRA is particularly helpful in providing a verification assessment of data from other sources.

d. TBAG, the Textile Business Analysts Group, is also an important source of industry and firm-level data. Its members, including this researcher, form an important part of the textile industry data network and between them have a comprehensive knowledge of the industry and its constituent parts.

e. The Coats and Coats Viyella archives 1830-1986 are held in Glasgow University (Archive Services). These archives consist of registers, ledgers, minute books and journals.

f. The Tootal archives 1888-1972 are held in Manchester City Library. These archives include minutes from the board meetings and from various management committees. The Tootal, Broadhurst Lee Co. Ltd. archives also include the mergers with English Sewing Cotton Ltd. in 1963 and with the Calico Printers' Association in 1968. The group became Tootal Ltd in 1973 and Tootal Group PLC in 1982, before being taken over by Coats Viyella in 1990. The Calico Printers' Association archives 1814-1982 are also held in Manchester City Library and are particularly useful in relation to the discovery of the polyester fibre 'Terylene'.

g. Coats, its employees and ex-employees, are a key data source for the firm-level pre-thesis research, for the testing of the thesis propositions and for the preparation and selection of the ten case studies that are used to operationalize the

eight-cell PCA analytical framework set out in chapter 5. In the interview component, triangulation is achieved by cross-referencing and cross-checking data obtained from interviewees one to another and against the available written sources including the firm archives.

h. The pilot project to quantify PCAs in Coats subsidiary companies is briefly set out in chapter 6. A complete quantitative research project to measure PCAs would require a formal application to use internal company accounting data, and to measure the value of PCAs in the same way as the firms measure or estimate their other firm-specific competitive advantages and disadvantages.

1.2.4.ii. Selection of core concepts.

A number of relevant core themes and concepts were identified from the literature review.

- i. Competitive advantage theory.
- ii. Resource-based view of the firm (RBV).
- iii. Transaction cost/internalization theories of the firm.
- iv. Entry barriers.
- v. Market failures.
- vi. Externalities.
- vii. Internalization/transaction cost theory.
- viii. Firm-specific advantages (FSAs).
- ix. Efficiency.
- x. Endogeneity.

xi. Shelter.

An analysis of these core concepts is set out in chapter 2.

1.2.4.iii. Formulation of propositions.

Seven propositions are formulated from the literature, the core concept reviews and by a process of reflection, in order both to focus and to set limits to the research. The definition of the research propositions, within the broader fields of strategic management and international business research, serves to specify the kind of data and the organizational approach required. The thesis propositions are set out and discussed in section 1.3. below. The propositions set out a step-by-step research path whereby the analysis of impact of government on the textile industry, and the nature of that impact upon firms, can be facilitated.

1.2.4.iv. Selection of methodology.

A strategic management research study of this complexity requires a combination of different data collection methods and types in order to achieve triangulation (Mintzberg, 1979; Martin, 1982; Gummesson, 1988; Pettigrew, 1990; Buckley and Casson, 2001). In this research, conventional data collection methods of interviews, observations, and archival analysis are used to achieve a more grounded approach and to facilitate a synergistic view of the evidence.

Quantitative data in this thesis is limited but includes published information relevant to an analysis of the structure of the international textile industry, and firm-specific data in the form of management and consultancy reports.

From the outset the underlying methodology chosen was based on grounded theory whereby data accumulation takes place simultaneously with theory generation during the research process. However within the doctoral thesis format there are limits to a contextual and longitudinal approach. The open-endedness was therefore bounded by the formulation of the seven research propositions which both focus and set limits to the research. The resulting hybrid methodology enabled a two-stage approach where the propositions were tested in interviews which, interactively with the literature review and the study of the global textile industry, facilitated the generation of the PCA theory and its operationalization.

Data collection overlaps preliminary data analysis in an ongoing process (Glaser and Strauss, 1967). Entering the field of research with a strategy of concurrent data collection and theory development requires adjustments to aspects of the data collection process. The freedom to make these adjustments is essential to this kind of theory-building research, enabling the research to probe emergent issues or to take advantage of unique opportunities arising in the course of data collection (Eisenhardt, 1989).

Anecdotal evidence is also important. A component of the data collection exercise is centred on interviews where triangulation is essential in order to validate anecdotal data. "Theory building requires rich description, the richness that comes from anecdote. We uncover all kinds of relationships in our hard data, but it is only through the use of this soft data that we are able to explain them" (Mintzberg, 1979, p. 587).

The data analysis design strategy recognizes, firstly, the voluminous quantity of textual qualitative data that the research is likely to produce, and, secondly, that the difficult task of analysing this data requires a consistent structure to ensure proper recognition of the relevant data. The data analysis strategy must effectively make sense of potentially complex patterns from data that is both voluminous and highly contextual (Coffey and Atkinson, 1996).

1.2.4.v. Interview process to test propositions.

Forty-eight interviewees (see schedule in appendix 2) were selected. Twelve were senior Coats directors or managers located in Head Office, twenty-four were regional Coats directors or managers and a further twelve non-Coats interviewees were chosen because of their experience of similar MNE/government interfaces. In arranging appointments for interviews the general nature of the research (i.e. the effect of government on the competitive advantage of firms) was communicated.

Semi-structured interviews are used in an attempt to understand complex behaviour of members of society without imposing any *a priori* categorization that might limit the field of inquiry (Malinowski, 1967; Fontana and Frey, 1994). The interview participants and protocols need to be carefully selected and tailored. Interviews are conducted in a loosely structured manner, allowing a high level of interviewee participation in line with recommendations for effective ethnography (Hammersley and Atkinson, 1983; Glaser and Strauss, 1967). The researcher needs to remain aware of constant dangers: leaping to conclusions on

limited data (Kahneman and Tversky, 1973); being overly influenced by vivid or rich data, or by elite respondents (Nisbett and Ross, 1980; Miles and Huberman, 1994); and of disregarding contradictory evidence (Nisbett and Ross, 1980).

The semi-structured interviewing process is a simple and efficient method of getting at data not easily obtained otherwise, including feelings and emotions. Semi-structured interviews allow the respondent the time and scope to give opinions on particular subjects selected by the researcher. It allows the interviewee to place his or her emphasis on events or behaviour within a focused framework. While it uses open-ended questions (“Tell me about.... What do you think about? Tell me more about....”), these questions are focused by the researcher onto those areas that the researcher is interested in exploring.

One of the weaknesses of semi-structured interviews can be that success depends on the rapport between the researcher and the interviewer. In this thesis the researcher and most of the interviewees were linked by their knowledge and experience of Coats and this helped to establish a close rapport. Most of the interviews dealt with historical rather than current and possibly more contentious issues. In view of the difficulties that Coats was experiencing, it was important that the interviews were not seen as ‘company approved’, or ‘attributable’ in a form that might be reported back to the company. ‘Off the record’ the interviewees, in most cases, were prepared to give rich, detailed and revealing accounts of and opinions on the relevant events and on recent Coats developments.

Care was needed in interviewing to avoid leading interviewees and to allow them to lead, within the limits of the proposition under discussion. Equally, where audio tapes were not permitted, great care was required in both taking and analysing interview notes. Follow-up telephone interviews were used to clarify points of doubt as to meaning or emphasis.

The semi-structured and iterative interview process enabled the researcher to check, and re-check, with the participants as to whether or not the propositions had 'got it right' or required modification. Of the 48 interviews, 11 were single interviews and 37 were multiple interviews where the respondent was interviewed more than once (see Appendix 2).

While the duration of the interviews totalled over 200 hours, the amount of time directly devoted to the propositions was around 40 hours. Consistency was established by asking the participants to read and to agree or disagree with the seven propositions one by one. The key themes encompassed by the propositions, i.e. the effect of various levels of government on MNEs, at industry, firm and profit centre level, were discussed in depth. Participants were asked to elaborate on any relevant examples from their experience or knowledge. The acceptance or non-acceptance of the propositions was relatively simple to summarise and to analyse on a grid, with propositions and themes on the horizontal axis and interviewees on the vertical axis (see Appendix 3).

The semi-structured, multiple interview process also enabled the collection of large amounts of additional data on the textile industry, on Coats, on government/firm interfaces in other industries and in other companies.

1.2.4.vi. Generation of PCA theory.

Theory generation takes place in an interactive process, whereby simultaneously data is collected and propositions are formulated and tested. The concept of *political competitive advantage (PCA)* is developed by synthesising and applying the core concepts (chapter 2) to government/firm relationships, in the light of the study of government and the global textile industry (chapter 3), and the interview process and analysis that tested and modified the research propositions.

1.2.4.vii. Operationalization of the theory using an eight-cell PCA analytical framework and the development and selection of case studies.

Following the generation of the theory in chapter 4, the PCA concept is operationalized by analysing firm strategies within an eight-cell PCA analytical framework in chapter 5. Ten case studies are selected and used to demonstrate firm strategies pertaining to each of the eight cells.

The effects of government upon firm profitability are very varied and complex, and from a practitioner viewpoint, an analytical framework that is not sufficiently flexible to permit a holistic strategic analysis is inadequate. Operationalization of the theoretical concept of political competitive advantage (PCA) and political competitive disadvantage (PCD) is achieved by extending the PCA efficiency/endogeneity matrix into an eight-cell PCA analytical framework and inserting case studies into the framework in order to demonstrate the PCA strategic options open to the firm.

The formulation and write-up of the case studies required an extensive knowledge of Coats gained from interviews, personal experience and a wide range of available published sources and internal sources. Cases were selected where it appeared, *prima facie*, that government actions had a significant impact upon the firm. Further interviews took place with participants selected because of their direct involvement in, or expert knowledge of, particular or potential case studies. Where possible this information was triangulated with views from others who had experience or knowledge of the particular case, and with the written sources.

The final case study selection was made by the researcher in order to best represent each cell of the eight-cell PCA analytical framework. No cases fell outside the framework and those that were not used were dropped purely for reasons of scope and time. However it must be stressed that further research is required to test the validity of the eight-cell PCA framework as a means of operationalizing the PCA concept.

1.2.4. viii. Thesis write-up.

Having completed the interviewing, conducted content analysis on the transcripts, analysed the evidence in relation to the thesis propositions, developed findings on the validity or otherwise of the propositions, and generated and operationalized PCA theory means of the eight-cell analytical framework, the task of writing-up the thesis was carried out.

1.2.4. ix. Conclusions.

Conclusions were then drawn on the contributions and limitations of the research in chapter 6. Some of the implications of the PCA concept for managers and for government, the possible extension of the concept to other firms and industries, and suggestions for further research are also considered in chapter 6.

1.3. Thesis Propositions.

Proposition 1

Government has played, and is continuing to play, a decisive role in the development and structure of the global textile industry.

Proposition 2

Government is a direct and indirect component of firm, industry and national competitive advantage, and should be included in the relevant strategic management theory.

Proposition 3

Political, non-commercial, principally government activities produce externalities that impact, positively and negatively, upon firms in the form of political advantages and political disadvantages (PAs and PDs).

Proposition 4

PAs and PDs impact on firms asymmetrically because of their unique structures and networks. Some firms gain politically-derived competitive advantages (PCAs) over others. PCAs are a subset of firm-specific advantages (FSAs) and operate over a wide variety of time horizons.

Proposition 5

PCAs are firm-specific competitive advantages and can be efficiency-based, or non-efficiency, shelter-based.

Proposition 6

In their quest for sustained, and stable, strategic competitive advantage firms may try to internalize and endogenize political advantages into PCAs.

Proposition 7

Successful firms develop firm-specific advantages, FSAs, including PCAs, that are manifested as superior returns and can be quantified.

Proposition 1 will be demonstrated by the inclusion of selected extracts from my unpublished study of the development of the global textile industry (Bowen, 2001) that illustrate the critical, direct and indirect roles played by governments. Textiles have a major place in the global economy and in economic development. Governments throughout recorded history have almost invariably been closely involved in the textile industry.

Proposition 2 requires the insertion of government into Porter's competitive advantage theory, the dominant strategic management theory of industry profitability. It will be argued that Porter's five-forces analytical model (Porter, 1979a, 1979b, 1980) can be improved by explicitly recognising government as a direct force, as well as the interaction between government and the other five forces.

In an attempt to gain a deeper understanding of the mechanism by which government activities affect firms, the thesis uses internalization/transaction cost theory (Williamson, 1975, 1979, 1985; Buckley and Casson, 1976; Hennart, 1982, 1988, 2001; Teece, 1986; Hill and Kim, 1988; Wilkins and Schröter, 1998; Rugman and Verbeke, 1992b; Hennart, 1993) to argue that government actions produce politically-derived externalities that impact upon firm profitability in the form of political advantages and political disadvantages, PAs and PDs (Proposition 3).

In line with the resource-based view of the firm (Penrose, 1959; Richardson, 1972; Lippman and Rumelt, 1982; Wernerfelt, 1984, 1989; Dierickx and Cool, 1989; Grant, 1991b, 1991c), it will be argued that, since each firm has a unique set of resources, competences and capabilities, PAs and PDs will have an asymmetrical impact upon each firm. The result is that some firms gain politically-derived competitive advantage (PCAs) over others. Further it will be argued that PCAs are a subset of firm-specific advantages (Barney, 1986, 1991; Erramilli, Agarwal and Kim, 1997; Foss, 1997; Rugman, 1980c, 1981a; Breeley and Myers, 1988; Boddewyn, 1988, 1993; Boddewyn and Brewer, 1994; Teece, Pisano and Shuen, 1997; Winter, 2000; Eisenhardt and Martin, 2000; Henisz, 2003), and can operate over a wide variety of time horizons (Proposition 4).

In support of Proposition 5 the politically-derived, firm-specific advantages (PCAs) that underlie superior returns will be shown to be of two distinct types: efficiency-based and non-efficiency-based (Safarian, 1966, 1993; Caves, 1982, 1996; Ghoshal 1987; Rugman, 1980a; Casson, 1987; Dunning, 1993; Rugman and Verbeke, 2001; Hennart, 2001).

Firms that base their strategy on efficiency can offer value enhancements to customers, while non-efficiency-based strategies rely on shelter from competition and increased consumer costs.

It will be argued that sustained superior firm returns require overall superior firm specific advantages. Firms will try to devise reactive and proactive, efficiency-based and non-efficiency-based strategies in order to enhance their PCAs and FSAs. Moreover, firms will try to endogenize positive politically-

derived externalities in an attempt to preserve and enhance their competitive positions (Proposition 6).

Proposition 7 suggests that in order to successfully operationalize the concept of PCAs, some form of analytical framework and of measurement of impact on firm profitability is required.

1.4. The Global Textile Industry.

In this thesis the global textile industry serves as the contextual background to the study of MNE/government relationships and to the concept of political competitive advantage (PCA).

1.4.1. Origins.

The origins of the textile industry stretch back into pre-history. Animal skins, at first hunted, and then farmed, were used for clothes from earliest times. Domestic animals can move with the family or tribe in times of migration or danger so they were developed by careful breeding to have multiple, essential uses including food, shelter, clothing and footwear. Animal fibres are superior to animal skins because fibres can be woven into flexible garments which fit closely and move with the body. Once settlements and farms were established, plants offered another source of textile fibres.

Cotton and wool fibres have important chemical and physical properties – they are stretchable and, when woven, they trap air retaining the warmth provided naturally by the human body. Linen was used by the civilised peoples of ancient times and was known in Egyptian as *Shenu*, in Greek as *Linon* and in Latin as *Linum*. Fragments of linen, in all stages of manufacture (straw, seeds and seed capsules, fibres, yarns, ropes and various types of fabrics), have been found amongst the remains of Swiss lake dwellings that date from about 8,000B.C. Early Chinese weavings utilised natural fibres including hemp and cotton, but it was the use of silk that was their greatest achievement, and the term "Chinese

silks" often became synonymous with "Chinese textiles". Silk was used to produce garments 5,000 years ago. Parts of a primitive loom have been found in Hemudu, Zhejiang province, from about 4,900B.C. (Museum of Textiles, Washington, D.C.) The use of silk itself was an indication of status because the common people could only wear cotton, hemp and other fibres. Silk, raw or woven, represented wealth, and was used as currency and for payment of tax.

1.4.2. Classification.

Until the late nineteenth century textile products were easy to classify either by end-use or by fibre type. The end-use of textiles was overwhelmingly as clothes to cover the human body and then, as now, garments were denominated by the part of the body that they were designed to cover. Cotton and wool (from a wide variety of animals) provided the vast majority of garments throughout the world, although linen products, from flax, and silk were important. In temperate climates wool was the major fibre for cold seasons, for both underwear and outerwear, and cotton for warm seasons.

Before the invention of man-made fibres it still made sense to link fibre processing for the production of garments into one industrial group. The definition was principally by fibre type and by the processing method. Thus the woollen industry bought wool from wool merchants and, by a series of complex and often geographically separated processes, produced woollen garments. The non-fibre leather industry separated itself from textiles at an early stage, because

its processing methods were quite distinct; but the remainder divided into three parts: fibre-to-yarn spinning, cloth weaving and finishing, and make-up into garments.

This classification sufficed while textile production was still a cottage industry, although many specialist sub-divisions emerged as simple tools and machines for the different textile processes such as carding and combing developed. When the woollen industry became the first modern industry in Britain in the eighteenth century, this simple three-stage classification, with increasing sub-divisions, was still adequate. However when the new cotton processing industry started in Britain in the late eighteenth century, modifications were required because the manufacturing processes for cotton varied from those of wool. In spite of the fact that both are natural fibres chemically composed of cellulose, cotton has a shorter fibre length and required different, but similar, manufacturing, known as the 'cotton processing system' as opposed to the 'wool processing system'. Divisions by fibre lengths are less relevant now, although in many countries the historical division continues, with cotton and wool processing often taking place in different geographical locations. The use of blends of fibres and the invention of a vast range of man-made fibres still left the original groupings of fibre, yarn, fabric and garment intact, but the boundaries between the sub-divisions of cotton-type processing and woollen-type processing were weakened and became confused.

Classification by production into the three processes, spinning, weaving and garment production, became even more difficult as vertical integration

blurred the separation between these processes. New technology further confused traditional boundaries as, for example, when non-woven textiles produce fabric directly from fibres without spinning or weaving. Developments in 'fibre to fabric' technology and in new 'technical textiles' demanded re-classification of the textile industry into new groupings. In the United States, yarns and fabric production became known as the textile industry, while garment production became the clothing or apparel industry.

A recent analysis of the articles in the magazine *Technical Textiles* reveals products made from the following raw materials:– acetate, acrylic, alginate, aramid, bitumen, carbon, cellulose, ceramic, chitin, chitosan, clay, collagen, concrete, corn, cotton, elastane, flax, glass, graphite, hemp, hydroxyapatite, jute, kenaf, latex, leather, lyocell, melamine, metals, mineral wools, nylon, olefins, paper, peanuts, poly(cyclohexylene dimethylene terephthalate), polyamide (nylon), polybutylene terephthalate, polychloroprene, polyether, polyether ether ketone, polyetherimide, polyethylene, polyethylene terephthalate, polyhexamethylene biguanide, polyolefin, polyphenylene, polypropylene, polysaccharide, polystyrene, polytetrafluoroethylene, polythiopene, polytrimethylene terephthalate, polyurethane, polyvinyl alcohol, polyvinyl chloride, polyvinyl fluoride, rayon, rubber, silica, silicone, silk, sisal, thermoplastics, tourmaline, viscose, viscose rayon, wood, and wool.

Trela and Whalley (1990) divided the Textile-Apparel Industrial Complex into seven sections: 1. Textiles 2. Apparel 3. Cotton 4. Cellulosic man made-fibres 5. Non-cellulosic organic fibres 6. Textile machinery, and 7. Needles, pins and

fasteners. (They divide the remainder of the economy into 8. Agriculture, forestry and fishing 9. Mining 10. Construction 11. Non-durable manufacturing 12. Durable manufacturing 13. Transport, communication and utilities 14. Trade 15. Finance, insurance and real estate, and 16. Services.)

From a traditional textile manufacturing point of view this is quite a good classification since it at least separates textile accessories. However it makes no attempt at end-user analysis. In 1995 60% of the products of textile mills in the United States did not go into the apparel industry and this percentage of non-apparel usage is increasing (Dickerson 1999, p.262, figure 8-3). Technological advances and globalisation have shifted the emphasis from supply chain definitions of the textile industry to attempts to define textiles by product end-use. This has run into problems since the number of end-use products of the textile industry has multiplied geometrically. Textile fibres are now used as components in a wide variety of industrial and consumer goods. These include running shoes, car tyres, boats and blood filters. Chemical chains and metals are spun on textile-type machinery. Yarns can be 'air spun', no longer requiring the traditional ring spinning frame. Fibres can be made into fabrics in one process. Threads can be extruded from liquid polyester and spun and twisted in a single process. Even the 'count' or thickness of yarns and threads is no longer a guide to end-use and higher tenacity threads can be made much stronger as well as finer than coarser yarns and threads.

Non-woven fabrics include synthetic fibres moulded into fibre-glass substitutes, for cars and houses, without any recognisable 'textile' processing. The

technical textile industry produces a multitude of products from fibres which go into every industrial classification and have no obvious connection to traditional textiles. Further developments in chemicals, bio-chemicals and genetic engineering techniques will soon render the present industries classification obsolete. Genetically modified crops will make it impossible to draw the line between natural and man-made fibres.

Increased cross-border trade puts a much higher emphasis upon the classification of imported products by end-use rather than by fibre or manufacturing process. It can be argued that most industry classifications that concentrate on supply chain rationale are no longer particularly relevant when globalization has increased cross-border trade to such an extent that the manufacturing routes of many goods are no longer important to, or reflected in, national statistics.

In this thesis the following definitions are used:

The 'textile industry', or 'textiles' is used here to denote textile firms processing textile fibres into yarns, threads and fabrics (for use in garments, home-furnishings and industrial products), and apparel or clothing firms. The words 'apparel' and 'clothing' are synonymous. (Note that while the textile industry covers textiles and apparel, firms are usually said to be in either the textile industry or the apparel industry.)

The 'textile complex' is used here to include the major inputs and all the outputs of the textile industry. These include, in addition to the textile industry,

those parts of other industries such as agriculture, chemicals and engineering dedicated to supplying the textile industry, and the vast range of other manufacturing and marketing firms dedicated to the further processing and selling of products produced by the textile industry. Included in the textile complex are all those parts of associated industries which form the supply and value chains from fibre to consumer.

In Figure 1.1. I have attempted to give an overall picture of the whole textile complex and the textile industry within it, referenced to the North American Industry Classification System (NAICS) classification numbers.

{Insert Figure 1.1 here}

The way in which an industry is classified by governments or international organizations is important because it reflects the way in which the industry is perceived, and the manner in which data is accumulated and presented. Classification by industry code is very important in the collection of comparable data. The change in United States industrial classification codes from the 'Standard Industrial Classification System (SIC)' to the 'North American Industry Classification System (NAICS)' covering NAFTA countries, is having a dramatic

effect on the way industries are perceived. NAICS was published in 1999 and tries to give the classification a product orientation whereas SIC concentrated on process. The rapid pace of change, in the industry and in its classification, is reflected in the “350 new industries being separately recognised for the first time” (<http://www.census.gov/epcd/www/naics>).

An alternative classification, by sales outlet, is even more complex and perhaps outdated already as information systems and internet sales shift power from the retailer to the consumer (Cash and Konsynski, 1985).

It should also be noted that a detailed analysis of the way that industry statistics are collected and collated raises further and very worrying questions about the accuracy and significance of the data (Coker, 1997; Dickerson, 1995).

The textile industry is best pictured at the present time as consisting of the three major manufacturing segments set out in NAICS:

Subsection 313 Textile Mills. “Industries in the Textile Mills subsector{,}¹ group establishments that transform a basic fibre (natural and synthetic) into a product such as yarn or fabric {or thread}, that is further manufactured into usable items, such as apparel, sheets{,} towels and textile bags for individual or industrial consumption. The further manufacturing may be performed in the same establishment and classified in this subsector, or it may be performed at a separate establishment and be classified elsewhere in manufacturing.”

NAICS tries to capture the process flow from the preparation and spinning of the fibre through weaving or knitting to the ‘finishing’ of the textile. Finishing

¹ Researcher’s corrections denoted between brackets {,}.

includes both fibre finishing and fabric finishing. Processes that include both fibre preparation and fibre finishing together, such as texturizing, throwing, twisting and winding, are classified under the preparation of fibres rather than with fibre finishing.

“Excluded from this subsector are establishments that weave or knit fabric and make garments. These establishments are included in Subsection 315, Apparel Manufacturing.”

Subsection 314 Textile Product Mills covers “the manufacturing of textile products (except apparel) from purchased fabric”. These, “with a few exceptions”, are cut and sewn to make “nonapparel textile products”.

Unfortunately these three groupings are not applied universally and so comparative statistics are impossible to find. The SIC classifications are in wide usage but, in spite of continual modifications that many countries find it difficult to keep up with as the focus shifts from manufacturing process to end-product classification, they give a rather outdated industry picture, especially in developed countries. Harmonisation of classification systems will hopefully advance and the Office of Tariff Affairs and Trade Agreements in the U.S.A. has been working with other countries and trading blocs. The United Nations, Department of Economic and Social Affairs, Statistics Division has established an ‘Expert Group’ consisting of statistical classification experts from 15 countries. The Final Report of the group meeting in November 1999 reported that of the 142 countries currently using the ‘International Economic and Social Classifications’ (ISIC), 93 countries are using national classifications based on ISIC Revision 3 and a further

49 countries are using national classifications based on ISIC Revision 2 (United Nations, 1999). The report stressed the need for alphabetical indexes for ISIC as a “first step towards a greater convergence among activity classifications to be formalised as part of a more comprehensive improvement or revision of ISIC targeted for implementation in 2007.” It also established a ‘Technical Subgroup’ (TS) whose “first task is to further the work and implementation of ISIC and CPC” (Central Product Classification). The TS is also to examine the “optimal levels for international standardisation”. Harmonisation is a long and continual, but valuable process. Classification and harmonisation by demand rather than supply is a very long way away.

Figure 1.1. is already out of date because it does not do justice to all those technical textile products and services being currently delivered to the market and which are expanding at such a speed and diversity that analysis of the traditional industry supply chain links is no longer adequate.

1.4.3. Complexity.

The classification problems have already pointed towards the complexity and diversity that make textile industry-level analysis very difficult.

Professor Porter’s “working definition of an industry as the group of firms producing products that are close substitutes for each other” (Porter, 1980, p.5) is impossible to apply to the modern textile industry where synthetic chemical and

biological molecule chains are developed by or for specific firms, to be processed for example into blood filters, houses, boats and spacecraft nose cones.

Porter recognised the problem and suggested that we should not get side-tracked into trying to draw boundaries too closely (Porter, 1980, pp.5, 32-33, 186-187). This is unsatisfactory. If his five-forces analysis of competitive advantage is to be used as a practical analytical tool by firms to understand and plan their competitive position within an industry or industry sub-group, the definition of the competitive group is crucial. The outcome of the analysis is too often determined by the selection of the sub-group.

One of the problems in attempting to operationalize Porter's 'strategic positioning view' (SPV) industry-level analysis on a global basis (as was attempted by Coats Viyella in 1991) is that the complexity, diversity and dynamism of the components of competitive advantage do not lend themselves to simple analysis. The forces driving competition in Austria are very different from those in Australia. Analysis in terms of five generic forces becomes superficial and insufficient as a basis for strategic planning.

The global textile industry is very large and is fast expanding. If statistics were available on cottage industry employment in India and Asia they would confirm the textile complex as the biggest manufacturing employer in the world (International Labor Office, World Employment Report, various years). In 1980 it was estimated that the clothing industry alone accounted for 10.9% of manufacturing employment in developing countries and 5.7% in developed countries (GATT, July 1984).

Between 1970 and 1981 absolute employment in the clothing industry in developing countries increased by 100%, and absolute employment in the textile industry increased by 40%. In the U.S.A. the wider textile complex provides employment, recorded and unrecorded, for over 2m people, nearly 10% of the industrial workforce. In China some 13m persons are employed in the textile complex, excluding vast numbers in cottage industry and in cotton production, and they account for 16% of China's industrial output in 1992 (Guobiao, 1993). The textile complex is India's largest industry, accounting for 20% of industrial output and employing 20m people.

World trade in textiles and clothing amounted to USD332bn in 1997, or 6.2% of world merchandise trade or 8.5% of world exports in manufactures (WTO, March 1999). The global market for fibres, textiles and manufactured textile products continues to expand rapidly. World fibre production has risen from 30 million tons in 1980 to nearly 50 million tons in 1997. World consumption per head of textile fibres rose from 6.8 kilos per head per annum in 1980 to 7.5 kilos per head in 1995, with the consumption per head in the U.S.A. reaching 29 kilos (Coker, 1997).

There is no one satisfactory definition of the 'textile industry'. The link that held the industry definition together used to be the processing of animal, plant and man-made fibres. However vital parts of the textile value chain lie outside the traditional definitions of the industry, requiring a broader definition – 'the textile complex'. The textile complex was traditionally involved in the production of natural and man-made fibres, their conversion into apparel, home furnishings and

industrial goods and their sale to end-users. In fact in the developed countries there are now many other domestic and industrial uses of yarns and fabrics. Study of the textile industry and apparel industries alone gives a misleading picture. Natural fibre production is part of the agricultural industry but demand is driven by the demand for textile end-products. On the other hand, many man-made fibres are used in many other industries besides textiles. Textile mills produce many products that are neither spun nor woven and which go as intermediate products to many other industries which have nothing to do with clothing. Another problem is that many so-called 'textile MNEs' have widespread interests of which textiles are only one (Payne, 1995). Trying to isolate the textile interests of MNEs is very difficult since divisional statistics along industrial classification lines in many cases and countries are rarely available. In some parts of the textile industry, especially in the highly fragmented garment industry, statistics are unreliable in nearly all countries, including the United States, since neither the labour nor the profits are officially recorded.

A detailed study of textile MNEs leads to the conclusion that there is a breakdown of recognisable industry groups and sub-groups at any but the highest level. The larger textile companies often helped to develop, and sometimes own, natural fibre producers. Benetton is the largest single owner of sheep in Argentina. J & P Coats' subsidiary in Brazil had its own cotton fields to produce cotton sewing thread until the 1990s, and has been closely associated with long-staple cotton development around the globe for more than one hundred years.

The competitive environment in textiles in the developed world has long been influenced and quite often driven by demand in the chemical industry for the basic chemicals used in the manufacture of man-made fibres (see chapter 3). Study of the U.K textile industry reveals several examples where the notion of textile competitive advantage can only be understood by reference to competitive conditions in other industries. Perhaps the most notable is the competition between man-made fibre producers (notably Courtaulds and ICI) after the Second World War that led to the restructuring of the U.K. textile industry by the British government. This had a profound effect not only on the U.K. textile industry and many other national textile industries, but on the demand for natural and man-made fibres around the world. The effects went far beyond textiles, for example affecting the cost structure of the manufacture of polyester cassette recording tapes.

Chemical plants, processing petroleum derivatives for man-made fibre production, have become central to the textile industry and are sometimes owned by textile companies. Chemical products, other than fibres, are required by the textile industry in large quantities and represent a substantial part of textile industry costs. These include bleaching chemicals and dyestuffs (Coles, 1998), that often have important relationships to demand supply in the pharmaceuticals industry. Resins for durable press, soil release and fluid repellency are often related to the technology of polymers and plastics. Chemicals such as chlorine, urea and formaldehyde form the basis of many auxiliaries used in textile wet-

processes and finishing, and their commodity prices are determined by supply and demand in industries thought to be totally unrelated to textiles.

1.4.4. Structure.

In an academic analysis of the textile industry, and in any practical strategic planning exercise, a pre-requisite is an understanding of the structure of the industry. The definition of ‘industry structure’ is not exact and is used in various ways in the literature. Scherer and Ross list the following parameters of industry structure (Scherer and Ross, 1990, p.57):

- i. the extent to which economic activity is dominated by large enterprises.
- ii. the extent to which particular markets are dominated by one or a few sellers.
- iii. the extent to which firms are diversified across multiple product lines.
- iv. the degree to which firms are vertically integrated.
- v. the height of entry barriers.
- vi. the extent of product differentiation.
- vii. the degree of buyer concentration.

One of the main aims of research into any industry structure is to locate the power in the value chain. This equates to the competitive advantage that one firm has over another and is reflected in the creation of superior added value. Porter’s five-forces analysis has been very widely accepted and used by strategy practitioners (Porter, 1980). The question underlying this thesis is: ‘Can the

industry or firm power structure be explained without including government as a specific source of that power?’

One way of examining structure is through historical analysis. The power of market forces over time is reflected in present-day supply and value chains. Equally distortions in the market and barriers to trade can often be explained only by historical analysis. In a variety of ways the early industrial development of textiles is still reflected in the industry's structure today. The British textile industry was the first mover into ‘industrial revolution’ and dominated international trade in textiles for over a hundred years; its history has left its mark on current industry structure, for example in the different locations of the wool and cotton processing industries.

Textiles are manufactured in most countries but few have the supply and demand conditions to support an entire textile complex. As a result there are considerable variations between countries in their textile manufacturing industries, their dependence on foreign markets and their ability to compete internationally. International trade in textile components dates back at least as far as the Ancient Egyptians. Complex patterns of trade have developed and often defy any obvious present-day explanations based on comparative or competitive advantage. Globalization has accelerated in textiles as in most other goods and services, but this acceleration of international trade will come as no surprise to students of the textile industry. Textile exports were the major source of revenue for the English King in the fifteenth century and the major source of foreign exchange for China in the 1990s. The importance of international trade, not just

in finished garments, but also in components and semi-manufactured textiles for use in industry and home, is one reason why government has always been involved in the textile industry. International trade has been a measurable, controllable and taxable source of government revenue. It will be shown that the government role, planned and realised, in international trade has greatly affected the global textile industry. Any attempt to study international business and locate the power in the value chains cannot progress without reference to government. Studies of competitive advantage, even where they are based on a traditional industry approach rather than a resource-based firm approach, cannot analyse the distribution of power without adding government as a distinct dimension. Similarly the patterns of world trade in textile components and products cannot be explained without reference to the existence and actions of governments, local, national, regional, supranational.

Traditional economics-based industry structure analyses ignore government and so must be modified when applied to the global textile industry. For many years the two major components of the textiles industry, textiles and clothing, have been thought of as examples of near-perfect competition. At first textiles - the production of yarns and fabrics - consisted of a large number of firms producing very similar, standardised products, each firm so small that it was unable to control the price of its products. Even after vertical and horizontal integration, textile companies are usually perceived as operating in a highly competitive environment. The clothing industry is seen as near-perfect with literally millions of small firms competing fiercely.

Integration enabled textile companies to achieve competitive advantage through scope economies of scale. Horizontal integration (e.g. expanding one spinning operation by increasing the number of spinning spindles) makes it possible to use labour more efficiently (e.g. by better allocation of spindles per person). It also enables overheads such as the cost of land, buildings, supervision, insurance, marketing and research to be spread over higher volumes of production, thus reducing unit cost. Vertical integration, in theory, by bringing successive stages of production into one firm, enables balanced production and, again, the possibility of defraying overhead costs over larger volumes. While the integration of the textile industry from raw material to yarn or fabric is common, integration between textile firms and clothing firms is far less common. Competitive advantage in clothing, unlike in textiles, relies on the creation of a distinctive brand or image. Each firm tries to create a style that will enable its products to be differentiated from those of its competitors and which will therefore attract a price premium, thus disrupting the so-called near-perfect market.

The general impression of the textile industry is of many small firms engaged in cut-throat competition. This is certainly true in some sections of the garment finishing industry, such as the Dickensian sweatshops to be found in many countries including Mexico, Morocco, China, Pakistan, India, and in odd corners of nearly every major city in the world.

Space does not permit an exhaustive analysis or a detailed review of each sector but the structural complexity may be emphasized by reference to two very contrasting areas of textiles: fibres and apparel.

Demand for fibres is ultimately determined by the demand for the end-products which they help to produce – mainly clothing, home furnishings and industrial goods. This in turn tends to be largely driven by macroeconomic factors, such as economic growth, population growth, and levels of personal disposable income. As the world's population grows and living standards improve, demand for textiles has increased correspondingly. There would appear to be a strong correlation between economic growth and the consumption of fibres.

Another major factor in fibre demand is the substitutability between fibres. Substitutability is affected by a number of criteria such as the relative prices of the different fibres, availability, quality and relative technical performance (Keynote, 1992). Since 1985 world production of synthetic filament yarn has risen 3% to 19%, reducing the consumption of cellulosic fibres to 5% of world fibre output.

Between 1990 and 1997 world demand for textile fibres increased by 50% to 45m tons. Cellulosics and wool have continued to decline in volume terms. Cotton's share of the total also continues to decline, although volume is up (Juvet, 1997).

Changes in the market for traditional end-products and the introduction of new end-products have a big influence on competition between fibres. While both man-made fibres and natural fibres have particular qualities that make them

suitable for various products, they remain vulnerable to changes in upstream applications. A good example is the case of wool, where fibre consumption has been declining over the last three decades. In one traditional use of wool, carpets, the market has moved towards synthetics and blends, partly for technical 'wearability' reasons. In another traditional use of wool, blankets, the total market has declined as consumers switch to other forms of bed covering.

Consumer preference and income differentials also drive substitutability. Consumption of luxury fibres such as mohair and cashmere is greater in countries with higher per capita incomes. In the 1980s there was a consumer preference move away from man-made fibres and back to natural fibres. Natural fibres are subject to the demand and supply fluctuations inherent in agricultural markets. Supply of natural fibres is particularly inelastic in the short term. Overcapacity in the oil industry and the early-70s oil crises had a devastating effect on man-made fibre producers' profits.

The major polyester producing companies are Amoco (now BP Amoco), DuPont, Eastman, Dow, Shell and Hoechst, which have all suffered from further price falls in 1998. Total fibre production is expected to continue rising at around 4% per year, from 48 million tons per year in 1998 to 64 million tons in 2005. Annual consumption growth was 7.5% between 1970 and 1996. The polyester share will depend on the availability of cotton. Cotton yields increased substantially during the 1980s but since 1985 have been static. Since the planted area has been declining, and yields are not expected to rise rapidly, it is unlikely that cotton output will increase significantly over the next ten years. China holds

half of the world's cotton stocks, which are at high levels at present, but any reductions in stock levels are not expected to have significant long-term effects and so the increase in fibre consumption over the next ten years is expected to be largely supplied by polyester. Of the increased demand for polyester 90% will go to the mass market sector but 10% will go to the speciality polyester fibres where smaller runs, and flexibility, are the key to higher margins.

On the mass supply side, scale is still able to lower production costs. On the speciality side, Japanese research and development since the late 1980s has focused on a process called 'shin gosen' whereby ultra-fine polyester filament yarns are used to produce a new range of fabrics with enhanced properties, such as handle and drape. New ranges of worsted-wool-like and silk-like polyesters have also been developed.

The present recession (2001-3) is encouraging further rationalisation of the industry. After the European rationalisation of the 1970s and 1980s, divestments continued in the 1990s when ICI sold its fibres business to DuPont in exchange for DuPont's acrylic plastics business. ICI had already almost eliminated filament yarn production in Germany, and passed its share of cut-staple polyester production in Portugal to Hoechst. ICI sold its remaining polyester assets to DuPont and transfer was complete by 1998. In 1999 DuPont put its polyester staple fibre business into a joint venture with Akra, part of Alpek, Mexico, and its polyester filament yarn business in the Americas into a joint venture with Alpek and Teijin of Japan. In Europe DuPont formed a joint venture with Sabançi of Turkey.

The rationalisation of the world polyester industry has much to do with government-driven investment in polyester in the Far East, especially in China, as well as specialisation into polymer production and development for non-fibre applications where margins are higher. The increased concentration of polyester producers in the developed world would have led to increased pricing power had it not been for investment in capacity by the Chinese government, apparently unrelated to the present structure of world supply and demand. In addition the very high subsidies to cotton producers in the United States have held global cotton prices down and reduced the demand for man-made fibres.

In the developed world garment manufacturing is not as competitive as many suppose, because of tariff and non-tariff barriers. There are many more fabric producers than fibre or yarn producers, but the majority produce a small percentage of total output. The bulk of fabrics are produced by a small number of large firms, for example in the U.S.A. there are approximately 5,000 textile firms (SIC22) of which the 50 largest account for 50% of total output, and the largest 35 for 35% of the industry's total output. Among the large firms there are big differences between companies in terms of their production by end-use categories.

In garment manufacture and household products such as carpets the large manufacturers are vertically integrating into retailing, including internet sales, and moving bulk manufacturing to the Subcontinent and to the Far East. The United States retailers have led the way towards cheaper textile imports and this, together with relatively high employment, has weakened the power of the United States textile manufacturers to lobby their government for continued protection.

1.4.5. Neglect.

The importance of the textile industry to individual citizens and to all levels of government around the world is indisputable. The textile industry satisfies a basic human need, and is an important element of the process of economic development and the advance of material living standards.

The textile and apparel industries often lead the industrialisation process and reflect the economic specialisation essential to peoples who wish to progress beyond the hunter-gatherer stage. The work skills and disciplines learnt in the co-operative production of clothing are considered essential to industrialised societies. More recently, the expansion of domestic production of textiles and clothing into exports has provided, and is providing, essential trading experience and foreign exchange to many developing countries including India, Pakistan and China.

In spite of the fact that textiles remain the largest employer of labour in the world (Dickerson, 1995), in both industrialised regions and lesser-developed regions, academic study of the textile industry is sparse. There is a wealth of technical and individual country data but almost no attempt has been made to take a global perspective. In the last twenty years only one book has tried to cover the whole industry, and this in the form of a student textbook. In the late 1970s an excellent attempt at an industry study was made in three parts (Toyne et al, 1984) but unfortunately this work has never been extended or updated. No literature can be found that connects recent developments in strategic management theory to the global textile industry.

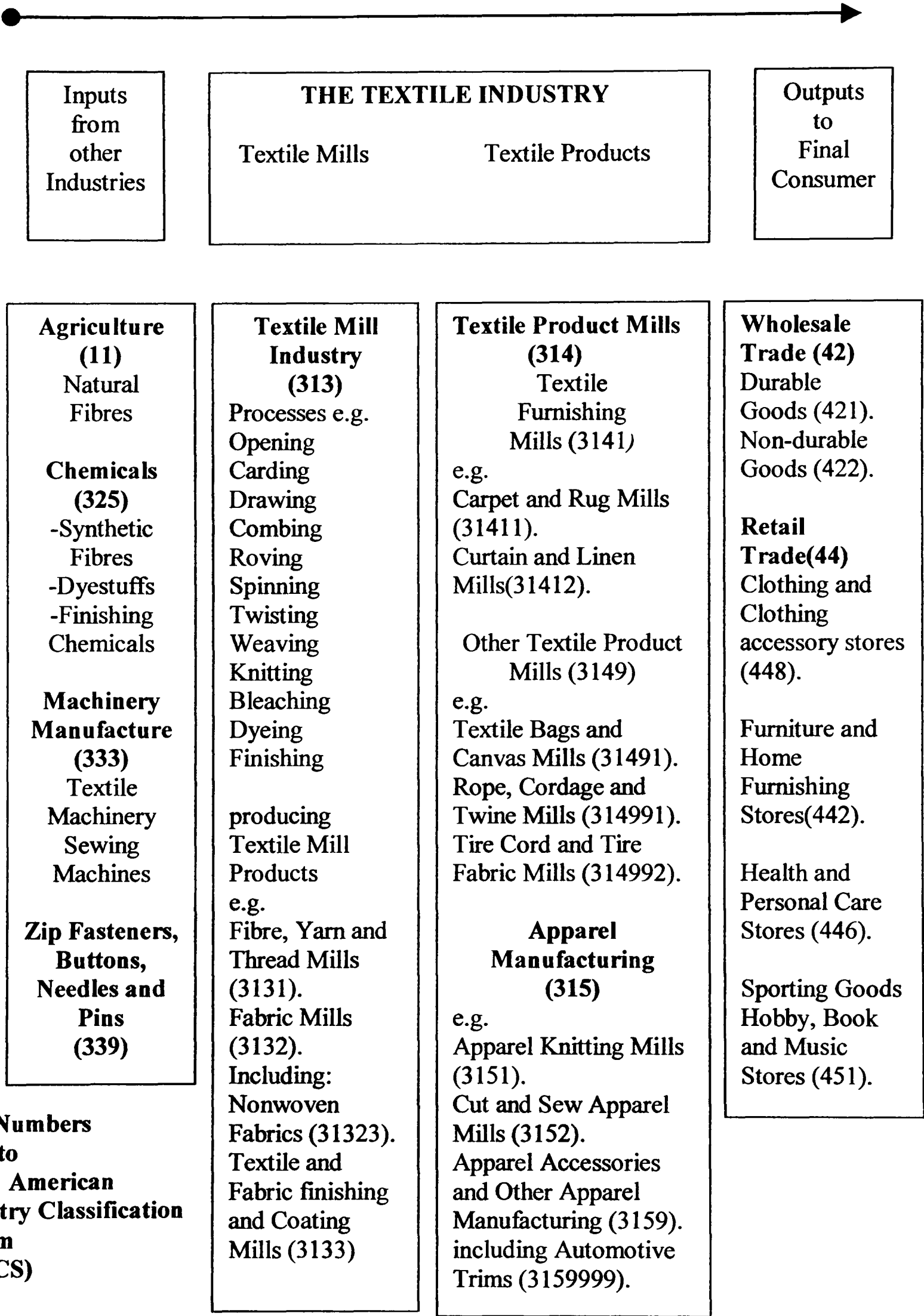
Most national governments have incorporated textiles into their industry and trade policies and yet there is little comparative literature on government textile policies. Because of its importance in the early stages of economic development and in the industrialisation process, many countries have singled out the textile industry for subsidies or trade protection. It is therefore surprising that very little comparative research has been done into the relationships between governments and MNEs in the global textile industry. Development economics has considered textiles in more detail but this literature sheds little analytical light on these relationships.

At the present time (2003) supranational agreements on textiles are profoundly affecting the pace of progress towards global free trade in other industries, such as agriculture and e-commerce, and in other areas, such as intellectual property. The phasing out of the Multifibre Arrangement was agreed by the GATT (General Agreement on Tariffs and Trade) members in the 1994 Uruguay Round, and is due to be completed by January 1, 2005. This gave the World Trade Organization (WTO) an overall responsibility for international trade in the world textile industry under the Agreement on Textiles and Clothing (ATC). If completed as proposed, this will have an enormous impact on world textile manufacture and trade and is already causing a strategic reassessment by all the leading textile companies in the world. The first stage of phasing out MFA, completed in January 1995, had little impact because countries were able to leave their most sensitive categories until last, and those most threatened had 'back-loaded' their trade liberalisation accordingly. The final stage is expected to

have a very great impact and there should then be no trade barriers, for the agreed range of products, between WTO countries. The full implementation of the WTO textile agreements is being watched very carefully by the lesser-developed countries. If the WTO fails to fully implement global textile trade liberalisation it may mark the end of a multilateral approach to global trade liberalisation. There is considerable doubt over the WTO's ability to succeed in the face of the host of bilateral agreements that individual nations and regional blocs are negotiating. The importance of the textile industry in global economic development and to the development of free trade make it even more surprising that there has been no recent global study.

Technology and consumer demand are highly dynamic, and producer-led definitions of the textile industry and its traditional segmentation are increasingly less accurate and relevant. The ability of the industry classifiers to keep up with the changes is being tested to the limits. Moreover the relevance of such classifications in highly developed countries, except as an academic exercise, becomes more and more questionable as imports of finished goods and semi-manufactured goods flood into markets. As the structure shifts from large importers, wholesalers, retailers to the individual consumer ordering on the internet, government's ability to classify may be overwhelmed by the complexity. At the same time the breakdown in the traditional textile industry structure in the developed world has considerable implications for strategic analysis by firms and governments.

Figure 1.1. The Textile Complex.



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2.1. Introduction.

2.1.1. The Neglect of Government.

Competitive advantage is generally regarded as the key to strategic success (Porter, 1985; Ghoshal, 1987; Enderwick, 1989; Prahalad and Hamel, 1990; Rugman and Verbeke, 1995a; Porter, 1996; Grant, 1998b; Segal-Horn, 1998b; Thompson and Strickland, 1998; Cantwell, 2000; Campbell-Hunt, 2000; Birkinshaw, 2001; Kogut, 2001; Rugman and Verbeke, 2001). Here we are interested in the ways in which firms develop political competitive advantages (PCAs), rather than in a wider study of the political economy of MNEs. Studies of political risk are only relevant where the assessment of risk has a firm-specific advantage dimension (Kobrin, 1979, 1981; Kobrin, Basek and LaPaombra, 1980; Kennedy, 1985; Sethi and Luther, 1986; Tallman, 1988, 1992; Subramanian, Motwani and Ishak, 1993).

Studies of the threats that government perceives from MNEs are only of interest here where they encompass a strategic management perspective (Vernon, 1971, 1977, 1998; Doz, 1979, 1986a; Doz and Prahalad, 1980; Encarnation and Wells, 1986; Dunning, 1997; Lipsey, 1997).

At firm level, no detailed and comprehensive strategic management analysis exists of the effects of government upon the firm. This gap is particularly obvious in competitive advantage theory, which is considered core strategic management theory. Professor Porter's seminal works on competitive advantage (Porter, 1980, 1985, 1986, 1990) have had a great influence on scholars and practitioners of strategic management, but they demonstrate that, at the very least,

the effects of government on competitive advantage require a more detailed analysis.

Porter's five forces driving industry competition analysis has been a standard practitioner tool in strategic positioning analyses for over twenty years. It encapsulates Porter's view of efficiency-based competitive advantage. From the outset, Porter interweaves the concept of industry structure with the concept of company capabilities (Porter, 1979a, 1979b). He portrays the five-forces strategic analysis as a holistic management tool to be used to locate the sources of competitive advantage, to gain control over some of these forces, and, in the process, to improve the firm's profitability and growth prospects. Porter posits three generic strategies – overall cost leadership, differentiation and focus – with which firms could “cope” with the five competitive industry forces in order “to create a defensible position in an industry” (Porter, 1980, pp.34-46).

Porter acknowledged that government is an important element in industry structure but excluded government from his five-forces strategic analysis framework (Porter, 1980). The five-forces model assigns only two direct roles to government policy in determining industry structure:

- i. that of acting as the seventh type of industry-level entry barrier under the heading “threat of new entrants”(Porter, 1980, p.13; 1985, p.6, fig.1-2).

- ii. that of acting as one of five sources of “high exit barriers” which in turn is one of a list of eight “interacting structural factors” which produce “intense rivalry”. Exit barriers keep companies competing in business in spite of low or negative returns, and include government concern over unemployment and

regional economic effects (Porter, 1980, p.21).

However Porter does concede that government can have a much wider influence on industry structure. Examples of government influence include its impact on industry as: a buyer (e.g. defence-related products), a supplier (e.g. timber), a regulator (setting “limits on the behaviour of firms as suppliers and buyers”), a source of subsidies (e.g. solar heating), a deregulator (e.g. natural gas), and as the setter of safety and pollution standards (Porter, 1980, pp.28-29).

Baron (1995a) has made an important contribution to the study of the effect of non-market institutions, including government, upon firm strategy. Market strategies are separated from non-market (“social, political and legal arrangements that structure the firm’s arrangements outside of and in conjunction with the market”). The characteristics assigned to the non-market environment issues, institutions, interests and information, would not seem to delineate the sector sufficiently. He recognises the importance of government to firms and distinguishes between industries that are controlled by government to a greater or a lesser extent. Thus he follows a strategic positioning view (SPV) industry-level analysis that tends to ignore the fact that firms are affected much more by general government activities than by government actions aimed at particular industries. His view of strategies pursued by industries rather than individual firms is naïve since industry organizations are almost invariably driven by a few interested firms. Moreover Baron’s example of non-market strategies that have the characteristic of public goods, but “where the private incentive can still be sufficient,” is confusing.

Baron gives many examples of different non-market strategies. He suggests that although they might be addressed through Porter's five-forces model they are different because they target effects emanating from different institutions to the markets normally considered under the heading of rivalry. He rejects non-market forces as a sixth force on two weak arguments: firstly, on the grounds that managers are responsible for both and that they should therefore be integrated; and secondly, because non-market actions such as lowering trade barriers may actually shift control away from government and towards the market. His conclusion is that "the most effective approach is to integrate non-market analysis and strategy formulation into the strategy process and focus both on specific non-market issues that affect the firm and on non-market action as complements to, or substitutes for, market actions. That is, both markets and non-market strategies should be considered in addressing, and defending against, market forces and realising alternatives. In addition, some non-market issues that arise externally or in response to a firm's actions should be considered as a sixth force to be addressed by market and non-market strategies."

Baron suggests that it is important to view non-market environments as endogenous rather than exogenous and two of his three examples, Calgene and Toys'R'Us, are examples of firms not taking regulatory environments as exogenous.

One of the difficulties lies in Baron's very wide definition of non-market forces that fails to separate government from non-governmental forces. Non-market, firm-specific, assets include "expertise and competency in dealing with

government, the media, interest and activist groups and the public,” as well as “a reputation for responsible behaviour earned with consumers, government, stakeholders and the public.” From a strategic management view these definitions are confusing. Reputation is a key market asset and results from a successful differentiation strategy (Kay, 1996). The division between market assets and non-market assets is imprecise and extremely difficult to operationalize.

Baron (1995b) attempts to provide managers with a ‘non-market strategy system’, a conceptual framework and a strategic management process, using his concept of ‘the rent chain’. The rent chain is an analogous concept to Porter’s value chain but results from non-market strategies. In fact managers pursue increased added value (superior returns) and do not differentiate between market and non-market sources. Baron is right however in stressing the complexity of politically-derived, competitive advantages, be they gained either by an individual firm or through the concerted action of several firms. Both market and non-market sources produce externalities that may or may not have an impact on the firm value chain and may produce firm-specific, politically-derived, competitive advantages, but non-market sources often require more complex reactive and proactive strategies.

Baron (1997) contains a rich analysis of Kodak’s trade dispute with Fuji Photo Film. The environment of business consists of two interrelated components: the market environment governed by markets and private agreements, and the non-market “characterised by the social, political, and legal arrangements that structure interactions outside of, but in conjunction with markets and private

agreements. The non-market environment encompasses those interactions that are intermediated by public institutions.” The Kodak case study is an excellent example of a market-directed firm-specific growth strategy where the MNE enlists the support of a national government in order to reduce another nation’s barriers to free trade. The U.S. Government in this case was in partnership with Kodak in an efficiency-based strategy designed to open markets in support of World Trade Organization (WTO) rules. Here the company was also putting pressure on its own government, which had not shown the resolve that many expected with regard to exports of luxury automobiles and automobile parts to Japan. Free trade strategies are very good examples of instances where firms and national governments combine to achieve mutual efficiency-based objectives. They are however only one example of how firms design proactive strategies in order to secure politically-derived competitive advantage from governments (see chapters 4 and 5). Such strategies embrace rules-based petitions to the WTO, where firms pursuing free trade strategies, perhaps surprisingly, must go via their national governments. Baron thinks that this may reduce the number of firm-specific trade disputes and increase industry-specific disputes. This is by no means certain in view of the manipulation of technically based rules that is demonstrated by Salorio (1993) and by this thesis.

2.1.2. Government as an Indirect Force.

While conceding that government can be a more influential force than his analysis admits, Porter concludes that “for purposes of strategic analysis it is

usually more illuminating to consider how government affects competition *through* the five competitive forces rather than to consider it as a force in and of itself. However, strategy may well involve treating government as an actor to be influenced” (Porter, 1980, p.29).

Porter generally treats government as synonymous with government policy and outside the control of the industry or the firm. However he occasionally hints at proactive strategies to influence government, e.g. “while institutional factors often remain outside a firm’s control, means may exist to influence them or minimise their impact” (Porter, 1985, p.83). The context diagram (Porter, 1980, p.xviii) only refers to government in one corner under “industry opportunities and threats (economic and technical)”. Government is excluded from company strengths and weaknesses. These are classed as internal to the company. The fact that firms can harness advantages derived from government (politically-derived advantages, or PAs), is excluded from the fundamental framework. In case this should be dismissed as an early work, it is important to note that Porter (1998b), which “draws together for the first time in one place, more than a dozen existing and new articles ... on competition” (p.2) begins with a reprint of his article “How competitive forces shape strategy” (Porter, 1979b).

Porter recognised the importance of government at firm level. “Dealing with governments in a globally co-ordinated way is a skill just being developed in many companies.” A firm must understand the significance of various government policy instruments for its ability to configure/co-ordinate, and the

factors that will shape its long-term bargaining position with government (Porter, 1986, p.53). In the three chapters dedicated to government in “Section II: The Functional Agenda” (Porter, 1986), Porter and his contributors recognize the direct effects of government on the firm's competitive advantage but he does not incorporate it into the analysis framework.

Porter's indirect approach to assessing the potential effects of government on industry-level competitive advantage foreshadowed a similar perspective in later works, when Porter extended his industry-level, market-power approach to national and international levels. Porter's 1990 framework and his exclusion of government as determinant of national advantage is open to considerable criticism (Winden, 1995; Waverman, 1995). At the national level, government was again excluded from the direct analysis, but simultaneously its important role was recognised. On the one hand government was viewed as a controlling institutional factor that can be influenced by firms, but on the other, it was only an indirect determinant of national competitive advantage to be sidelined along with chance (Porter, 1985, pp.83 and 105; 1990, fig.3-5, p.127).

The exclusion of government from a role as a determinant of competitive advantage is an inaccurate reflection of the business world. Porter himself recognises that his treatment of government is very limited and that government's potential for influencing industry structure is much wider. “Government has been discussed primarily in terms of its possible impact on entry barriers, but in the 1970s and 1980s government at all levels must be recognised as potentially influencing many, if not all aspects of industry structure both directly and

indirectly” (Porter, 1980, pp.28-29).

Porter’s more recent studies recognize that government has a significant influence on clusters and that clusters can affect competition by increasing productivity and innovation capacity in constituent firms and industries and by stimulating new business formation (Porter, 1995, Porter, 1998a; Porter, 1998b, pp.197-287; Porter and Sölvell, 1998). Cluster theory calls for a new paradigm for industrial policy where the common view that government attempts to distort competition in favour of particular locations, is replaced by a focus on government removing constraints to productivity and productivity growth (Porter, 1998b, p.249). Moreover Porter recognises that “the existence of clusters suggests that much of a company’s potential to achieve competitive advantage, both in operational effectiveness and in establishing a unique strategy, lies outside the company and even outside the industry” (Porter, 1998b, p.255). Cluster thinking has highlighted the important role of government at a number of geographic levels, beyond the traditional focus of economic policy at national level. The importance of location advantages and disadvantages (Porter, 1998b, pp.309-348) are recognised in both Porter’s diamond and cluster theory but Porter does not incorporate them into his theory of competitive advantage at firm level.

Porter’s cluster theory assigns a direct and proactive role to the firm’s relationships with government. Cluster participants “inform and prod government to address the constraints or weaknesses under its control across all parts of the diamond” (Porter, 1998b, p.258). Here Porter envisages firms working with government to increase efficiency. The firm should engage and educate individual

departments or units of government on the effects of regulations and policies, and on the quality of government services. This thesis demonstrates that, as well as being an indirect force, government is also a direct force on the profitability of firms. Firms therefore need to develop reactive and proactive strategies directed at the sources of politically-derived advantages and disadvantages. Porter's competitive advantage theory and analysis framework needs to be modified accordingly.

2.2. Government in the Strategic Positioning View of the Firm (SPV): The Sixth Force Driving Industry Competition.

Porter has acknowledged that “institutional factors, including government regulation, tax holidays and other financial incentives, unionisation, tariffs and levies, and local content rules, constitute the final major cost driver” (Porter, 1985, p.83). It is therefore even more surprising that he does not include them as a sixth force in the determination of industry profitability (1985, p.5, fig.1-1).

Most managers recognize that various avenues exist to pursue a political strategy: organizing within the context of a set of industries with common interests, an industry association, a strategic group within the industry, or some kind of coalition of economic actors pursuing similar goals. The main problem often assumed to be characteristic of firm-level political action is that a single firm will bear all costs associated with obtaining government favours, whereas all other firms in the industry will subsequently benefit from the firm’s actions (free-riding problem). This view, however, wrongly assumes that all firms in the industry will benefit equally from specific government policy measures, which is seldom the case, especially in the international business context where enormous asymmetries may exist among firms in terms of the benefits they derive from specific government measures (trade barriers, subsidies, etc). Even if so-called collective goods are granted by government (e.g. across-the-board tax relief), the actual extent to which individual firms benefit from these may be widely divergent within industries. For example, recent empirical research demonstrates that within single industries trade preferences regarding trade liberalisation/deregulation fundamentally depend upon such specific company

characteristics as having subsidiaries abroad, foreign alliances and a high export dependency (Porter and Fuller, 1986; Van den Bulcke and Verbeke, 2001).

In addition, the potential impact of political elements on a firm's profitability and growth is unlikely to remain constant over time. The dynamic nature of politically-derived advantages and disadvantages emphasises the need for a six-forces-based strategy analysis. Since the effect of government will change over time and since it is instrumental to achieving desired levels of profitability and growth, strategic management needs an analysis framework that reflects that dynamic. For example, especially when domestic demand is down as the result of a recession or import penetration increases, firms may decide to actively pursue political strategies intended to create trade barriers against foreign rivals (Schuler, 1996).

Professors Rugman and Verbeke have criticised the imprecision of Porter's global version of Porter's strategic positioning view (SPV) as a generic strategy framework (Rugman and Verbeke, 1990a, 1992a, 1993c). Porter indeed extended his initial generic strategy framework to global markets in his later work on competition in global industries (Porter, 1986). He saw international strategy primarily as an issue of geographic scope.

Porter extended his generic strategy framework to take into account the issue of geographic scope in a global industry and the three initial generic strategies were transformed into a set of five: global cost leadership, global differentiation and three possible focus strategies, namely global segmentation (narrow segment but global geographic coverage), national responsiveness

(narrow segment and limited geographic coverage) and finally, protected markets (broad segment but limited geographic coverage). Unfortunately, managers will face three main problems when attempting to apply Porter's extended generic strategy framework.

First, the type of competitive advantage, namely cost leadership or differentiation, is not used as a parameter for discriminating between strategies in three of the five global cases. This could indicate that in the case of a protected market strategy, global segmentation and national responsiveness, the type of competitive advantage sought apparently is not very important. If so, this implicitly suggests that firms that pursue both cost leadership and differentiation simultaneously within chosen geographic and/or market segment niches, may not become "stuck in the middle". If cost leadership and differentiation advantages are not clearly distinguishable from each other in an international context, Porter's initial generic strategy framework is unsatisfactory.

Second, Porter's strategy of protected markets does not seem to fit at all with the other four strategies, because protected market strategies usually reflect a company's inability to gain a cost and/or differentiation advantage in the market place without help from government. Unless government policy can be fully endogenized by the firm, protected market strategies must remain, at least partially, outside the firm's control.

Third, what are the normative implications of a generic strategy framework? What is important from a managerial perspective is that each generic strategy should be associated with clearly identifiable patterns in decisions and

actions. For example, all large electronics manufacturers (Philips, Matsushita, GE etc.) pursue a combined cost leadership/differentiation strategy. It would be difficult to argue that any of these firms has a substantially different emphasis on one of the two types of competitive advantage as compared to the other firms. A dual focus on both cost leadership and differentiation is required across the various segments of the value chain. Thus it becomes very difficult to identify patterns in decisions and actions which are associated with only one of Porter's types of competitive advantage. Even though different generic strategies may be pursued simultaneously, their generic character should reflect the fact that they deal with a fundamentally different approach to competing and to achieving a satisfactory economic performance.

{Insert Figure 2.1 here}

Figure 2.1. suggests that government can impact directly on firm strategy (Rugman and Verbeke, 2000). A change in government regulation may, through its impact on Porter's five conventional market forces, lead to a firm-level, indirect shift in strategy. However it may also lead to a direct shift in strategy, irrespective of its impact on the five market forces. This further reinforces the

point that government should be included as the sixth force driving industry competition, as reflected in figure 2.1.

The important managerial implication which emerges is that, irrespective of whether certain advantages and disadvantages are viewed as coming directly from government or indirectly from government via the five forces, the firm-level strategic response may well need to be directed towards government itself.

Given the above elements, an SPV analysis augmented with government as the sixth force driving industry competition leads to the following questions (Verbeke and Bowen, 2002):

- i. For which issues should the firm consider government as a sixth force driving industry competition, i.e. for which issues is there some impact of government on the firm that can be studied more effectively through direct analysis, rather than through indirect analysis via the conventional five forces (e.g. tax, the impact of anti-trust legislation on the firm, impact of new environmental policy rules)?
- ii. Does government in one industry (or industries) provide shelter to some companies at the expense of others, especially in the international context?
- iii. Is the analysis of government as a sixth force likely to trigger a change in firm strategy?
- iv. If so, are resultant changes in firm strategy limited to reactive political strategies or can firms develop proactive political strategies in order to alter present or anticipated future public policy, and thus its expected impact on the firm? For example, is shelter triggered by, or does it stimulate, firm-level shelter-

seeking strategies?

v. To what extent can government-targeted strategy contribute to profitability and growth?

vi. Can the strategy towards government best be pursued by the firm, or through concerted action with other economic actors (industry association, professional lobbyists etc.)?

vii. How should the firm organize itself internally to manage the sixth force (e.g. organization of a central government affairs function, integration versus national responsiveness in subsidiaries, etc...)?

Recently Porter (Argyres and McGahan, 2002) has defended his omission of government as a sixth force on the grounds that “there is no monotonic relationship between the strength and influence of government and the profitability of industry.” This statement lacks clarity. The same article is very revealing about Porter’s arrival at his strategic positioning view of the firm within its industry. Porter’s work needs to be placed within a 1950s-1960s context when macro-economic industry-level studies still dominated post-war business studies. In such studies individual firms are rarely mentioned (Burn, 1958; Allen, 1959). Porter began his Ph.D. in 1971 when “in both business policy and industrial organization we were talking about industries” (Argyres and McGahan, 2002).

The five-forces framework was an industrial organization (IO)-based analysis of industry structure (Porter, 1981). “Developing the five-forces framework was a long process. And then at the last minute, just months before

this massive project was over, I decided I needed to say something about positioning. Most of that book is about industry structure, both static and dynamic. At the eleventh hour, I tried to get at the question of how to think about positioning in a way that was fundamental and connected to competitive advantage” (Argyres and McGahan, 2002, p.44).

If one studies industries long enough, patterns emerge. Strategic group theory has certainly contributed to our understanding of the nature of industries. From the firm viewpoint the application of SPV to firm strategy was a last-minute development and there is no clear justification or mechanism to explain why the forces determining industry-level structure should be the same forces that guide firm strategy.

Even if we accept that the five-forces SPV analysis is sufficient for the determination of firm strategy, the treatment of government as a sixth force that is somehow different from the other five forces seems unjustified. From a firm strategic management point of view, government should be included as an equal force to the other five, acting directly and indirectly, as well as interactively with the other five forces, upon the firm value chain. Figure 2.2. simply extends Porter’s five-forces diagram to include government as a sixth force.

{Insert Figure 2.2. here}

All six forces act on the value chains of companies. The problem with Porter's five-force SPV approach as a framework for strategic analysis is that an industry structure analysis is required as a prerequisite to firm-level analysis. Porter recognised that "industries are not homogeneous" and that industry definition and segmentation was difficult (Porter, 1985, p. 231). Porter's definition of an industry as "the group of firms producing products that are close substitutes for each other" (Porter, 1980, p.5) was modified to: "a useful working definition should encompass all segments for which segment interrelationships are very strong" (Porter, 1985, p.272). It is difficult, or perhaps impossible, to apply this definition to the modern textile industry where synthetic chemical and biological molecule chains are developed by or for specific firms, to be processed into blood filters, houses, boats and spacecraft nose cones. Only at a macro level can Porter's definition of industry be applied to textiles, and his own advice not to get side-tracked into trying to draw boundaries too closely is of little help in firm-level strategic planning. Technological advances and globalization have shifted the emphasis from supply-chain definitions of the textile industry to attempts to define textiles by product end-use (Trela and Whalley, 1990). These attempts have run into problems since the number of textile industry product end-uses has increased geometrically in the last few decades. In 1995, 60% of the products of textile mills in the United States did not go into the apparel industry and the percentage of this non-apparel usage is increasing (Dickerson, 1999, p.262). The difficulties inherent in this approach are demonstrated by the failure of well-funded national agencies, such as the North American Industry Classification

System (NAICS), to accurately reflect the dynamic and arbitrary nature of industry definitions and boundaries.

The importance of the unique endowments of the firm to sustainable rents, and the relative unimportance of industry boundaries and groups, has been spelt out by Rumelt (1991). As the strategic emphasis on the consumer behaviour (Antonides and van Raaij, 1998; Aaker, 1998) grows with the development of e-business and one-to-one marketing, the weaknesses of the SPV approach become more obvious and operationalization even more difficult. There would seem to be little point in trying to extend strategic group theory (McGee, 1985; McGee and Thomas, 1986, 1989; Mascarenhas, 1989; Seth and Thomas, 1994; McGee, Thomas and Pruett, 1995) to cover the role of government when the boundaries of the industry are so difficult to define and are so dynamic. However the strategic analysis of global markets and the search for “strategic space” is a powerful and useful concept in the analysis of firm/government relationships, opportunities and threats (McGee and Segal-Horn, 1990; Segal-Horn, 1992).

Strategic management requires a new way of analysing the effect of government upon the firm. In order to find this new way some core concepts of strategic management and international business are examined below, with special attention paid to their relevance to the impact of government on MNEs.

2.3. Core Concepts: Government and the Firm.

2.3.1. Introduction - Theories of the Firm.

This is a strategic management thesis about the effects of government on competitive advantage and firm strategy, and, in particular, on multinational enterprises (MNEs). Its theoretical underpinning is a synthesis of economic, international business and strategic management theory. This chapter does not set out to present a comprehensive literature review but only to focus on the available concepts from strategic management and international business that are considered relevant.

Theories of the firm provide a paradigm and a vital framework for analysing the underlying concept of the firm, permitting us to investigate strategic issues and acting as a basis for the selection of research methodologies. The theory of the firm was developed by neo-classical economists as part of “The Theory of Value” (Ricardo, 1819). It investigates the way in which prices are arrived at and resources allocated between alternative uses. The individual firm is subject to microeconomic laws of supply and demand, and it employs capital and labour to produce goods and services. As scale increases average costs are reduced according to the law of economies of scale, but then costs turn upwards in accordance with the law of diminishing returns to scale. Firms try to optimize their size to the point of lowest average costs. Profit maximization is assumed as the norm, and firms survive only by selecting optimal strategies in a manner that has been called “economic Darwinism”. Firms that deviate from the optimal will tend towards extinction. In perfect markets firms will produce to the point where

marginal cost equals price, and since there are no barriers to entry profits will tend towards zero. This would mean that long-term investment cannot take place, since the cost of investing in the future would tip the firm into present-day losses and out of business.

Economics, strategy and political economy (Brewer, 1993) share a common problem in so far as markets are not perfect and much work has been focused on the nature of such imperfections. Any deviation from the extreme cases of perfection and pure monopoly presents complex theoretical problems. The economic debates of the second half of the twentieth century about monopolistic competition (Edward Chamberlain, 1899-1967) and overlapping oligopolies (Nicholas Kaldor, 1908-1986) showed the limitations of starting from absolute extremes and relaxing assumptions to arrive at a closer approximation of reality.

The increasing internationalization of trade and of MNEs has led to an increasing overlap between international business and strategic management which has been focused on the apparent development of a 'globalized' world economy (Killing, 1982; Toyne et al, 1994; Bartlett, 1985; Kogut, 1985a, 1985b; Hamel and Prahalad, 1985; Stopford and Turner, 1985; Mahini and Wells, 1986; Encarnation and Wells, 1986; Chandler, 1986; Doz, 1986a; Porter, 1986; Porter and Fuller, 1986; Clegg, 1987; Milner, 1988; Bartlett and Ghoshal, 1989; Prahalad, 1990; Rugman and Verbeke, 1990a, 1993c, 1995a, 1995b; Rugman and Gestrin, 1991; Stopford and Strange, 1991; Dicken, 1992; Slocum, 1992; Lei and Slocum, 1992; Yip, 1992; Pucik, Tichy and Barnett, 1992; Dunning, 1992, 1993,

1994, 1997; Bleeke and Earnst, 1993; Moran and Riesenberger, 1994; Dickerson, 1995; International Labor Office, 1996; Boyer and Drache, 1996; Lazer, 1996; Wade, 1996; Baron, 1997; Lipsey, 1997; Rugman, 2000; Birkinshaw, 2000; Van den Bulcke and Verbeke, 2001).

Recent developments in strategic management have centred around the resource-based view (RBV) of the firm and have developed from firm-based organizational studies. Only now is RBV theory being connected back to other theories of the firm to explain the birth of domestic firms in imperfect markets, and the international expansion of some firms to become MNEs. The bridge between Porter's SPV, RBV and internalization theory is being developed largely by students of international business who have moved from national macro-economic trade theory considerations, via the study of foreign direct investment, to new theories of the MNE that focus attention on firm-level analysis. Transaction cost analysis and internalization theories seem to better explain the imperfect markets that we observe, but at the same time, are firmly rooted in traditional economic theory.

2.3.2. The Resource Based View of the Firm (RBV).

The term "resource-based theory" was coined by Wernerfelt (1984, 1989). The historical basis of RBV and its position in comparison with various IO schools was examined by Connor (1991), Montgomery (1995) and Connor and Prahalad (1996), in relation to the theory of the firm. RBV is developing into an

accepted theory underpinning strategic management studies. Kay described RBV as a strategic management paradigm that could be classed with those underpinning physics, economics and medicine, “unifying most of what is substantial and significant in our existing knowledge of business behaviour” (Kay, 1996). RBV is defined in this thesis by Kay’s summary of its main elements (Kay, 1996, pp.34-35).

Penrose (1959) had conceptualised the firm as “a collection of productive resources” and this led indirectly to the resource-based view of the firm: the theory of the firm as tangible assets, intangible assets and competencies that together form a bundle of productive resources. Firms expand by making the best use of their pre-existing skills and resources. This theme was further developed by Richardson (1972). This resource-based view of the firm has been linked to theories of sustainable competitive advantage (Peterlaf, 1993). Models attempt to reconcile the strategy perspective with neo-classical economic theory, and to provide a framework for simultaneously handling resource heterogeneity and uncertainty, while searching for predictions of competitive equilibrium (Lippman and Rumelt, 1982).

The firm as a bundle of contracts had been examined by Alchian and Demsetz (1972), and as a unique bundle of property rights over assets by Grossman and Hart (1986). Essentially however the resource-based view of the firm relies on the perception of the firm as a collection of resources, competences and capabilities, and the effectiveness of a firm depends on the match between its capabilities and the market it serves. The growth of the firm is limited by its

capabilities. Some of these capabilities can be purchased or created and are available to all firms. Other capabilities are inimitable (Lippman and Rumelt, 1982) and irreproducible, or reproducible only with substantial difficulty (Dierickx and Cool, 1989) by other firms. It is on these capabilities that competitive advantage depends. The firm's net competitive advantage (i.e. firm-specific advantage) is manifested by its ability to create superior added value. Such capabilities are generally irreproducible because they are path-dependent, or their exact nature is uncertain even within the firm itself.

The identification and examination of the internal resources and capabilities of firm e.g. R&D capabilities, specialised human resources, etc. (McGee and Thomas, 1986) has been central to the quest for sustainable long-run competitive advantage in a range of competitive contexts. In the 1970s and 1980s there were many inward-looking studies in which firm-specific resources and capabilities were identified (Stevenson, 1976). 'Core competences' were analysed but few went further to look for the original external sources of competitive advantage. The competitive context specifies the conditions of competitive rivalry that the firm confronts, and different contexts represent different resource-deployment opportunities available to firms. For Porter the competitive context of the firm was its industry, while McGee, Thomas and Seth concentrated on conceptualising strategic groups (McGee and Thomas, 1986, 1989; Fiegenbaum, McGee and Thomas, 1987; Seth and Thomas, 1994). The problem of industry definition is a fundamental operational problem of the SPV industry-level analysis approach. Porter recognised that "industries are not homogeneous" and that

industry definition and segmentation was difficult (Porter, 1985, p.231). “A useful working definition should encompass all segments for which segment interrelationships are very strong” (Porter, 1985, p.272).

At an industry level the problem of industry definition may not be crucial. Different definitions of industries, industry sub-groups and strategic groups add considerable academic challenges to a macro-economic study of industries. However, at a firm level they become cumbersome. To analyse a firm into several different categories according to different definitions of its position within and across industries becomes complex. At a practitioner level it becomes impossible to produce continuous strategic plans based on changing and developing industry, or industry sub-group definitions. Each change of definition implies a different value-chain analysis.

Grant (1991b) sets out a resource-based approach to strategy analysis in response to a perceived neglect of the link between strategy and the firm's resources and skills, in favour of industry structure analysis and competitive positioning. Grant envisages strategy as more of a quest for Ricardian rents, rather than for market power (Grant, 1998a, p.110; 1998b, p.183). Competitive advantages are seen as being principally endogenous to the firm. Although Grant did not use the term firm-specific advantage, it is clear that his concept of competitive advantage encompasses efficiency-based and non-efficiency-based competitive advantages. The resource-based theory of the firm is built on empirical findings that competitive advantage, rather than external environments, is the primary source of inter-firm profit differentials.

Grant pointed out that monopoly rents resulting from market power also have their basis in the resources of the firm (Grant, 1991c). Barriers to entry (see below) are based on resources such as brands and scale economies that incumbent firms possess and which are difficult and expensive for entrants to acquire (Yip, 1982). From the point of view of the focus of this thesis, as one that explicitly recognises the effect of government on the strategic management of the MNE, the economic argument about definition of profits as either normal or abnormal is problematic: firstly, in practice, it is difficult to evaluate and measure, and second, it is intractable as a readily distinguishable theoretical proposition that leads to prescriptive and normative implications for the two main frameworks developed in this study. The studies now being developed from a combination of transaction cost/internalization theory and RBV suggest a more productive balance between optimal growth patterns of the firm and the seeking of rents (Dierickx and Cool, 1989; Reed and DeFillippi, 1990; Mahony and Pandian, 1992; Amit and Schoemaker, 1998; Priem and Butler, 2001a, 2001b; Barney, 2001).

Grant's concept of firm-specific resources clearly extends to cover exogenous as well as endogenous resources. The challenge to Porter's strategic positioning view (SPV) of the firm's environment is clear. RBV does not see the firm as trying to struggle to the top of the pile of competitors in its industry, by analysing them and outperforming them (Collis, 1991; Collis and Montgomery, 1995). An internal/external resource-based view of the firm (RBV), together with internalization, underpins the concept of politically-derived competitive advantage presented here. The external world of the firm is seen as intimately

linked to the internal world of the firm to a greater or lesser degree. The boundary between the internal and the external has no clear edge and is constantly changing. It can be compared with the endogenous and exogenous boundary between a person and the external world, where networks and partnerships ebb and flow. This is not surprising since firms are collections of people who pool their interdependencies in order to make money (Hennart, 2001). The external world of the firm consists of formal and informal relationships that are not only the source of the firm's unique set of capabilities, but also the quarry from which it can extract an identifiable set of firm-specific advantages in order to improve performance and returns.

The overall paradigm of the diversified MNE here, based on research and experience, is as a collection of unique, sometimes overlapping, value chains. Each profit centre has a very wide set of physical and information inputs from consumers, suppliers, competitors and potential competitors, head office, regional offices, other subsidiary profit centres, governments local and foreign etc., and outputs to a unique set of customers.

MNE location has become an important topic in the theory of the MNE and in international business and strategic management literature (Dunning, 1976, 1977, 1979, 1980, 1988, 1995, 1996, 1998; Shan, 1991a, 1991b; Rugman, Lecraw and Booth, 1985; Carey, 1994; Anand and Delios, 1997; Enright, 1998, Porter, 1998a, 1998b). The importance of location to firm/government relationships is obvious since it defines the interfaces. In spite of this, PCA theory is applicable to any and all government/firm interfaces that create, or have the

potential to create, firm-specific advantages (FSAs). These are location specific but often vary within national boundaries and so will not be referred to here (as in much of the IB literature) as country-specific advantages (CSAs). Any politically-derived advantages, sourced at local, national, regional and/or supranational levels, may provide FSAs to a firm with the appropriate competences and capabilities.

The MNE is not visualised here, as so often and generally incorrectly, as a body with one thinking head in head office (Goold and Campbell, 1987). The current, generally favoured, cost-conscious, MNE organizational structure contains a small centre that is only involved in subsidiary strategy and management on a project basis, for example during foreign direct investment (FDI) and capital expenditure (capex) decisions or crises. The first draft of a subsidiary strategic plan is almost invariably produced by the subsidiary itself.

Birkinshaw (2001) has undertaken an excellent review of MNE subsidiary literature. Until recently MNEs were mostly studied as a whole from a centre-based strategy, structure and relationship perspective (Chandler, 1986). The complex reality of the relationships and the autonomous behaviour of subsidiaries were belatedly acknowledged (Bartlett, 1979; Doz, 1979, 1980; Hedlund, 1986, 1994; Prahalad, 1976; Doz and Prahalad, 1980; Kanter, 1982; D'Cruz, 1986; Prahalad and Doz, 1987, Gatignon and Anderson, 1988). Study of the subsidiary's role as the primary level of analysis in innovation processes was begun by Ghoshal (1987). Consideration of the role of foreign-owned subsidiaries and their relationships with government policy in smaller nations was pioneered in Canada

(Poynter and Rugman, 1982; White and Poynter, 1984).

This thesis recognises that subsidiaries can be driven from within or without but given their unique structures, networks, customers etc, driving them from outside is a difficult task doomed to failure on anything but a very short-term basis (Chang, 1995; Malnight, 1996; Birkinshaw, 1997; Birkinshaw and Hood, 1998; Birkinshaw, Hood and Jonsson, 1998). Mature MNE subsidiaries, like those of Coats, become deeply embedded in their locations but at the same time their multinationality can often give them advantages over domestic firms in the endogenization of government activities (Harrigan, 1980; Grant, 1986; Vasconcellos and Hambrick, 1989; Baden-Fuller and Stopford, 1998). It would be of interest to extend the literature on flagship firms to encompass the role of MNE subsidiaries and of different levels of government (Rugman and D'Cruz, 2000).

Some of the problems arising from the use of variants of transaction cost/internalization theory developed by international business (IB), and that Birkinshaw refers to as 'troublesome', arise from the IB paradigm based on country-level analysis and conceptualising the MNE as centre-driven and operating from one home base. Non-location-bound transferable FSAs are fundamental to MNE theory, but are only an additional benefit to the strategic management RBV paradigm adopted in this thesis, where the MNE is seen as a collection of value chains, sometimes overlapping, and conforming to the network conceptualisation of the MNE (Ghoshal and Bartlett, 1990; Forsgren and Johanson, 1992; Birkinshaw and Hood, 1998; Gupta and Govindarajan, 2000). Rugman and Verbeke (1992a, 2000) offer a bridge between the two schools by

arguing that ownership advantages could arise anywhere in the MNE and that location-specific FSAs can be leveraged locally and internationally. The link between the two schools developed here is based on the identification of location-based (and sometimes transferable) FSAs as being equivalent to unique sets of profit-centre capabilities (sometimes developed and transferred from other parts of the MNE), in turn equivalent to location-based competitive advantage and superior returns.

2.3.3. Transaction Cost/Internalization Theories of the Firm.

Coase (1937) added the role of transaction costs to economic theory as the key determinant of the organization of economic activity. In imperfect competition profit-seeking firms will produce goods and services where there is no market.

In the 1960s economists attributed the existence and growth of MNEs to differences in real interest rates between countries. Empirical evidence however did not appear to support interest rate theory, nor its more sophisticated portfolio variant (Markowitz, 1959). Hymer challenged this view in his Ph.D. thesis (1960). Further empirical evidence (Hennart, 1982) suggested that foreign direct investment (FDI) cannot be explained by portfolio theory. The quest for a more satisfactory explanation of MNE cross-border expansion and FDI became a central topic for international economists and business scholars (Kindleberger, 1969; Stobaugh, 1969; Aliber, 1970; Rugman, 1975, 1980b; Kobrin, 1976;

Calvet, 1981; Lall and Siddharthan, 1982; Dunning and Narula, 1996).

While transaction cost/internalization theory was a response to unsatisfactory interest theories as an explanation of FDI, many aspects could be applied to domestic firms as well. Hymer (1960, 1976) moved the focus of MNE theory from the nation to the firm. Hymer recognised that the MNE is an organization which exists in a world of imperfections (Rugman, 1981b). Hymer's model led to research into MNEs as manifestations of oligopolistic behaviour (Knickerbocker, 1973; Flowers, 1976; Yu and Ito, 1988; Hennart and Park, 1993, 1994). The basic argument of transaction cost theory is that the cost of organizing a given transaction varies with the method of organization chosen to organize it (Hennart, 2001, p.133). The two basic methods of organization are the market and the firm. These two systems experience different levels of cost because they tend to use different methods of control, i.e. market prices or firm hierarchies (Williamson and Ouchi, 1981; Thorelli, 1986).

MNEs arise to organize interdependencies between agents located in different countries. This will occur:

- i. when organizing these interdependencies within the firm is more efficient than organizing them through the market;
- ii. when the benefits of organizing interdependencies within the firm are higher than their costs.

Transaction cost theory is therefore based on a comparison of the cost of organizing interdependencies in firms and in markets. An alternative approach used by Hennart (1982, 2001) is to suggest that market failure is not a sufficient

reason for the existence of MNEs, since it is quite possible that the internal governance costs that both MNEs and markets experience in organizing an interdependency are higher than the gains. MNEs arise to organize their interdependencies by means of hierarchies linked by employment contracts between agents located in different countries in order to reduce governance costs.

The interdependencies give rise to two types of externalities:

- a. competition in the final product market gives rise to pecuniary externalities that can potentially be internalized by mergers, cartels or collusion (Scitovsky, 1958).
- b. natural market imperfections generate non-pecuniary externalities that can potentially be internalized by spot markets, contracts or MNEs. MNEs expand abroad i.e. will organize interdependencies via hierarchy, if three conditions are met: i. interdependent agents are located in different countries, ii. the MNE is the most efficient way to organize these interdependencies (otherwise international market transaction) and iii. the costs of the second are lower than the benefits.

Transaction cost/internalization theory (Williamson, 1975, 1985; Buckley and Casson, 1976; Buckley, 1988; Wilkins and Schröter, 1998; Hennart, 1982, 2001) offers the most plausible explanation to date of why MNEs arise and expand. Many cases of foreign expansion can be explained by the high cost of using the market when property rights are imperfectly defined and enforced.

Hennart (2001) explains that transaction cost theory is not coherent or monolithic. It is a general theory of economic institutions and applies to domestic institutions as well as MNEs. Transaction cost theory focuses on the problems of organizing interdependencies between individuals. Individuals can generate rents

by pooling together different or similar capabilities. Transaction cost theory argues that firms arise when they are the most efficient institution to organize these interdependencies.

MNEs thrive when they are more efficient than markets, and the best method for organizing contracts between interdependent agents located in different countries. In order for co-operation between firms with similar or different capabilities to take place, both parties must be aware of the potential gains and must be able to agree on the price. Otherwise protracted bargaining might eat up the potential gains. Because of bounded rationality and opportunism, organizing this co-operation will require information, enforcement and bargaining costs i.e. transaction costs.

In reality, bounded rationality and opportunism make nearly all markets less than perfectly efficient. When measurement and enforcement costs are high, and the small number of buyers and sellers renders price endogenous, switching from market to hierarchy may be preferable. Markets and firms are institutions. Prices and hierarchies are methods of control. Hierarchy replaces the output constraints of the market (pricing difficulties) by behaviour constraints (Hennart, 1982, 1986, 1993). Behaviour constraints may be imposed upon the individual from outside or inside, either by a superior in the hierarchy or by 'interiorized rules' that make employees behave as though they were being observed.

Most applications of transaction cost/internalization theory have focused on international interdependencies involving know-how (Arrow, 1962; Buckley and Casson, 1976; Magee, 1977; Rugman, 1981a; Teece, 1981; Cantwell, 1989).

Know-how developed in one country can be transferred at low marginal cost. Markets for know-how suffer from information asymmetry. For markets to function well, buyers and sellers must have perfect knowledge.

The internalization approach has become the dominant paradigm for the explanation of the MNE and has distinguished antecedents in economic theory. Since its inception (Buckley and Casson, 1976) it has been considerably refined, notably by the 'Reading School' who built bridges to the transaction cost studies (Rugman, 1981a). Internalization has become a core theory in IB, focusing on MNEs and changing the sequence of entry modes in favour of those modes that help the MNE to protect and exploit the market imperfections created by the internalization process. The extension of internalization theory from IB into closely related fields, such as finance and production, led Rugman to consider entry modes in a strategic management context and to adapt Porter's diamond theory of international competitiveness to the 'double diamond' (Rugman, 1991a, 1992; Rugman and D'Cruz, 1993; Rugman and Verbeke, 1993a, 1993b, 1995b; Moon, Rugman, and Verbeke, 1995).

2.3.4. Entry Barriers.

Entry barriers in general are seen as competition-based and thus interactive with the competitive strategies of firms. Some firms use their proprietary know-how to generate cost- or differentiation-based entry barriers (Rugman, 1982, 1986; Rugman and McIlveen, 1985).

Entry barriers are constraints that prevent a firm's (potential) rivals from taking over and eliminating the firm's product market domain. An entry barrier can be strong or weak – the former allows the firm to have a superior market performance and/or financial performance, the latter merely guarantees the firm's survival.

Porter's early work is focused on industry-level barriers to entry and exit (Porter, 1976). Porter's basic theory of competitive advantage is a study of industry positioning as a technique for analysing industries and competitors, and entry and mobility barriers are fundamental to his argument (Caves and Porter, 1977, 1978; Porter, 1980, pp.7-17, 30-31, 142-144, 340-350).

Entry barriers are an important concept linking Porter, Rugman and government. The only specific, active role that Porter (1980) assigned to government was in relation to industry structure entry barriers. His 'Elements of Industry Structure' diagram (Porter, 1985, fig.1.2, p.6) only mentions government under entry barriers and then only as 'Government policy' not government per se. Government is not mentioned under the other elements of industry structure (rivalry determinants, determinants of supplier power, determinants of buyer power and determinants of substitution threats). "The threat of entry places a limit on prices, and shapes the investment required to deter entrants" (Porter, 1985, p.5).

Grant pointed out that monopoly rent resulting from market power also had its basis in the resources of the firm (Grant, 1998b, p.183). Barriers to entry are based on resources such as brands and scale economies that incumbent firms

possess and which are difficult and expensive for entrants to acquire. At this point the concept of firm-specific resources is extended to cover exogenous as well as endogenous resources. Once again the challenge to Porter's strategic positioning view (SPV) of the firm's environment is clear. The extended resource-based view (RBV) perceives the external world, not only as the source of its present unique set of resources and capabilities, but also as the quarry from which it can extract an enhanced set of FSAs in order to improve performance.

2.3.5. Market Failures, Externalities and Government.

The concept of market failures and imperfections underpins important strands of IB and strategic management literature including FDI and barriers to entry. The study of market imperfections has supplied international business and strategic management with foundations in economic theory that are important theoretically, and provide acceptable academic precedents for both of these relatively recent fields of study. Industrial Organization (IO) theory (Bain, 1956; 1965) suggests that firms attempt to gain advantages by erecting barriers to reduce competition. Most entry barriers studied in the IO field result from proprietary FSAs that reduce cost or increase differentiation.

As economic activity grew in the nineteenth century, market failures were identified where the private sector was not prepared to provide long-term capital for infrastructure projects such as roads, canals and railways. The role of government was seen to promote long-term productive efficiency, because in

perfect competition, with profits tending towards zero, capital would not be provided for long-term technological and infrastructure upgrades.

In addition, the apparent inability of capitalism to promote a fair society led the government to take a role in promoting social welfare with poor laws and factory acts. In the name of social justice, government redistributed wealth. Government also became the agent of allocative efficiency, when, in the name of society as a whole, different production choices were commanded that the market would not naturally make by itself, e.g. guns over butter. In theory a government can maintain overall productive efficiency by allocating resources to guns rather than butter while remaining on the production-possibility frontier. An increasing number of products took on the form of 'collective consumption' or 'public goods'.

The development of the concept of third-party externalities and the distinction between social and private costs, developed by Marshal (1920) and Pigou (1932), led to arguments in favour of positive government interventionism of the type urged by Keynes (1936). The costs or benefits of a transaction can be incurred or received by third parties, other than the two primary parties to the transaction. Externalities cause allocative inefficiency where social costs outweigh private revenue and thus cause market failure.

Coase (1937) then added the role of transaction costs as the determinant of the organization of economic activity, which enabled systemic and structural market failures to be divided. Economic theory shows that goods with negative externalities will tend to be overproduced because the costs conferred on outsiders

are not taken into account either by producers or by consumers. Equally goods with positive externalities will be under-produced because the producer cannot exact payment for the external benefits that arise. There is a *prima facie* reason for government intervention either with rules, regulations, taxes and subsidies or in the case of negative externalities by transferable rights. The state may create property rights and then monitor and enforce them.

Rugman recognised that governments produce externalities that can give rise to firm-specific advantages. In relation to FDI, Rugman realised that while firm-specific advantages such as scale economies, managerial expertise, technological or knowledge advantages, monopoly, product differentiation, and financial strength, encourage the MNE to seek worldwide markets, “many of these firm-specific advantages arise from government controls and regulations”. Such artificial externalities can be thought of as ‘induced’ externalities, in contrast to ‘natural’ externalities such as knowledge (Rugman, 1980a, p.26). It is the process of internalization that permits the management of the MNE to overcome such induced externalities as government regulations in the product market (Rugman, 1980b, p.368).

All non-commercial, political activities create externalities (third-party effects). Many of these externalities are produced by governments (supranational, regional, national, provincial and local), but they may also be created by political parties, non-governmental organizations (NGOs) etc. All government activities create positive and negative externalities. Some of these externalities are the willed result of government plans, others are merely unintended consequences.

Firms are the recipients of many government externalities and sometimes these have a major effect on their survival, profitability and growth. Political externalities impact on firms to a different extent because each firm has a unique structure (i.e. fixed and human assets, resources and capabilities, core competences, networks, customer base, trading patterns, access to information, bounded rationality etc).

A central question for strategic management is how can the firm benefit from the positive and negative externalities (benefits and costs) generated by others, including government?

2.3.6. Internalization and Government.

The theory of internalization explains that firms develop internal markets in response to externalities. The classic externality is the failure of the market to set a price for the production and dissemination of knowledge. Any distortion in the goods or services market will encourage the development of a firm, and, across borders, an MNE. Rugman sees MNEs being created when perfect competition in international trade breaks down. When free trade is destroyed, the market is replaced by “second best solutions such as the MNE” (Rugman, 1980b).

Rugman argues that MNEs will develop in response to exogenous government-induced regulations and controls as well as to other types of market failure (Rugman, 1980b, reprinted in Rugman, 1996a, pp.12-13). In the case of

imperfections in the goods or factor markets, caused, for example, by the introduction of a government tariff, firms will act as “a substitute for free trade, in the rigorous terms of economic theory.” A country-specific advantage (CSA) which leads to trade is replaced by a firm-specific advantage (FSA) internal to the MNE, which leads to FDI.

Internalization can occur in response to any type of externality in the goods or factor markets. Imperfections in the factor markets, especially the intermediate goods market, lead to internalization and MNEs. MNEs overcome appropriability problems by assigning property rights to the hierarchy. Information becomes an intermediate product that can be used across borders. A distortion in the goods market, e.g. a tariff, will induce MNE activity and FDI (Rugman, 1980a, 1981a).

MNEs develop in response to natural market imperfections (e.g. economies of scale etc, bounded rationality and opportunism) and induced market failures including exogenous government regulations and controls. Internalization permits the MNE to use its hierarchy to overcome both natural and government-induced cross-border market failures.

Internalization of activities by firms enables them to create internal markets, protecting monopoly positions from the market and reducing transaction costs. The economic efficiency, equilibrium and Pareto optimisation concepts are all satisfied by the market imperfection concept, which does not invalidate the neo-classical paradigm.

Hymer saw MNEs as internalizers of pecuniary externalities due to

structural market imperfections (Hennart, 2001, p.131). However, as the traditional literature on externalities shows, markets are not perfectly efficient, and suffer from natural market imperfections (Dunning and Rugman, 1985). These imperfections arise because agents are 'boundedly rational' and 'opportunistic'. Economic agents do not always know prices and are not always able to measure outputs; and they cannot always trust others to be honest (Williamson, 1975, 1985; Simon, 1991). These are non-pecuniary externalities. When natural market imperfections are high, expansion across national boundaries may be a more efficient way to internalize non-pecuniary externalities, producing a positive sum game in which both producers and consumers gain. This is the argument of the transaction cost/internalization theory of the MNE (Buckley and Casson, 1976; Hennart, 1982, 1986; Rugman, 1981a) which, according to Caves (1988), is the dominant theory of international business.

In internalization theory, firms, especially MNEs, internalize transactions in order to outperform imperfections and/or inefficient markets, e.g. use their hierarchy to produce at a cost less than the market price, or in order to operate where a market simply does not exist. Alternatively, if a market exists, they can dismantle part of their hierarchies and buy from the market at market prices. In imperfect competition firms have some power over their price levels. Firms set prices according to their perceptions of the shape of demand curves for their products given perceived levels of supply. Due to bounded rationality and opportunism in imperfect, dynamic and turbulent markets, firms have opportunities to set prices above marginal cost and to appropriate consumer

surpluses by differentiating and segmenting their products.

Following Coase's (1937) explanation of why competitive markets may not always be efficient, and when firms might overcome market failure by internalization, the theory of market failure has been developed. In principle there is no reason why the transaction costs model which refers to markets and firms as institutions, and prices and hierarchies as methods, should not be extended to include government (Dunning, 1997, p.48). In the communist model the government uses its bureaucracy as its method of implementation. Coase (1937) has little to say about government but Coase (1960) analysed various ways in which the negative externalities of market transactions could be overcome by public administration. The "appropriate social arrangement for dealing with harmful effects" could be handled by markets, firms and/or government.

Wade (1990, 1996), Stiglitz (1989) and Krueger (1990) attempt to formalise the conditions under which governments might successfully intervene, either to replace, or to facilitate, particular organizational arrangements, as well as to analyse the costs of non-market failure. Some of the limitations to direct government intervention, including the bounded rationality of public decision-takers, are analysed.

Chang (1994) treats all costs of state intervention as transaction costs. He argues that such costs are justified as long as they yield net benefits exceeding those offered by the market or by market-based hierarchies. Both Chang and Dunning (1994, 1997) argue that government can help to lower the transaction and co-ordination costs of the economic system by ensuring that the activities of

private and public institutions are “suited to the needs of the day”. Chang argues that market failure does not always warrant an exit strategy. Dunning suggests that Japanese firms, rather than responding to market failure with internalization, tended to pursue a strategy of reducing the co-ordinating costs of markets by way of inter-firm co-operative alliances, with the help of Japanese government market-facilitating support (Dunning, 1997, p.49). Dunning declares that “research into ways in which governments, in their capacity of overseers of the wealth-creating activities within their jurisdiction, can help advance these by reducing the structural costs of readjustment and the *X* inefficiency of non-market organizational modes is in its infancy.”

North (1981, 1990) focuses on the increasing transaction costs in the twentieth century due to the impact of technological and organizational advances on institutional arrangements. Although computers and satellite communications have helped reduce transaction costs, as national economies have got richer so goods and services with high transaction costs have become increasingly important. North argues that the relocation of decision-making from economic to political institutions has adversely affected productivity and competitiveness (North, 1993a, 1993b), but argues that governments can play a positive role in encouraging institutions to undertake structural change in ways consistent with societal good.

Internalization theory tended to perceive government regulations and trade barriers as exogenous and to ignore the impact of government on MNEs (Buckley and Casson, 1976; Dunning, 1981, 1988; Hennart, 1982; Utton, 1986).

Rugman argued that market imperfections vary from country to country and that firms reduce risks to profits by internalizing a wide range of transactions (Rugman, 1975). The double diamond theory suggested that firms could circumvent entry barriers at a national level by expropriating and internalizing another nation's home market advantages (Rugman and D'Cruz, 1993).

This thesis does not take a judgmental attitude towards government. From a firm perspective, a democratically elected government has a perfect right to act in accordance with the wishes of the voters. Even a dictatorship, such as those in Argentina or Chile, usually establishes a legitimacy that is rarely challenged by firms as institutions. From a strategic management viewpoint the question is not whether such governments are 'good' or 'bad' but in what way does the new political situation threaten my profits and what opportunities does it present? That is not to say that the actions of government are regarded as exogenous. Every day and in many ways the agents of the firm have opportunities to influence the various levels of policy-makers and bureaucrats. In Chile the military coup d'état of General Pinochet in September 1973 changed the whole social and economic environment overnight. While there were new decrees that affected everyone, even the general curfew hours were differently implemented in different locations. Each firm had a different network of friends and contacts, and the speed at which individual firms were allowed to reopen varied considerably.

2.3.7. Firm-Specific Advantages (FSAs).

The theory of firm-specific advantages (FSAs) is firmly embedded in

current theory of the firm, which in turn has been embedded into neo-classical economics. FSAs (Rugman, 1980c, 1981a) are defined as the core skills or unique know-how of a firm. The IO-based concept of FSAs is derived from the concept of market imperfections leading to the creation of monopoly-based advantages. Cross-border trade offers MNEs greater scope for exploiting market imperfections (Helpman and Krugman, 1985).

As with other developments of the theory of the firm emanating from the IB field, FSAs have been related largely to FDI and trade theories. The importance of the choice of entry mode is linked to internalization, as a general theory of foreign direct investment, and to MNE strategic decision-making and therefore to strategic management as well.

The narrow definition of firm-specific advantage (FSA), as described by Rugman and Verbeke, is limited to endogenous, efficiency-based, proprietary, cost-reducing or differentiation-enhancing resources and capabilities. This is in line with the main endogenous thrust of the resource-based view of the firm.

The resource-based strategy model of the MNE presented by Tallman (1992) locates competitive advantage with the firm-specific resources (FSRs). Tallman tries to link levels of analysis by identifying specialised resources of two types, industry-specific and firm-specific. A 'managerial perspective' differentiates strategic plans, highly circumscribed by managerial limitations (bounded rationality), but providing motivation for actions, from structure (institutionalising these plans in the economic environment). From such a perspective, we cannot predict governance structure preferences without

understanding the MNE's strategy and knowing the characteristics of its underlying resources. The discretionary aspect of strategy is unavoidable due to the uncertain identity of FSRs and the bounded rationality of managers, which explains why MNEs in a single industry may enter the same host market using different structures, rather than responding uniformly to the same set of industry and location conditions (Ghoshal and Nohria, 1993).

A financial approach to firm-specific advantages argues that positive net present value (NPV) investment opportunities rest on firm-specific "special advantage" (Breeley and Myers, 1988). This advantage arises when a firm possesses unique specialised resources that other firms could only acquire by incurring extra costs.

The importance of information and of information technology (Cash and Konsynski, 1985; Feeny, 1987) in creating firm-specific competitive advantage deserves a special mention. Information asymmetries underlie much of the late-twentieth-century development of the theory of the firm and the MNE.

A wider definition is given by Erramilli, Agarwal, and Kim (1997). Firm-specific advantages are "interchangeably termed as monopolistic advantages, ownership advantages or competitive advantages".

Recent developments in the study of FSAs focus on their dynamic nature and considerably extend Porter's SPV static analysis and further link RBV to internalization theory. The RBV of the firm argues that firms are bundles of heterogeneous resources (Penrose, 1959). It is these resources, when combined into FSAs, that can lead to sustained superior returns and growth, to the extent

that they are indeed firm-specific (i.e. imperfectly mobile), valuable to customers, non-substitutable and difficult to imitate.

The theory of firm competences and capabilities has in part been developed to explain the ability of some MNEs to cope with uncertainties and dynamic environments (Mascarenhas, 1982; Hill and Kim, 1988; Pettigrew and Whip, 1991; Grant, 1996; Teece, Pisano and Shuen, 1997; Chandler, 1998; Winter, 2000; Eisenhardt and Martin, 2000). Winter views competences as bundles of resources but capabilities as high-level routines or collections of routines. Capabilities “confer sets of decision options upon an organisation’s management for producing significant outputs of a particular type” (Winter, 2000). This definition of capabilities implies intangible complex sets of routines and processes, not merely combinations of resources.

In practice, various resources must indeed be bundled in order to achieve competitive advantage (Barney, 1986, 1991; Foss, 1997). Specific combinations of resources leading to competitive advantage are called capabilities or ‘competences’ in the strategic management literature (Winter, 2000), and firm-specific advantages (FSAs) in the International Business (IB) literature.

Dynamic resource capabilities or FSAs are instrumental to competitive advantage and explain why the final products of some firms are more attractive to consumers than others, enabling those firms to outperform their rivals. Such dynamic competencies focus on the underlying heterogeneity of each unique firm.

Dynamic capabilities applied to learning emphasise the possibility of managerial control and the ability of some firms to outperform others over time.

In the case of geographically diversified MNEs, such as Coats, this may help to explain the limits of head office control (and perhaps the limited success of company mergers in general). The intangible capabilities, and therefore potential decision options, cannot be quickly understood by head office managers and directors, who have no previous knowledge of the subsidiary or host country.

The dynamic capabilities approach is an important development in the explanation of firm-specific advantages (FSAs). An important feature of FSAs is that they can be location-bound, i.e. only leading to superior performance in a narrow geographic space, or they can be internationally transferable, that is easily diffused to other affiliates abroad. As most MNE managers know, one of the great challenges in international business is not to underestimate the difficulties of transferring success from one country to another.

2.3.8. Political Advantage as a Firm-Specific Advantage.

If it is accepted that government can directly influence the international competitiveness of firms, the question arises whether firms can develop FSAs in government relations (Boddewyn, 1988). Here the recent literature on joint ventures and co-operative advantage between firms is most useful and needs to be extended to government/firm relationships (Killing, 1983; Beamish, 1985, 1994; Kogut, 1988; Contractor and Lorange, 1988; Schann, 1988; Hamel, Doz and Prahalad, 1989; Asanuma, 1989; Borys and Jemison, 1989; Geringer and Herbert, 1989, 1991; Badaracco, 1991; Lyons, 1991; Pucik, 1991; Lorange and Roos,

1992; Lorange, Roos and Bronn, 1992; Bronder and Pritzl, 1992; Lei and Slocum, 1992; Lei, 1993; Lyles, 1993; Geringer and Frayne, 1993; Murray and Mahon, 1993; Simonin and Helleloid, 1993; Faulkner, 1993, 1995; Glaister and Buckley, 1994; Gulati, Khunna and Nohria, 1994; Kanter, 1994; Scheffer, 1994; Madhok, 1995; Gerlach, 1995; Simonin, 1997; Faulkner and McGee, 1997; Child and Faulkner, 1998; Dyer and Singh, 1998).

It can be argued that a resource-based perspective implies a long-run approach rather than an issue-by-issue management of politically-derived opportunities and threats (Hillman and Hitt, 1999). Here, the geographic variation and the complexity of government/firm interactions should be recognised (Hillman and Keim, 1995). Government regulation in advanced democratic systems, characterised by the rule of law, cannot be simply endogenized, in the sense of gaining privileged firm-level control over the process of government policy formulation and implementation, thereby setting up entry barriers against foreign (or even domestic) rivals. In lesser developed countries endogenization of government policies and activities is often simpler but increasingly involves global legal and ethical perspectives.

In the quest for isolating mechanisms, it is the impact on profitability and growth that counts for managers, not the perceived macro-level significance of the efficiency-based versus shelter-based market position gained by the firm vis-à-vis rivals. In other words, firms will choose a particular political strategy, building upon a set of idiosyncratic resources that may then lead to market-enhancing or market-closing outcomes, just as is the case with conventional FSAs.

Political advantages can take many forms, including “(1) better intelligence about political actors and opportunities; (2) readier access to political opinion- and decision-makers, and (3) superior influence skills at handling the latter through various means” (Boddewyn, 1988). In this context, political advantage implies the semi-internalization of government actors: other firms cannot just purchase the same political advantage on an open market. These advantages are developed over time and are fundamentally path-dependent, i.e. resulting from prior managerial decisions to invest resources in government relations. They may include gaining proprietary control over facilitating intelligence, negotiating skills and individuals with direct access to government decision-makers, e.g. through hiring professional lobbyists as employees. They may also include resource allocations directly geared towards obtaining beneficial government policy outcomes through creating linkages with the decision-makers in government themselves, both via generally accepted means (such as political campaign funding) and via means viewed as illegitimate in countries such as the United States and E.U. member states, e.g. bribes (Verbeke and Bowen, 2002).

Recently and most importantly Dr. Witold Henisz (Henisz, 2003) has argued that a firm-level “ability to manage institutional idiosyncrasies” should form an extension to Buckley and Casson’s drivers of internationalisation and of the internalization of cross-border activity (Buckley and Casson, 1976). The empirical background to the Henisz study is the market for power generation, where he identifies the MNE skill of “effective cooperation with host governments” as a possible advantage over domestic competitors, in industries

characterized by substantial government involvement.

2.3.9. Efficiency and the Firm.

Efficiency has many meanings in economic theory (Chrystal and Lipsey, 1997, pp.279-288). To the firm however efficiency means improving the output to input ratios (Caves, 1992). Both inputs and outputs are measured by the firm in units and money. Ratios of costs to sales are the most common ratios by which firms are managed and strategies planned. Lowest cost required to obtain the required quality has been a fundamental management mantra and is one of the most basic strategic objectives (Ghoshal, 1987).

Diversified firms, domestic or MNEs, are collections of profit centres. Each has a unique value chain and each is ultimately measured on its ability to add value to its inputs. Its ability to produce superior returns is a reflection of the resources, capabilities and dynamic competencies that enable it either to reduce cost or to earn sustained high prices from its consumers. The ability to earn sustained superior returns is a measure of the firm's ability to reach levels of superior efficiency, that is, sustained superior added value.

Transaction cost and internalization theory leads to the conclusion that firms choose to use the market price mechanism or their own internal hierarchy based on a decision as to which bears the lower transaction costs. Transaction cost theory focuses on the problems of organizing interdependencies between individuals. These individuals can generate rents by pooling together different or

similar capabilities. Transaction cost theory argues that firms arise when they are the most efficient institution to organize these interdependencies.

Since markets are naturally imperfect due to various reasons, including economies of scale, bounded rationality and opportunism, firms can often outperform an inefficient market. Firms are created, survive and grow if they can develop competences (FSAs) that enable them to sustain superior returns. Whatever other objectives arise from time to time which may have nothing to do with seeking superior added value, in the long run, large firms, with many shareholders, that fail to create added value, will go out of business. Eventually the alternative opportunities for capital to earn higher returns will starve the business of funds to grow and to survive. The link between theories of internalization and Porter's development of competition theory is the resource-based theory of the firm and FSAs.

Managers take strategic decisions to internalize transactions in order to outperform the imperfections and inefficiencies of the market. They try to make efficiency improvements in firm supply and value chains so as to deliver better value to consumers. Firms also try to develop firm-specific advantages (FSAs) that enable them to better satisfy dynamic customer expectations and to outperform competitors. But because of imperfect information and bounded rationality, managers often fail to increase added value.

Many factors are beyond the control of managers. Some of these are internal where again inadequate information and skills, and bounded rationality, often lead to less than optimal efficiency decisions. Given complexity, lack of

transparency, information inefficiencies and bounded rationality, there is a high possibility that the opportunities and threats that firms think they perceive do not in fact exist, or that, even if they do, the firms will fail to appropriate superior returns from the reactive and proactive strategies that they choose.

Market inefficiencies provide two generic types of strategic opportunities. Firstly, firms can attempt to be more efficient than the market by reaching higher levels of productive efficiency through higher factor productivity (Flanders, 1964; Grant, 1986). This reduces total and average cost curves and permits superior returns to be earned if prices are not reduced, or not reduced by the same amount.

Secondly, firms can pursue non-efficiency strategies that enhance market inefficiencies, reduce consumer choice by reducing supply, and thus increase their pricing power over their consumers. Both these generic strategies are illustrated in later chapters.

Government is a third institution constantly involved in the quest for productive efficiency. Government often intervenes in the market, or regulates hierarchies, in a quest for increased productive or allocative efficiency. Governments affect the market and the firm, directly and indirectly. Their actions alter the productive efficiency of markets and firms by altering costs and prices, thus affecting supply and demand costs. Some of these actions increase firm costs, thus reducing short-term, and possibly longer-term, firm-specific productive efficiency. Firms are aware of government actions that impact on them directly and can sometimes spot opportunities and threats and take appropriate, reactive, profit-seeking action.

Government demand management is a dynamic variable in the life of all companies. When government actions lead to an expansion of demand, scale efficiency can be achieved by firms and vice versa. Governments directly and indirectly control the expenditure of approximately fifty per cent of total expenditure in most developed countries (Hamalainen, 1993). Government purchasers are major buyers and consumers. Many firms can gain profitability and growth exclusively by selling to governments. As with any other buyers and suppliers, firm strategies emerge reactively and proactively towards purchases from, and sales to, all the different levels of government. The debate about how far governments should be involved in the direct production of goods and services is not relevant to this thesis (Boyer and Drache, 1996; Brodie, 1996).

Government policies, and the implementation of those policies, produce positive and negative externalities that impact on the unique value chain of each profit centre in different ways. These government-derived externalities affect costs and prices advantageously or disadvantageously. Firms can develop dynamic competencies (FSAs) that enable them, reactively or proactively, to secure maximum benefit from the former, and to minimise the effects of the latter.

FSAs lead to a cost advantage or a differentiation advantage in the market place vis-à-vis rivals, and potential rivals. Some FSAs will be location-bound, i.e. limited to one unique value chain. Others will be transferable to other profit centres in the same country or abroad. FSAs are the competences of the firm. The firm will appropriate advantage from external and internal sources. By internalizing resources and capabilities to form competences the successful firm

achieves superior added value.

Most strategic management literature refers to efficiency. Porter sees productivity as underpinning economic prosperity. Productivity is the “prime determinant of a nation’s long-run standard of living, for it is the root cause of national per capita income” (Porter, 1990, p.6.). He suggests that economies of scale and other market imperfections and technology differences are sufficient to explain differential industry- and nation-level competitive advantage. Differential labour productivity among nations in producing particular goods rests on technology differences in a broad sense. “According to these theories {‘technology gap’ theories} nations will export in industries in which their firms gain a lead (gap) in technology. Exports will then fall as technology inevitably diffuses and the gap closes” (Porter, 1990, pp.16-21). Porter answers the question of why a productivity difference emerges by reference to the home nation: “differences in national economic structure, values, cultures, institutions and histories contribute profoundly to competitive success” (Porter, 1990, p.19). Based on Vernon (1966) and the “product cycle” theory, this home-nation argument led directly to Porter’s diamond theory of national advantage. This theory has been demolished by the “double diamond” theory of Rugman et al. Rugman argues convincingly (but as yet unacknowledged by Porter) that one nation can access another’s advantages (Rugman and D’Cruz, 1993).

Industry-level productivity is a problematic concept, given the difficulty of identifying the boundaries and segments of particular industries in the fast changing business world (Grant, 1991a, chapter 8).

At firm level, in spite of his primary emphasis on strategic positioning, Porter argued that firms improve and sustain their competitive advantage by improved cost or differentiation advantages, and that “competitive advantage of either type translates into higher productivity than that of the competitors” (Porter, 1990, p.37).

MNEs have an extra incentive for internalization over domestic firms because many government regulations vary from country to country. By creating internal markets with transfer prices across borders, MNEs can try to optimize the benefits, and to reduce the costs, of government-derived advantages and disadvantages. Every firm must manage the disjointed complications of national, local, regional and supranational government legislation, regulation and relationships. The very scale of these government relationships across borders favours the MNE with sufficient accumulated resources and skills to efficiently manage the necessary, often mandatory, non-commercial political relationships with the many levels of politicians, civil servants and non-governmental organizations.

Focus on the economic efficiency aspects of MNE activities follows important elements of economic, IB and strategic management literature. The basic analytical approach adopted by Caves (1982, 1996) is to concentrate on the efficiency aspects of MNE activities in a world where, in reality, government regulations on MNEs are imposed for equity/distributional reasons. This distinction between efficiency and equity has been used by many writers on MNEs (Bauer, Pool and Dexter, 1963; Safarian, 1966, 1993; Rugman, 1980a;

Casson, 1987; Dunning, 1993; Rugman and Verbeke, 2001). Efficiency is a key element in the theoretical explanation of the existence of MNEs (Hennart, 2001). Buckley and Casson (1976), Rugman (1981a), and Hennart (1982) all consider the public policy implications of the MNE in a similar manner to Caves (1982). However Hymer (1960, 1976) as well as many political-science-based writers (Vernon, 1971; Bergsten, Horst and Moran, 1978; Gilpin, 1975; Grieco, 1982; Gilpin and Gilpin, 1987; Strange, 1988, 1997; Behrman and Grosse, 1990) concentrate on the relative power of MNEs versus the nation state rather than the efficiency aspects of MNEs (Rugman and Verbeke, 2001). The relative power of MNEs, governments and NGOs in trade and environmental issues has been analysed by Ostry (1997), Vogel (1995), Vogel and Rugman (1997), Rugman and Verbeke (1998b), Rugman, Kirton and Soloway (1999).

Efficiency strategies lead to competitive advantages that form barriers to the entry of potential competitors and lead to the chance to earn rents. Such advantages tend to be short-lived in competitive markets because they are quickly eroded by existing and/or new competitors. In addition, in developed democratic economies, abnormal profits are likely to attract countervailing duties from governments.

Rugman and Verbeke have called efficiency-based advantages 'competition-based', and non-efficiency-based advantages 'shelter-based' (Rugman and Verbeke, 1991). This thesis argues that both can be competitive advantages and firm-specific advantages since firms can obtain advantages over competitors by employing both efficiency-based and non-efficiency-based strategies.

2.3.10. Shelter.

The concept of shelter arises from the seventh of Porter's list of seven entry barriers, namely 'government policy' (Porter, 1980, p.13). Porter states that all entry barriers that he lists are competition-based except those derived from government. He suggests that government policy may have direct social benefits, for example in environmental and health regulations, but that those policies often have secondary consequences for entry which are unrecognized. Porter says, "although entry barriers change for reasons outside the firm's control, the firm's strategic decisions can have a major impact" and he cites the U.S. wine producers who in the 1960s raised economies of scale and made access to distribution channels more difficult (Porter, 1980, p.15). Similarly firms in the recreational vehicle industry raised capital cost barriers by vertical integration. As far as global industries are concerned, Porter refers briefly to protected markets (citing India, Mexico, Argentina, France and Canada) and firm protected-market strategies (Porter, 1980, pp.47-48), and again in his general attack on regulation and protection which is part of his argument in favour of effective antitrust policies and free trade (Porter, 1990, pp.664-665).

Porter lists several 'governmental impediments' to global trade that serve as entry barriers and reduce economic efficiency – tariffs and duties, quotas, preferential procurement, local content rules, preferential tax treatment, domestic laws disadvantageous to international firms (Porter, 1980, p.286). Porter recognises that such barriers will give rise to 'protected niche' strategies whereby firms seek out "countries where governmental restraints exclude competitors by

requiring a high proportion of local content in the product, high tariffs and so on." Foreshadowing the resource-based view of the firm, and capabilities as firm-specific advantages, Porter suggests that a firm relying on protected niche strategies must develop the capabilities to deal effectively with those particular national markets, and necessarily "places extreme attention on the host government in order to ensure that protection remains in force" (Porter, 1980, p.295). Such capabilities are unlikely to be developed simultaneously and to the same extent by all competing firms. Some firms will gain FSAs in this area that may give them considerable competitive advantages, including first-mover and negotiating advantages.

Rugman and Verbeke go further and argue that an entry barrier is 'competition-based' if the government creates the barrier autonomously, but 'shelter-based' if the creation of the entry barrier was "stimulated" by the "affected firm" (Rugman and Verbeke, 1992a, p.11).

According to this theory, shelter-based advantages only arise from intentional firm behaviour. They are contrasted with firm-specific advantages (FSAs) which are defined as "the core skills or unique know-how of the firm" (Rugman and Verbeke, 1992a, p.4). These FSAs are seen as the "primary" source of the entry barriers created by the internalization by the firm of market transactions (Rugman, 1980c, 1981a).

'Shelter' is the strategic use of import protection by the firm. It is argued that this can amount to a government policy of "administered protection" (Rugman and Anderson, 1987). Strategic management is defined as "all patterns

in decisions and actions aimed at improving or maintaining the firm's survival, profitability and growth" (Rugman and Verbeke, 1990a, p.8). Shelter is an example of government regulation as an entry barrier that imposes "artificial" costs on rival firms (Rugman and Verbeke, 1990a, 1990b, 1992a). Government protection, in the form of a tariff, is an example of shelter. Other examples are export subsidies and non-tariff barriers. Rugman and Verbeke argue that shelter-based entry barriers lead to a reduction in competition and are not efficiency-based. Such barriers are created when firms are able to engage in industry-wide collusion to influence government regulations (Rugman and Verbeke, 1992a, p.4). Shelter is seen as an IO-based concept, viewing competition-reducing entry barriers at industry level (Bain, 1956, 1965).

Shelter-based strategies are especially significant in the international business context, where firms located in a particular nation may convince public policy makers that protectionist measures will lead to higher economic welfare in terms of value-added creation, or to a special type of public good, in terms of domestic control over strategic sectors, technological spill-over effects, etc. This occurs even where such public goods may be non-existent or where shelter leads to a substantial reduction in consumer welfare. Such strategies may even subvert policies aimed at achieving a level playing field and fair trade, as now frequently occurs in the United States and the European Community through the abuse of countervail and anti-dumping laws (Rugman and Gestrin, 1991).

In the case of shelter-based advantages the firm enhances added value without incurring a cost, since the cost is borne by government (Rugman and

Verbeke, 1992a). It could be argued whether shelter-seeking behaviour truly constitutes a generic strategy that is fundamentally different from more conventional efficiency-driven behaviour, as it is clear that government performs a fundamental role in the context of such strategies. It could also be argued that this further reinforces the point that government should have been included as the sixth force driving industry competition in Porter's analysis and that it cannot be excluded from any holistic strategy analysis and planning framework.

Examples from the textile industry, perhaps the most protected of global industries, reinforce Salorio's argument and case studies which powerfully demonstrate that government does not always arrive at its protection policy autonomously and in a manner that would improve overall industry profitability. Often governments, knowingly or unknowingly, collude to use protection to improve the competitive position of individual firms (Salorio, 1993).

In this thesis it is argued that shelter is one example of firm non-efficiency-based, market-closing strategies which in turn are a subset of politically-derived competitive advantages (PCAs). Shelter is not just about international trade. Domestic firms and MNEs develop a wide range of shelter-based non-efficiency, market-closing strategies aimed at reducing competition. Firms operating in only one country can gain politically-derived competitive advantage from both the asymmetrical nature of government policy and the implementation of that policy. This includes a vast range of internal differences, from the more obvious, such as specific national regional development policy and local government tax breaks to attract new firms or new projects (e.g. the 2003

contest between U.S. states for the location of new Boeing manufacturing facilities), to the inefficiency of the implementation of national government policy between different locations (especially obvious in large countries such as Brazil, India or China). Shelter is not limited to MNEs and international business. Rugman's diamond (Rugman and D'Cruz, 1993), whereby firms gain advantage across national frontiers, can be applied within a nation and even within a region. However, because politically-derived advantages and disadvantages usually vary more across national borders than across local or state borders, MNEs have greater access to advantages and greater flexibility to avoid disadvantages.

Local factors such as 'old boy networks' are particularly useful to firms in firm/government relations. Many social groupings take advantage of their links to politicians and civil servants to gain non-efficiency-based competitive advantages (Benson, 1975; Child and Rodrigues, 1994).

The increase of government activities has led to new opportunities to protect and to circumvent protection (Krauss, 1978). Further, firm-specific advantages, and superior returns, can be gained by developing the resources, competences and capabilities necessary to manage shelter more effectively than competitors.

2.3.11. Public Goods.

As industrialisation increased in the nineteenth and twentieth centuries national governments increased their intervention in national economies (see

above 2.3.5). From promoting social welfare with poor laws and factory acts, many governments became involved with every aspect of economic activity. An increasing number of products came to be regarded as public goods. However a clear distinction should be drawn between the goods that governments choose to provide and those which cannot be provided by the private sector because a price cannot be assigned to them. The classic examples quoted by economists over centuries in defence of government intervention in markets are increasingly proving to be less than pure public goods. Street lighting and police forces, for example, can certainly be priced and the fact that many societies prefer that non-market institutions provide these general services, and to pay for them through taxation, does not make them pure public goods. In many cases such services are contracted out to the private sector who charge local government rather than the citizen direct. "In practice, some pure public goods do exist, but in many other cases there is a mixture of public and private characteristics" (Chrystal and Lipsey, 1997, p.292).

A key characteristic of public goods is that their consumption by one person does not prevent their consumption by someone else. Pure public goods or services are non-rivalrous i.e. they are not depleted when consumed, and non-excludable i.e. it is impossible to prevent individuals who haven't paid for them from consuming them (Goldin, 1977; Cowen, 1988).

In their pure form public goods cannot be appropriated to form firm-specific advantages (FSAs). However once pure public goods cease to be pure and become rivalrous and excludable, they become potential sources of

competitive advantage. Such public goods are often referred to as quasi-public goods. There is also the possibility that access to a public good will be restricted by a private good, such as a private car-park restricting access to a public beach (West, 2000).

Many non-rivalrous pure public goods become quasi-public once congestion occurs. Thus many motorways have become congested and no longer qualify as public goods since access to them is becoming rivalrous and exclusion is only too common. In many countries certain registration plates are only permitted on certain roads on certain days of the week. A second car with a different registration becomes a necessity for some people and businesses, and the acquisition of the right selection of numbers to permit access every day can become extremely rivalrous. Tolls and the electronic tagging of cars provide a range of pricing possibilities and controls.

Technology and human ingenuity have whittled down the list of non-excludable public goods, converting them into quasi-public goods where exclusion and measurement enable pricing. Only a few of the traditional examples passed down by generations of economists are still considered a pure public good. Pricing and charging for outdoor band concerts, television, and access to public services, such as roads, is now commonplace. As technology becomes more advanced, ways of measuring and charging become more sophisticated. Toll systems on roads in the U.S.A. can identify the vehicle and make different charges according to usage, local residence and so on. The possibility of satellite tracking and charging of each journey made by each vehicle is being discussed in

the U.K. Some examples such as band music have always been mixed examples. While the band may be able to be heard equally by those who have paid and those who have not, the shrewd band owner can offer seating, screening, food and an enhanced experience to those who do pay.

Clean air is perhaps one of the very few pure public goods left, but for example in Mexico City the cost of breathing it is reflected in the property prices of houses located above the smog. Many look forward to the day when technology enables private or public companies to provide residents with clean air at almost any price! As pressure on the environment grows congestion renders public goods scarce and no longer pure public goods. Once a good becomes rivalrous and excludable pricing can occur and the normal process of competition for scarce goods and services can begin. Firms with the appropriate resources and capabilities can convert those sources into firm-specific advantages, giving themselves a competitive advantage that is manifested as superior rents.

Information was once considered to be a pure public good (Spence, 1974; Goldin, 1977). Information shared by more than one person is not reduced. But information may have first-mover advantages that mean that its value diminishes and early access to it becomes rivalrous. Few would now disagree that tacit information can give competitive advantage (Spender, 1993). While in theory it may be non-excludable, some of the underlying assumptions of transaction cost theory, such as bounded rationality and opportunism, can lead to exclusion. Bounded rationality can lead to self-exclusion. Even first-mover advantages can

be reduced by competition where, for example, competitors can bid up the price of the information and reduce first-mover value.

The paradigm offered by transaction cost/internalization enables us to explain how firms are able to appropriate public goods and quasi-public goods, package them into complex goods and services and arrive at costs and prices that are distinct from those of competitors. In practice when internalizing and transforming public goods, quasi-public goods and private goods and services into complex final goods or services packages, firms assign a value to all the individual elements. Because of the combination with their own unique resources and capabilities, different firms will assign different values. In addition different firms, especially MNEs, will have asymmetrical access to quasi-public goods. Further bounded rationality will result in asymmetrical combinations and the creation of different firm-specific advantages with unique sets of costs and prices.

This is a simple concept if one is considering goods and services as a complex bundle of consumer perceptions and experiences. The concept of differential value is dependent not merely on the product, but on all aspects of the supplier/consumer relationship allowing for almost infinite price variations. Classical economic explanations of horizontal demand curves are distorted by the infinite variety of consumer perception. Even if they all have equal access to the beach, consumers soon form perceptions as to which areas of the beach are 'better' and are prepared to pay for them. This enables some firms to charge and to package actual pre- and post-buying experiences in a way that attracts the consumer to pay a price above marginal cost, thus providing a firm-specific

advantage measurable as superior added value. Each complex firm with its complex history and value chain is in a different actual and potential position to take advantage of sources of firm-specific advantage.

Porter only mentions public goods theory when introducing his study of clusters (Porter, 1998b, pp.218-219). He writes that clusters “make many inputs that would otherwise be costly into public or quasi-public goods.” For example the ability to recruit employees trained in local programmes eliminates the cost of internal training. Firms in clusters can often access benefits, such as specialized infrastructure or advice from experts in local institutions, at very low cost. “Indeed, the information built up in a cluster can in itself be seen as a quasi-public good. ...The public goods held in clusters may be better termed quasi-public goods, because accessing them involves some cost, although well below full cost. The analysis of public goods in economics has been limited to the pure cases of a fairly narrow range of largely governmental functions. Clusters create a far broader array of circumstances in which something approaching a public-good asset arises and include many instances in which *private* institutions and investments help create them” (Porter, 1998b, pp. 218-219).

Porter goes on to say “some public goods or quasi-public goods available in clusters are similar to conventional public goods in that they are closely linked to government and to public institutions. Public investment in specialised infrastructure, educational programs, information, trade fairs, and other forms that benefit a cluster is encouraged by the number and visibility of cluster participants and by the number of firms likely to experience spillover benefits from such

investment.” “Spillover benefits” are presumably added-value factors appropriated at less than cost. A trade fair stand, for example, that is financed by a government, can provide real value added to the participant in the form of increased sales. There is a cost involved in participating but it is far less than the cost of renting a booth outside the government-sponsored stand. The benefit may well be higher, however, because of the government’s ability to secure a better location than the individual firm. The cost is the same but it is spread over all taxpayers rather than being wholly charged to the firm.

“In addition, public or quasi-public goods at cluster locations often arise from private investments in training programs, infrastructure, quality centres and so on,” e.g. testing laboratories and trade journals. “Such private investments are common because cluster participants perceive the potential for collective benefits.” Often such investments take place via trade associations or other collective mechanisms.

The theory of asymmetrical firm appropriation relies on the concept that individuals can generate rents by pooling capabilities. Such co-operation between individuals or between firms does not automatically take place. The parties must be aware of the potential gains of co-operating and they must be able to agree a price. They must also not eat up all the potential gains in protracted bargaining. Because economic agents suffer from cognitive limitations and are boundedly rational, and because some of them are opportunistic, organizing them will incur positive information, enforcement and bargaining costs, called transaction costs (Williamson, 1975, 1985). Different costs will result from the different methods

of organization chosen, and in particular from the choice of the market or the hierarchy. "In practice, bounded rationality and opportunism make markets less than perfectly efficient" (Hennart, 2001). Economic agents are sometimes unable to define and measure property rights, to measure output, to stop cheating, or to ensure sufficient numbers of buyers and sellers. Hierarchy replaces the output constraints of the market by behaviour constraints.

From a practitioner strategic management view, the definition of goods as pure public or quasi-public can hardly be deemed to be relevant. However the ability to create firm-specific competitive advantages from government activities, incurring less than full cost because of taxpayer subsidies, makes politically-derived FSAs i.e. PCAs very attractive to firms. Firms develop unique resources and capabilities that enable them to appropriate competitive advantage from quasi-public goods and to package them into complex products and services that are uniquely valuable to the consumer.

The new emphasis on public/private partnerships invites a more productive economic discussion about the contribution of firms to welfare and of the state to efficiency-based wealth creation. Porter envisages firms working with government to increase efficiency, arguing that the firm should engage and educate individual departments or units of government on the effects of regulations and policies, and on the quality of government services (Porter, 1998b, p.258).

Porter describes this as the "corporate role" but in practice it is the MNE business units that will develop relationships with all levels of government in

thousands of different clusters across the world. It is most unlikely that a central MNE strategy will guide these relationships, in anything but the broadest of outlines.

This of course is nothing new. MNEs like Coats have been part of cluster networks for decades and even centuries. What is new is that economics-based strategic management has brought them into its theory and realised that firms need to develop strategies towards the government elements in the cluster in order to promote efficiency in government services. In a call for a new type of firm/government relationship – what Dunning terms ‘alliance capitalism’ – Porter advocates a new firm/government “open, constructive dialogue to replace self-serving lobbying or paternalism.”

2.3.12. Associated Literature.

This thesis attempts to insert government into strategic management competitive advantage theory. International business has adopted and developed transaction cost/internalization theory into a general theory of the MNE. This thesis applies this IB theory to strategic management. It applies to domestic as well as international firms and is used here not merely to underpin trade theory and FDI theory, but as a foundation, along with RBV, on which to build the strategic management concept of politically-derived competitive advantage (PCA).

A great deal of traditional trade theory literature is confined to industry or

country level. Although interesting, it is not relevant to an RBV/internalization firm-level MNE strategic management study. The problems of industry boundaries and frequent lack of relevance to firm strategy have been dealt with elsewhere.

Nothing about political boundaries is of particular importance to the firm unless the effect of government is distinctly different on one side of the border from the other. It often is different, but then it often varies from province to province, from local authority to local authority, and it is of course highly dynamic as different political regimes come and go. Some similar countries (e.g. Benelux) have governments whose activities have become so closely aligned over time that MNEs largely ignore the political boundaries, preferring instead to differentiate consumers (e.g. by language) rather than by lines on a map.

International business became interested in competitive advantage with the publication of Porter's global and country studies (Porter, 1986, 1990). Neither shed much light on MNE strategic management except to reiterate the requirement for industry-level structural studies and an SPV-based firm strategic analysis.

The lesson for MNE managers is that even in areas of public policy traditionally viewed as totally outside the realm of formal strategy analysis, because of their alleged exogenous nature, political advantage and the creation of isolating mechanisms against rivals may well be feasible. In the case of transfer prices, it could be argued that advance price fixing will not necessarily lead to an increase of MNE profitability and growth, but the elimination of uncertainty in

the context of intra-firm goods flows is a valuable contribution.

Milner argues that “the more sizeable and the more integrated a firm’s foreign direct investments are, the more likely it is to resist protection and to prefer open markets even if it is confronting intense competition from imports” (Milner, 1988, p.22). Her explanation focuses on key variables linking firms to the international economy: (1) export dependence, (2) multi-nationality. “Firms with more extensive exports and multinationality should be less likely to demand protection and more likely to resist it actively, even when facing serious export competition” (Milner, 1988, p.18). Milner supports her conclusions by looking at the costs of protection: foreign government retaliation, general economic effects, and the effects on the firm's domestic market position. In general, Milner’s argument is that internationally orientated firms should be less likely to demand and benefit from protection.

In this connection, my study of Coats, the world’s largest sewing thread producer, selling in very nearly every country in the world, reveals that attitudes to protection vary from profit centre to profit centre. Domestic and MNE subsidiaries accept exogenous government trade policy and develop capabilities/FSAs to optimize returns. Given a chance to wholly, or partially, endogenize government trade policy, they prefer to operate behind barriers that keep out direct competition from other MNEs. However in conditions of open competition, both Coats and its only global competitor Dollfus Meig Cie (DMC) were able to reach reasonably comfortable informal accommodations at subsidiary and head office levels.

Yoffie (1983) asserts that “without denying the obvious relevance of the comparative or competitive advantages of nations, we argue that, under particular conditions, firms and governments are what really matter in determining international trade” (p.1). He sets out “five empirical propositions and several hypotheses that build on the observations of our eight industry studies,” culminating in “a new framework for international trade” (pp.11-21). The “overarching theme is that the complexities of international trade and investment can only be understood by looking at the interplay of five factors: country advantages, industry structure, organizational and strategic attributes of firms, government policies, and corporate inertia.” Yoffie confirms that government is a major force acting on international trade and investment. In that sense he is also stating the need for the addition of government as a sixth force.

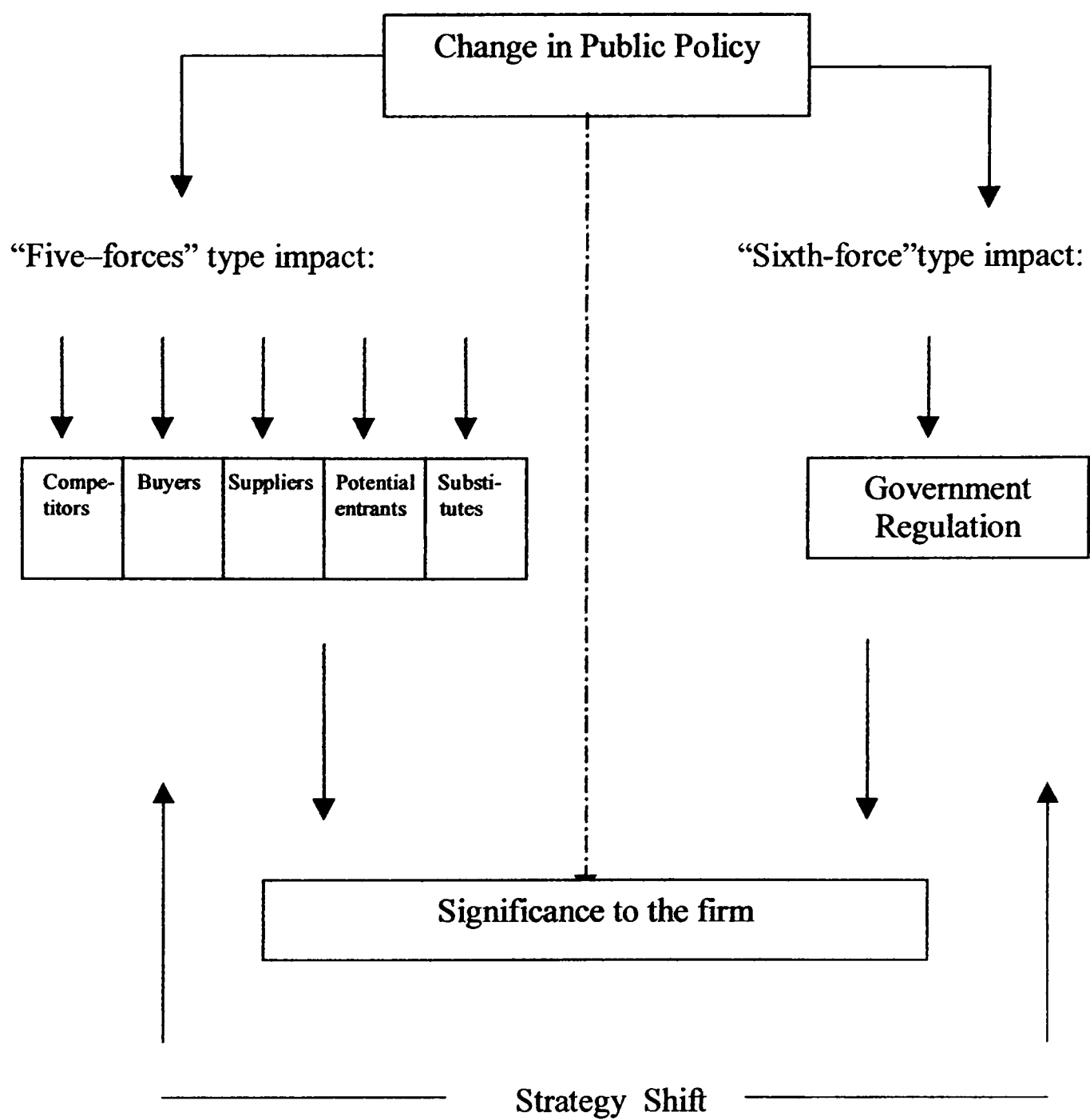
Yoffie’s framework for international trade consists of a matrix comparing industry concentration against the level of government involvement. He concludes (p.430) that “the patterns of trade and investment could be understood only by systematic analysis of all the factors in our framework, including the structure of industries, characteristics of firms, government policy, and historical inertia.” While we can agree about the complexity from a strategic management perspective, this does not seem to take us much further forward. It is also worth noting that Yoffie appears to assume that FDI and exports are synonymous with firm success, gives no clear definition of the phrase “political competition,” and barely mentions customers.

The conclusion drawn here is that Yoffie (1983, 1993, 1998), like Porter, searches for patterns at country or industry levels and finds them. Yet this is not a robust approach to government/firm relations compared to a microeconomic RBV/internalization approach that identifies externalities emanating from government activities and analyses their impact upon firm value chains.

Political economy and political science literature is often concerned with the power of the MNE versus the sovereignty of the state (Vernon, 1966, 1971, 1977, 1998; Brown, 1976; Krauss, 1978) and confirms the importance of firm/government relationships. Some of the relationships between political perspectives and IB are explored in the five papers that make up chapter five of Toyne and Nigh (1997). None of these focus on the principal theme of this thesis i.e. the impact of government activities upon firm value chains and politically-derived competitive advantages.

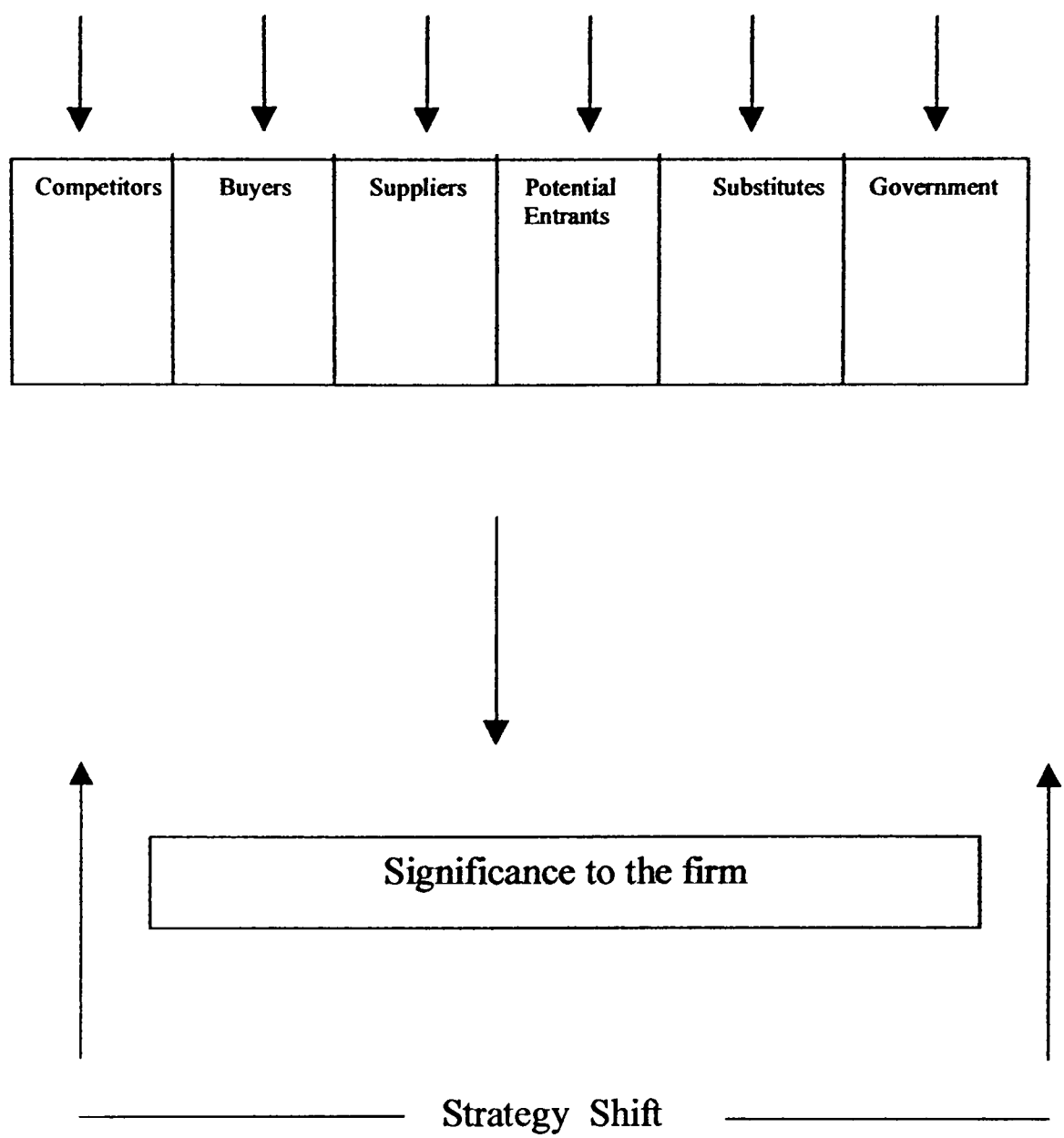
Boddewyn (1986, 1988) demonstrated the strong interaction between MNEs and governments. Building on Porter's (1980) framework he shows that MNEs can pursue political strategies that he referred to as the "fourth generic". Boddewyn's study of the political dimension of business was based on his 1960s studies of the Washington State wine industry, which showed that a few small local wineries were dominating the local state wine market by political rather than economic means. They were able to enlist political support to ensure that out-of-state wine was high-priced, had limited distribution, was sold only in larger bottles and was not advertised. Political theorists however have not gone on to examine the government as a source of firm-specific competitive advantage.

Figure 2.1. The Impact of Changes in Public Policy on Corporate Strategy.



Source: Rugman and Verbeke, 2000

Figure 2.2. The Six Forces Model.



Chapter 3.
The Textile Industry and Government.

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Chapter 3. The Textile Industry and Government

3.1. Introduction.

The first proposition of this thesis is that government has played and is continuing to play a decisive role in the development and structure of the global textile industry. Accurate measurement of the effect of government on specific industries does not exist and there is no widely accepted methodology model or methodology for analysis. It would, however, seem a reasonable hypothesis to argue that government actions that affect the costs and/or sales of specific industry groups will affect the structure and development of those specific industry groups. Without specific measurement the definition of 'decisive' is more difficult to assess but this chapter sets out to present sufficient desk research and anecdotal evidence to convince peer academics that the effect of government, principally national and supranational governments, on the past and present structure and development of the global textile industry can indeed be considered 'decisive'.

The textile industry is an ideal subject for this thesis since governments have regarded it as a legitimate target for intervention because textiles, in one form or another, have become an almost universal necessity for human beings and, as a result of almost universal consumer demand, have inevitably developed into a large industry employing a considerable percentage of the world's workforce. Governments have therefore regarded the textile industry as an important element in social stability, as a source of revenue and, since the dawn of industrialisation, as a key industry in the almost universal search for economic

growth and development.

The textile industry is difficult to define due to its size and complexity. The link that holds the industry together is the processing of animal, plant and man-made fibres. It can be argued that the textile industry includes several industries, while vital parts of its value chain lie outside the traditional definition of the industry and must be encompassed by a wider term – the ‘textile complex’ (Dickerson, 1995). The textile complex is involved in the production of natural and man-made fibres, their conversion into clothing (apparel), home furnishings and industrial goods, and their sale to end users. Animal and plant fibres plus the well-known man-made fibres - rayon, nylon and polyester - are no longer sufficient however and complex blends and recent developments in ‘fibre to fabric’ technology demand the re-classification of the textile industry into new groupings. Textile products are now made out of at least 68 natural and synthetic raw materials (*Technical Textiles*, various recent issues). Further developments in chemicals, bio-chemicals and genetic engineering techniques will soon render the present industries classification obsolete. Genetically modified crops will make it impossible to draw the line between natural and man-made fibres. These technical applications are estimated to account for 30% of textile fibre consumption in the U.S.A. and to be growing at 7% - 10% per year (*Technical Textile Markets Quarterly*, various issues).

The North American Industry Classification System (NAICS) tries to capture the process flow from the preparation and spinning of the fibre through weaving or knitting to the finishing of ‘the textile’. This approach is no longer

coherent. Finishing includes both fibre finishing and fabric finishing. Processes which include both fibre preparation and fibre finishing together, such as “texturizing, throwing, twisting and winding”, are classified under the preparation of fibres rather than with fibre finishing. Non-woven fabrics include synthetic fibres moulded into fibre-glass substitutes, e.g. for cars and houses, without any recognisable ‘textile’ processing.

An alternative classification, by sales and retailing outlet, is even more complex and perhaps outdated already as internet sales shift power from the retailer to the consumer (Cash and Konsynski, 1985; Secretariat of the International Textiles and Clothing Bureau, 1988; Coker, 1995, 1997). The U.S. Census Bureau, which publishes NAICS, is wrestling with a ‘Product Classification System’. The problems of classifying textiles by sales become immediately apparent when one considers the areas in which technical textiles are producing spin-off technologies. Textile firms are heavily involved in the development of areas which do not fall within traditional textiles, such as: static and dust free environments; flame retardants; moisture absorbents; acid, ballistic, radiation, infra-red, sound, bacteria, heat and water resistant materials; adhesives; biodegradable materials; buoyancy; deodorizing; electrical and electronic conductivity; industrial fasteners; flooring; geosynthetics and geotextiles; insulation; luminance; non-allergenic materials; orthopaedics; prosthetics; packaging; papermaking; reflective and refractive materials; self-lubrication; sportswear; shoes; surgical and healthcare materials.

In almost every case employment is the single biggest reason why

governments have been, and in many cases still are, so heavily involved in the textile industry. Nearly all national governments perceive that they have a duty to provide high levels of employment. The reasons for this concern over the level of employment range from an individual citizen's "right to work", via the vital role of employment in economic growth and development at individual, local, national, regional and supranational levels, to the threat that unemployment offers to all types of governments and political institutions. Even if a limited definition of the textile industry is accepted, the researcher faces a major problem analysing the textile statistics, which are available in abundance but not always reliable (Steele, 1990; Coker, 1995; Dickerson, 1995; Jackson, 1997). It is certain, however, that the textile complex is the largest source of employment in the world. It provides employment for over 10% of the world's manufacturing labour force, a total of over 200 million people (International Labor Office, World Employment Report - various years). If a wider definition of the textile complex is used, including estimates of fibre producers, outworkers and non-recorded labour, the employment figure increases towards 20% (Guobiao, 1993; Sengupta, 1992; COMITEXTIL, 1990, 1992, 1993; MacMurray and Woetzel, 1994; Graham and Kilduff, 1994; Khanna, 1996; Chen and Jackson, 1996; Leung, various years).

The clothing or apparel industry is particularly important for employment because automation is difficult and costly due to the three-dimensional and irregular nature of the human body. As a result it is labour-intensive and requires a high proportion of unskilled and semi-skilled workers. Since many of the manual processes in the clothing industry can be carried out in the home and fitted

around domestic tasks, official employment statistics are unreliable and the importance of the industry to household incomes and culture, and especially to women, goes largely unrecorded (Harte and Ponting, 1973; Wade, 1990).

Over the course of economic history, governments have been continuously concerned with economic growth and development and the textile industry has played a major role in economic development (Fisher, 1992; GATT, 1984; Maizels, 1963; Toyne et al, 1984; U.S. Congress OTA, 1987; Tussie, 1987; Mitchel, 1988; Lucke, 1990; Wade, 1990; USITC, 1991, 1995a, 1995b, 1997; Fortin, 1994).

The history of industrialisation in the developed countries shows the importance of the textile industry, not only in clothing and employment, but also in its substantial effects upon the agriculture and chemical industries, and upon trade patterns (Power and Postan, 1933; Mackie, 1952; Robson, 1957; Deane and Cole, 1962; Akamatsu, 1962; Richardson, 1968; Coleman, volume 3, 1969; Reader, 1970; Briscoe, 1971; Addy, 1976; Salway, 1981; Toyne et al, 1984; Leiter et al, 1991; Fritze, 1995; Brown, 1995; Dickerson, 1995, 1999; Finnie, 1998; Davies, 1999; Owen, 1999; Moore, 1999; Sawyer, 2001).

National governments have also had an almost continuous preoccupation with international trade and their individual balances of trade and of payments. The sheer size of world trade in textiles and clothing, amounting to USD332bn in 1997, i.e. 6.2% of world merchandise trade or 8.5% of world exports in manufactures (Anson and Simpson, 1999) means that the textile industry is often an important concern in the development of government policies toward trade and

exports. Consumption of textiles is growing rapidly and world fibre production has risen from 30 million tons in 1980 to nearly 50 million tons in 1997. World consumption of textile fibres rose from 6.8 kilos per head per annum in 1980 to 7.5 kilos per head in 1995. In these terms the importance of the U.S.A. in world trade is immediately obvious since textile consumption per head in the U.S.A. now exceeds 29 kilos (Coker, 1997).

Since global textiles play such an important economic role it follows that any government actions that impact critically upon the industry are likely to have a significant impact on the world economy. The remainder of this chapter is dedicated to demonstrating that governments have had, and continue to have, a major impact on the textile industry and that any comprehensive analysis of industry profitability should therefore regard government action as a key variable.

3.2. Government and the United Kingdom Textile Industry before 1945.

In the United Kingdom (U.K.) the textile complex has been central to the interests of government as the principal source of tax revenue, exports and employment for well over a thousand years. Government has been involved in shaping most of the major developments in the U.K.'s textile industry, which, in turn, often had repercussions for the structure of the textile industry throughout the world.

Since the Romans placed purchasing orders for mass-produced military uniforms, the textile industry has played an important role in defence and employment, both of them key areas of interest for citizens and governments alike.

The medieval and Tudor monarchs dominated every aspect of the textile trade: manufacture, selling, prices, employment, transport, exports and taxation were in the hands of the monarchy or its representatives (Power and Postan, 1933; Lipson, 1946, 1953; Mackie, 1952; Fritze, 1995; Butt, 1989; Davies, 1999).

Following the Norman Conquest of 1066 there was a great expansion of English trade with France, based largely on English woollen exports via the wool 'staple' in Calais. For centuries woollen fleeces represented two-thirds of English exports. The wool trade was so important to England that in 1328 Edward III was married to Philippa d'Hainault in order to cement the political and trading relations between England and Flanders. Every aspect of the wool trade was controlled by some level of government (Davies, 1999, pp.409-410). In a quest for higher added value, and in a typical economic development pattern, England

moved from the export of wool fleeces to the processing of the fleeces and the manufacture of clothing.

Edward III led the move towards higher value-added wealth creation by import substitution. With the help of his Queen, Flemish weavers were settled in London and Norwich, and strict controls were imposed on wool exports, with the reintroduction of the Ordinance of the Staple of 1313. Staples were trading centres and royal monopolies. The Statute of Staple 1354 fixed the main wool staple at Calais. Norman Davies (1999) sets out the accounts of a shipment of wool from Hull to Dordrecht in 1337. The wool was purchased at 3s 10d per sack; all the transport and port dues totalled 34s 4½d of which the customs duties, paid to the royal custom at Hull, amounted to 26s 8d. The cost per sack, after damaged sacks were discounted, was £3 11s 11¼d, eighteen times the cost of the wool.

So complete was the change to import substitution that the Crown eventually forbade the export of fleece altogether, and it remained illegal until 1824. Edward IV in 1464 banned the import of foreign cloth and in 1467 prohibited the export of 'unfulled' cloth. Export was almost entirely of undyed cloth. Weekly markets flourished around England, all licensed and taxed by government.

Under Henry VIII (1509-1547) the export figures continued to rise to over 120,000 cloths. Manufacture and trade in the towns was supervised by craft guilds who controlled every aspect of the textile manufacturing in the towns in the name of, and taxed by, the monarch. Gradually most of the craft guilds were taken over by wealthy manufacturers and traders and became capitalist societies excluding

craftsmen. The new industrialists moved out of the towns to the waterpower in the countryside and established new towns and villages free from guild and municipal regulations and taxes. The monarchy and its supporters now saw opportunities for centralising their authority through justices of the peace in the counties and thus escaping from the interference of parliament and the strong guilds.

The migration of woollen manufacture to the countryside threatened the established order of Tudor society. The guilds were powerful and paternalistic. The idea that one man should follow one trade was believed to ensure full employment and to protect the consumer from overpricing. Tudor government attempted to ensure that both the King and the King's subjects maintained their appointed places in society by upholding the authority of the towns and town-based guilds.

As the power of the towns and guilds declined, the power to fix detailed prices gradually passed to central government. Prices could be raised or lowered by the Lord Chancellor. An act of 1512 prohibited the import of foreign wool caps and contained a full statement of all the qualities of English caps and the prices to be paid for them. A cap of the finest 'Cotswold' was to be marked 'C' and to cost 2s. Acts of 1512, 1515 and 1532 go into great detail about cloth qualities and prices (Mackie, 1952, p.467).

Central government took over the role of controlling the highly regulated Tudor textile market and its underlying paternalistic aims of maintaining full employment and protecting the consumer. In the process it gained direct and increased power over taxation. However central government was unable to

supervise all aspects and details of trade in the way that the town guilds had done and, by default, freer trade and capitalism triumphed over the guild oligarchies and the King. Government policy was to centralise authority but it was incapable of implementing this policy.

While the advance of English mercantilism and the rise of the ‘merchant adventurers’ partly reflected the inability of central government to control textile trade, central government had more success in controlling the transport and export of wool, and in ensuring that all staple goods were exported through approved channels, paying the appropriate customs duties. After 1370, all woollen exports had to go through Calais, which was the only staple town. The Merchant Staplers were, in effect, a public corporation containing all those merchants of the realm engaged in foreign trade (Lipson, 1946, p.573). Foreign textile trade, like home textile trade, was liberated by default rather than design. The fall of the Merchant Staplers and the Calais garrison was mainly due, not to loss of control, but to the decline in the export of wool fleeces. Power passed into the hands of the cloth makers and traders, the ‘Merchant Adventurers’, a loosely regulated group of merchants who had depots in various ports at home and abroad. The London Merchant Adventurers received a charter in 1505, with a governor based in Antwerp. The Adventurers tried to absorb the Staplers and disregarded a Star Chamber pronouncement that they should mutually respect each other’s rights. The Staplers declined and the Merchant Adventurers went on to challenge the Hansa League and to establish English and British (after 1709) trading supremacy across the world.

In the eighteenth and nineteenth centuries, the British textile industry was virtually left alone by government. It was very successful and by far the biggest contributor to taxes and to exports (Rose, 1996; Toms, 1998). Eventually led by 'the Manchester School', it was in the forefront of the movement for unfettered capitalism and free trade. By 1830 half of British exports were supplied by the cotton industry, and a further 25% by wool (12.7%), linen (5%) and other textile products. By 1850, 80% of all British cotton textile products were exported (Deane and Cole, 1962, pp.30-31).

By 1870 the chemicals required for the dyeing and bleaching of textiles, mainly alkalis and acids, had played a direct part in the expansion of the new chemical industry in Britain. Britain accounted for nearly half of the world's production of sulphuric acid, compared to 14% in U.S.A. and 9% in Germany (Richardson, 1968). William Perkin invented synthetic dyes in 1856 in London, but the Germans were involved from the beginning and their advanced science education produced a rash of new dyestuffs companies. Hoechst (1863), Bayer (1864), BASF (1865) and AGFA (1873), accompanied by Ciba, Geigy and Sandoz in Switzerland, went on to become the leading European chemical companies in the twentieth century. Basle became the centre of dyestuffs production. The alkali producers in Britain were wedded to the Leblanc process of producing soda ash, and 48 alkali producers formed the United Alkali Company in 1890, but they were unable to keep pace with the German and Swiss chemists and companies. The British textile industry was committed to free trade and saw no reason to try to buy British. Although Owens College in Manchester had

chemistry professors trained in Heidelberg, neither the textile industry nor the U.K. government were prepared to invest in science education in Britain to match Heidelberg, or the other great science and technology universities in Germany.

The growing political tensions between Britain and Germany in the late nineteenth century brought government back into the textile industry and the new explosives industry that had become critical to defence policy (Richardson, 1968; Reader, 1970; Briscoe, 1971; Brown, 1995). Government forced the textile industry, with government finance, to set up British Dyes, with the aim of merging and rationalising the existing dyestuffs manufacturers, and organizing joint research. Even then, Levenstein, the most technically competent U.K. dyestuffs producer, refused to co-operate. The claim that only when the import of dyes was disrupted by war did the British government intervene in textiles, “if only to see that soldiers got uniforms of the proper colour” (Reader, 1970, p.266), ignores the fact that the chemical and explosives industry was still largely part of the textile industry.

Competition from Japan and the U.S.A. had already made a considerable impact on Britain’s first mover advantages in textiles in the second half of the nineteenth century. By the late 1870s the percentage of U.K. textiles exported had dropped from 80% to just over 50% and by 1913 it had fallen to 35%, although the actual volume of exports had increased. ‘Free Trade’ was still the battle cry of the ‘Manchester School’, but they faced protected markets around the world.

Japan had nearly equalled Britain’s exports of cotton yarn by 1913. India almost replaced Britain’s virtual monopoly of the U.S. jute market between 1897

and 1913. In 1913 Germany was the second largest exporter of cotton textiles but only had 10% of world trade compared to Britain's 55% (Brown, 1995). In 1913 the cotton textile industry by itself was the largest manufacturing industry in the U.K. and accounted for 25% of British exports.

Trade protection by foreign governments, in the form of the introduction of import tariffs in the U.S.A. and in continental Europe, forced the U.K. industry to concentrate on exports to India and China. By 1913 India was taking 45% of Britain's cloth exports. In 1913 Britain still supplied over 40% of world trade in textiles and clothing. Raw materials for the textile industry accounted for 16% of British retained imports. Britain bought almost one third of the world's raw cotton and wool (Briscoe, 1971, p.77).

In 1914 politics and war disrupted British textile exports. Shipping duties were imposed and exports controlled by the government. In 1915 duties were imposed on British imports as a temporary measure designed to save shipping space for war priority imported goods. Exporting became hazardous and British companies, like J&P Coats, responded by undertaking foreign direct investment (FDI). The driving force of FDI was the difficulty of servicing overseas customers from Britain. Political externalities increased transaction costs and uncertainty and led directly to MNE internalization in the form of foreign sales offices, warehouses and manufacturing subsidiaries.

It is important to remember that J&P Coats had already developed a trading network in the major South American countries in the nineteenth century and had set up its first South American local subsidiary, La Plata Hilos, in

Argentina in March 1900. Economic development led to growing demand for industrial thread in the developing countries and this required technical service. The experience of the First World War and the threat of a European war in the 1930s were important contributory factors in the establishment and expansion of production facilities across the world. Importantly, the balance of competitive advantage shifted from production in the U.K. to production in host countries. This was due both to the actual costs and difficulties of shipping, and to the increased thread service needs in developing countries as a result of the boost that wartime disruption had given to developing countries. Politically-derived advantages and disadvantages raised distribution costs and risks and thus boosted economic development and location advantages abroad.

The U.K. textile industry came through the First World War (1914-1918) in good condition and to some extent the discovery of new synthetic fibre technologies shifted competitive advantage back to the U.K. (In 1904 Courtaulds, founded in 1849 as a weaving company, secured the rights to manufacture viscose rayon.) The 1915 import duties were temporary measures and post-war optimism that profits would continue and increase led to a wave of financial speculation. Some mills took out large bank overdrafts, others were bought by speculators who thought that they would be able to float on the stock exchange at higher prices. The downturn in trade that began in 1920 took the industry by surprise. Falling commodity prices had reduced the purchasing power of primary producer countries that had taken the bulk of British exports. Import substitution during the war led to calls for protection around the world, especially by the Indian mill

owners, and an 11% tariff on cotton imports was imposed in 1921.

The link between textiles, chemicals and defence dominated government intervention in the textile industry in the early post-war years and accounted for the shift in power from the textile industry to its new offshoot, the chemical industry. This largely non-commercial, politically driven power shift was to have profound effects on the textile industry throughout the twentieth century.

Because of the importance of explosives, government retained a minority interest and voting control in the new British Dyestuffs Corporation, and the import of dyestuffs was prohibited except under licence in 1920 (Reader, 1970, p.425). The British government's determination that the British chemical industry should be able to compete with the German chemical industry led in 1921 to the Safeguarding of Industries Act, which placed a 33.3% duty on products regarded as key and strategic. Brunner Mond, the British company founded in 1872 by the talented émigré German chemist Ludwig Mond, was encouraged to acquire a plant that the government had built at Billingham during the war for research into the production of synthetic ammonia to replace imports of Chilean nitrates, one of the principal ingredients of explosives. While this was a big step forward for the British chemical industry, the textile industry had to buy from the badly organised British Dyestuffs Corporation (BDC), now fast expanding behind a tariff wall.

The German dyestuffs companies came together in a giant merger to form IG Farbenindustrie in 1925. In January 1926 Reginald McKenna, Chairman of the Midland Bank, who had helped to refinance BDC, suggested to Harry McGowan, Chairman of Nobel Explosives, that they should take over BDC. McGowan's first

reaction was that dyestuffs were not his “line of country” (Reader, 1970, p.452), in spite of the shareholding in BDC, but he proposed a four-way merger between BDC, Nobel Explosives, Brunner Mond and the United Africa Company, to produce a ‘British IG’. Ludwig Mond’s son, Alfred Mond, who became Lord Melchett, conceived the idea of an international alliance between IG Farben, BDC, Solvay in Belgium and Allied Chemicals in U.S.A., but McGowan and the British government were worried about the independence of the British chemical industry, and when Allied Chemicals rejected the idea, the two men and their advisers agreed on the formation of Imperial Chemical Industries (ICI). Merger terms were agreed in October 1926 and on 1 January 1927, ICI started up with Mond as Chairman and McGowan as his deputy (Reader, 1970, chapter 19).

As the economic position and unemployment worsened, government became more and more involved. In 1925 the Safeguarding of Industries Act was extended and now covered even such items as lace and gloves. Duties were also placed on silk imports although these were reduced in 1934 under trade agreements with France. Competition grew and the well-organised Japanese trading houses fully exploited the pre-war development of the Japanese textile industry. By the mid-1930s Japan had taken over from Britain as the world’s leading exporter of cotton textiles. Japan’s colonial expansion led to the establishment of cotton mills in China (Duus, 1989) and, perhaps surprisingly, post Second World War Japan's textile FDI in China has been the most successful of all nations'.

The trade depressions of the 1920s and 1930s led to greater horizontal

integration and the formation in 1929 of the two great spinning combines – Lancashire Cotton Corporation (LCC) and Combined English Mills. LCC absorbed 96 firms representing about 20% of total cotton spinning capacity. The rationalisation was financed by the government and LCC alone scrapped 20,000 looms. Montague Norman, Governor of the Bank of England, took the initiative in the LCC venture and in capacity reduction, partly because he was worried about the loans that banks had made to the industry immediately after the war (Garside and Greaves, 1996). Frank Platt, LCC's managing director after 1932, was an enthusiastic reorganiser and helped to promote the Cotton Spinning Industry Act of 1936, which aimed to finance industry-wide scrapping schemes by a levy on all manufacturers.

The British policy of free trade was finally jettisoned in the name of job protection and Empire and Commonwealth preference. In 1932 10% duties were imposed on all commodities not covered by previous acts, although exceptions were made for Commonwealth countries. In 1934 Britain imposed quotas on imports of foreign textiles into British colonies (Robson, 1957, p.265). The industry largely abandoned its attachment to free trade and welcomed protection.

1934 can be considered a turning point in the history of U.K. textiles. It is at this point that the real choice was made between free trade and protection. The formation of LCC is the point at which the U.K. textile industry, with government finance, chose economies of scale through volume rather than the development of niche markets with high added value. It is also the birth of a peacetime government/textile industry partnership, led at this time by the Bank of England,

which forced a so-called modernisation on an industry, instead of a market-driven regeneration after the depression. The German government, in no position to finance textile rationalisation, let market forces operate and its textile industry shrank but developed very successful niche markets which today include the export of English style wool/synthetic men's suitings to the U.S.A.

It can be argued in retrospect that the strategy of the Manchester Chamber of Commerce and the U.K. government was poorly thought through, even if protectionism was expected to be short-term. The idea that Britain could, or should, be an exporter of textiles in the long term to India or China was surely a non-starter. To succeed in the medium term this strategy needed the scale of production and organization perceived as being 'along American lines', but catering for a much smaller internal market. The independent research organization, Political and Economic Planning (PEP), published a report in 1934 calling for greater industrial co-operation and industry-wide associations to co-ordinate the activities of individual member firms (Political and Economic Planning, 1934). Interestingly PEP accepted the need for amalgamations but rejected vertical integration because it was believed that this would limit the industry's ability to produce the wide range of yarns and fabrics that the domestic and export clothing industries required. PEP also attacked the perceived separation of production from the market by the middlemen or merchants. It claimed that the interests of the manufacturer were too often sacrificed to the interests of the merchant. The stage was set for a government/textile industry partnership to 'modernize' the textile industry and attempt to return power to the

hands of the producer. In fact it became a government/chemical industry alliance and it dominated the British textile industry for over fifty years.

During World War II textiles and clothing industries were totally disrupted. The government took direct control and many textile factories were transferred to the production of munitions. Managers and employees were called up to the armed services or transferred to work in areas of higher priority. Some sectors almost disappeared such as carpets. Raw materials were allocated strictly and very detailed regulations were laid down. In clothing, regulations covered the type of clothes to be produced and the amount of cloth to be used, so as to maximize on scarce raw materials. The destruction of shipping and the shortage of ships available for lower priority goods led to reduced imports and all prices of yarn, cloth and clothes were fixed by the government according to the cost of labour, raw materials and a fixed assets depreciation allowance. Most of the clothing produced was utility quality and its purchase was rationed with coupons. With a reduction in variety, and with large orders, costs were reduced and seasonal fluctuations virtually eliminated. Regulation, price control, directed labour and rationing were the order of the day and textiles became a fundamental part of the command economy.

3.3. Government and the United Kingdom Textile Industry after 1945.

In contrast to 1918, the U.K. government in 1945 made no serious attempt to return the textile industry to market forces and continued to play a major part in the direction of the textile industry throughout the rest of the twentieth century, until the decline of the industry rendered it of little importance to government in terms of employment, exports, defence or votes.

At the end of the war the new socialist government returned the munitions factories to industry and in the late 1940s these factories reopened. Labour shortages were met by government calls for higher investment and productivity. As early as 1944, before the war in the Pacific was over, a cotton textile mission chaired by Sir Frank Platt visited the U.S.A. in order to find out what the U.S. industry was doing and to help prepare the U.K. industry for the post-war period (Platt Report, 1944). Productivity in the U.K. textile industry was close to 1910 levels whereas in the U.S.A. it had risen substantially. Measured in productivity per man hour, British productivity in 1936 ('normal pre-war staffing') was said to be inferior to American productivity by 18-49% in spinning, 80-85% in winding, 70-80% in beaming and 56-57% in weaving (Briscoe, 1971, p.130). These differences were ascribed to American investment in new machinery, with faster speeds and larger take-up packages. The Americans had longer order runs, permitting standardisation of machinery and jobs. The Platt Report concluded that the American textile industry was more efficient in every respect except the handling of raw materials.

From 1945 to 1947 the government set up a number of working parties

consisting of industry representatives and government-appointed 'independent' members. There were working parties for cotton, wool, jute, hosiery, lace, carpets, heavy clothing, light clothing and rubber proofed clothing. The terms of reference were: "to examine and enquire into the various schemes and suggestions put forward for the improvements of organisation, production and distribution methods and processes in the industry, and to report as to steps which should be adopted in the national interest to strengthen the industry and render it more stable and more capable of meeting competition in the home and foreign markets" (Briscoe, 1971, p.131).

Shortage of foreign exchange led to tight import controls, while labour shortages and the elderly composition of the work force limited production. The working parties came up with a variety of suggestions and most emphasized the need for new machinery. Some suggested co-operation to increase exports. The jute working party advocated a reduction in the number of firms but most of the working parties only advocated a reduction in the number of middlemen. Briscoe comments that their recommendations for making industries more competitive "seem weak" (Briscoe, 1971, p.132). Suggestions that development councils should be set up were accepted by the government and in 1947 under the Industrial Organization and Development Act development councils were set up for wool and clothing and the Cotton Industry Board was also renamed as one of the development councils.

Vertical integration of the U.K. textile industry was not an industry-driven agenda. The larger firms before the Second World War preferred to keep their

independence (Robson, 1957, p.125). Vertical integration only became important in the post-war period when it was assisted by the Cotton Reorganisation Scheme (CRS) and the large man-made fibre producers (Briscoe, 1971, p.149). Under the CRS 20% of the firms (203 companies) in cotton textiles left the industry altogether. Of these only twenty had carried out two or more processes. Of the remaining 183 firms, 123 were entirely specialised in weaving (Robson, 1957, p.125). Government involvement in the post-war changes in the structure of the U.K. textile industry was justified on the grounds that the textile industry was still a strategic industry as well as a very large employer. In retrospect it can be argued that the attempt to plan the textile industry was merely an extension of the wartime civil service central planning into the Labour Party's post-war brand of socialist command economic planning.

In 1947 the government set up the Evershed Committee to investigate the cotton textile machinery industry. It concentrated on the supply side again, reporting that this industry was unlikely to be able to supply future demand. However it did not assess new technology and believed that the new types of automatic loom being developed in Europe were not at the moment relevant. Briscoe commented in 1970 that "in retrospect this looks myopic" (Briscoe, 1971, p.133).

By 1948 the government was ready to finance the scrapping of old machinery and re-equipping. The Cripps Scheme (Cotton Spinning Re-equipment Subsidy Act) in 1948 offered a 25% subsidy on re-equipment in the spinning sector to firms above a minimum size. The response was rather disappointing and

a total subsidy of £2.6m was paid out on equipment costing £10.6m.

The Conservatives replaced Labour in 1951 and were inclined to leave the textile industry to sort out its own future. Peter Thornycroft, President of the Board of Trade in Churchill's 1951-55 government, told the Cotton Board in 1952 that "the government has no featherbed to offer you and very little shelter in the harsh winds of competition blowing through the world today" (Cotton Board, Nov 1952). Harold Macmillan however was a middle-of-the-road Tory and needed votes and MPs in Lancashire, so government and the textile industry joined forces to secure voluntary export restrictions from the Commonwealth countries of India, Pakistan and Hong Kong, which were agreed in 1958. The "Butskellism" of the 1950s was a philosophical modification of socialist command economics but it had little impact on the centralist controls of the civil service.

In 1959 the Cotton Industry Act was passed whereby the government agreed to pay two-thirds of the cost of a scheme designed to substantially reduce overcapacity. It aimed to eliminate 50% of spinning and 40% of weaving capacity. In addition re-equipment subsidies were made available under the Cotton Industry Act of 1959 with a 25% subsidy on new machinery investments. In the event both the scrapping scheme and the reinvestment subsidies proved disappointing. The industry was well aware of the dangers of increasing imports and of the lack of demand for long production runs of standard yarn and fabric qualities that could justify U.S.-type investment in modern large-scale production machinery.

The 'voluntary' export restraint agreements did not stem the flow of textile imports. One of the most powerful arguments against attempts at trade restrictions is that they almost always have effects far removed from those originally intended. The restrictions in export quantities forced onto the developing Commonwealth countries resulted in their searching for ways to increase the per unit value of their exports. The result of trying to decrease the import of cotton yarn was an increase in cotton clothing imports. By 1963 Hong Kong was supplying Britain with 62% of woven cotton clothing by value and 73% of knitted clothing (United Kingdom Textile Statistics Bureau).

Any reduction of imports that might have resulted from the voluntary Commonwealth agreements was torpedoed by the government itself. In 1959, when Britain joined the European Free Trade Area (EFTA), Britain agreed to remove all import restraints on manufactures from member countries, and this led to a rapid increase in imports, especially from Portugal and Austria. Britain tried to restrict these imports by means of an 'understanding'. However the net result of Britain's embryonic Europe-first policy was merely a transfer of textile and clothing production and trade from the Commonwealth's developing countries to the EFTA countries. The EFTA Secretariat held this to be one of the greatest sources of trade and employment creation! (European Free Trade Organization, Annual Report, 1969).

The failure of either socialism or mixed economy planning to revive the great British textile industry, which had underpinned the economy and tax collection for a thousand years, created a policy vacuum in both government and

civil service. This vacuum was filled by the strategy of a new breed of chemical and textile directors and managers recruited into ICI and Courtaulds in the 1950s. It is tempting to compare the failure of centralised government control in the fifteenth century and the rise of the merchant adventurers in the sixteenth, to the failure of socialist/mixed economy planning in the 1950s and the rise of the industrial magnates of the 1960s. However the merchant adventurers were satisfying new and old textile markets, whereas the new multinational managers in ICI and Courtaulds were chiefly interested in restructuring the textile industry so that it could absorb the largest possible amount of their new man-made textile fibres.

The U.K. chemical industry, now a booming new industry at the leading edge of world production of both regenerated cellulose and polymers, became central to the development of the U.K. textile industry. Together with the United States government, and with the very active encouragement and involvement of the U.K. government, the giants of the U.K. and U.S. world chemical industries attempted to bring about a supply-side shift from natural to man-made fibres. It is no accident that Britain's textile trade policy shifted from Empire Free Trade, where Britain had no chance of competing with cotton products from India and Hong Kong, to focus instead on Europe where Britain's man-made fibre technology would be offered protected markets.

The Cotton Industry Act of 1959 had attempted to help the industry modernise itself and to subsidise a reduction in capacity. Together with the limitation of imports of cotton goods however it had the unplanned effect of

improving the competitive position of U.K. cotton manufacturers who chose to slow down the move to synthetic fibres. This was not at all what the chemical giants had anticipated. Courtaulds responded by direct acquisition of textile companies and ICI continued to finance Viyella International. The formation of Coats Patons Ltd in 1960, and its unfortunate attempts at expansion by acquisition in the 1960s, were a direct result of the attempt of the Scottish J & P Coats to retain its independence from Courtaulds.

In 1961, Paul Chambers, Chairman of ICI, took the then unusual step in Britain of launching a hostile bid for Courtaulds. Frank Kearton of Courtaulds, who could see the commercial logic of the bid, nevertheless did not believe that the terms of the bid were fair. Although a junior director, Kearton played a large part in shifting city and shareholder opinion against ICI, by claiming that Courtaulds was just about to enter a new phase of profitable growth. In an embarrassing defeat for Paul Chambers, ICI only secured 38% of Courtaulds shares. Kearton became Deputy Chairman of Courtaulds in that same year, 1961, and Chairman in 1964. Kearton and his Finance Director, Arthur Knight, convinced the Board that there were limits to the Courtaulds strategy of diversification and competition with ICI, and that the alternative was to expand the textile side of the business. He believed that the decline of the Lancashire cotton industry could be halted by injecting new capital and technology (Knight, 1974). With modern management they would be able to compete with low-cost imports (Alfred, 1965). This view was heavily influenced by the successful economies of scale and management developments in the United States.

Scale economies were still seen as the solution to Britain's vulnerability to imports. The proponents of 'rationalization', meaning consolidation into larger groups, argued that vertical integration from cotton bale to fabric distribution would lower costs and reduce the worst effects of stock cycles. Scale was also seen as a way of increasing supplier power. A new feature of the British market in the 1960s was the growing power of the large retailer, demanding 'own label' branding and able, as the producers perceived it, to play one supplier off against another.

Cyril Harrison, Chairman of English Sewing Cotton (ESC), was an advocate of rationalisation. ESC had diversified from sewing thread into spinning and weaving in the 1950s and 1960s by acquisition, but was not large enough to take on the restructuring of the whole of the cotton industry. A 'Northern Project' was formulated in 1962 whereby Courtaulds would take over five of the largest Lancashire spinners: Lancashire Cotton, English Sewing Cotton, Tootal, Combined English Mills, and Fine Spinners and Doublers. ICI as a major shareholder in Courtaulds agreed to participate and take 45% of the shares in the new group while Courtaulds held 55%. Negotiations broke down over the offer prices, but English Sewing Cotton and Tootal merged, with both ICI and Courtaulds taking a minority stake. Courtaulds went ahead with the purchase of Lancashire Cotton and Fine Spinners and Doublers in 1964 and an extraordinary wave of mergers and acquisitions followed. By the end of 1968 Courtaulds controlled about 30% of U.K. cotton-type spinning capacity and 35% of warp knitting production, and had significant shares in weaving and finishing.

The man-made fibre industry was very happy to have horizontally and vertically integrated textile firms consuming large quantities of its standard fibre products, in protected markets. The idea of a less complex, more stable textile industry with a few large firms consuming large volumes of synthetic fibres was very appealing to Courtaulds and ICI. The 'reduction of excess capacity' was also seen as a key justification for government intervention in the industry. This government-financed scrapping of old machinery was intended to reduce production per firm. With the same or reduced production capacity, and with a government-directed priority on exports, firms were expected to come together in horizontal co-operation and vertical integration into bigger, more efficient units. In fact the new, more productive machines (faster speeds and broader looms), together with the reduction in the number of firms, led to increased capacity per firm (Briscoe, 1971, Table 16, p.150). Capacity reduction schemes (CRSs) not only increased capacity, they also unbalanced capacity. This led ambitious companies to look to acquire downstream production capacity that they could modernise, with government grants, and which, in turn, would absorb their newly increased and modernised upstream capacity.

Government encouragement of vertical integration meant that by 1968 four integrated firms - Courtaulds, Viyella International, English Sewing Cotton, and Carrington & Dewhurst - controlled 47% of the industry's spinning capacity (excluding waste spinning), 33% of its weaving, 62% of dyeing and 61% of printing. Merchant converters had declined from 1,155 in 1959 to 683 in 1968 and since most of the large weavers now carried out their own converting activities,

individual merchant converters now had only 32% of that trade. Vertical integration, driven by the government through CRSs and by the man-made fibre giants, had not led to balanced capacity. Viyella International took over Bradford Dyers' Association and ended up with far more finishing capacity than it required for its own cloth. Courtaulds took over Lancashire Cotton as well as Fine Spinners and Doublers and had more spinning capacity than it needed. Firm response led to more vertical and horizontal integration.

The British government was now pursuing conflicting policies that greatly affected large sections of the textile industry and other industries as well. Its interventions presaged a complete change in British industrial policy throughout the 1960s and 1970s. Harold Wilson's Labour Government from October 1964 encouraged mergers in so far as large firms could rationalise production and market their goods more effectively abroad. Above all the Treasury was concerned about the British balance of payments. The Industrial Reorganisation Corporation (whose first chairman was Sir Frank Kearson) had been set up in 1966, and promoted the mergers in the car industry which produced British Leyland, and in the electrical industry the amalgamation of GEC, AEI and English Electric. The IRC was part of a 'National Plan' which, perhaps building on Wilson's own immediate postwar experience with Treasury civil servants, aimed to intervene and set out a path for the private sector, leading to more efficient wealth creation, and to channel goods into exports, solving the pressing balance of payments situation at the same time. The basic philosophy applied by the IRC, backed by the Treasury, was to reduce the costs of British industry by

economies of scale. This approach had the fundamental flaw that it was driven by supply, not demand (Chandler, 1990; Peters, 1992).

Kearton expected and received 'temporary' protection during reorganisation. Cotton textile trade policy completely changed with the introduction of a rigid quota system that was gradually extended, as government attempted to plug the gaps, to cover eventually almost all developing and semi-industrialised countries. Of course global quotas on cotton yarns and fabrics accelerated the move to synthetic fibres, much to the delight of the chemical giants. However the shift of the global textile production to countries with lower labour and other costs was not to be thwarted and quotas on cotton textile imports merely encouraged imports of cloth made from man-made fibres (Keesing and Wolf, 1980).

Meanwhile the GATT restrictions had developed into the Multifibre Arrangement. Britain signed the Long Term Agreement (LTA) in 1962, but was only willing to allow a 1% per annum increase (instead of the prescribed 5%) in her import quotas, claiming that she was already importing more than her fair share, and hoping that liberalisation in other countries would reduce the pressure on the U.K. market. Britain, because of the size and history of her textile industry and her flirtation with Empire Free Trade, was much more vulnerable to cotton textile imports than her European competitors. In 1960 cotton textile imports accounted for 35% of domestic consumption compared to an average of 5% in the six principal countries of continental Europe. The British Conservative government was anxious not to offend the Commonwealth (which could appeal

directly to the Queen) but could point to the protectionist provisions of the LTA and the developing MFA.

In 1966 the National Plan was jettisoned as part of the government's introduction of deflationary policies. General government surveillance was handed over to the National Economic Development Councils (NEDOs), one for each of the largest sections of the industry starting with the wool textile industry, the clothing industry, and the hosiery and knitwear industry. The NEDOs varied in quality but there was an attempt to emphasise productivity. The clothing industry NEDO made continual efforts to get the firms within it to compare their performance, although it was unable to find a satisfactory basis of comparison in the production of highly differentiated products. Partly as a result of its patchy performance, in 1967 the government invited the Textile Council to conduct a thorough investigation into the textile industry.

In 1965 the Board of Trade had asked the Monopolies Commission to conduct a special inquiry into the supply of man-made cellulosic fibres. This was an established practice under the 1948 Monopolies and Restrictive Practices Act when a single company had a 50% market share. In effect this became an investigation into Courtaulds, which was the sole supplier of rayon. The report, published in 1968, recognised that Courtaulds operated in a competitive market where other fibres were potential substitutes for cellulose, but it considered that Courtaulds had exploited its 98% share of the U.K. market by differential pricing to some niche markets. It also found that, in times of short supply, Courtaulds had favoured supply to its own subsidiaries, or companies in which it had an interest

such as Carrington & Dewhurst. The Commission recommended a bigger reduction in duties than that agreed under the Kennedy Round. It also recommended that Courtaulds should not be allowed, without the permission of the Board of Trade, to make any further acquisitions in any sector of the textile and clothing industries where its share of capacity (or of sales) exceeded 25%. Since that was already the case in cotton-type spinning and warp knitting, the recommendation took immediate effect (U.K. Monopolies Commission, 1968).

The U.K. government's attitude towards this report was dominated by concern for the United Kingdom balance of payments. The international competitiveness of British firms had become far more important than the degree of competitiveness in home markets. It was in effect facing two ways. On the one hand it encouraged mergers aimed at more efficient production and marketing and greater exports and had set up the Industrial Reorganisation Corporation in 1966 with Sir Frank Kearton as its first chairman with this aim in view. On the other hand it was now attacking the monopolies that it had helped to create. When Courtaulds bid for Ashton Brothers, the government did not prevent the takeover, even though it increased Courtaulds' percentage of cotton-type spinning. Courtaulds then launched another bid for English Calico in January 1969 and ICI threatened to start taking over textile firms directly if Courtaulds was allowed to continue in this fashion. ICI saw Courtaulds as a threat to their own fibre sales, and proposed that a group of firms including English Calico and Carrington & Dewhurst should merge, with ICI taking a 40% share. Faced with a confrontation between "two great powers" (Dell, 1973, p.91), the government was forced to

take more positive action. Edward Dell, the Minister of State at the Board of Trade, conducted an inquiry into the structure of the textile industry. In June 1969 the government prohibited further mergers between any of the five largest companies in the textile industry, Courtaulds, English Calico, Viyella International, Carrington & Dewhurst and Coats Patons, and the takeover of any of these concerns by overseas interests. These companies could, however, continue acquiring other smaller firms and could transfer capacity between each other. It is a measure of the U.K. government's policy of massive interference in the industry, that it felt partly able to justify its decision on the grounds that managers needed more time to absorb change. Takeovers, it felt, had been proceeding so rapidly that the companies had not had sufficient time to reorganise and integrate their component units, and that further mergers of this scale would increase management problems.

By the end of 1968, Viyella was finding it difficult to live up to its profit forecasts. Joe Hyman was dismissed as Chairman in December 1969. Carrington & Dewhurst had used ICI money to make a series of unsuccessful acquisitions and strategic moves, including trying to market textured filament yarn in West Germany under ICI's 'Crimplene' trade mark. ICI felt that it could not let one of its largest customers collapse and made a takeover bid for Viyella with the intention of then merging it with Carrington & Dewhurst. A government committee was set up under Harold Lever, the Paymaster General, which recommended that ICI should be allowed to go ahead, provided it reduced its share-holding in the combined Viyella/Carrington & Dewhurst Group to not more

than 35 per cent, only had one director on the combined board, and did not use its share-holding to influence the companies in their choice of fibres.

The government accepted these recommendations. The government had now been forced to change its decision about the number of very large firms in the textile industry, but argued that the monopoly and oligopoly power of ICI and Courtaulds would be restricted by the reduction of tariffs on imports of man-made fibres to 15% by 1972, which had been agreed by the GATT Kennedy Round. The government still argued that smaller firms should integrate into larger units, but it accepted the recommendation of the Textile Council committee, that closer links were needed between marketing and production, and that this was best achieved by financial integration.

In the event the merger creating Carrington Viyella did not solve Carrington's problems and weakened Viyella, which had been one of the most progressive firms in the industry, partly because several senior managers opposed to the merger left the company.

The Textile Council's report, commissioned in 1967, was published in March 1969, and was the most comprehensive survey into the U.K. textile industry carried out before EC entry, but its conclusions seem difficult to correlate with the data presented. The Textile Council concluded, "we expect the industry to be internationally competitive by the mid-1970s". The textile industry would be viable "subject only to protection against goods imported at prices unrelated to costs, either because of Government subsidies or incentives or dumping". Quite remarkably this report concluded, "we therefore envisage a dismantling of the

quota arrangements and their replacement by a duty against imports from Commonwealth cotton yarn, piece-goods and made-up items,” subject only to protection from unfair competition (Textile Council, 1969).

These optimistic conclusions were not substantiated by the mass of data accumulated. Yarn production costs in the EC were 85%-90% of the U.K. and in Portugal 75%-80%. In weaving EC countries also had a productivity edge while costs in Hong Kong, India, Pakistan and Japan were some 70% of U.K. costs. In general the industry blamed the lack of modern machinery in the U.K. British textile firms looked towards developments in machinery in the U.S.A., but these were often designed for the longer production runs which the large U.S. home market permitted, and reduced the flexibility and short runs on which, it can be argued, the U.K. textile industry should have been focused.

Owen comments, “not surprisingly, given the role played by Courtaulds in drawing up the report, the Council concluded that the restructuring process had been wholly beneficial” (Owen, 1999, p.75).

The question of the degree to which free international trade should be allowed does not appear to have been directly addressed, perhaps because of the exclusion of textiles from GATT. In a directed economy, looking for higher economic growth rates and increased exports, the National Plan of 1965 did not address the question of what proportion of national resources should be devoted to the textile industry. In retrospect the whole basis of the National Plan seems misguided since it relied on estimates made by members of the industries themselves. From a national economic viewpoint the problem should have been

seen as the return on investment in the textile industry compared with other industries. The reports of the Textile Council (Textile Council Report, 1969, Appendix XV) and of the Wool EDC, did not face up to this question and based their calculations of capital charges on the average expected return on investment in manufacturing industry as a whole (15% per cent cash return before tax and depreciation).

The next great shift in government policy towards the U.K. textile industry came with Britain's entry into the European Community. The textile industry, as a whole, favoured entry, hoping for greater protection from the developing world. It could be argued that U.K. textile policy now passed to Brussels. The British government no longer had the power to participate in the management of British industry to the extent that it had before. As a parting shot the British government claimed that it was supporting the Textile Council's 1969 report by increasing tariffs on Commonwealth textile imports from January 1972.

Coats Patons never took the Textile Council very seriously and believed that its international strength would enable it to replace U.K. production and profits with production from its foreign subsidiaries, a policy that it had begun before the Second World War. One of the criticisms of the 'industry approach' to the analysis of the economy competitive advantage is that it tends to ignore the ambivalence of large MNEs towards both industry and government bodies. Different sections of the same MNE often have very different reactions to the official industry line. Company directors often without detailed knowledge are subjected to different pressures and opinions from within the company and

frequently do not feel the need to arrive at one clear overall company view. Thus in the large diversified companies the spinners and weavers wanted to restrict yarn and cloth imports in order to reduce competition while the clothing manufacturers wanted access to cheaper sources of yarn and cloth.

The U.K. entry into the EC in 1971 brought the U.K. into the Multifibre Arrangement and avoided any necessity for the Textile Council to stand by the conclusions it had reached in 1969. Under MFA, the EC placed the most stringent duties on imports from the cheapest sources. The effect on the U.K. textile and clothing industry was that imports from EC countries rose while U.K. production in every sector declined. Imports from MFA countries into Britain of imported woven cotton cloth actually declined but there was an appreciable increase in the import from MFA countries of cloth made from man-made fibres. Between 1973 and 1995 there was a sharp decline in the U.K. production of yarn, cloth and carpets. Entry to the EC and signing on to MFA did give the U.K. industry greater protection from developing countries, but it then faced greater competition from EC manufacturers.

The cost of MFA to the final U.K. consumer has been considered in two reports by Silberston (1984, 1989). He concluded that MFA was a grossly inefficient form of redistribution from consumers to textile workers. Silberston's highest estimate of the jobs that would have been lost but for MFA was 31,000. He estimated that the cost to the consumer of retaining these jobs was £29,700 per worker. Since the average wage in textiles in 1988 was around £8,500 and in

clothing £7,650, “every job saved therefore costs the consumer three or four times as much as each textile and clothing worker earns” (Silberston, 1989, p.122).

The declared object of U.K. government policy was to maintain employment in the textile industry and to protect the balance of trade, and on both counts it failed. Entry to the EC had the same effect as entry to EFTA had had before. Production and trade was now merely diverted from the developing countries to the EC. Trade was also diverted from Hong Kong, the most heavily restricted country, to other less developed countries (LDCs). The main beneficiaries outside the EC were LDCs with special arrangements with the EC such as the former French colonies.

The British government's grand design for the British textile industry fell apart in the 1970s. The companies that were created were not suited to European competition. They were suited to the production of basic ‘commodity textiles’ where price competition was the objective. They were not suited to the design conscious, short-run European demand for fabrics by the garment and household textiles markets. Not only was the strategy faulty but the implementation did not increase efficiency. Geoffrey Owen concluded, “the synergies which were supposed to flow from putting the various stages in the production process under single ownership were largely illusory” (Owen, 1999, p.77).

Vertical integration produced dinosaurs unable to compete, even behind tariff walls, with imports of ‘commodity textiles’ either in price or quality, and unable also to export into European continental markets of which they had little experience or understanding. The government’s strategic plan captured by

Kearton and Courtaulds had created a group of tame textile companies ideal for buying synthetic fibres but with no hope of competing in the European Union.

In retrospect it is difficult to avoid the conclusion that restructuring of the British textile industry paid little heed to the past and none to the future (Chapman, 1988; Moore, 1999). Unlike Britain's eighteenth- and nineteenth-century textile industry it was not driven by market demand, reinforced by the British government's use of its global political power to protect and promote British exports. The falsehood accepted by the government was that the restructured textile industry could compete with the help of 'temporary' protection. Nothing could have been further from the truth and it became obvious, even to the most fervent supporters of national planning, that the government no longer had the power to offer continued protection even if it had wanted to. Conveniently Kearton has been blamed, but the blame must fall on those who, through neglect or ignorance, allowed a technocrat to build a theoretical industry structure quite unsuited to mid-twentieth-century conditions of demand and supply.

British government intervention was extended to many other industries, notably the car industry and the electricity industry, demonstrating that government interventionist tendencies spread far beyond the textile industry. Skelmersdale, one of the large new weaving plants, closed in 1977. Not one of those new mills remains in production today. The government had a tendency to single out managers from large companies and to delegate to them the implementation of unfocused and impractical grand strategic designs. It was also

the period of the grand publicity-seeking manager. ICI managers had been to the 'right' universities and their advice was accepted by government on the basis of another U.S. imported concept, i.e. "what is good for ICI is good for Britain". ICI was responsible for much of the financing of Viyella International and was permitted to attempt to restructure the U.K. textile industry as a captive market for its fibres and dyestuffs. Kearton at Courtaulds had mergers and scale in his blood. At every stage he was awarded another medal by the British government until as Lord Kearton he went on to amalgamate a large part of the British car industry under the infamous and disastrous British Leyland brand. Others, including Sir Charles Clore and Sir David Alliance, were all swept away by the apparent economies of scale and transaction cost reduction.

Integration developed its own momentum while short-term rationalisation gains could be promised to shareholders or short-term rationalisation costs could be used as an excuse for lower than forecast profits. No one played this game better than Sir David Alliance but when the buying spree ended and the attempt to weld a ragbag of companies into a coherent MNE failed, there was neither the industrial logic to sustain the MNE nor the creativity to redefine the industry. While Arthur Knight as Chairman of Courtaulds after 1975 was beginning to reverse the highly personal structure built up by Kearton, and to allow units to look for value by sourcing externally, David Alliance was still earning plaudits by increasing his empire; he acquired Vantona in 1975 and added Carrington Viyella in 1982 to form Vantona Viyella, and Coats Patons in 1986 to form Coats Viyella.

The effects of government involvement in man-made fibres and textiles went far beyond the narrow definition of the textile industry as production units. In retailing, Marks & Spencer could not have built a dominant clothing retail empire if the government plan had not resulted in the creation of a few, very large, textile companies largely out of touch with the end-consumer. The idea of relying on the U.K. textile industries to produce the majority of its clothing and importing one third from Israel was simply not a viable strategy in a consumer market demanding individuality, choice and competitive prices. The ramifications of Marks & Spencer went far beyond clothing. It indirectly and directly set a pattern for British retailing of other goods. Sainsbury, Boots and W.H. Smith developed similar models of large-scale self-service retailing. This is not to say that these retailing patterns were not already being developed in the U.S.A., but the U.S. industry structure was based on different patterns of production, consumption and international trade. The power given to Marks & Spencer by large market shares reinforced its own brand domination and, by reducing or eliminating producer own brands, increased the distance between the producers and the final consumer. When Marks & Spencer failed to respond to changing consumer behaviour and sales fell in late 1998 and 1999, they decided to reduce their textile suppliers from four to three, creating enormous problems for William Baird PLC which was unable to switch to other outlets. The share of clothing sales held by independent stores had dropped from 53% in 1950 to 35% in 1967. By 1967 the fifteen largest retail chains in the U.K. accounted for 40% of clothing and household textile sales and Marks & Spencer had a 10% share, which rose to

16% by 1989 (Moore, 1999, p.265). The unravelling of Marks & Spencer in the late 1990s can be directly traced back to the 1960s government industrial policy which created four or five companies capable only of supplying Marks and Spencer. Marks & Spencer could frighten and dictate design to them while, at the same time, reducing choice for the consumer.

The British textile industry was restructured, not on the basis of the demand from the consumer, but on the demands of the chemical industry, supported by a government preoccupied by balance of payments crises. Some restructuring and loss of export markets was inevitable after the war. Left to market forces, the creativity of surviving individual textile firms would have found competitive niches in the market. The restructured firms were incapable of finding those niches. Courtaulds, who led the fashion for 'giantism' in the 1960s and 1970s, constructed huge new mills in U.K. development areas with local and central government assistance. This was uneconomic even within Courtaulds and the whole edifice collapsed when, in a desperate attempt to compete with cheap imports, subsidiaries of this elaborately constructed vertically and horizontally integrated company were given permission to source from outside the group.

As the uneconomic British textile industry sank under the gradual but irresistible impact of global market forces, the U.K. government lost interest. Without ICI backing it did not have the same importance or government access. More fundamentally, the alliance between government and the textile complex had been underpinned by a political need to maintain and expand manufacturing employment and exports. By the mid-1980s it was obvious to nearly all that the

textile industry could provide neither. Only in the deep recesses of the DTI, and perhaps among textile entrepreneurs seeking peerages, did the belief remain that the U.K. textile industry could be a net exporter. The government's agenda had moved on. The balance of payments crises were solved by the collapse of sterling and floating exchange rates, as Keynes had predicted. In a way that had been completely unforeseen in the 1970s, the employment issue died, except in a few heavily subsidised regional areas. By the 1990s, textile unemployment ceased to be an issue, except as a means to extract regional subsidies from the EC.

3.4. Supranational Textile Agreements post 1945.

Japanese economic development in the late nineteenth and early twentieth century was perceived as a threat to textile employment in the U.K. and the U.S.A. Both governments attempted to obtain Voluntary Export Restraint (VER) agreements and to protect their textile industries but such agreements failed to satisfy either the textile industry or the trade unions.

In 1945 the United States Presidency emerged from the Second World War with the belief that free trade, regulated by a multinational trade organization, could benefit the United States, world recovery and world economic development. The International Trade Organization (ITO) was an American idea born in Washington during the war. The British thought the American idea, championed by William L. Clayton, Assistant Secretary of State, that the cure for unemployment was stable exchange rates and free trade, “was a very dangerous trend of thought” (Krueger, 1988). Britain however had no choice but to agree since non-discriminatory trade and current account convertibility were made conditions for the 1945 Anglo-American loan.

The General Agreement on Tariffs and Trade (GATT) was formed in 1947. The ‘Contracting Parties’ drew up the ‘Code of Rules’ regulating international trade, and also formed the members of this international forum for world trade discussion. There were 120 members plus 30 other countries that subscribed but did not become members.

Japan joined GATT in 1955, but in contradiction to multilateral trade liberalisation, the U.S.A. forced Japan into a ‘voluntary’ export restraint

agreement on certain textile products in the same year. This opened the door to the U.S. protection lobby, who could now see that the U.S. government was prepared to treat textiles as a 'special case', as the only traded industrial goods to which GATT rules would not apply. One week after the VER was signed the U.S. textile producers petitioned the U.S. State Department to consider stronger controls over Japanese textile products (Aggarwal, 1981, 1985). Japan was not in a position to argue since 20% of its total exports went to the U.S.A., and a second VER went into effect in 1957 with a five-year limitation on the export of cotton textile products. The U.S. now suffered the same problems that the British had already experienced. As soon as agreements were concluded with one country, new imports arrived from another. American textile producers lobbied to have the Japanese VER extended to Hong Kong, but Hong Kong refused. While the U.S.A. invented tortuous language to show that they were not violating GATT, Britain, already trying to reverse Empire Free Trade, talked about 'burden sharing', and the European countries protected their textile industries by applying quotas in open violation of GATT rules. By 1960 the bilateral textile arrangements threatened to spread to other goods and thus to undermine the very existence of GATT.

The Democratic Party had a strong right-wing 'Southern Caucus' that had its roots among the textile workers of Georgia and the Carolinas and other Southern states. Textile imports, although representing less than 2% of U.S. textile consumption in 1960, were a threat to the employment of registered Democrats among blue-collar workers in the South. President Kennedy, who had

won a very narrow victory over Nixon, needed the South in order to get any legislation through Congress.

Thus Kennedy, who wanted to champion global economic development, had first to protect the U.S. textile industry. This apparent contradiction was squared by incorporating the concept of 'market disruption' into GATT. The concept of market disruption adopted by the Contracting Parties in November 1960 was a direct result of U.S. domestic policies. While the United States could argue that there was a common desire by the developed countries to limit low-wage textile imports, this would have been true for other industries as well as textiles. The U.S. claimed that legal and illegal constraints on trade from Japan and the developing countries had proliferated to a point where GATT had to acknowledge the problem. However it was the U.S. that had concluded a VER with a new GATT member, Japan. In fact, by formulating the 'market disruption' concept to cover its own domestic political requirements and, at the same time, giving the Europeans the chance to legitimise their activities, the U.S. changed the nature of GATT. From now on it did not look like an efficient substitute for ITO, but could be portrayed as a developed country club, aimed at preventing third world development. The boost given to the Soviet Union and the advocates of non-alignment was immeasurable. During the war there had been a loose coalition of developing countries who either supported Britain out of historical and trade ties, such as India and Pakistan, or who, like China, supported America against Japan. After 1945, Britain, crippled by two wars, lost its markets to the U.S.A. and moved towards Europe. India, Pakistan and Hong Kong now looked at a

much more powerful United States, that had supplanted Great Britain, to provide unrestricted markets for their goods. In 1960 GATT signalled that this was not to be.

The GATT working party report in November 1960 reported that a problem did exist and that it should be called 'market disruption', but added that "there were political and psychological elements in the problem" suggesting that the tendency to use exceptional measures to control textile imports would not stop until more comprehensive policies were in place to handle the problem (GATT, 1960, 1984). In November 1960 the GATT Contracting Parties adopted 'Avoidance of Market Disruption' clauses (GATT, 1960, pp.26-28). Countries did not even have to prove damage since a 'potential' increase in injurious imports was sufficient to justify protection. Unilateral action could be taken against a single country if it undermined the 'most favoured nation' (MFN) concept, whereby there should be reciprocal and equal treatment.

The mere existence of a sizeable price differential between particular imports and their domestic equivalent could be used to justify import restriction. The textile interests in the United States had been instrumental in fundamentally altering the underlying policy concepts for all traded goods throughout the world. Although the market disruption clause was discussed and formulated by the GATT Contracting Parties it never became part of the GATT Articles. Although the textile agreements were negotiated at GATT, participation was limited to those Contracting Parties that accepted the textile rules.

The United States government continued its leading role on into the

formulation of the Long Term Arrangement Regarding International Trade in Cotton Textiles 1962 (LTA) and the Multifibre Arrangement regarding International Trade in Cotton Textiles 1974 (MFA I). In 1961 an American initiated conference of major textile traders had been convened under GATT auspices to produce the Short Term Agreement Regarding International Trade in Cotton Textiles (STA). The STA withdrew cotton textile trade from the Most Favoured Nation (MFN) system of international trade for a period of one year. Negotiations continued and in October 1962, the STA was replaced by the Long Term Arrangement Regarding International Trade in Cotton Textiles (LTA). The LTA covered the period 1962 to 1967 and allowed importers to curb imports in cases of 'market disruption' via bilateral (Article 4) or unilateral (Article 3) action. The LTA paved the way for the passage of the 1962 Trade Act by the U.S. Congress and was renewed in 1967 and 1970. By 1972 the U.S. had restraints on textile imports from 30 countries.

In December 1972 a GATT working party completed a fact-finding study on the world textile trade and was further instructed to use it as a basis for developing a 'multi-lateral solution to 'problems' in the world textile and apparel trade. The working party was transformed into a negotiating group and a final agreement was reached on December 20, 1973. There was considerable pressure in the U.S.A. at this time to extend the LTA to wool and man-made fibres (Cline, 1990, pp.148-149). The result was the Multifibre Arrangement (MFA) in January 1974, a multilateral arrangement for managing textile and apparel trade for cotton, wool and man-made fibres. The MFA was renewed in 1977 (MFA II) against the

background of the post-1973 downturn of world economic activity. The 1977 protocol did not modify the original text but provided for the “possibility of jointly agreed reasonable departures in particular cases”. Goto (1989, p.211) argues that MFA II was more restrictive ‘primarily because of EC initiatives’.

MFA was renewed again in 1981 (MFA III), when the ‘reasonable departure’ provision was dropped, and again in 1986 (MFA IV), when the agreement was extended for five years and expanded to include vegetable fibres and silk blend at the insistence of the U.S.A.

Under MFA I, if restraint was to remain in force for more than a year, a 6% growth rate was to be allowed in subsequent years in all but exceptional cases of ‘market disruption’. Under MFA II, the bilateral agreements made by the U.S. with its most important suppliers (Hong Kong, Taiwan and South Korea) were more restrictive than the 6%. MFA III was equally or more restrictive. Under MFA IV U.S. bilateral agreements were even more restrictive (Arpan et al, 1982; Majmudar, 1996). Thus from 1957 the U.S.A. increased its protection of the textile and apparel industries both in size and scope (Baughman, 1987).

Cline (1990) gives a detailed history and institutional analysis of U.S. textile and apparel import restraints and conducts a partial equilibrium analysis of their economic effects. Reinert (1993) attempts to address the general equilibrium effects, following de Melo and Tarr (1992), who outlined four considerations calling for a general equilibrium treatment of quantitative import restraints. These four are balance of trade constraints, quota rent transfers, economy-wide resource constraints and inter-industry linkages. Reinert distinguishes between the textile

and apparel sectors and includes five important upstream supplier sectors. These seven sectors are termed the “textile-apparel industrial complex”. The remainder of the economy is aggregated into nine broad industrial groups. Reinert explores the implications of quota rent sharing, demonstrating its potential importance to the resource allocation effects of textile and apparel liberalisation. It utilises a set of econometrically estimated trade elasticities. Thus, “the MFA was introduced to restrain developing countries' exports of textiles and apparel to protect developed country producers of garments and materials, supposedly while they adjusted to the new realities” (Hewett and Koning, 1996).

Around the world governments and textile industries reacted very differently to the international MFA trading rules (Hartmann, 1985). The declining numbers of textile workers proved a major social problem in Europe during the 1970s, beginning in the Netherlands and West Germany, then spreading to France and the U.K. and then on to Belgium and Italy. Governments asked for time to transfer workers from an increasingly uncompetitive textile industry to specialised textiles or other industries. Rather than negotiate bilateral treaties, the EC accepted MFA. EC trade with associated states, not covered by MFA, caused problems and in 1977 under MFA II Mediterranean imports were included. However safeguard clauses were not enough and the EC Commission's attempts to get voluntary agreements with Greece, Spain and Portugal proved difficult. By 1979/80 two-year and three-year voluntary agreements were reached.

The primary EC plan was still to accept MFA, as a temporary measure, and to prepare for free trade. West Germany and the Netherlands seemed the

most prepared to allow the free market to operate because they had strong economies and currencies and their textile firms were encouraged to invest in low-cost countries (Friman, 1990). However between 1970 and 1976 half of the Dutch textile industry disappeared and the Dutch government switched from support of the free market to job preservation.

In Belgium, Italy and the U.K. substantial subsidies were offered to the textile industry. When this failed, some Italian firms were nationalised. Employment continued to drop, sometimes at a faster rate, and policies were re-evaluated. Textiles in Italy have become the subject of social and location studies. The study of the Modena knitwear industry demonstrates the advantages and disadvantages to be gained from government action and inaction (Lazerson, 1995). The success of Benetton was used by Porter in support of his argument that MNEs require a strong home base (Porter, 1990, pp.579-580) and more recently to demonstrate Rugman and D'Cruz's extended double diamond (Segal-Horn and Faulkner, 1999, pp.40, 60, 258). A further interesting aspect of this argument is the involvement of Benetton in Argentina, where it is the largest individual sheep-farmer in a country that has a very large immigrant population of Italian origin, many of whom are involved in textiles and textile-related activities, partly due to the immigration and industrial policies of successive Peronist governments. The argument as to whether or not Benetton's success is the product of the Italian textile environment is relevant here only to the extent that some firms are able to build FSAs, and specifically PCAs, from national characteristics and national government activities.

France provided assistance to small and medium-sized firms and encouraged extensive technological research to increase productivity and competitiveness. This was not particularly effective.

Germany was prepared to accept textile free trade and its consequences, although its policy was modified by EC policy, once MFA had been accepted. A Law for the Promotion of Employment provided, and still provides, assistance to those workers adversely affected by its essentially free trade policy. Enterprises are not aided, but their social costs are reduced by cushioning the impact of free trade on labour. EU rules enable individual countries to help textile companies downsize by taking over the extra costs of early retirement both in severance and in pension payments. Nevertheless Germany was prepared to allow its textile industry to struggle on its own and to relocate in other countries. Most German policy makers reportedly felt that the economy could absorb these changes without undue disruption. This approach appears to have been enlightened since the German textile industry has emerged strongly, whereas in countries like the U.K. where governments were prepared to give shelter and subsidies to the textile industry, the tough process of natural selection was delayed. It is arguable that this delay in adjustment fossilised industry structure and contributed to long-term decline.

Germany had arrived at a free market stance with some difficulty. With the foundation of the EC the West German textile and apparel industries were faced with heightened intra-EC competition but protected from low-cost imports from developing countries. In the early 1960s they reacted by vertical and

horizontal consolidation to exploit economies of scale and to achieve market power in the rapidly growing internal EC market. They also invested to become more capital intensive, and adopted an undifferentiated strategy concentrating on the production of standardised fabric and clothing. There was some specialisation among smaller firms in fashion-related fabrics and apparel, home furnishings and industrial goods. By the mid-1970s the undifferentiated strategy was floundering. In 1975 at least 7 of the top 49 textile firms were receiving subsidies from provincial governments, and employment was contracting at 7% annually. This failure was the result of the growing liberalisation of extra-EC low-cost imports by the federal government until about 1978. West Germany was a reluctant supporter of the EC signing the MFA in December 1977. Relative to other EC countries, West Germany tended to be more liberal in the interpretation and enforcement of the MFA's restrictive clauses (Anson and Simpson, 1988, 1999).

By 1981 the defects of the MFA (Aggarwal, 1981), and of GATT (Blackhurst, 1986, 1988) were clear and by 1990 most countries and textile firms knew that there must be a new approach (Aggarwal, 1985; Bagchi, 1989). The World Trade Organization (WTO) was established on January 1, 1995. In 1986 the countries participating in the launch of the Uruguay Round of international trade negotiations at Punta del Este agreed to the principle that negotiations in the textile and apparel areas 'shall aim to formulate modalities that would permit the eventual integration of this sector into GATT on the basis of strengthened GATT rules and disciplines, thereby contributing to the objective of further liberalisation of trade' (Finger and Olechowski, 1987; Sander and Inotai, 1996). In 1989 the

Trade Negotiations Committee agreed that this integration process would begin immediately following the conclusion of the Uruguay Round negotiations. The Draft Final Act of the Uruguay Round in December 1991 (GATT, 1991a, 1991b), commonly referred to as the Dunkel Text, commits the parties to a ten-year transition period during which quantitative restrictions on imports are reduced in three phases, at the end of which the textile and apparel sectors are to be fully integrated into GATT with no extension of the agreement. (In 1993 the U.S. textile and apparel industry threatened to challenge this in the U.S. Congress unless the period was lengthened to 15 years.) The ten-year process was to be supervised by a Textiles Monitoring Body, consisting of a chair and 10 representative members, reporting to the GATT Council.

The Agreement on Textiles and Clothing (ATC) states that 'parties should allow for continuous autonomous industrial adjustment and increased competition in their markets' (Article I, paragraph 5, p. 0.2). However Article VIII echoes U.S. anti-dumping legislation, providing for 'transitional safeguards' to be applied on a country-by-country basis. 'Safeguard action may be taken ... when, on the basis of a determination of a party, it is demonstrated that a particular product is being imported into its territory in such increased quantities as to cause serious damage, or actual threat thereof, to the domestic industry producing like and/or directly competitive products' (Article VIII, p. 0.11). The exhortation was added that transitional safeguards should be 'applied as sparingly as possible'. ATC is a transitional instrument basically encompassing yarns, fabrics, made-up textile products and clothing. It lays out a progressive integration into the GATT 1994

rules, gradually expanding and finally eliminating all existing quotas by January 1, 2005. Progress is being monitored by the Textiles Monitoring Body (TMB). Article IV of the ATC deals with other restrictions not covered by GATT rules, which are also to be phased out over ten years. The reductions in protection are in three phases and most countries with strong domestic textile industries have decided to leave the most difficult sectors until last. This means that the real pain for the developed countries will come between 2002 and 2005. There are safeguards against surges in imports but with a maximum time limit of 3 years and not beyond 2005.

MFA, which still regulates the international textile trade pending the introduction of the most difficult phases of trade liberalisation under WTO, has not protected the U.S.A. from substantially increased textile imports during the booming nineties. In 1990 with an economic slowdown the volume of U.S. MFA textile and clothing imports rose by only 0.4% but as the economy recovered imports accelerated. The increases amounted to 13.4% in 1992, 9.1% in 1993, 9.05% in 1994, but then reduced to 6.0% in 1995 and 4.1% in 1996. 1997 saw a further large increase, 20.1%, and 1998, 13.3%. Given that U.S. textile and apparel imports are still limited by quotas it is surprising that imports have risen so quickly. Under MFA growth rates would normally be expected to be around 6% and from some 'dominant' suppliers like China only around 1-2%. However free trade under NAFTA has produced a boom in volume imports from Mexico, nearly 38% in 1997, and from Canada (19% increase in 1998 over 1987). Additionally under quota flexibility rules there has been some quota switching

and carrying forward. As the growth rates for quotas have been increased under the ATC rules since 1995, some new quota levels have been filled and others that were under-utilised have been filled (*Textile Outlook International*, Nov 1999: 64-65).

By the early 1990s it became obvious to all that MFA was unable to stop the pent-up flood of developing countries' exports. Indeed it can be argued that by totally distorting the world market MFA made the situation considerably worse. Leading exporters of textile and apparel in the developing countries had quotas imposed upon them, and this led those countries, other developing countries, and major textile producers and retailers in the developed world, to look for other suppliers of cheap labour. Thus production was artificially dispersed around the world. Some countries had been exempted from MFA under the Lomé Convention (the so-called African, Caribbean and Pacific, or ACP countries), and some of these such as Mauritius and Jamaica built up substantial textile export markets. The economies of several developing nations benefited from the introduction of the semi-skilled and skilled jobs that come with the establishment of a domestic textile industry (Koning, 1994). However the artificial and often completely unexpected effects of MFA protection so distorted the world market that many countries, and even major companies, were not fully aware of the probable short-term nature of the distortions. Many developing countries saw textiles and apparel as a means of providing jobs and earning foreign exchange. Investments were made without regard to underlying market realities, resulting in world overcapacity in many sectors of the industry. In 1989 Silberston and Ledic

reported that the benefits of MFA were far outweighed by the costs as far as the U.K. economy was concerned (Silberston, 1989). Several studies have estimated that the cost of MFA (textiles and apparel) to the U.S. consumer is around US\$15bn per year. The U.S. Council on Wage and Price Stability study showed that in 1975 textile and apparel protection costs passed on to the consumer amounted to US\$175 per U.S. household. As Asian costs fall this figure has been increasing (Suehiro, 1980).

Adjustment strategies implemented by national industries, governments and firms will be critical to long-term competitiveness and even survival. Some industries have responded competitively, others have merely reacted. At the end of the 1970s Toyne et al (1984) wrote, "It is too early to pass judgement on the various adjustment strategies identified in this study. ... However, the experiences of France and the U.K. on the one hand, and those of West Germany, Italy, Japan, the Netherlands and Taiwan on the other, suggest that future strategies must be aimed at developing an international competitiveness, not just an internally focused domestic competitiveness (Chen, Jackson and Kilduff, 1996). Even the U.S. industry, which is unique because of its large domestic market, is beginning to show signs of lagging the more internationally oriented industries in its ability to remain internationally competitive."

3.5. The Chinese Government and Global Textiles.

Although all countries have their own textile industries, nearly all national production and marketing chains are globally interdependent (Ford, 1986; ILO, 1996; Dickerson, 1999; WTO various years).

In the People's Republic of China (PRC) the government economic reforms of 1979 started the transformation of the Chinese textile industry from an inefficient part of the public sector producing only for the domestic economy to the world's leading supplier of clothing and footwear (WTO, 1996). With a population of 1.3 billion, 24% of world population, and labour costs still under US\$100 for a six-day week, China has unique competitive advantages in the world textile complex but MNEs face many political problems (Boisot and Child, 1988).

The Chinese textile complex was among the first to attract foreign investment, estimated at US\$8bn 1978-1995 (Leung, various dates). Officially China, including Hong Kong and Taiwan, has some 89,000 textile enterprises (Chen and Jackson, 1996), employing 30 million workers, representing 17.6% of the work force (Chinese Embassy, London, 2002). This does not include millions employed in the enormous informal cottage industry, or in natural fibres (cotton, silk, cashmere, camel hair, ramie and flax) and in the man-made fibre industry. The Chinese textile and apparel sectors alone represent 25% of China's total exports, some US\$35bn. Many of the textile mills are very old-fashioned and the vast majority of the state-owned enterprises operate at a loss. In 1996, 130 of these were allowed to go bankrupt but blind expansion exists throughout the

textile industry with reportedly 1.5 billion men's shirts stockpiled in 1996 (Leung, Feb 1997).

China's textile expansion, directed by the government, has had a dramatic effect on the supply and prices of man-made fibres and of cotton fibres. The China effect in the last 25 years has been to destabilise the natural and man-made fibres markets. China is the second largest producer of raw cotton, after the U.S.A., and overtook the United States to become the world's leading producer of man-made fibre in 1998 (*Textile Outlook International*, Sept 1999: 40). Government intervention in both the Chinese textile domestic market and the Chinese textile export market has distorted the world market in fibres with chaotic effects on supply and demand and some interesting consequences for major textile fibre producers and consumers.

In 1994 the PRC purchased nearly 900m kilos of cotton (5 times higher than 1993 and similar to the 1979 twenty-year high.) The cotton price doubled over 20 months and within 6 months the polyester staple price had risen 70% and other man-made fibres followed suit. PTA, the chemical building block for polyester fibre, doubled in price between first quarter 1994 and fourth quarter 1995.

One of the most remarkable knock-on effects of Chinese intervention was how quickly the world switched to polyester. The polyester manufacturers then created new capacity on the back of overestimates of future demand.² PTA prices

² "The cotton message is clear and the world reaction can be predicted, provided it takes note of what is happening throughout the textile pipeline. Unfortunately, I suspect, there will be more shocks to the global fiber, textile and apparel system; we are, regrettably, an industry that never seems to learn." Minutes of First World Synthetic Fibres and Feedstocks Conference, Singapore 7/8 Nov 1996.

collapsed and polyester prices fell back to near 1993 prices, but cotton prices stayed at 40% above 1993 and the global market share of cotton against synthetic fibres fell from 47% in 1990 to 43% in 1996. Cotton is basically capacity-limited and can only adjust slowly and relatively incrementally. On a five-year view cotton is limited to around 20bn kilos worldwide, and hence the price remained historically high (Buck, 1996). This represents a loss of over 1.5bn kilos of potential cotton business that had moved to man-made fibres.

Moreover the effects of Chinese government actions were felt far beyond the textile industry itself, for example in the production of such items as cassettes and automobile parts that also involve the use of polyester.

Similar intervention by the PRC government has destabilised the global cashmere industry. Cashmere production is largely confined to Iran, Afghanistan and Chinese Mongolia, but China has failed to capitalise on the political problems in the other two producer countries. The Chinese government policy of exporting cashmere to Japan in exchange for cashmere de-hairing machines has resulted in overcapacity in the industry and a flood of poor quality cashmere onto the world market, lowering the prestige and prices of the fibre.³

³ Conversations with Nicholas Kuenssberg, formerly CEO of Dawson International PLC. Dawson established a technical monopoly of cashmere de-hairing in the early 19th century, importing raw cashmere and de-hairing in Scotland, and producing fine quality cashmere garments under prestigious trade marks like 'Pringle'. Dawson's attempts to form local joint ventures in Chinese Mongolia, in order to internalize the production of quality cashmere, have not yet achieved success (2002).

3.6. The United States Textiles and the United States Government.

After Independence the United States protected its textile industry from the very first. The first Congress in 1789 imposed a 3 cents per pound weight tariff on cotton imports to protect the cotton industry. In the eighteenth century it was Britain's links with Africa and its sea power that provided slave labour to work in the cotton fields of Georgia. In the nineteenth century the repeated failures in the Ireland harvest and the desire for a better life led millions of impoverished Irish to emigrate to the U.S.A., where many started out working in the garment industry. Before the First World War successive United States governments operated a trade policy which was not dissimilar to the post Second World War Japanese policy in so far as they imported technology and developed home industries by trade protection and import substitution. The U.S.A. had the additional advantage of a supply of continual cheap labour from new immigrants, still mainly coming from Europe with basic levels of education and work skills (Leiter et al, 1991, p.64). Work for the immigrants and votes for the political parties were secured by high tariffs levied on textile imports, notably in 1816, 1824 and 1828.

The size and wealth of the U.S.A., compared to any other single country, gave the U.S.A. a predominant place in world textiles after World War II. Domestic demand per head for textile and apparel products outstripped the rest of the world. The U.S. government was constantly involved with the textile industry and textile trade policy (Brandis, 1982).

Consumption per head in U.S.A. reached 29.9 kilos per head in 1995,⁴ one-third higher than in Europe and far above the world average of 7.5 kilos per head. As a result of a consistent policy of textile trade protection throughout its history, U.S. textile and apparel imports amounted to less than 2% of total textile consumption in the 1950s. It was the importance and power of the U.S. government and textile industry that caused textiles to be excluded from GATT. The United States government crafted and then imposed MFA on the global textile trade.

In 1992 the textile complex contributed US\$56bn to the total U.S. GDP of US\$5,522bn, or just over 1% (Dickerson, 1995). In 1997 textile and clothing imports into the U.S.A. amounted to US\$62.76bn, 18% of the world textile and clothing trade. In 1997 textile and clothing exports from the U.S.A. amounted to US\$17.86bn, 5% of the world's textile and clothing trade.⁵ In 1999 the Textile and Apparel Industries in the U.S.A. still provided work for over 2m people if undeclared home and sweatshop workers are taken into account.

United States government policy has continually changed since 1945. The U.S. government moved from supporting the concept of free trade to promoting a protectionist policy. This change occurred in 3 stages:

- i. Immediately after WWII - high demand, low foreign competition - relatively few tariffs or problems.

⁴ According to John Coker (*Textile Outlook International*, March 1997:44) fibre consumption in the U.S.A. increased from 29.0 kilos per head in 1993 to 29.9 in 1995. EU(15) 19.1 kilos per head 1993. China 1992: 5.3 kilos per head 1993. Estimated average world consumption 1995: 7.5 kilos per head.

⁵ Extrapolated from *Textile Outlook International*, March 1999: 45-47.

- ii. As foreign competition developed, pressure on the government grew from the U.S. textile industry and later from the U.S. apparel industry, and in 1961 the government agreed to negotiate a bilateral trade agreement with Japan to control cotton, textiles and apparel goods imports. From 1961 to 1973 new and more restrictive agreements followed.
- iii. 1973-1983. Numerous bilateral agreements and the MFA were negotiated which were even more restrictive. The implementation of the Uruguay Round agreements on textiles by January 1, 2005 is fundamental to the success of WTO but implementation will only succeed if the United States drives it forward. At present (early 2002) there is conflicting evidence.

If the political and economic changes in China proceed towards privatisation and competition, reducing the PCDs for the private textile firms, and if WTO reduces the PCAs that U.S. private companies hold by dint of protection and regionalisation, the break-up of the large U.S. commodity textile companies would seem only a matter of time. The U.S. textile industry however has far from given up and the powerful political textile lobby shows every sign of fighting to the death. At first, by excluding China from WTO and negotiating bilateral agreements with it, the U.S.A. attempted to circumvent the end-2004 deadline. By developing outward processing agreements from the Caribbean to Mexico, the U.S.A. is enlisting regional support for future regional protection battles. This is

put more subtly by the U.S. Department of Commerce: “The elimination of quotas in the global trade in textiles and apparel on January 1, 2005, will be a watershed event whose full consequences are difficult to predict. Certainly trade, cross-border investments, and joint ventures will be stimulated, and trade and investment patterns probably will change somewhat. Regional tariff preference, combined with the possible expansion of such arrangements in various parts of the world, could result in a trend for textile companies to focus their efforts largely on regional markets” (U.S. Department of Commerce, 1999 Industry and Trade Outlook, Chapter 9).

There are still powerful lobbies, especially in the Southern states, that would like to see the WTO textile agreements collapse. It could be concluded that the U.S. government, pushed by the textile lobby, is pulling the textile industry into regional confrontation, by protecting its large private companies. The resultant political competitive advantages (PCAs) gained by the industry will not be lightly removed.

Total employment in the apparel and fabricated textile products industry was approximately 865,000 workers in 1996 compared with 985,000 in 1992 (U.S. Bureau of the Census, various years).

Average production workers' income is recorded at \$7.67 per hour, 2% above 1992, but this industry employs many unrecorded, largely new and illegal immigrant workers, and all figures are very approximate. Some calculate that up to 35% of garment production takes place in unregulated and illegal operations.⁶

⁶ Dr. Patricia Kelly, Johns Hopkins University. Letter to US Office of Technical Assessment, April 20, 1986, p.3.

The number of workers has been declining steadily due to increased imports and a rise in domestic productivity.

The U.S. apparel industry comprises about 24,000 establishments, most of them small (Annual Economic Profile, American Apparel Manufacturers Association, 1999). Just over 60 percent of the establishments have fewer than 20 workers; 3862 employ over 50 people. Only 10 percent employ 100 or more. In general, the small establishments make a few garment styles for niche markets, while the larger firms tend to produce a wider range of goods for different market segments. 75% of apparel employment is with large firms. Contrary to the impression often given, “the apparel manufacturing profile in the United States is basically a small number of large manufacturers that employ a lot of people”.⁷

Mexico and the Caribbean countries were the fastest-growing major suppliers of U.S. apparel imports, although Asia is, and is likely to remain, the largest supplier (Galli, 1996). Import growth during 1993-97 was 278% for Mexico and 91% for the Caribbean countries, but just 18% for Asia. Asia’s share of U.S. apparel imports fell by 12% to 58% in 1993-97, while the combined share of Mexico (11%) and the Caribbean countries (16%) rose by 11%, to 27%.

The U.S. market for apparel rose from \$87.3bn in 1993 to \$95.6bn in 1997, a growth of 9.6%. In the industrial and technical textile sectors U.S. firms dominate. Textiles are vital to a large range of industrial uses from safety harnesses to oil spill control, from parachutes to blood filters, and from automobile tyres to spacecraft insulation. Non-woven textiles are used in

⁷ Jack Morgan, Director of Communications, American Apparel Manufacturers Association, November 1999.

construction of houses, boats and roads. A considerable part of this market is government driven or controlled and U.S. producers are preferred.

In the early 1970s the apparel industry was still living under the delusions induced by the political competitive advantage that it derived from MFA and domestic protection. The 1990s have seen a shift to value over style⁸. As has been said above, the 1990s have also seen pressures on consumer lifestyles and time which have resulted in reduced apparel shopping time, down to 3.2 hours per month, a drop of more than 50% since the early 1990s (*Consumer Outlook '98*, 1998: 1).

The reaction of the largest U.S. apparel producers has been to restructure their operations, and to focus on marketing. They are looking to global sourcing to reduce cost, and 'quick response' to satisfy retailer demands. For many years the retailers dominated the producers and private label retail brands pushed producer brands off the shelves. Now alliances have developed between the retailers, themselves under pressure from discount stores that offer a wider range of competitively priced goods, and the producers. Thus the biggest names in apparel production are growing, developing their brands in the same way that the jeans manufacturers retained their own producer brands throughout the last thirty years. The large producers are able to commit to large orders, to carry more stocks, and to source globally and outsource domestically into the domestic rag-trade, both for their retail customers and for their own brands. They are no longer afraid to get back into close touch with the end users, selling to discounters,

⁸ Standard & Poors Report quoted in USITC Industry and Trade Summary, Publication 3169, March 1999.

developing 'shops-within-shops' and even selling direct to the final customer. The large firms are radically restructuring their value chains, divesting away from fixed assets and concentrating on their knowledge-based skills to develop and market their products. Sara Lee launched its 'de-verticalization' programme in late 1997, selling off nine production operations. Russell Corp closed two domestic sewing operations in June 1997 and expanded operations in the Caribbean and Mexico. Levi Strauss closed 12 production plants in 1998 eliminating 38% of its domestic production capacity.

Brands are being developed. VF Corporation bought Bestform lingerie, as well as Britannia Sportswear. Levi's implemented its 1995 five-year strategic plan by establishing 100 Levi's stores and 45 Dockers Shops. Oshkosh B'Gosh expanded its retail channels and by end 1998 was operating 119 domestic Oshkosh B'Gosh branded stores, including 11 factory outlet stores.

U.S. foreign direct investment in the apparel sector has risen continuously from \$971m in 1993 to \$1.3bn in 1997. This represents 0.5% of U.S. direct foreign investment (U.S. Department of Commerce, March 1999).

As was mentioned above, the principal recipients of U.S. FDI in the 1990s have been the Caribbean and Mexico. The growing use of the Caribbean and Mexico has boosted U.S. exports. \$7.2bn of garment parts for assembly were exported in 1997, \$4.1bn to the Caribbean and \$2.8bn to Mexico. These offshore operations qualify for tariff and quota preferences, given to regional offshore assembly of U.S.-origin fabric pieces. Thus, once again, political competitive advantage has been a deciding factor in the development of major companies. In

spite of this protection, there is some evidence that post-devaluation East Asia can still undercut the U.S. regional arrangements by 15 or 20%.⁹ In a period of greater uncertainty, this bodes ill for the regional industry being built up by U.S. industry and government if they do indeed abolish all regional protectionist measures by end 2004 in line with their agreements with WTO.

The largest suppliers of apparel by value to the U.S. in 1997 were China, Mexico, Hong Kong, Taiwan and the Dominican Republic. The big four of the 1980s - China, Taiwan, Hong Kong and Korea - have lost share to Mexico and the Caribbean. Officially there are 12,774 registered apparel manufacturers in Mexico employing 557,000 people to produce \$6.5bn of garment exports to the U.S.A. These numbers do not include the 'maquila' work, or the huge, virtually duty-free 807-807A arrangements whereby U.S.A. cloth is shipped offshore for make-up and re-import.

⁹ An Oxford Industries official, interviewed by USITC staff, Atlanta GA., Aug 5, 1998.

3.7. Conclusion.

This chapter has shown how national and supranational governments have played a decisive role in the development and structure of the global textile industry, in support of Propositions 1 and 2.

The involvement of government in the U.K. textile industry penetrated down to an extraordinary level of detail until the late Tudor times and although, as government centralised, detailed control was lost, the textile complex remained the main source of exports and taxes until the late nineteenth century. Medieval monarchs directly controlled the location of manufacturing and markets, prices, exports and entry to the craft guilds. In the late nineteenth century government reasserted its influence through taxation and eventually regained direct control during the First World War. A loosening of control after 1918 was short-lived and during the Great Depression and the Second World War the U.K. developed a command economy which governments and officials were reluctant to give up, especially when the balance of trade and exports were government priorities.

The result was the government co-ordination of a massive reorganisation of the textile industry on lines that put scale economies before market demand. The government-led reorganisation, manipulated by the man-made fibres industry, led to massive over-capacity in the hands of a few textile and clothing manufacturers. This distorted the size and structure not only of the textile and clothing industry but of many other sectors of the wider textile complex, including the man-made fibre sector of the chemical industry and the clothes retailing sector. Marks and Spencer were able to dominate the artificially

concentrated, overextended and uncompetitive U.K. supply chain.

The end of state control was marked by free trade agreements first with EFTA and then in 1971 by entry into the European Union, and with its adherence to the Multifibre Arrangement. These treaties removed the U.K. government's ability to provide shelter protection. While EU protection and the MFA protected European-wide textiles and severely restricted Commonwealth imports into Britain, the U.K. was unable to compete with the flexible, low-cost unstructured competition from within the EU. By the 1990s, for the first time for over one thousand years, textiles ceased to figure on the U.K. government's agenda. The rapid decline of the British textile industry meant that it was now of little interest to the government in regard to exports, taxes or employment.

The gradual collapse of MFA restrictions on textile and clothing imports from the lesser developed world was principally due to market demand. The protectionist dam was broken by ingenious initiatives to circumvent quotas and tariffs, often led by U.S. retailers. The supranational MFA world order still controls textile trade but the GATT Dunkel Text agreement at Punta del Este to move to global free trade in textiles over ten years, and the subsequent deadline of January 2005, monitored by the WTO under the United Nations, will, if fully implemented, severely restrict national governments' control over their domestic industries. However rules and regulations of the supranational WTO are already providing fertile opportunities for firms and national industries, working through and in alliance with their national governments, to find and exploit loopholes in the legislation and to retain or gain shelter protection.

During the last thirty years China has become the homebase of global textiles. While the Chinese government's control over many of the new fast-growing textile and clothing firms is less detailed than over the declining, but still massive, state-owned textile sector, the role of the Chinese government is still paramount. It controls imports and exports, FDI and the value of the Chinese currency. Through its control of Chinese agriculture and the Chinese man-made fibre industry it has a dramatic effect on the world prices of cotton and man-made fibres. Interestingly, the inefficiency of the Chinese central government and the resultant power accruing to Chinese regional and local government have made it impossible to produce or sell textiles in China without the formal and informal agreement of several tiers of politicians and officials.

It might be thought that the involvement of the United States government in the textile and clothing industry would be negligible. In fact the United States led the world in the protection of the textile industry with the import duties imposed by the first Congress in 1789. In the second half of the twentieth century the U.S. government developed the forerunners of MFA and shaped and to a large extent controlled MFA. The enormous amount of time and resources across the world that have gone into defending and evading MFA have largely been focused on access to the U.S.A. market. U.S. government policies of import quotas and tariffs, export and regional employment subsidies, agricultural subsidies, competition policy and environmental policies have all played an important role in shaping the size and structure of the global textile and clothing industry, culminating in the formation of NAFTA. The successful implementation of the

Punta del Este agreement by WTO is dependent on U.S. government support.

The conclusion is that government has played, and is continuing to play, a decisive role in the development and structure of the global textile industry (proposition 1). In line with proposition 2 it can also be seen that government is a direct and indirect component of firm, industry and national competitive advantage, and should be included in the relevant strategic management theory.

Chapter 4.
The Concept of Political Competitive Advantage (PCA).

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4.1. Introduction.

This chapter develops a new concept of ‘political competitive advantage’ (PCA). PCA theory is built upon, and is an extension of, the core concepts derived from competitive advantage theory, internalization theory and the resource-based view of the firm as set out in chapter 2.

It should be noted that one of the fundamental objectives of this thesis is that the research should be useful to strategic management practitioners. It must therefore provide a framework for the analysis of PCAs and contingent strategies that can be readily operationalized.

The PCA concept is embedded in strategic management theory but it is also experiential and intuitive. *Prima facie* it would seem unlikely that the time spent on firm/government contact, and in developing firm/government networks and relationships, has no effect on firm competitiveness at all, or only affects it in a neutral manner.

Managers, especially those in multinational firms, spend a good deal of time dealing with government in one form or another. Points of contact with government are numerous, often department-specific and uncoordinated. Government contact ranges from reactively fulfilling statutory requirements, for example on health and safety, engineering, accountancy and employment to proactively working to secure government modifications either in legislation or in the implementation of legislation as defined by government bureaucracies. Examples of proactive persuasion of government are frequently to be found over local and national issues such as applications for planning permission, interpretations of tax and employment legislation, but also include supranational-

level and high-profile cases before the World Trade Organization (WTO) over non-tariff barriers, fair trade and ‘dumping’.

The theory of internalization explains that firms develop internal markets in response to externalities (see chapter 2). Here it is argued that governments produce externalities that are sources of politically-derived advantages and disadvantages to firms. Political advantages and disadvantages may be derived from “government” in its widest form, at local, national, regional and supranational levels.¹⁰

Since each firm has a unique structure of assets and networks, some politically-derived advantages (PAs) and disadvantages (PDs) impact asymmetrically on firms and may give rise to firm-specific, politically-derived competitive advantages (PCAs) and disadvantages (PCDs). This is most clearly demonstrated with multinational enterprises (MNEs). PAs and PDs derived from government activity will affect MNEs in markedly different ways to domestic firms.

Having reviewed the literature on competitive advantage, two fundamental concepts, efficiency and endogeneity, have been selected to demonstrate the mechanisms by which government affects industries and firms, and to provide a framework for firm-specific strategic thought and planning.

Examples taken from international trade literature are particularly useful

¹⁰ “Political” is defined in the Oxford English Dictionary (OED) as: “Of, belonging or pertaining to, the state, its government and policy; public, civil; of, or pertaining to the science or art of politics” but “government-derived competitive advantage” would be too narrow a definition. The reason for referring to “political competitive advantages” (PCAs), rather than “government-derived competitive advantages”, is that PCAs can be derived from any political source including NGOs, quangos, political parties and individuals, as well as from government.

to strategists since it is relatively simple to demonstrate that government-derived tariff and non-tariff barriers (NTBs) often fall asymmetrically on foreign and domestic firms.

4.2. Political Competitive Advantage (PCA) – Efficiency and Endogeneity.

Figure 4.1. classifies sources of political advantage resulting from political externalities into an efficiency and endogeneity framework. Firms are faced with sources of political competitive advantages (PCAs) in all four quadrants.

{Insert figure 4.1. here}

The vertical axis in figure 4.1. reflects the extent to which the firm's directors and managers regard the sources of firm-specific competitive advantage as within their control (endogenous) or outside their control (exogenous). In quadrants 1 and 3 the sources of the firm's competitive advantages are regarded as exogenous and outside the control of owners and managers. In quadrants 2 and 4 the sources of PCAs are regarded as endogenous and within the control of owners and managers, that is to say manageable.

The horizontal axis represents efficiency, defined as the least inputs for a given level of output. The quest for increased efficiency, i.e. fewer inputs for the same outputs, is the underlying rationale behind most strategic management planning. The quest for efficiency is also a quest for waste reduction since

maximum efficiency produces minimum waste.

In addition to efficiency improvements in their supply and value chains, firms try to develop sustainable core competences and capabilities that enable them to satisfy dynamic customer expectations for increasing consumer surpluses. Sustained, long-term, firm-specific success is difficult to achieve unless the firm can deliver enhanced value to its consumers more efficiently than its competitors and potential competitors. In competitive markets profitable firms will soon be challenged by competitors employing different combinations of fixed and human assets to deliver the same, or enhanced, value to consumers at lower costs.

Firm strategies can be efficiency- or non-efficiency-oriented (Rugman and Verbeke, 1990a, 1998a, 2001). Efficiency-based strategies aim to achieve firm survival, profit and growth through: a) the provision of cheaper and/or better products and services to the firm's customer than those of potential competitors; b) transaction cost minimizing behaviour that is possible because of market imperfections resulting from opportunism, information uncertainties, asset specificity and bounded rationality; and c) the development of resources and capabilities in line with the resource-based view of the firm (RBV).

Non-efficiency-based strategies aim to achieve firm survival, profitability and growth, or any other set of objectives, by means other than a), b) or c) above.

Unlike Rugman and Verbeke, it is argued here that both efficiency and non-efficiency strategies may lead to competitive advantages that form barriers to the entry of potential competitors and to opportunities to earn rents.

Firms endogenize or internalize transactions in order a) to replace the

imperfections and inefficiencies of the market; b) to obtain shelter by gaining partial control over a source of competitive advantage.

Figure 4.1a. is a repetition of the matrix in figure 4.1. with generic examples of firm strategies aimed at obtaining political competitive advantage inserted. It uses the 4.1. efficiency/endogeneity framework to analyse politically-derived competitive advantages. The two axes in figure 4.1a form four quadrants, representing four generic strategies that enable firms to gain PCAs from government externalities. Quadrants 1 and 3 represent the exogenous, public solution to market failure, while quadrants 2 and 4 represent the endogenous, private solution to market failure.

(Insert figure 4.1a. here)

Examples of pre-competition research, development and training are given in the efficiency quadrants 1 and 2. Examples of PCAs gained from protectionist policies of national tariffs and non-tariff barriers are used as examples in the non-efficiency quadrants 3 and 4.

Figure 4.1a. Quadrant 1

Reactive strategies to gain firm-specific, efficiency-based advantages from exogenous, generally available, government externalities.

An efficiency-based strategy reduces cost and/or increases differentiation. Strategies in quadrant 1 are reactive to politically-derived externalities (PAs and PDs), over which the firm has no control. The firm, however, does have a choice of how to react to general government policies and try to predict future government policies. Different firms and managers will react differently due to their different asset structures, resources and capabilities, levels of bounded rationality, information and knowledge etc. Some firms will pursue emergent and/or planned strategies that result in greater economic returns than other firms. A successful response to a government externality will give a firm a political competitive advantage (PCA).

A firm may decide that a particular line of research could lead to an important technological break-through. If the existence of a generally available pre-competition grant is known to the management, the firm may apply for it in the usual manner. If it secures the grant, the firm has entered into an efficiency-based research partnership with the nation, local authority or region, where part of the cost is borne by the taxpayer. The firm has received a quadrant 1 reactive political advantage (PA). Depending on the terms of the grant, the firm will have obtained ownership of the research, which even if generally published, will probably contribute some skills and knowledge to the participating firm that are not available to other firms, thus potentially creating a competitive advantage (PCA) as well.

Many firms may receive the same externality. For example an improvement in transport infrastructure may benefit many firms in many national industries, reducing commuting, distribution costs etc. They will all receive a general political advantage (PA). This will give them all a politically-derived competitive advantage (PCA) over imports from firms located in countries that have a less efficient public transport infrastructure and higher resultant costs. Even within one country some domestic firms, competing with other domestic firms operating in regions with poorer transport infrastructures resulting in higher costs, will receive a political competitive advantage (PCA).

Economic theory suggests that economic efficiency can be increased by government subsidies for research and development (R&D). In perfect competition or monopolistic competition, firms cannot invest in long-term R&D because, as price takers, they would be put out of business by the lower costs of their competitors. One of the advantages sometimes claimed for oligopolies, over more competitive markets, is that they encourage long-run innovation, resulting in cost-reducing methods and new products. These dynamic gains may even compensate for the allocative efficiency loss. Whether or not this is so, lack of long-term R&D is an example of market failure in contestable markets.

Pure research may lead eventually to greater economic efficiency. If firms are unable or unwilling to invest in possible future efficiency enhancement, a case can be made for exogenous R&D investment and subsidies and for a government role in the promotion of long-term economic efficiency. Long-term R&D is an extremely important contribution to national and global economic growth, since it

may lead to increased scientific breakthroughs that radically increase technological efficiency, permitting equal output with lower or cheaper inputs. Governments offer generally available subsidies to R&D and training which are generally thought to be equally available to all firms but which in fact will be more easily obtained by firms possessing more appropriate fixed and human asset structures.

R&D subsidies are rarely pure public goods and generally have an asymmetrical effect on individual firms. In practice by internalizing and mixing public goods, quasi-public goods, and private goods and services into complex final goods or services packages, all the individual elements can have a value assigned to them. The unique combination of capabilities and resources of each firm will result in unique value chains. Even if two firms have very similar levels of access to information, of bounded rationality and of opportunism, in practice their performance is likely to differ considerably. First-mover advantages may block or severely limit the ability of latecomers to appropriate the same amount of added value. Penalties for latecomers, or for firms with less appropriate asset structures, may involve higher exploitation costs for some firms than for others. Firms therefore design reactive strategies to efficiency-enhancing, exogenous government actions in the knowledge that competitors may not be capable of adding value to the same extent.

The question of whether efficiency-promoting government R&D subsidies are public or quasi-public goods is not of crucial importance to strategic management. Even if every firm took equal advantage of a public good, for

example of a government-funded, technological, cost-reducing breakthrough, and each firm obtained exactly the same increase in added value, gaining no competitive advantage, the firm strategy would still fit into quadrant 1. If all firms gain the same advantage at the same cost, it is still an example of an exogenous, efficiency-increasing PA, although no one firm receives a PCA. In practice this is extremely unlikely to be the case even among domestic competitors, and out of the question for a foreign firm relative to a domestic firm.

Figure 4.1a. Quadrant 2.

Proactive strategies to gain firm-specific, efficiency-based advantages from endogenized government externalities.

Efficiency-based advantages derived from proactive firm strategies that endogenize government activities have received little attention. Here firms design strategies that internalize or partially internalize government decision-making processes aimed at increasing government efficiency and firm-specific efficiency at the same time. This offers firms the possibility of increased producer surpluses and the potential to offer increased consumer surpluses to their customers.

A firm strategy aimed at lobbying government for a pre-competition research grant would be placed in quadrant 2. A firm that obtains a research grant from government as a result of interaction with politicians or bureaucrats has successfully pursued an endogenous, efficiency-based strategy and the firm has gained a firm-specific political advantage. Since the effects of such subsidies are almost certain to confer asymmetrical advantages to different firms these political

advantages may result in firm-specific superior returns (Kor and Mahoney, 2000). Firms will therefore try to obtain R&D subsidies in the knowledge that they may be able to secure quadrant 2 political advantages that yield superior returns.

Some R&D government subsidies have been accepted by international trade organizations. Leaving aside definitional problems, and the difficulties of identifying cheating, subsidies for pre-competitive research and development (Tyson, 1992, p.250) have been accepted as legitimate “green box” or “green basket” (Jackson, 1997, chapter 11) subsidies by the U.S.A. and the EU. The green-light acceptable category (“green box” or “green basket”) “is in principle limited to subsidies that are welfare-enhancing and those that serve acceptable national economic objectives such as regional development and worker adjustment assistance” (Tyson, 1992, p.284). Disputes in this area have centred round pre-competitive subsidies in response to the market power of foreign firms (e.g. the European Airbus case). However these may be seen as part of a wider 'infant industries' argument that may in reality be part of a non-efficiency, national protection policy. Genuine government pre-competitive R&D subsidies result in real increases in productive efficiency that would not have occurred without the subsidy, and which have the potential to benefit the whole world.

In practice even firms reacting to generally available R&D grants may well have to enter into considerable discussion with government in order to find out exactly what research grants are available and how best to present their project in order to obtain the grant. This is often very time-consuming and many firms simply do not have the skills, the management time or the advisers to pursue

such grants, thus rendering the grants less than generally available. In the discussion process firms may be able to take a proactive role in order to secure subsidies for firm-specific research.

There is a risk that a successful R&D project, resulting in the creation of a firm-specific competence, may be generally disseminated or specifically communicated to possible competitors, before it can generate superior returns as a PCA. If the research is genuinely pre-competition then this may not be a problem, but the directors and shareholders of the firm are unlikely to want the firm to engage in pure research for the sake of it. There is a considerable danger that government-funded research may only receive partial publication, further endogenizing the PA into a PCA. The boundary between pre-competitive research and competitive research is in practice very thin from the outset.

The important and often overlooked point in the discussion about the use of public money to subsidise firm-specific R&D, is that efficiency-based firm-specific PAs have the potential to increase consumer surpluses as well as producer surpluses, the two components of firm added value and economic growth.

Further examples of quadrant 2 political advantages obtained from government are set out in chapter 5. Firms and governments have a mutual interest in encouraging efficiency-seeking strategies. For governments and citizens increased economic efficiency is the means of increasing wealth-creation and economic growth, offering the possibility of higher standards of living. For firms, quadrant 2 endogenous efficiency-based political advantage strategies are generally considered more sustainable than those obtained from shelter in

quadrant 4. Chapter 5 will show that this is not always the case and that MNEs can develop sustainable PCAs in all four quadrants.

Since the search for political neutrality is a non-starter because of the asymmetrical incidence of government externalities upon unique firm structures and networks, it will be argued that transparent quadrant 2 relationships between government and firms should be encouraged provided that the benefits to the consumer and to the producer are monitored and published.

Figure 4.1a. Quadrant 3.

Reactive strategies to gain firm-specific, non-efficiency-based advantages from generally available government externalities.

Non-efficiency based firm-specific advantages enable a firm to increase operator surpluses and returns without increasing or potentially increasing consumer surpluses.

When the sources of advantage are truly outside the firm's control, firm strategies can only be reactive. A typical example of an exogenous non-efficiency-based source of firm-specific advantage is a national, generally applied, import tariff. A tariff is a tax levied on imports of goods or services (Bowen, Hollander and Viaene, 1998). Such a tariff raises the domestic price above the external world price. Tariffs reduce the volume of imports and thus reduce the level of competition to domestic firms. By restricting supply, tariffs move the equilibrium price point upwards, permitting domestic firms to increase the margin between price and cost and to secure returns superior to those

available in the absence of the tariffs. Domestic firms may also have an opportunity to increase production volumes to compensate for the volume effects of the tariff on imports. Domestic firms and MNE subsidiaries will gain non-efficiency, exogenous PAs. Since each firm has a unique capital and human asset structure, the tariff barrier will have an asymmetrical effect on different firms, giving some firms a PCA compared with others.

Porter recognises that government entry barriers will give rise to “protected niche” strategies whereby “firms seek out countries where governmental restraints exclude competitors by requiring a high proportion of local content in the product, high tariffs and so on. Such a firm must develop the capabilities to deal effectively with those particular national markets and places extreme attention on the host government in order to ensure that protection remains in force” (Porter, 1980, p.295). Such capabilities are unlikely to be developed simultaneously and to the same extent by all competing firms. Some firms will gain PCAs in this area that may give them considerable competitive advantages, including first-mover and negotiating advantages.

A foreign firm might pursue a variety of reactive strategies. It might reduce profit margins so that its exports could compete in spite of the tariff. It might find partners behind the tariff barrier in order to license or franchise its goods and services. It might become a multinational and create a subsidiary behind the tariff barrier by setting up a new company or buying an existing company.

Some firms will simply take a strategic decision to exit and not bother to

participate in that particular geographic market because the usual strategic assumption of constant profit-maximization is not realistic. Some MNEs may decide to invest in other countries where tariffs are not present and their introduction seems unlikely. Others will regard that country as vital and go to great lengths to circumvent the tariff barrier.

Profit-seeking firms try to position themselves so as to obtain maximum advantage from the general non-efficiency PAs and PDs offered by the political externalities created by the trade policy of one nation or region. Such externalities may result from deliberate government policy or they may arise from unforeseen effects of other policies. All nations have policies and rules on internal trade and international trade and “any policy that affects relative costs, or demand, or labour markets can shift the international trading environment, favouring some firms at the expense of other” (Spar, 2001, p.208). More specifically from an international business perspective, Spar lists five different kinds of domestic policy: trade policy, foreign direct investment policy, capital controls, regulation, and competition policy, as examples of national government policies that affect firms (Spar, 2001, pp.206-231).

Over the last few decades tariffs have been lowered in many countries and non-tariff barriers (NTBs) have become the principal focus of studies of the extent to which international trade is distorted and restricted (Bhagwati, 1988; Deardorff and Stern, 1998). Porter lists several “governmental impediments” to global trade that serve as entry barriers and reduce economic efficiency – tariffs and duties, quotas, preferential procurement, local content rules, preferential tax treatment,

domestic laws disadvantageous to international firms (Porter, 1980, p.286).

The range of NTBs is almost infinite (Deardorff and Stern, 1998, appendix 1). Government-derived NTBs include government subsidies, government procurement policies, state trading monopolies or exclusive franchises, industry and regional policy, government-financed R&D, taxation and social insurance systems, macroeconomic policy, competition policy, foreign investment policy, anti-corruption policy and immigration policy.

NTBs can affect trade directly and indirectly. If the technical certification for imports of certain goods takes longer than for domestically produced goods, then trade is affected directly. A general or local wage subsidy, however, perhaps in the form of lower wage taxes or social security payments, affects trade indirectly. The growing use of NTBs rather than tariffs reflects the lack of clear GATT rules. The WTO since 1995 has tried to include NTBs more specifically in its framework of administered protection (Bowen, Hollander and Viaene, 1998, chapter 2).

The difficulty of applying technical standards fairly to domestic firms and foreign firms alike is in itself partly technical. The use of price comparisons may be misleading since price differences may not in themselves reflect barriers to trade. Detailed estimates of added costs are required in order to make accurate comparisons. In some cases governments require higher standards of imported goods than of domestic production, or regulations may be more stringently applied to imports or, again, the imports may be subject to more cumbersome and costly certification procedures (Deardorff and Stern, 1998, p.42). Such technical

problems, where greater expertise may reside in firms than in government, can provide opportunities for proactive, quadrant 4 strategies,

The complexities of analysing the exogeneity of non-efficiency-based government-derived PAs and PDs are amply illustrated by the textile Multifibre Arrangement (MFA). MFA is a supposedly voluntary export restraint (VER) system, where import quotas are allocated to competitive firms in foreign countries. The problems of measurement and policing are great (Deardorff and Stern, 1998, pp.20-21; 32-33), especially as firms are allowed to sell unused quotas. The price effects of VERs are difficult to model. The quantity effects, which should be easier to analyse since the quantities permitted by the VER and the actual quantity traded are both observable, require complex and accurate modelling of industry supply and demand over time. Importantly, the supply and demand curves of individual firms are not reflected in industry averages. An MNE subsidiary will usually have a very different cost structure to a domestic firm. The result is that MFA represents a poor compromise between exporting and importing countries. Firms have developed reactive strategies to exploit the loopholes in both the concept and the implementation of MFA (Yoffie, 1983). Further proactive, quadrant 4 strategies have evolved as firms seek to endogenize government policy towards MFA. Interestingly national governments have tried to endogenize supranational agreements as some individual countries and firms have learnt how to manipulate MFA in their national and/or private interest (Dickerson, 1999).

MFA is also an excellent example of the unintended externalities that arise

from poorly drafted and poorly implemented government policies. Differences in the application of government policies result from the varying efficiency of different governments. If government employees in one country are less efficient in the application of policy than in another, for example re quota agreements, the firms in the country with the less efficient civil service will suffer a politically-derived disadvantage (PD). This argument can be extended to all the activities under government control. Government employees are also subject to asymmetrical information flows, bounded rationality and opportunism (Lindbloom, 1959). The varying efficiency with which all the government-controlled infrastructures of communications, healthcare, education and social security may be administered, from level to level and from location to location, will impact on firms' efficiency and costs in different ways and in different amounts. Such differential costs, due to varying government efficiency, form unintentional NTBs.

The higher costs of goods and services due to tariffs and NTBs are paid for by consumers, both households and firms. The cost of European Union protection is estimated to have been just over 90 billion euro in 1990 (Messerlin, 2001, p.50), depending on the model used. Using the Hufbauer and Elliott (1994) model, the costs of protection to U.S. consumers and to European Union consumers were both estimated at around 70 billion dollars in 1990.

Political externalities, creating PAs, PDs, PCAs and PCDs, arise from the manner in which government policies are implemented by the bureaucracy. It may be, for example, that a theoretically sound firm strategy based on an investment

behind a tariff barrier is rendered impossible by bureaucratic delays and uncertainties. Customs policy and practice can vary greatly, and customs classification systems vary between countries and, in some countries, from one port to another. In extreme but well-known cases, clearance procedures can differ from week to week. Such inconsistencies cannot be dismissed as aberrations to otherwise orderly systems, or to generalised arguments, since they can greatly affect firm costs over long time horizons. Among such exogenous non-efficiency NTBs should be included inefficient ports and airports that confer an extra cost on imports, and therefore a political advantage on domestic firms.

Figure 4.1a. Quadrant 4

Proactive strategies to gain firm-specific, non-efficiency-based advantages from endogenized government externalities.

Some MNEs may accumulate and develop particular resources and capabilities that enable them to negotiate favourable arrangements with host governments, obtaining PCAs from proactive non-efficiency quadrant 4 strategies that lead to superior profits.

The complexities of tariffs and NTBs provide opportunities for proactive, firm-specific, quadrant 4 strategies. The use of government regulation as a non-efficiency adjunct to efficiency-based strategies has been studied by Gale and Buchholz (1987). Rugman and Anderson (1987) draw attention to the growing number of import barriers arising from the use of technical objections to free trade and argue that this has developed into a system of “administered protection” in the United States. The system gives rise to complex firm strategies designed to

gain political competitive advantage. Salorio (1993) gives several excellent and detailed examples of endogenous, non-efficiency-based firm strategies, using technical track, administered protection, to improve the competitive position of “individual firms vis-à-vis specific industry rivals, both foreign and domestic” (Salorio, 1993, p.120).

Rugman and Verbeke (1989) have developed the concept of shelter to encompass firm strategies that are proactive in obtaining non-efficiency advantages from trade policy. Here, firms are not just reacting to the exogenous government trade policy measures to be found in quadrant 3, “but actively lobby and interact with government bureaucrats and politicians as a means of endogenizing the political process to their own advantage. In this manner trade policy moves from the realm of the neutral state and the technical administration of democratically determined laws and procedures, towards a more commercial and self-serving set of competitive entry barriers” (Rugman and Verbeke, 1989, p.140). They argue that firm strategy of this type will only result in short-run competitive advantage. Shelter, by definition, protects uncompetitive firms and industries at the expense of consumers and long-run national interest. The resultant entry barriers usually result in the perpetuation, or development, of inefficiencies that erode the long-run competitive edge of the firm.

Rugman and Verbeke confine their concept of ‘shelter-based strategies’ to firms consciously and proactively seeking to secure or maintain firm-specific advantages (FSAs) obtained from government (see chapter 2). Yoffie (1983) has termed this behaviour “private goods strategy”. Most studies of commercial

pressure on government have been conducted at industry or interest group levels (Lowi, 1964; Krueger, 1974; Brock and Magee, 1978; Becker, 1983). A typical example is where domestic companies join together as an industry to gain shelter from foreign competition (Rugman and Anderson, 1987).

Shelter-based literature has concentrated on tariff barriers but non-tariff barriers (NTBs) can give equal or enhanced shelter. NTBs are usually thought of as being exclusively derived from government but the characteristics of NTBs (reduction in import quantities, increase in import prices, changes in elasticity of import demand, variability over time, uncertainty, welfare costs and resource costs) can also be derived from private arrangements between firms. MNE/MNE arrangements, such as barter arrangements, can be examples of NTBs. Such PCAs often include obtaining favourable tax and/or location advantages in return for foreign direct investment and local employment.

Various examples taken from Coats, and set out in chapter 5, confirm the efficiency-eroding tendency of shelter-based firm trade policy strategies, although it is also shown that the duration of shelter-based, non-efficiency political advantages can be longer than is usually supposed.

4.3. The Political Competitive Advantage (PCA) Analytical Framework.

This section presents a comprehensive strategic management PCA analytical framework.

A firm gains politically-derived advantages and disadvantages from externalities produced by different levels of government (local, provincial, regional and supranational) and from other non-commercial political sources such as political parties and NGOs. These political advantages and disadvantages (PAs and PDs) are so numerous and complex that they defy analysis. However, from a strategic management view, the firm is only interested in those PAs and PDs that have a significant impact on firm survival, profitability and growth.

Since each firm has unique characteristics and a unique value chain, PAs and PDs have an asymmetrical impact. In some cases they become factors critical to firm success and superior returns i.e. part of its competitive advantage (CA). Politically-derived competitive advantages (PCAs) are a subset of firm-specific CA.

Some PCAs are efficiency-based advantages and add value to the product or service by decreasing its cost and/or increasing its uniqueness to the consumer. Lower costs increase firm added value. Both lower costs and product differentiation have the potential to increase firm returns as well as consumer value.

Other PCAs, such as shelter, are non-efficiency-based, and potentially increase firm returns by reducing competition. Some politically-derived externalities reduce consumer choice and, *ceteris paribus*, raise price equilibria

e.g. a tariff. Tariffs increase firm costs and, usually, consumer costs. Because the impact of this non-efficiency, politically-derived externality is asymmetrical, most obviously between domestic and foreign firms, profit-seeking firms will try to increase firm returns and gain superior competitive advantage.

Both efficiency- and non-efficiency-based competitive advantages can increase product uniqueness which in turn will reduce competition and produce superior firm returns. However the former are generally thought to be more sustainable than the latter because they are more manageable. Sustainability is important to shareholders and share value and therefore it is especially important to MNEs with publicly traded shares. Strategists usually argue that competitive advantages and potential competitive advantages must be understood and managed if they are to be sustained over long time horizons. The endogeneity or manageability of CAs is critical to the successful firm. Firms can gain some degree of management over exogenous politically-derived externalities by devising appropriate reactive strategies that enhance positive PAs or reduce negative PDs. By devising better reactive strategies (for example by employing better tax consultants) firms can increase firm returns. Proactivity signifies endogeneity or internalization whereby the firm gains a higher degree of control by managing the source of the political externality itself. Partial endogeneity can take place, signifying different degrees of internalization of the political activity into the firm hierarchy. However, truly proactive strategies require full internalization, to the point where the firm's managers are confident that they are managing the source of the political externality.

By implementing reactive and proactive strategies firms can enhance PCAs and reduce PCDs and increase their competitive advantage: for example, by taking advantage of the shelter provided by government tariffs to increase prices and returns. However an MNE might choose to reduce the effects of a non-efficiency political externality such as a tariff on itself and/or on its customers by reactive strategies designed to absorb extra costs within the firm, or by circumventing the tariff. MNEs have greater strategic choice, either to gain superior non-efficiency returns from shelter over competitors less able to benefit, or to circumvent tariffs, for example by exploiting loopholes in the tariff barriers by importing semi-assemblies that fall into different tariff categories.

The concept of competitive advantage is a firm-level concept. Industry and national competitive advantage are aggregates of firm-level CA. MNEs are collections of interconnected location-based profit centres. Location is of critical importance since a successful and diversified MNE gains most of its competitive advantages, i.e. superior returns, from the location-based relationships. Few MNEs can simply roll out one set of products and services around the world, supplying the same formula to different sets of customers, directed from the centre. Most MNE profit centres have unique upstream supply chains as well as unique downstream relationships with wholesalers, retailers and consumers. Each successful profit centre has unique CAs, the sources of which are quickly obscured by consolidation. All these PCAs impact on the location-based profit centre. Many PCAs are the result of local, provincial and national government activities, but many are also the result of the activities of governments in other

countries, be it at local, provincial, national, regional or supranational levels. It is for this reason that a PCA analytical framework must be primarily location- and profit-centre-based.

Figure 4.2. divides the sources of PCAs into four groups:

{Insert figure 4.2. here}

The horizontal axis of figure 4.2, which measures efficiency, is exactly the same as in figure 4.1. Some political externalities impact on some firms in such a way as to raise firm efficiency, reducing inputs for the same output. Others reduce efficiency, increasing inputs for the same output. Because of the asymmetrical incidence of the impact of PAs and PDs upon firms, some firms will benefit more than others.

The vertical axis reflects the impact of PAs on firm profitability and growth, and this is expressed as impact on firm returns. The vertical axis is

confined to high impact, and potentially high impact, PAs. Low impact, or weak, PAs and PDs are of almost infinite variety and are not of strategic interest.

The important concept of negative advantage, or political competitive disadvantage (PCD) is introduced on the vertical axis, the result of the impact of negative political externalities upon the firm. This enables the matrix to cope with the complex and dynamic nature of PCAs. Both government and the firm are in multi-level dynamic relationships. Some government sources produce PAs and PDs with positive and negative effects simultaneously and these effects must be netted off to arrive at the overall effect on the profit centre.

Figure 4.2. Quadrant 1.

High impact politically-derived, efficiency-based PCAs that are crucial to firm success. That is to say they have an important and positive effect on firm returns, by increasing firm efficiency.

Figure 4.2. Quadrant 2.

High impact politically-derived, efficiency-based PCDs that are important barriers to firm success. That is to say they have an important and negative effect on firm returns, by reducing firm efficiency.

Figure 4.2. Quadrant 3.

High impact politically-derived, non-efficiency-based PCAs that are crucial to firm success. That is to say they have an important and positive effect

on firm returns, by reducing the advantages of the firm's competitors.

Figure 4.2. Quadrant 4.

High impact politically-derived, non-efficiency-based PCDs that are important barriers to firm success. That is to say they have an important and negative effect on firm returns, by increasing the advantages of the firm's competitors.

Firms have eight groups of strategic responses open to them in order to enhance PAs or reduce PDs, so as to increase PCAs and increase firm returns. These can be pursued singly or in combination.

Four are efficiency-based strategies. Successful firms will achieve superior returns by implementing superior reactive and proactive strategies and gaining competitive advantage. Efficiency-based strategies can reduce inputs for the same outputs, increasing firm added value and, potentially, increasing value to the consumer without increasing price.

Typically firms try to increase efficiency in order to increase consumer value and firm returns simultaneously, by reducing costs and/or increasing differentiation and price. Profit centre employees manage the value chain of each product, reducing the costs of producing the existing product range and introducing new products with equal or higher margins where there is consumer demand. Obtaining price increases above inflation on existing products and

services is usually quite difficult, so firms must budget costs carefully, and are very sensitive to relatively small changes in costs that will undermine budgeted margins and/or reduce the projected profitability of new products. Cost changes attributable to government are dynamic and not always predictable. Increases in government-derived costs such as taxes or infrastructure failures are often unexpected and therefore unbudgeted.

In addition to improving efficiency constantly and incrementally by introducing practices and technologies which raise factory productivity, MNE profit centres usually have a whole range of strategic make/buy alternatives (Venkatesan, 1992) available to them for responding to efficiency losses due to cost and/or differentiation changes. Most MNE profit centres can switch their mix of products between local production and imports, usually from other subsidiaries.

Four strategic options are non-efficiency-based strategies, two reactive in response to exogenous government activities, and two proactive whereby the firms endogenize government actions in order to reduce competition and gain competitive advantage.

Figure 4.2a. has exactly the same efficiency/profitability axes as figure 4.2, but is divided into eight cells enabling it to handle three sets of variable: profitability, efficiency, and endogeneity. The vertical axis measures the impact of PCAs and PCDs upon profitability. The horizontal axis distinguishes between efficiency and non-efficiency. The division into cells allows each quadrant to

divide reactive strategies to exogenous PAs and PDs, from proactive strategies that endogenize government activities in order to enhance PAs or reduce PDs. Both reactive and proactive strategies aim to enhance PCAs and/or reduce PCDs.

(Insert figure 4.2a. here)

Figure 4.2a. Cells 1A and 1B.

1A. Reactive firm strategies that try to optimize political advantages derived from generally available government activities that reduce firm costs or increase firm differentiation advantages. Such strategies will optimize the available benefits from politically-derived efficiency-based advantages and may, because of the asymmetrical incidence of PAs on firms, give the firm politically-derived competitive advantages (PCAs).

1B. Proactive firm strategies where the firm gains PCAs by endogenizing government activities that will specifically reduce firm costs or increase firm differentiation advantages.

Figure 4.2a. Cells 2A and 2B.

2A. Reactive firm strategies that attempt to minimize the impact of generally available government activities that lead to increased firm costs and/or decreased firm differentiation advantages.

2B. Proactive strategies that endogenize government activities specifically in order to reduce the impact of PCDs that increase the costs and/or decrease the differentiation advantages of the firm.

Figure 4.2a. Cells 3A and 3B.

3A. Reactive firm strategies that optimize firm PCAs gained from generally available government activities that reduce firm competition and increase firm monopoly power.

3B. Proactive strategies that gain PCAs by endogenizing government activities and specifically aim to reduce firm competition.

Figure 4.2a. Cells 4A and 4B.

4A. Reactive firm strategies that aim to reduce firm-specific PCDs incurred from general government activities intended to increase competition.

4B. Proactive strategies that reduce PCDs by endogenizing government activities in order to reduce firm competition.

Competitive advantages are firm-specific advantages, that is, advantages that are superior to those of the competition. (In the case of MNEs the competitors are often other subsidiaries of the MNE itself: see chapter 5.)

In the case of political externalities, firms with the appropriate resources, competences and capabilities can gain greater advantage from PAs, and suffer less disadvantage from PDs, and thus reactively or proactively gain firm-specific advantages (FSAs) that are superior to those of its competitors. Some firms will react better than others due to their unique combination of assets, networks, information, rationality and capabilities, thus gaining competitive advantage. Some firms will be better placed to gain control over certain government activities and to channel them proactively to their own advantage. This is not necessarily 'bad'. In some cases firms endogenize government activities in order to increase overall efficiency, for example by improving inefficient aspects of government infrastructure, in its own interests but also to the benefit of the wider population of that location. MNEs can develop capabilities that enable them to manage politically-derived externalities better than competitors. An MNE employing large numbers of people in one location will have an advantage in developing proactive strategies in partnership with local and national government. Small flexible companies with few employees may gain advantages by simply avoiding the attention of governments and NGOs. Both can develop unique capabilities in the management of political externalities and the creation of PCAs. Importantly for MNEs, some of these capabilities will be transferable to other locations.

The impact on profitability of politically-derived externalities (PAs and PDs) is shown on the vertical axis. However since this is a strategic management thesis and political externalities are so numerous and complex, figures 4.2. and 4.2a. limit the political externalities analysed to those that are the sources of

important political competitive advantage and disadvantage (major PCAs and PCDs). Some of the forces that produce superior profitability are politically-derived advantages (PAs). Firms with superior returns frequently possess strategies, planned or emergent, reactive or proactive, that enable them to use their unique structures and networks to convert PAs into PCAs. By reducing PDs firms can also gain comparative PCAs, in the sense that they experience fewer politically-derived disadvantages than competitors. Profit-seeking firms will try to devise reactive and proactive strategies to enhance PCAs and reduce PCDs. Successful firms will achieve a net positive balance of PCA over competitors, manifested as superior competitive advantage and superior returns.

The analysis of PCAs and PCDs cannot be limited to proactive strategies. Reactive strategies are just as important. Firms can often devise reactive strategies that avoid the costs and hazards that may be associated with proactive political strategies. Strategic management planning requires a holistic view of strengths, weaknesses, opportunities and threats, and any limitation of the strategic horizon reduces the ability of management to gain some measure of control over the future. By understanding the asymmetrical nature of the impact of PAs and PDs upon different firms, strategic management can gain PCAs from commonplace positive government externalities, such as close proximity to a good new hospital (see chapter 5).

This chapter has developed the concept of PCAs and PCDs. Following internalization theory it shows how government-derived externalities (PAs and PDs) have an impact upon firm value chains, and how firms, especially MNEs,

can manage these externalities, reactively and proactively, to gain politically-derived competitive advantages (PCAs).

The eight-cell PCA analytical framework enables firms to assess PCAs and PCDs for their impact on profitability, their endogeneity or manageability and their efficiency or non-efficiency characteristics. It also enables them to track and analyse PCAs and PCDs over time. Profit centre, location-based analysis will enable firms to recognize critical PCAs and PCDs, to identify their political sources and to devise reactive and/or proactive strategies accordingly. Firms can compare their PCAs and PCDs against those of their competitors, and MNEs can compare subsidiaries. The complex and dynamic nature of CAs and PCAs is the reason why strategic analysis and planning must be a continual and flexible process.

Figure 4.2a, the eight-cell PCA analytical framework, enables PCAs to be classified according to efficiency and endogeneity (manageability), but further analysed for a range of strategic constructs including efficiency, endogeneity, competitive/firm-specific advantage, location and profitability. In chapter 5 this PCA analytical framework is applied to the textile MNE, Coats Viyella PLC.

Figure 4.1.
Firm Strategies – Efficiency and Sources of Political Competitive Advantage (PCA).

		Firm Strategies	
		Efficiency-based	Non-efficiency-based
Sources of Political Competitive Advantage	Exogenous	1	3
	Endogenous	2	4

Figure 4.1a.
Generic Examples of Efficiency and Non-efficiency Firm PCA Strategies.

		Firm Strategies	
		Efficiency-based	Non-efficiency-based
Sources of Political Competitive Advantage	Exogenous	1 Reactive Strategies to Generally Available Public Policies - R&D and Training Subsidies	3 Reactive Strategies to Generally available Public Policies - Tariffs and NTBs
	Endogenous	2 Proactive Strategies to Gain Advantages from Government R&D and Training Subsidies	4 Proactive Strategies to Gain Advantages from Government Shelter-based Tariffs and NTBs

Figure 4.2. Sources of Political Competitive Advantage and Disadvantage.

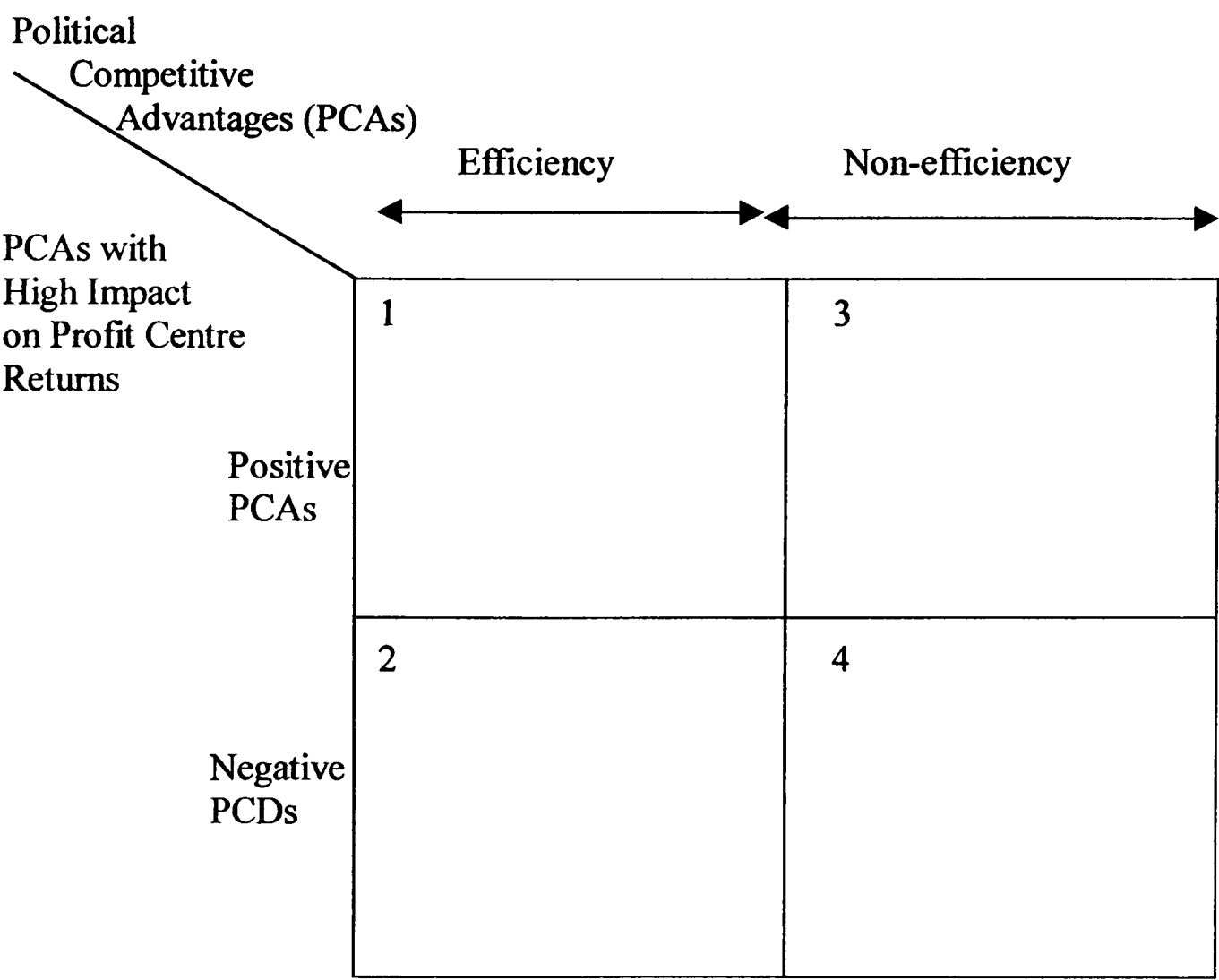
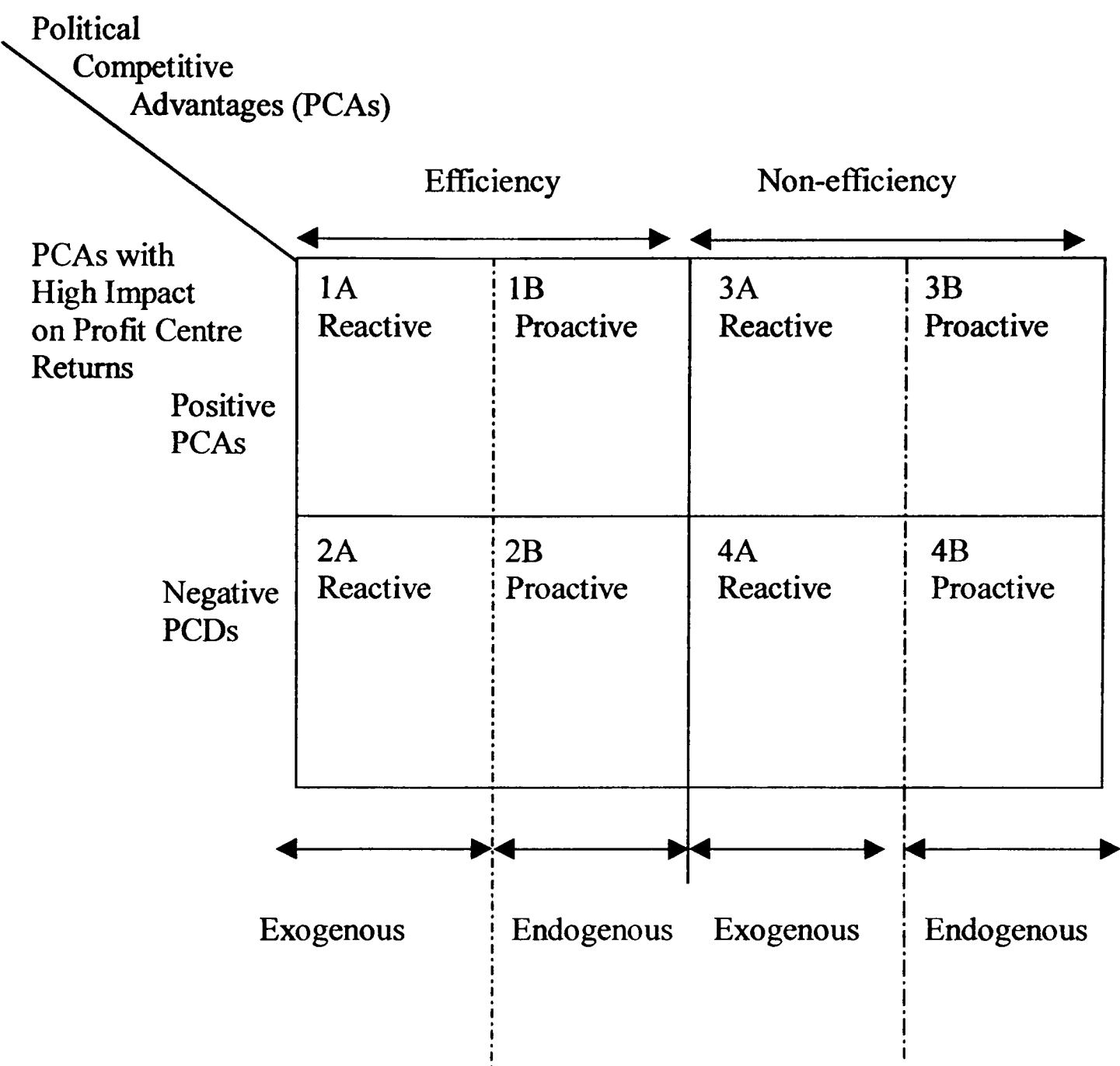


Figure 4.2a. Firm Strategies - The Eight-Cell PCA Analytical Framework.



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Chapter 5. Applications of Political Competitive Advantage (PCA) Theory.

5.1. Introduction.

This chapter applies the concept of PCAs, developed in chapter 4, to Coats PLC and its subsidiaries. Empirical case studies have been assembled from interviews and from desk research in the Coats archives in Glasgow and Manchester.

The eight cell PCA analytical framework introduced in chapter 4 enables management to carry out a comprehensive analysis of any and all the PCAs that have a substantial affect on the profitability of the firm. This analysis should enable management to formulate the appropriate strategy in order to increase and sustain profitability and growth by increasing the firm's unique set of PCAs and reducing PCDs. The firm can examine the myriad of interfaces that it has with various levels of government, identify opportunities and threats, calculate or estimate the magnitude of the impact that government has upon firm profitability and formulate strategies that will increase its efficiency and endogeneity.

Coats (see appendix) is the global market leader in the production and sale of industrial sewing thread. It has developed from a domestic and multidomestic company in the nineteenth century to a traditional global corporation in the twentieth century and is now facing up to the challenges of transforming itself into a modern global corporation with transnational aspirations (Stopford and Wells, 1972; Bartlett 1979, 1985, 1986; Bartlett and Ghoshal 1987, 1989, 1993, 1995; Ghoshal, 1987; Ghoshal and Bartlett, 1990; Ghoshal and Nohria, 1993; Doz, 1979, 1980, 1996a, 1996b, 1988; Doz and Prahalad, 1980; Prahalad, 1976,

1990; Prahalad and Doz, 1987; Prahalad and Hamel, 1990; Yip, 1992; Hedlund 1986, 1994).

Following takeover and unsuccessful integration into Coats Viyella PLC, the core thread business is now under new ownership and has been delisted. Today the management have returned to the main strategic preoccupations of the 1970s and 1980s – how to capitalise on its dominant global position in order to achieve sustainable profit and growth. While it has no global MNE competitors, the cost of multinational structure makes it vulnerable to local and regional challenges offering lower prices and better service. Coats' search for strategic space involves increasing market share in areas where it has been challenged and weakened, or where traditionally it had less strength. The strategy behind purchase of Tootal was to re-establish dominance in the U.S.A. and to buy market share and manufacturing facilities in the Far East. As Coats struggles with the challenges of global integration and one-to-one local service, it comes increasingly into contact and potential conflict with government, political factions and NGOs. The balance between local production and imports has important political and employment dimension in many countries, including the U.S.A. The need to analyse the impact of government upon the firm has never been higher and is increasing. The identification and exploitation of strategic space for the firm as a whole requires multilevel and multidimensional strategies towards government.

Ten case studies have been selected to illustrate each of the eight possible PCA matrix configurations. A common methodology is used to analyse the cases:

- i. Possible examples of government-derived externalities resulting from an event or a specific action are selected.
- ii. The significance of the impact on Coats is analysed. Cases assessed to have a less than one per cent effect on the ROCE (return on capital employed) of the appropriate profit centre are dismissed.¹¹
- iii. The government sources of the externalities are analysed.
- iv. The strategic response from Coats is analysed.
- v. The nature and significance of the outcome is assessed.
- vi. Case study summary with the strategic response is linked to the appropriate location in the 8-cell matrix.

Positive government externalities confer political advantages (PAs) on the firm and increase, or have the potential to increase producer surpluses and firm returns. Negative government externalities confer political disadvantages (PDs) on the firm and reduce, or have the potential to reduce, producer surpluses and firm returns.

As a result of the unique asset structure, information, bounded rationality, opportunism etc. of each firm, politically-derived externalities have an asymmetrical effect and some firms may gain politically-derived competitive

¹¹ The common measure of profitability in Coats profit centres is operating profit divided by net assets (ROCE).

In 1991 Coats (the Coats Viyella Thread Division) had sales of £840.5m, the operating profit was £72.5m and net assets were valued at £527.1m. ROCE 13.75%.

For the Coats Viyella Group (CV) as a whole operating profit before interest was £131.9m and net assets £1039.7m. ROCE 12.7%.

After net interest (£20.5m) and tax (£36.9m), and excluding a surplus of £84.5m resulting from the disposal of a subsidiary, CV profit was £54.1m (£53.5, 1990). Total CV net assets £1039.7. ROCE after interest and tax 5.2%.

advantages (PCAs), while others may incur politically-derived competitive disadvantages (PCDs), from the same set of actions.

Profit-seeking firms will try to optimize the PCA opportunities presented to them by PAs, and to minimise the impact of PDs.

Government activities affect firm competitive advantage and firm returns in four ways, represented in the four quadrants of figure 5.1.

Figure 5.1. has exactly the same efficiency/ profitability axes as figure 4.2. in Chapter 4, with four quadrants.

(Insert figure 5.1. here)

The horizontal axis distinguishes efficiency from non-efficiency-based strategies. The vertical axis distinguishes PCAs with a high positive impact on profitability from those PCDs with a high negative impact on profitability.

Some government sources produce PAs and PDs that have both positive and negative effects on firms simultaneously and these effects must be netted off to arrive at the overall effect.

Quadrant 1.

High impact politically-derived, efficiency-based PAs that are crucial to

firm success. That is to say they form important firm-specific PCAs that have a significant and positive effect on firm producer surpluses and firm returns, by increasing firm efficiency.

Quadrant 2.

High impact politically-derived, efficiency-based PDs that are important barriers to firm success. That is to say they form important firm-specific PCDs that have a significant and negative effect on firm producer surpluses and firm returns, by reducing firm efficiency.

Quadrant 3.

High impact politically-derived, non-efficiency based PAs that are crucial to firm success. That is to say they form important firm-specific PCAs that have a significant and positive effect, increasing producer surpluses and firm returns by reducing consumer choice and consumer surpluses.

Quadrant 4.

High impact politically-derived, non-efficiency-based PDs that are important barriers to firm success. That is to say they form important firm-specific PCDs that have an important and negative effect on firm producer surpluses and firm returns, by increasing consumer choice and consumer surpluses.

5.2. The Eight cell PCA Analytical Framework.

Profit-seeking firms have a choice of eight active strategic responses to the impact of government externalities upon them in order to enhance politically-derived competitive advantage (PCA) and/or to reduce politically-derived disadvantage (PCD). These eight strategic responses are illustrated in figure 5.2. In all cases the firm objective is to gain PCAs from government-derived externalities. Each cell is divided into reactive strategies and proactive strategies. Reactive strategies are firm responses, emergent or planned, to exogenous government activities that secure PCAs for the firm. Proactive strategies occur where the firm's management has intentionally, partly or wholly, endogenized government activities, so as to secure PCAs.

(Insert Figure 5.2. here)

Figure 5.2. has exactly the same efficiency/profitability axes as figure 4.2a. in Chapter 4, with four quadrants divided into eight cells, enabling it to handle three sets of variable: profitability, efficiency and endogeneity.

The vertical axis measures the impact of PCAs and PCDs upon profitability. The horizontal axis distinguishes between efficiency- and non-efficiency-based strategies. The division into cells allows each quadrant to distinguish between reactive strategies to exogenous politically-derived externalities (PAs and PDs), and proactive strategies that endogenize government activities in order to enhance PAs or reduce PDs. Both reactive and proactive

strategies aim to enhance PCAs and/or reduce PCDs.

Figure 5.2. Cell 1A.

Reactive firm strategies that try to optimize political advantages (PAs) derived from generally available government activities that reduce firm costs and/or increase firm efficiency-based differentiation advantages. Such strategies will optimize the available benefits from politically-derived, efficiency-based advantages and, because of the asymmetrical incidence of PAs on firms, give the firm politically-derived competitive advantages (PCAs) resulting in superior returns.

Figure 5.2. Cell 1B.

Proactive firm strategies where the firm gains PCAs by endogenizing government activities that will specifically increase firm efficiency by reducing firm costs or increasing firm value-based differentiation advantages, in relation to competitors.

Figure 5.2. Cell 2A.

Reactive firm strategies that attempt to minimise the impact of general government activities that reduce firm efficiency by increasing firm costs and/or decreasing firm value-based differentiation advantages. If successful, these strategies will mitigate politically-derived disadvantages and, in comparison with competitors, the firm will gain politically-derived competitive advantages (PCAs), and superior returns.

Figure 5.2. Cell 2B.

Proactive strategies that endogenize political activities in order increase PCAs, by deliberately reducing the negative impact of PDs on firm efficiency and returns in comparison with competitors, or by increasing the impact of PDs upon competitors in comparison to the subject firm.

Figure 5.2. Cell 3A.

Reactive firm strategies that optimize firm PCAs gained from generally available government activities that reduce firm competition and increase firm monopoly power.

Figure 5.2. Cell 3B.

Proactive strategies that gain PCAs by endogenizing government activities that specifically aim to reduce firm competition.

Figure 5.2. Cell 4A.

Reactive firm strategies that aim to reduce firm-specific PCDs by restricting competition.

Figure 5.2. Cell 4B.

Proactive firm strategies that aim to reduce firm-specific PCDs by endogenizing government activities in order to reduce firm competition.

5.3. The PCA Strategies of Coats.

Firms gain competitive advantage by creating entry barriers, defined as constraints, which prevent a firm's rivals and potential rivals from taking over and eliminating the firm's product market domain. There are two generic types of entry barriers: firstly, efficiency-based, where the firm hierarchy outperforms the competition and creates efficiency-based entry barriers; secondly, non-efficiency-based, where the firm gains shelter-based advantages in order to reduce competition. Coats employs efficiency and non-efficiency strategies in order to gain politically-derived competitive advantages (PCAs). These strategies are usually employed reactively in response to general government activity (and non-activity) but sometimes Coats proactively endogenizes government activities to create PCAs. That is to say that Coats internalizes those specific government activities, wholly or partially, into its hierarchy. Coats has developed core capabilities in the creation of PCAs, some of which are location-bound while others are transferable between subsidiaries and affiliates.

This section applies the eight cell PCA analytical framework to the strategies of Coats and its subsidiaries. In 1990 Coats Viyella was the largest publicly quoted textile company in the world, with subsidiaries and affiliates in over sixty countries and manufacturing operations in over thirty.

In figure 5.3., the eight cell PCA analytical framework is applied to ten case studies taken from the history of Coats Viyella PLC.

(Insert Figure 5.3. here)

5.3.1. PCAs gained from:

i. Defence Expenditure.

ii. Research and Development (R&D) Subsidies.

Cell. 1A. Firm-specific political competitive advantages (PCAs) derived from reactive strategies to exogenous, generally applied, efficiency-based government activities.

5.3.1.i. Defence Expenditure.

One of the earliest examples of Coats' strategies to gain cost and differentiation advantages from government activities was their ability to follow in the footsteps of the British Navy in the nineteenth century, as it opened up safe sea passages. The domination of the seas by British shipping enabled British firms, already benefiting from the technological and productivity advances of the industrial revolution, to gain further scale and first-mover advantages by extending their success to overseas markets. While many British firms limited themselves to the British Empire, where familiar governments and language dominated, more adventurous companies such as Coats followed the Navy and British shipping around the coasts of South America and throughout Asia in the second half of the nineteenth century. British government defence and empire-building policies stimulated the ship-building and shipping industries, and British commerce. British firms could gain efficiency-based, political, quadrant 1A, advantages, subsidised by the British taxpayer. Firms with the appropriate structures and strategies, such as Coats, could gain politically-derived competitive cost and differentiation PCAs across markets throughout the world, for example over its only truly global competitor, the French MNE Dollfus Meig Cie.

Summary - 5.3.1.i. Defence Expenditure.

i. Example of government-derived externality:

Naval protection of trade routes.

ii. Significance for Coats:

Permitted Coats to expand sales around the world, notably in South America.

iii. Government source(s) of externality:

U.K. Defence Expenditure.

iv. Strategic response from Coats:

Reactive strategy, expanding exports to agents, establishing overseas agents and local companies throughout the world, including South America.

v. Outcome for Coats:

South America produced significant revenue and profits throughout the twentieth century.

vi. Eight cell location:

1A: Reactive strategy to exogenous government actions leading to significant positive efficiency-based contributions to revenue and profits.

(Sources: Coats Archives Glasgow and Manchester; Dr Rory Miller, Liverpool University; Coats Annual Accounts.)

5.3.1.ii. Research and Development (R&D) Subsidies.

A twentieth-century example of a quadrant 1A, generally available, political externality turned by Coats into a competitive advantage, is that of government funding for research, development and training.

Government grants for longer term R&D research are justified on grounds of market failure. In pure competition and in contestable markets with low entry barriers, long-term research cannot take place because long-term costs would drive the firm out of business in the short term. Some government-funded research and development programmes result in important efficiency-based technological advancements, of the type that have enabled large-scale, cost-reducing productivity increases, e.g. research and development into the computer industry. Coats was able to benefit directly from government R&D subsidies, and indirectly from the close association of the U.K. government with Courtaulds and ICI and the new scientific chemical developments in textiles and man-made fibres (see chapter 1).

The important research programmes at Coats laboratories in the U.K. and U.S.A. are partly financed by the respective governments. With subsidiaries in over 60 countries Coats can search out exogenous government R&D subsidies and development grants and relocate part of its R&D facilities so as to gain cost advantages. By being present in all the major textile centres around the world Coats can gain cluster advantages that often include R&D, information, educational and other infrastructure advantages financed by government (Porter and Millar, 1985; Kanter, 1995; Porter, 1998b). The centres of world textiles and

fashion migrate around the world but in nearly all of them local and national governments play a role in encouraging clusters with subsidies. MNEs like Coats, with access to information and with the appropriate physical and human asset structures, can gain political cost and differentiation advantages (PAs), and because of the asymmetrical incidence of such advantages they can also gain political competitive advantages (PCAs). In the nineteenth and twentieth centuries Coats' reputation for advanced R&D gave it a differentiation PCA over all its thread competitors, forming an entry barrier and offering a pricing advantage, partly subsidised by government grants.

As the dominant thread-producing MNE with over 50% of the world quality thread market, Coats, because of its structure and strategy, is able to gain greater PCA than its competitors, many of whom are operating in only one domestic market.

Summary - 5.3.1.ii. Research and Development (R&D) Subsidies.

i. Example of government-derived externality:

Research grants.

ii. Significance for Coats:

Subsidised research and development.

iii. Government source(s) of externality:

Various central and local government educational and training ministries and authorities.

iv. Strategic response from Coats:

Decision to outsource and expand global technical training.

v. Outcome for Coats:

Common basic training made available to technical supervisors and managers across the globe; technological advances from Coats' Paisley R&D centre communicated in a detailed and timely manner to all technical managers attending Paisley Technical College courses. Local and national textile training centre benefits from some sponsorship and considerable reputation enhancement.

vi. Eight cell location:

1A: Reactive strategy to exogenous government policy leading to significant efficiency-based positive contributions to revenue and profits.

(Sources: Berkely Cox, Head of Research, Coats 1987 – 1990.)

5.3.2. PCAs obtained from Government Training Subsidies.

Cell 1B. PCAs obtained from government by proactive, endogenous, efficiency-based strategies.

Firms encourage government to invest in and to subsidise R&D and training. In many cases the effects of their encouragement do not amount to endogenizing of government activities in order to gain narrow firm-specific efficiency-based PCAs.

A typical example is where domestic companies join together as an industry to gain efficiency advantages from government. Trade organizations continually lobby for infrastructure and other government-funded improvements that will reduce cost or increase differentiation in specific geographical locations. Better local or national transport infrastructures will benefit all the local and national firms by reducing costs, but, again, because of the asymmetrical nature of firm asset-structures and trading patterns, some firms will benefit more than others.

Some industry and geographical lobbies are extremely powerful and large firms can play a large and proactive role inside such organizations, securing valuable, efficiency-based, politically-derived cost and differentiation advantages paid for by the taxpayer.

There are also opportunities for firms, openly and directly, to endogenize government-funded, efficiency-based activities for their own narrow interests.

A Coats example is its use of the government-funded higher education establishment, Paisley Technical College, to train managers and technicians. Coats centred its R&D on the Anchor Research Laboratories in Paisley and much

of its technical management training in the second half of the twentieth century was undertaken by the Textile Department of Paisley Technical College. Education in the U.K. is funded via local government and Coats, as by far the largest employer in Paisley, was able to work in partnership with the local and college authorities to establish one of the best textile training schools in the world. College textile department lecturers were recruited from ex-Coats employees. Technical standards managers with a teaching interest and ability would be 'transferred' to the technical college. Coats would assist with gifts of textile and laboratory machinery. Prospective production and general managers from all around the world would attend college courses funded jointly by Coats and the U.K. government. Managers and prospective managers were lodged in a Coats-owned mansion, Mackerston House, with the express purpose of attending courses at the college. Graduate trainees destined for manufacturing management posts around the world, with a high proportion of Oxbridge graduates, received three-month courses in detailed Coats thread-making technology, subsidised by the British taxpayer. Coats gained cost and differentiation politically-derived firm-specific advantages (PAs), and, because competitors were unable to benefit to the same extent, Coats also gained politically-derived competitive advantages (PCAs)¹².

¹² Sources: i. David MacIntosh, Personnel Manager, Coats U.K. 1980–87
ii. David Miller, Personnel Director, Coats Patons PLC 1955 – 89.

Summary - 5.3.2. PCAs obtained from Government Training Subsidies.

i. Example of government-derived externality:

Establishment of Textile Department of Paisley Technical College.

ii. Significance for Coats:

Subsidised technical training.

iii. Government source(s) of externality:

U.K. Ministry of Education and Local Government Education Authority.

iv. Strategic response from Coats:

Decision to outsource and expand global technical training.

v. Outcome for Coats:

Coats able to use government funding to subsidise cost of technological advances.

Government promotes efficiency-based economic growth and technology transfer.

vi. Eight cell location:

1B: Endogenous proactive strategy leading to a significant efficiency-based positive contribution to revenue and profits.

5.3.3. PCDs reduced by avoiding Regulatory Costs.

Cell 2A. Reactive firm strategies that attempt to minimise the impact of general government activities that lead to increased firm costs and/or decreased firm differentiation advantages.

Coats and Clark Inc. (Coats U.S.A.) has a name and trade marks known to most Americans and associated with sewing, cotton reels, and traditional American values. As a subsidiary of a foreign firm Coats U.S.A. keeps a low profile. The main extent of their involvement with government is to be members of powerful employers' federations. The American Textile Manufacturers Institute (ATMI) still exercises considerable lobbying power but, as employment in U.S. textiles has fallen, its power has declined. In its heyday throughout the twentieth century the textile industry could rely on powerful political support, especially from the Southern senators and congressmen. ATMI pressure played a major role in negotiating the bilateral textile trade limitation agreement with Japan in 1961, and then extended into a network of voluntary export restriction agreements (VERs) that, in turn, developed into a full-blown textile protection policy under MFA.

In spite of this protectionist textile trade policy, and a government textile exports expansion programme, the U.S. textile industry has been subjected to increasing regulation, some common to many other industries and some specific to the textile industry (Pfeffer and Salancik, 1978). A summary of the regulations most commonly cited by the U.S. textile industry to ATMI is included in Toyne et al (1984):

United States Regulations

Care Labelling
 Clean Air Act
 Consolidated Permit Regulations
 Davis-Bacon Act
 Effluent Guidelines
 Equal Employment Opportunity
 Hazardous Waste Regulations
 Industrial Revenue Bonds (proposed limitations)
 National Energy Conservation Policy Act
 Natural Gas Policy Act
 Occupational Safety and Health Act
 Powerplant and Industrial Fuel Use Act
 Public Utility Regulatory Policies Act
 Superfund Regulations
 Toxic Substances Control Act
 Tris Reimbursement (proposed)
 Vinson-Trammel Act
 Walsh-Healey Act
 U.S. Government Support Programs

One of the major complaints from textile firms has been that there was no unified policy towards the textile industry and that the regulations were fragmented and conflicting, producing varying impacts upon the industry. The effect of these regulations on firms was to increase the cost of doing business, especially manufacturing, and to discourage investment in textile production.

Examples of government's impact on the textile industry include:

- i. Trade protection - e.g. tariff and non-tariff barriers to imports.
- ii. Export subsidies, agricultural subsidies, import substitution subsidies.
- iii. Taxation: profits, sales, employees, transportation (toll roads, port duties, diesel and petrol taxes), customs duties.
- iv. Preference for local or national bidders to government contracts

e.g. Armed Services uniform contracts.

- v. Location subsidies – development area tax breaks.
- vi. Regulation – price setting, environmental protection, health and safety, regulation of capital markets, shareholders, public companies regulation, clean air, effluent and hazardous waste disposal, minimum wages, equal opportunities, wildlife conservation.
- vii. Industrial policy e.g. restructuring, research, asset modernisation, energy conservation.
- viii. Wartime regulations, e.g. import substitution, transport regulation, agricultural direction, rationing.
- ix. Retail regulation e.g. out of town shopping centres, factory outlets.
- x. Overall government economic policies e.g. economic growth, higher productivity, low unemployment, the redistribution of wealth or efforts to balance trade and payments.
- xi. ‘Generic key government activities’ - healthcare, education, training and social security.
- xii. Competition regulation.
- xiii. Consumer protection, product and origin labelling care labelling.
- xiv. Foreign relations, diplomatic representation (political and commercial staff). Foreign policy, regional policy, global policy e.g. UN, WTO, NGOs.
- xv. Local government regulation – building, waste disposal.

The above list is by no means comprehensive. It could be regrouped in many different ways. It could, for example, be structured government department by government department, so as to map all the interfaces between the non-commercial government departments and commercial firms. Since the public sector in most countries spends close to 50% of gross national income, it is not surprising to find that government touches on the lives of firms and their employees at many, many different points.

Within the U.S.A., Coats and Clark Inc. could do no more than react to the protection and regulation policies of the U.S. government by lobbying through the ATMI. However, as a subsidiary of a foreign firm, albeit founded over a hundred years earlier and with a history of considerable independence from Coats' head office in Glasgow, Coats and Clark Inc. could access the Coats international network. U.S. regulatory policy did not affect Coats in the same way as domestic thread firms, or the U.S. subsidiaries of other thread MNEs, because Coats had a unique global footprint and value chain. While these regulations presented problems to all thread companies, Coats could anticipate NAFTA and build up production in Mexico.

In the 1950s, as a result of labour difficulties culminating in a thirteen-month strike, Coats had been virtually thrown out of Mexico. Its factory was expropriated and it even had to part with its trade name 'Hilos Cadena', used throughout Spanish-speaking Central and South America, for one dollar, to a worker's consortium. This was a very rare occurrence since Coats had built up core competences that generally enabled it to ride out difficult times and wait for

the political and economic environment to change. Now in order to get back into Mexico Coats bought into a smaller but efficient Mexican thread company, Hilos Timon, and completed the full takeover in time for it to act as the low-cost manufacturing centre for Coats U.S.A.

Country-specific advantages (CSAs) in Mexico, principally a low-cost skilled and disciplined work force, can tap into CSAs in the U.S.A., principally a rich and leisured consumer market. At the firm level, cross border internalization between Coats U.S.A. and Coats Mexico could harness the dominant market share of Coats and Clark Inc. in the U.S.A. to Coats' international skills of manufacturing in South America, behind the new protectionist barriers surrounding NAFTA. Coats secured efficiency advantages from low-cost production in Mexico, and at the same time was able to support the U.S. government's NAFTA development policy. In addition Coats obtained support from all levels of the Mexican government, in contrast to its earlier experience. Thus Coats' reactive strategy to the growing and conflicting regulatory regime for textile firms in the U.S.A. led Coats to secure considerable PCAs over competitors.

Summary - 5.3.3. PCDs reduced by avoiding Regulatory Costs.

i. Example of government-derived externality:

United States Environmental Protection Agency (EPA) regulations.

ii. Significance for Coats:

Cost of water treatment etc and of application and delay.

iii. Government source(s) of externality:

EPA.

iv. Strategic response from Coats:

Investment in Mexico.

v. Outcome for Coats:

Development of ability to supply U.S. market from Mexico, close factories in U.S., gain competitive advantage in U.S. and to take over and further reduce capacity in U.S. Operator surplus enhanced by efficiency gains.

vi. Eight cell location:

2A: Reactive strategy to exogenous US government regulations leading to PCDs in the form of significant cost increases. Strategy gains PCAs from Mexican national and local government, moving case over time from 2A to 1A.

5.3.4. PCDs reduced and PCAs gained from Public Healthcare Expenditure.

Cell 2B. Proactive strategies that endogenize government activities specifically in order to reduce the impact of PCDs that increase the costs and/or decrease the differentiation advantages of the firm.

In the crowded suburbs of Buenos Aires surrounding the Coats factories in the mid-1980s public healthcare was bad and inefficient. Coats, as the largest employer in the area, became involved in a campaign to persuade the provincial and national government that a new hospital was desperately needed. As a result of a joint campaign with local pressure groups, financed by the company, and led by the Coats personnel manager, Roberto Dazzi, who was a local mayor and a member of the regional hospital board, a new and well-equipped, publicly funded hospital was opened in 1991.

Managers know how many valuable employee hours and days are lost to illness, and how many more are lost to inefficient healthcare provision. As a result of the proximity of the new hospital and its efficiency, reflected in low waiting times, facilities for child care etc, absenteeism due to direct employee and employee-family health problems was reduced by over two-thirds. The hospital board, chaired by Sr. Dazzi, let it be known that in recognition of the part played by the company in persuading the government to build the hospital and the employment that Coats Argentina brought to the area, employees of the company were to receive priority treatment. A letter to this effect, agreed and signed by the local authorities, was sent out.

Coats Argentina was able to make several direct savings as a result. It had previously employed two doctors and six nurses, two on each shift, and owned a

house in the street opposite the front of the factory that had been converted into a clinic. In addition the company was able to reduce the costs of private healthcare insurance paid for key managers. Perhaps equally beneficial, it enabled the company to remove a difficult, time-consuming and costly employee relations problem.

Over the years, as was common in Argentina at the time, the funding and staffing in medical clinics together with the annual budget for drugs and maintenance had become part of the annual pay bargaining round with the Peronist-controlled local section of the textile workers' union. The heavily politicised trade union virtually controlled the clinic, the dispensary, crèche, and the appointment of doctors, nurses and auxiliaries.

In the popular campaign to get a new hospital built, the union, somewhat upstaged by the company, had conceded that in the event of a new hospital being built nearby, the company could close the clinic and pharmacy, relocate the crèche inside the factory, purchase two new ambulances and sell the building. All the nurses were re-employed by the hospital.

This agreement not only got rid of a particularly emotive part of the annual negotiating round, it reduced total capital employed thus enhancing the important ROCE (return on capital employed) ratio, and saved an uncontrollable half of one percent in operating costs. This had a small but noticeable financial effect, increasing profit before tax and charges by over two percent to 16%. The savings in cash and the reduction in staff were important at a time when the company was suffering from cash flow difficulties, and trying to invest in

productivity enhancements with the inevitable staff reductions, during difficult national political and economic circumstances with hyperinflation and the resignation of President Alfonsín.

As well as reducing costs it considerably enhanced the firm's standing with its employees and its reputation in the neighbourhood. Permission was usually secured for key customers to be treated in the hospital if they wished, thus enhancing the firm's differentiation advantages.

Coats Argentina continued to be involved with the hospital and the post of Personnel Manager now permanently carries with it chairmanship of the hospital board. Two employees from the firm's administrative offices decided to leave with the firm's blessing to take up administrative appointments in the new hospital and had considerable success in introducing some of the supply control techniques familiar to them from their time at the company¹³.

This is an example of the company endogenizing a government health service decision and increasing both its own efficiency and that of local public services. Coats Argentina started out trying to reduce spiralling PCD firm costs resulting from inefficient local government provision of healthcare, that had also become an expensive and time-consuming point of conflict with the textile workers' trade union. In devising a successful strategy for reducing PCDs, Coats ended up by gaining Cell 1B PCAs, in the form of enhanced differentiation advantages, by partly endogenizing local healthcare provision.

¹³ Sources: i. Roberto Dazzi, Gerente de Recursos Humanos, Coats Argentina 1982–1991.
ii. George Bowen, Managing Director and President, Coats Argentina, 1987–1992.

Summary - 5.3.4. PCDs reduced and PCAs gained via Public Healthcare Expenditure.

i. Example of government-derived externality:

Provision of healthcare services.

ii. Significance for Coats:

Reduction in cost of healthcare services, improved healthcare, reduction in absenteeism.

iii. Government source(s) of externality:

Argentine national and local Ministerio de Salud.

iv. Strategic response from Coats:

Proactive strategy to help local community obtain healthcare funds, site hospital near factory and assist the project.

v. Outcome for Coats:

Able to reduce firm cost of healthcare, solve costly and controversial conflict with trade union, improve employee healthcare, reduce cost of management healthcare insurance, offer priority treatment to key customers and enhance firm reputation.

vi. Eight cell location:

2B: Proactive strategy to improve poor government and local healthcare and to reduce efficiency-based PDs. Partial endogenization of government healthcare expenditure leads to positive efficiency-based profitability gains, thus moving 2B to 1B.

5.3.5. PCAs gained from i. Tariff Protection and ii. Accounting Regulations.

Cell 3A. Reactive strategies deriving firm-specific, political competitive advantage (PCA) from exogenous, generally applied, non-efficiency-based government barriers that reduce competition.

Two distinct examples of reactive Coats strategies, leading to firm-specific, non-efficiency PCAs are set out here that had a positive impact on profitability. The first is the result of various national government tariff protection measures, and the second is the effect of U.K. government accounting regulations.

5.3.5.i. Tariff Protection.

Protectionist tariff barriers are the clearest example of quadrant 3A reactive strategy. A general protectionist tariff can provide a firm-specific, non-efficiency-based, competitive advantage to a domestic firm or to an MNE subsidiary based in that host nation. Coats developed core competitive advantages in exploiting exogenous protectionist barriers.

Coats in large part owes its foundation, and important first-mover advantages in the production of cotton thread in the U.K., to French government protectionist policy. Admittedly this was a blockade not a tariff but the effect - reduction of imports - was the same. Two families, Coats and Clark, in Paisley, involved in importing silk and silk textiles, were provided with non-efficiency shelter-based protection advantages, not by the British government, but by the French! Under the Berlin Decrees of 1806, Napoleon Bonaparte and the French government attempt to blockade Britain and close European ports to British shipping, cutting it off from exports from continental Europe and stopping British

exports to Europe. This pushed the development of cotton thread based on imported cotton from the ex-colonies in the United States. It is ironic that French government action laid the foundation for the British domination of the world thread market and that Coats' only unsuccessful and partial challenge in global thread markets in the nineteenth and twentieth centuries came from the French company, Dollfus Meig Cie, founded fifty years before Coats.

Throughout the nineteenth century, Coats preferred to export from its two large 'Ferguslie' and 'Anchor' Scottish mills, where it coupled natural scale advantages to efficiency-based core competences built on research and development and well-trained labour. In the early days Coats distributed through agents but soon preferred to establish some measure of control over its foreign sales operation. Coats exported thread around the world as soon as the British Navy secured safe sea passages.

The United States was the first prize. The United States government has protected its textile industry from Independence onwards when the first Congress in 1789 imposed a 3 cents per pound weight tariff on cotton imports. By the 1840s the Coats and Clark companies had agents in New York. Coats grew with the British Empire, and exported thread to the British colonies in increasing amounts. In the U.S.A. in 1898 J & P Coats and English Sewing Cotton promoted and financed 'American Thread', a merger of 14 U.S. thread producers. Between them they then controlled over 60% of U.S. cotton thread output. By 1919 Coats and Clark Inc. was one of the largest American companies in the U.S., and J & P Coats was the second largest company in the U.K. with a market valuation of

£45.0m (Chandler, 1990, p. 289). Coats held an above 50% share of thread sales in the U.S.A. throughout the twentieth century. In 1997 a third of Coats' global thread sales of just over £1bn came from U.S.A., with an operating profit of nearly 20% (Coats Viyella company reports).

Until 1914, and probably until 1939, Coats would have preferred free trade and export from its enormous Paisley mills, rather than setting up production units overseas. While sales offices and local technical advice were necessary to ensure efficient sales and delivery to overseas customers, overseas manufacturing was not. Coats had set up a selling agency in Bothwell Road, behind the St. Vincent Street head office in Glasgow, known throughout the textile world as TCA, 'The Central Agency'. TCA supervised the sales of thread exports across the world and grew as the British Empire grew. By 1900 Coats was one of the ten largest British public companies by market capitalisation. Coats began manufacturing abroad because it was the only way to keep foreign customers once tariff barriers were introduced. Even where the superior efficiency and quality of the Scottish manufacturing base would have enabled the extra cost of tariff barriers to be passed on to the consumer, two world wars meant that delivery from Scotland was no longer feasible or reliable.

As more and more countries introduced textile protection, in a quest for industrialisation and economic development, Coats developed knowledge-based core competences that increased returns. Behind tariff barriers, Coats could pursue reactive non-efficiency, higher cost strategies that increased returns by raising local prices. The inefficiency costs were paid for by the local consumers.

The reduction in choice and supply gave a political competitive advantage (PCA) to those firms operating behind the tariff barriers manifested in higher prices and enhanced margins.

In Argentina import tariffs on textiles were first introduced by President Rosas in 1836 (Rock, 1987, p.108). Coats exported to agents but in March 1900 a subsidiary sales office, 'La Plata Hilos', was opened to serve Argentina and Uruguay. This was a period of high British investment into Argentine infrastructure, and the large numbers of immigrants especially from Southern Italy were provided with employment by increased government textile industry protection. By 1914 Argentine per capita income was higher than Germany's. After the second world war general protection became the vehicle by which the Peronist movement created jobs for immigrants and a political party that dominates nearly all levels of government and the trade union movement, even when it is in opposition. Perón believed in keeping Argentina isolated from the Cold War and a possible third world war and protection ensured a large but uncompetitive domestic industry.

The effect of protection on Argentine industry in the post-war period was to raise internal prices and reduce efficiency (Amadeo, 1956; Di Tella and Dornbusch, 1989; Guadagni, 1989, pp.150-151; Eltis, 1989). Coats Argentina mirrored the rest of Argentine industry, in that the subsidiaries of large international companies were more efficient than the local companies but still fell considerably short of the factor productivity achieved in the developed countries.

Coats used its multinational advantages and experience to dominate

national and regional thread sales, controlling all the other thread firms with a carrot and stick policy. As price leaders they should have made large profits but poor management led them to be gradually dominated by wholesalers in the lucrative craft market. The performance of Coats Argentina, like all Coats operations in high inflation countries, was distorted by being translated at year end into USD or GBP without inflation adjustments (see below). In local terms the company was not covering depreciation and frequently losing money. By 1990 efficiency strategies increased sales to US\$16m with a 15% operating profit, based on full inflation accounting.

Non-efficiency shelter PCAs are often considered to be short-term but in the U.S.A. first-mover advantages behind tariff barriers, coupled with continual efficiency seeking and good management, enabled Coats to maintain the largest market share for over a hundred years. In Argentina, general protection and economic mismanagement led to hyperinflation, a declining economy, and isolated, uncompetitive industries. Coats, however, was able to dominate and control the thread market and pass the cost of inefficiency and lack of competition on to the consumers. The story was much the same in Brazil where the thread market was ten times larger than in Argentina.

Coats' experience of setting up behind tariff barriers became an internationally transferable firm-specific advantage (FSA). Generally applied tariff barriers have distinctly asymmetrical effects on each unique firm. Unique value chains consisting of unique combinations of fixed assets, resources and capabilities result in differential impact. Coats developed skills and local

knowledge, largely embodied in the experience and culture of its mobile expatriate management and technical workforce, that enabled it to exploit tariff PAs, and to develop PCAs, in ways that no other international firm could match. These reactive political skills were broadened. One of Coats' key FSAs at MNE level was its ability to thrive in politically unstable environments, deriving advantage by keeping a low profile and exploiting the crucial importance of thread in the development of protected national textile industries in world economic development.

At a national level, tariff barriers enabled Coats to develop overseas manufacturing operations behind them that dominated the local market and controlled domestic competition.

At a supranational level the distortions that the MFA introduced into world textile sales and production offered PCA to companies such as Coats that had developed flexible and transferable core competences throughout the world. One small example is Coats' ability to service the disproportionately large textile industry on the island of Mauritius, which, as a direct result of MFA, developed an expanding Indian textile community, based on its ability to secure export quotas and licences not available in India. In India government had always been intimately involved in the textile industry and the allocation of quotas and licences was merely an extension of legitimate and illegitimate government/textile industry interfaces (Leadbeater, 1993).

The WTO attempt to abolish all the barriers to global trade in world textiles by 2005 presents Coats with a challenge that it has not yet faced owing, in

part, to the distractions caused by its acquisition by Vantona Viyella to form Coats Viyella PLC in 1986. Vantona Viyella, like Coats, was well aware of some of the aspects of this challenge, since although it was a major U.K. textile producer and a key supplier to Marks and Spencer, Vantona Viyella was basically a collection of U.K. textile companies bought relatively cheaply by David Alliance and with no clear synergy. Its survival was increasingly threatened as the British government lost the ability and will to protect the British textile industry. At the same time it became more restricted by European Union legislation and less protected as the effectiveness of the MFA declined. Coats Viyella (CV) clearly showed, in its global strategic planning exercise of 1992-1994, that it did not understand the dynamic impact of government-derived PAs on its competitive advantage. Coats was unable to focus on the adjustments required in the face of two fundamental changes 1960-2000, consisting on the one hand of lower tariff barriers and on the other of increased non-tariff barriers. It had no framework for the identification or quantification of the effect of PCAs on its survival, profitability and growth.

While head office openly questioned the advantages of its size and global reach,¹⁴ it failed to understand the extent of the efficiency-based and non-efficiency-based PCAs, local and transferable, that its subsidiaries possessed. By imposing a uniform Porter-based competitive advantage strategic planning framework that omitted politically-derived competitive advantages and disadvantages, head office failed to understand the opportunities and threats

¹⁴ Source: Taped discussion with Coats Viyella Strategy Director, Richard Gilmore.

facing the profit centres and the true strengths and weaknesses of Coats Viyella as an MNE. As a result CV was unable to develop reactive and proactive strategies required to manage the high and dynamic impact of supranational, regional, national and local government activities upon profit centre profitability and growth. This was a significant contributing factor to its loss of £2bn in market capitalisation after 1994.¹⁵

¹⁵ Sources:

- i. Martin Flower, CEO Coats 1990 – present.
- ii. Coats Archives Glasgow and Manchester.
- iii. Coats Annual Accounts – various years.

Summary - 5.3.5.i. Tariff Protection.

i. Example of government-derived externality:

Tariff protection.

ii. Significance for Coats:

Increased cost or loss of export market.

iii. Government source(s) of externality:

Trade and industry policy.

iv. Strategic response from Coats:

Reactive FDI strategy to set up manufacturing assets behind protectionist barriers.

v. Outcome for Coats:

Coats able to retain overseas customers and to grow overseas market share.

vi. Eight cell location:

3A: Reactive strategy to exogenous government actions leading to significant positive non-efficiency contributions to revenue and profits.

5.3.5.ii. Accounting Regulations

The second example of a reactive strategy to non-efficiency government regulation providing the company with non-efficiency PCAs is rather different from protection in that it increased returns without reducing cost, enhancing reputation or reducing competition. Accounting irregularities have become very topical in 2002, but for decades up until the early 1990s Coats, like other U.K. companies, was able to take advantage, legally, of U.K. accounting regulations that did not insist on inflation accounting. The effect was to report exaggerated and non-existent profits from high inflation countries to shareholders. Local accounts in high inflation countries were usually adjusted for inflation on the basis of a government index. Coats produced local accounts in line with local law but they bore no relation, and in fact never reconciled, to the accounts prepared for the consolidated annual Coats accounts.

Local managing directors were not trained in finance, being generally drawn from the selling or manufacturing divisions. Even local finance directors were rarely aware since adjustments to the local accounts were largely left to the local office of one of the big international accountancy firms, with the joint aims of complying with local laws and legally minimizing local taxation. The local sterling accounts were prepared from the same basic data according to a standard accounting manual. With computerisation in the 1980s local raw data was fed directly into a central head office financial division computer and this process made the reconciliation of local to Group accounts virtually impossible. The fact that the local accounts bore no resemblance to the sterling accounts was not

considered important. Congratulations, together with large sterling-based performance bonuses arrived for the expatriate managers, while local currency cash was minimal, often requiring a blitz on creditors to pay the monthly salaries. In periods of higher inflation the position got worse. The level of inflation in Argentina was in excess of 100% per annum for over a decade. Minimal amounts of local cash were available for modernisation and computerisation. Since Coats was naturally reluctant to send cash from the centre, relying on its subsidiaries to provide their own cash for investment, the impact on modernisation was devastating.

The effect of this poor U.K. government regulation was to enable Coats and several other U.K.-based MNEs, operating in high inflation countries, to exaggerate their profits in sterling. This practice was kept secret and the full impact seems to have been known to very few (Hansard, 1991b). However the effect on Coats was devastating. Investors generally bought Coats shares for income not growth. The firm usually provided a reliable income stream for pension fund investors. Without revenue growth a comparatively generous dividend policy was required to maintain the share price. As inflation accelerated, particularly in South America, Coats were trying to pay a dividend based on sales and profit figures that included unadjusted profits and stock figures and where the profits only existed on paper. The supporting cash simply was not there. Coats reduced its dividend twice and the resulting shock waves lowered its share price and made the company increasingly vulnerable to a takeover, that eventually came from Vantona Viyella.

In 1987 Michael Bell (CEO of Coats Patons), who had a very detailed knowledge of each subsidiary market, appointed a new Managing Director of Coats Argentina, at the same time providing funds for a pilot 'Ultimax' project. Ultimax was a new thread technology, developed in the Coats Paisley research laboratories, whereby polyester continuous filament was cut into fibres and twisted in an air current. Potentially this could reduce the cost of synthetic thread production by at least one third by eliminating conventional preparation, spinning and twisting. The pilot scheme in Argentina was followed by commercial production and this technological breakthrough had the potential to produce the profit margins in high inflation countries that had been exaggeratedly reported under the U.K. inflation accounting standards. However the untimely death of Michael Bell in an air crash in India meant that the project was not fully understood or appreciated by his successor, because of the secrecy that inevitably surrounded the discussion of the exaggerated sales and profits in high inflation countries. While Ultimax was successfully developed in the United States, the project was not extended in South America, and was abandoned in Argentina after 1993 when the "Brazilianization" of Coats Argentina by Coats Brazil became official strategy. The last chance to use new technology to increase the efficiency of the South American companies, and to bridge the gap that new U.K. inflation accounting standards would inevitably reveal, was missed.

Other U.K. firms operating in South America, notably ICI and Unilever, reacted earlier than Coats in correcting the misleading effects of U.K. accounting regulations resulting from the consolidation of subsidiary accounts unadjusted for

high inflation.¹⁶

It is arguable whether this legal accounting scandal should be called a non-efficiency PCA and to what extent it reduced competition. However it had a positive effect on producer surpluses as declared in the reported returns, while reducing consumer value, since the lack of investment in the South American plants enabled Coats to sell inferior quality thread produced on old machinery at prices that were only possible because of the protectionist policies of the governments concerned. Coats Patons PLC gained a non-efficiency advantage in that exaggerated paper profits were presumably not factored out of the takeover price when Coats Patons PLC was sold to Vantona Viyella. Depending on one's judgement of the culpability of the firm compared to the culpability of the U.K. government, this strategy might be seen as reactive (quadrant 3A) or proactive (quadrant 3B). However, since there is no question of illegality on the part of the firm, it is included here as a quadrant 3A reactive strategy.

¹⁶ Sources: i. Conversations with Dr Rory Miller (1993, 1999), Liverpool University.
 ii. Conversations with Jim McLean, Coats Financial Director, Brazil 1986 – 1990, Financial Director, Coats 1990 – 1994; Financial Director, Dynacast, 1994 – 2001.

Summary - 5.3.5.ii. Accounting Regulations.

i. Example of government-derived externality:

Accounting regulations.

ii. Significance for Coats:

Increase in reported sterling profits.

iii. Government source(s) of externality:

Treasury and accountancy professional bodies.

iv. Strategic response from Coats:

Reactive strategy leading to increased focus on South American companies.

v. Outcome for Coats:

Distorted strategic focus. The lack of transparency of local and group accounts led to underinvestment in South American subsidiaries, difficulties in paying local staff, and exaggerated sterling bonuses for expatriate managers. World-wide exaggerated revenue and profit figures led to exaggerated shareholder dividend expectations that could not be met due to cash deficiencies.

vi. Eight cell location:

3A: Reactive strategy to exogenous government actions leading to significant positive non-efficiency contributions to revenue and profits.

5.3.6. PCAs gained from Administered Protection.

Cell 3B. Proactive strategies that gain PCAs by endogenizing government activities and specifically aim to reduce competition by other firms.

The concept of ‘shelter’ is a core concept of this thesis (see chapter 2). The original definition of shelter (Rugman and Verbeke, 1992a) is an entry barrier, resulting from intentional firm behaviour, that imposes higher (“artificial”) costs on new entrants than on existing firms, and where the cost of imposing or advocating the barrier is not borne by the firm.

Rugman and Verbeke’s concept of core competences/firm-specific advantages as only competition-based has to be modified, since we have seen that Coats has developed core capabilities, both local and transferable, in the creation of entry barriers arising from both efficiency and non-efficiency strategies.

Shelter-based strategies clearly demonstrate that firms can secure firm-specific non-efficiency, politically-derived, competitive advantages (PCAs) by endogenizing national and international government trade policies. Salorio (1993) has given excellent and complex examples of firms pursuing non-efficiency shelter strategies through the use of anti-dumping petitions sanctioned by national and international trade policies and agreements. These petitions are not used to punish infringements of free and fair trade but to pursue narrow firm self-interest and to gain non-efficiency, politically-derived competitive advantages (PCAs) by reducing the competitive advantages of competitors. National systems of administered protection (Finger, Hall and Nelson, 1982; Rugman and Anderson, 1987) are common in the textile industry, and the strategic use by nations and firms of the international MFA quota system is rife.

Coats has a truly global reach and, while subsidiaries support local tariff barriers where they gain competitive advantage, a high-profile, proactive, protectionist stance in any one country would not be appreciated by subsidiaries and customers elsewhere. Coats' overall strategy is reactive, aiming to follow and supply the shifting textile industry around the world and supply it as efficiently as possible.

Coats endogenize government activities at profit centre level in order to gain non-efficiency, competition reducing, shelter enhancing, politically-derived competitive advantages (PCAs). One of its most valuable capabilities is precisely its ability to influence protectionist legislation around the world.

In Argentina importers, including Coats Argentina, face tariff barriers and non-tariff barriers in the shape of imperfections in the government monopoly of the market for importation. The externalities created by these protectionist barriers have a positive impact on the profitability of Coats Argentina, located behind the trade barrier.

Tariff barriers provide opportunities for endogenizing government activities in order to further enhance the positive impact of PAs derived from protection and thus to increase non-efficiency PCAs. In Argentina the rationale for raising, lowering or removing tariffs and quotas was complaints-based. Proposed changes, usually initiated by individual firms, either directly with politicians or officials, or indirectly via the textile employers' federation, would be published. Objections made directly to politicians or officials, or indirectly via the textile employers' federation, which had subsections for each major industry

category, would then be considered 'on merit' and the proposal would be implemented or withdrawn.

Advance notification of imports also had to be officially published, before the appropriate import certificate was issued. At each stage of the import and export processes, duties and taxes were levied, in line with Argentina's history as a colonial trading post. The lawyers and accountants charged with overseeing these processes were also employed to report back to Coats on any proposed imports relevant to textiles. By organising its powerful local offices of international lawyers and accountants, Coats could invariably obtain the refusal of import licences to firms that had been so unwise as not to have discussions with Coats before applying for an import licence. Moreover Coats could add its weight to a firm objecting to the import of large quantities of clothing or other textiles which would threaten the size of the total domestic market in thread, which Coats controlled. Here, as in all cases of successful firm non-efficiency, shelter-based strategies, the additional inefficiency costs were born by the consumer.

Large domestic firms and MNE subsidiaries, such as Hilos Cadena SACel, (Coats Argentina), employed combinations of the major law and accountancy firms firstly to draw to their attention any proposals that seemed relevant to them and secondly to present their case for an amendment in the best possible manner. Only trained lawyers were able to extract from the bureaucracy the exact terms on which a change to the customs classifications would be granted. The use of lawyers was quite legal and enabled the firm to present a case, plus supporting documentation from other interested parties, including trade unions and the

employers' federation, anonymously. As with the anti-dumping petitions analysed by Solario (1993), all sorts of complicated tactics could then be deployed to gain the imports that Coats wanted, and to get the import petitions of competitors refused. Additionally they were able to discourage their own customers from importing simply by anonymously opposing all their import requests and involving them in expensive and time-consuming bureaucratic and legal processes.

The application of tariff codes required a technical knowledge of thread that was lacking in customs, and Coats would often be consulted, as technical experts, by customs officials. Thus Coats Argentina was able to proactively manipulate and manage the national system of administered protection, and to gain PCAs that deterred new entrants and reduced competition¹⁷.

¹⁷ Source: i. George Bowen, Managing Director and President, Coats Argentina, 1987-1992. ii. Thomas Hudson, Managing Director, ICI Argentina, 1984-1995.

Summary - 5.3.6. PCAs gained from Administered Protection.

i. Example of government-derived externality:

Administered protection.

ii. Significance for Coats:

Ability to manage (manipulate) national system of protection so as to exclude or include categories and/or specific requests for importation.

iii. Government source(s) of externality:

Trade and industry policy, Treasury, Customs.

iv. Strategic response from Coats:

Proactive strategy to endogenize customs officials.

v. Outcome for Coats:

Coats able to control relevant import and export regime. Reduced costs, better customer service.

vi. Eight cell location:

3B: Endogenous proactive strategy gaining significant non-efficiency-based positive contributions to revenue and profits.

5.3.7. PCDs reduced by Acquisition Strategies.

Cell 4A. Reactive firm strategies that aim to reduce firm-specific PCDs incurred from general government activities intended to increase competition.

The importance of dominant market share to Coats was to be able to exercise monopoly power and to deter or control competitors. Acquisition of local competitors who challenged Coats' control of a market, for example Lipasa in Brazil in 1996, was a core Coats strategy employed over centuries. In many cases there was no need to involve government, but occasionally a solution in one country involved getting government approval in another.

The solution to the problems of Coats U.S.A. in the 1980s with regard to the growing challenge from foreign and local thread manufacturers was to be found in an acquisition by the U.K. parent company of another U.K. textile company. By buying Tootal, Coats was solving its market share problem in the U.S.A.

The prize for Coats was the acquisition of Tootal's North American industrial thread operations. Martin Flower, CEO of Coats (Coats Viyella's Thread Division), wrote "the acquisition of Tootal effectively doubled our industrial thread division, giving us clear market leadership in every continent and in most countries in which we operate. This strength is being used to offer an unrivalled product range and level of customer service. The inclusion of Tootal's Chinese operations in our supply base has also improved our competitiveness."

The agreed merger did not proceed as planned because the U.K. government intervened and referred the proposed takeover to the Monopolies and

Mergers Commission (MMC). The Coats Viyella bid then lapsed after it was referred to the MMC on 26 June 1989. The findings were published on 26 October 1989. The MMC ordered that, if Coats wanted to continue with the acquisition of Tootal, it must sell its U.K. domestic thread business. This was to protect British consumers from Coats domination of the U.K. domestic thread market with the combined Anchor and Sylko brands. MMC also forced Coats to sell its long-held 20% shareholding in 'Gutemann', a very well-established German thread company specializing in high quality crafts threads.

It is clear that the MMC failed to foresee the damage that the dismemberment of Coats' U.K. domestic thread position would inflict on its competitive position in Europe. The narrow U.K. perspective was perhaps influenced by Sir David Alliance's own rhetoric that considerably exaggerated the strength of the Vantona Viyella companies in the U.K., and the synergies with Coats thread. The effect of the MMC decision was that Coats lost the most profitable half of its U.K. market. It is not certain whether Coats could have pulled together its thread, embroidery and hand-knitting interests into a genuine craft business, but the MMC decision destroyed any possibility.

DMC, the great French textile company, fifty years older than Coats and with superior quality embroidery and craft products, had developed a lower cost strategy of finding and supporting local shareholder/managers. Profitable growth was built on expensive, high quality craft ranges imported from the DMC factory at Mulhouse in France, with logistical and marketing support from DMC France and DMC U.S.A. The MMC judgement pushed Coats further down the road to

capitulation to DMC on embroidery threads and further away from successfully re-launching its ancient domestic and embroidery brands as the centrepiece of a real diversification into the growing and profitable global crafts industry. DMC was able, with a better basic range and local participating shareholder managers, to capture a 60% share of the U.K. embroidery and craft market and to overtake Coats and dominate the fast expanding U.S. craft market.

In an attempt to separate declining domestic thread sales from industrial thread, Coats now decided to split their thread operations throughout the world into two separate divisions, Crafts and Industrial Thread. There was no obvious buyer for Coats' declining U.K. domestic thread business on its own which the U.K. government forced Coats to sell, but Coats finally sold it to Amman und Sohne in mid-1990. More recently Coats appears to have reached a new understanding with DMC France whereby Coats reduces its participation in world craft markets in exchange for reduced DMC participation in world industrial thread markets.

The MMC's idea that Coats would be able to dominate domestic sewing and thus hold the housewife to ransom when sewing on buttons or making a dress showed a complete misunderstanding of the strength of the U.K. textile industry in the face of increasing importation. A large Coats consumer thread market share in the U.K. was not a recipe for price increases that would further attract imports from low-cost manufacturers abroad. What remains of the declining domestic thread market in the U.K. is now either in the hands of Far Eastern imports or has become part of a higher value added craft market dominated by foreign

companies.

The forced divestment of the Gutemann GmbH & Co. shares was equally counterproductive from a U.K. point of view. In the context of Britain or Europe a similar relationship would now be called an 'alliance' and would have helped Coats to compete with DMC in the world craft market. The effect of the MMC decision was that Coats, even if it had possessed the capability, was unable to develop a craft market from its domestic thread and embroidery threads because its home base had been fatally weakened. The increased strength of DMC and the lack of a credible Anglo-German alliance contributed to Coats' total withdrawal from the French craft market.

In 1991 Coats finally acquired Tootal after a long and acrimonious struggle. Tootal operated in 25 countries and sold in over 60. Thread represented around 45% of Tootal revenue but 62% of the profits. Tootal's U.K. businesses were in the same shape as the rest of the U.K. textile industry. The U.K. generated 46% of total Tootal sales and only 17% of operating profit; in Europe 18% of sales generated 19% of profits, but in North America 20% of turnover generated 34% of profits, while in Asia 11% of total Tootal turnover generated 23% operating profit.

In 1991 outside observers believed that Coats Viyella would sort out its problems. The £1bn Coats/Tootal thread and handknittings business would grow, fill in the gaps on the globe and raise operating profit to U.S. levels. "The thread operation of the new Coats Viyella must be regarded as the true core activity of the group, given its sheer size and geographical coverage. A consolidation of

Coats Viyella's global leadership position can be expected over the next few years" (Payne, 1992).

In fact the acquisition of Tootal was primarily about the non-efficiency acquisition of market share and increased revenue but did little for margins in itself. The cost of rationalisation to gain efficiency was completely underestimated and each year larger reserves had to be budgeted, at a time when funds were urgently needed to dismantle the terminally uncompetitive, and unsaleable, Vantona Viyella clothing companies. The PCAs gained by the approval of the Tootal acquisition by both the U.S. government and, eventually, the British government, exposed the weaknesses of non-efficiency PCA strategies on their own in the twenty-first century. Non-efficiency-based PCAs are sufficient while protected textile markets are the norm throughout the world, but with free trade they are no substitute for commercial efficiency-based strategies.

Summary - 5.3.7. PCDs reduced by Acquisition Strategies.

i. Example of government-derived externality:

U.S. competition policy.

ii. Significance for Coats:

Competition and overcapacity in a mature market.

iii. Government source(s) of externality:

Trade and Industry policy, Treasury, Monopolies & Mergers Commission, Competition Commission.

iv. Strategic response from Coats:

Proactively acquire U.K. parent company of main U.S. competitor.

v. Outcome for Coats:

Coats able to regain control and extend domination of U.S. market.

vi. Eight cell location:

4A: Reactive strategy to exogenous government actions leading to significant positive non-efficiency contributions to revenue and profits.

5.3.8. PCDs reduced by Infant Industries Policies.

Cell 4B. Proactive strategies that reduce PCDs by endogenizing government activities in order to reduce competition by other firms.

Coats has become an expert in FDI agreements. Coats negotiates agreements with countries that want to expand their textile industries, thereby obtaining privileged market access and subsidies in order to establish a thread manufacturing plant. Questions of whether or not such government policies are efficient, or good or bad, are not relevant here. The Coats strategy is to enter a market with a government agreement to limit competition, thus limiting the PCDs incurred from a government free trade policy. Coats endogenizes part of the host country's industrial policy in order to secure non-efficiency, competition-reducing advantages. This type of strategy (the latest example of which is Coats' agreement with the government of Vietnam) is increasingly important since infant industries policies are specifically excluded from the GATT Uruguay Round Final Act on global free trade in textiles and from the WTO implementation of that agreement by January 2005.

In the post-1945 period several agreements have been negotiated with foreign governments that have the effect of reducing competition from other firms. Venezuela in the 1950s is an excellent example: a rich, oil-based economy lacking jobs and pursuing industrialisation through an infant industries policy where the government was happy to grant Coats freedom from the competition of other foreign thread makers and imports. Coats provided FDI, quality domestically manufactured thread, employment, technology transfers, and import substitution. In return Coats obtained local subsidies and political support, for

example in wage negotiations, and protection against all but domestic competition. By appointing two external directors from Venezuela's two principal political parties, Coats de Venezuela was able to ensure that its voice was heard at the highest possible political levels for at least half a century.

Part of the myth commonly surrounding both MNEs and governments is that they are run from the top in an orderly and logical manner. Many such institutions contain policy vacuums waiting to be filled. A strong individual or group with a clear direction can often fill the vacuum and gain control over specific areas of policy or policy implementation. By recruiting and training senior managers from the older universities with recruitment and training methods modelled on the British Foreign Office, Coats established a diplomatic culture, similar to other large British MNEs. This gave Coats the capability of forming partnerships with host governments, in order to further the development of the textile industry and the national and local economies, but which also gave shelter to Coats. This shelter went far beyond non-efficiency shelter from foreign competition. With the right local management, Coats could gain a whole raft of enhancements to its PCAs and reductions in its PCDs. Every company knows that some level of PCDs is inevitable because governments are always going to levy taxes and regulate industry and commerce. However the extent to which governments at all levels have an impact upon firm costs is flexible especially at the margins. Skilled and diplomatic negotiators can influence the direction of government policy and help to fill policy vacuums¹⁸.

¹⁸ Sources: i. Roger Silver, Managing Director, Coats Venezuela, 1968 – 80.
ii. John Shaw, Managing Director, Coats Venezuela, 1988 – 1994.

Summary - 5.3.8. PCDs reduced by Infant Industries Policies.

i. Example of government-derived externality:

Venezuela's non-efficiency infant industries industrialisation policy.

ii. Significance for Coats:

Opportunity to enter Venezuelan market with protection from foreign competition.

iii. Government source(s) of externality:

Venezuelan trade and industry policy.

iv. Strategic response from Coats:

Proactive strategy to endogenize Venezuelan non-efficiency protectionist policies in partnership with the Venezuelan government and main political opposition party.

v. Outcome for Coats:

Coats able to manipulate and control Venezuelan market behind protectionist barriers. Instrumental in helping to establish Venezuelan national textile industry.

vi. Eight cell location:

4B: Proactive strategy to partially endogenize government policy, to reduce 4B non-efficiency PDs and gain non-efficiency-based PCAs, thus moving case from 4B to 4A.

Figure 5.1. The Political Competitive Advantage (PCA) Analytical Framework.

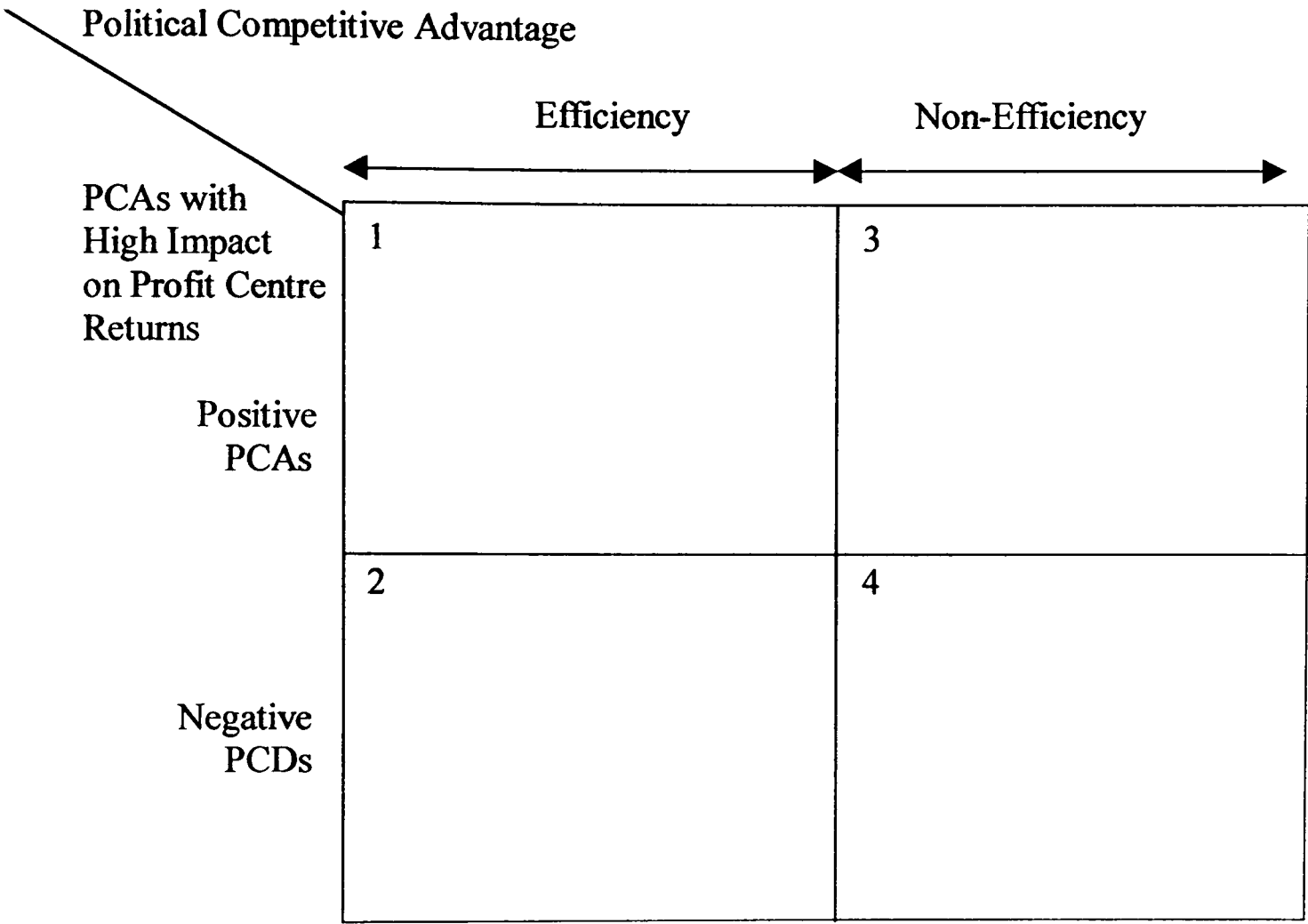


Figure 5.2. Firm Strategies – The Eight cell PCA Analytical Framework.

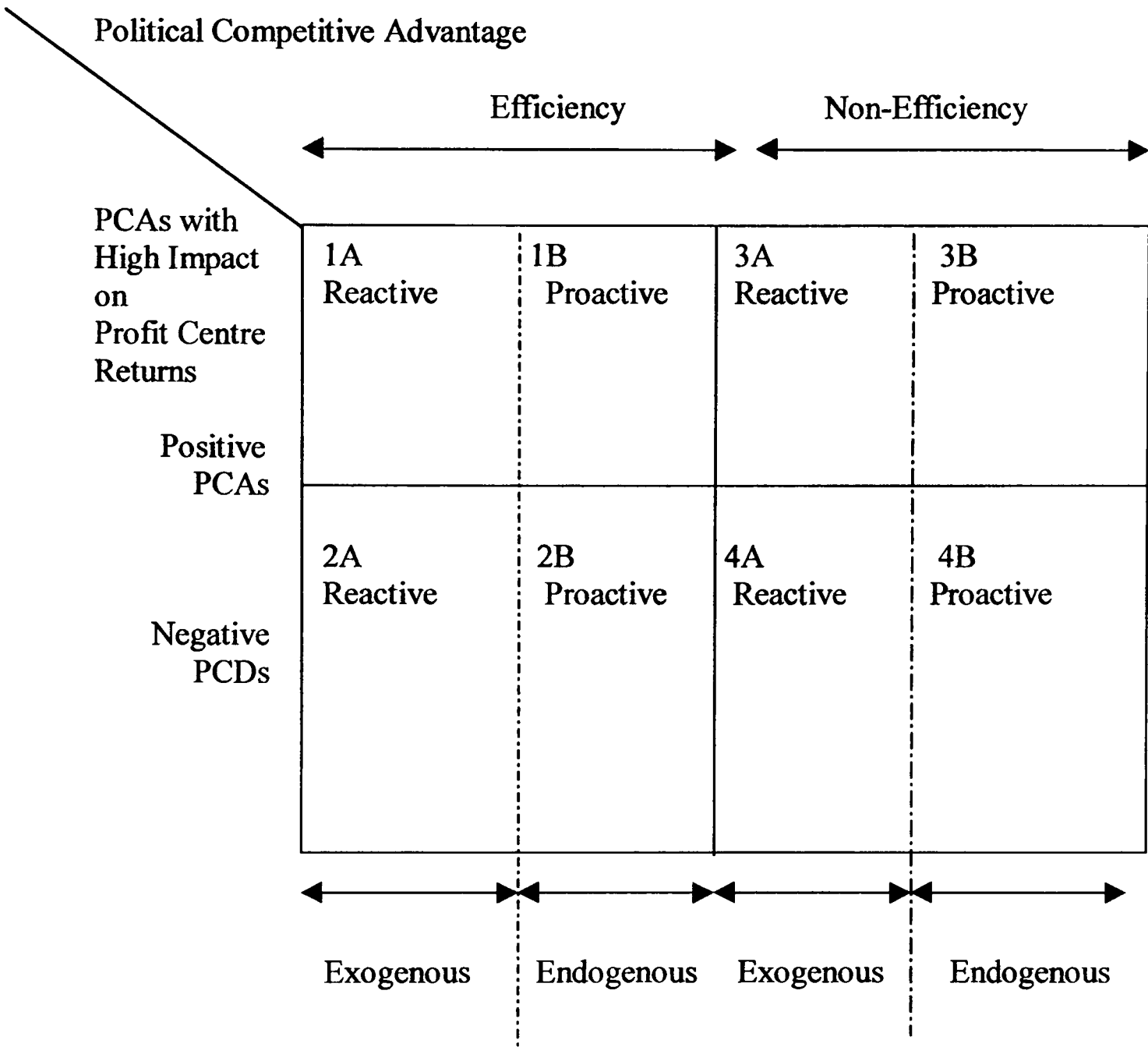
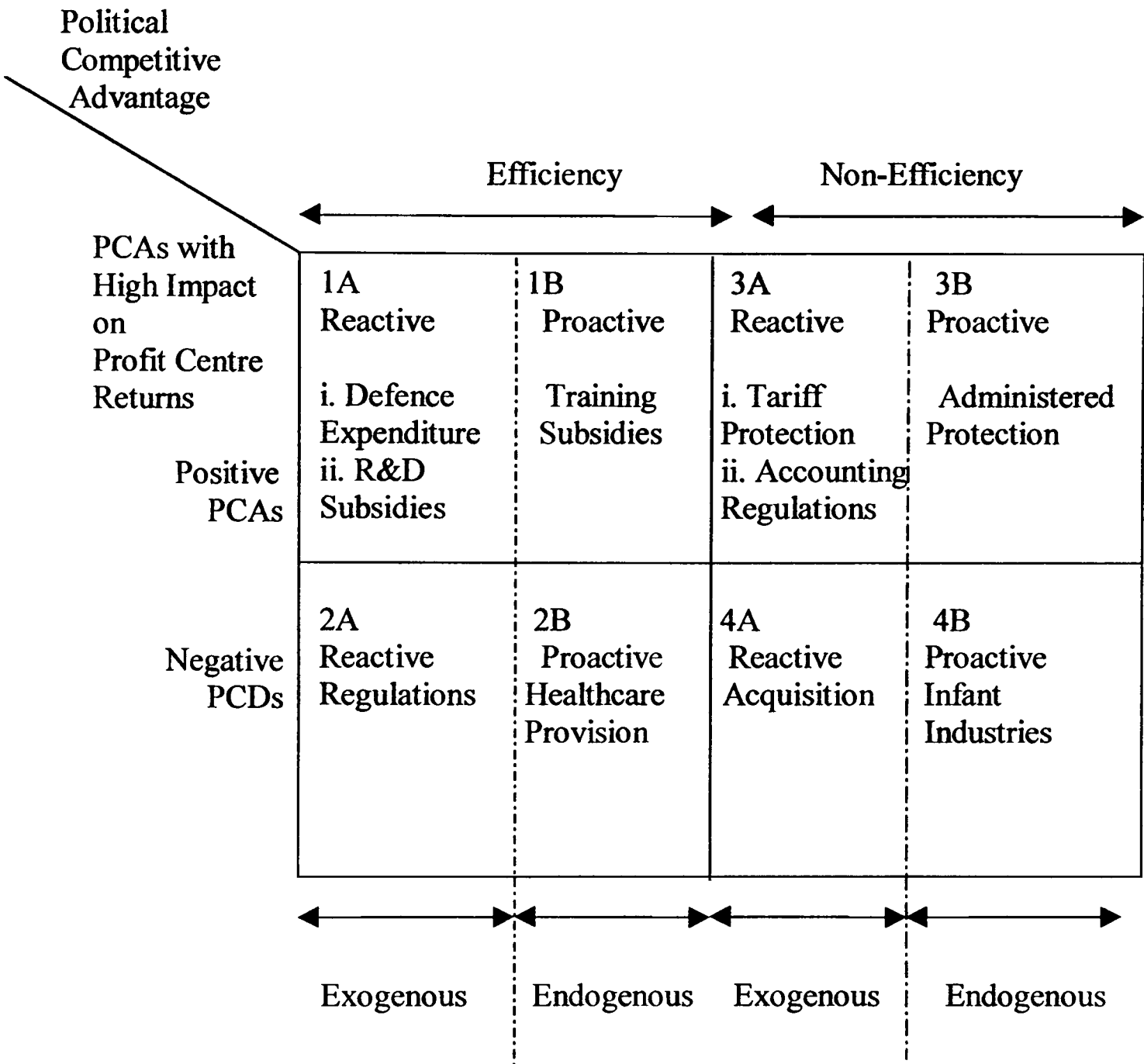


Figure 5.3. Coats – Firm Strategies to gain Political Competitive Advantage



Chapter 6. Conclusion.

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Chapter 6.

6.1. Review of Propositions.

Proposition 1.

Government has played, and is continuing to play, a decisive role in the development and structure of the global textile industry.

Several examples of the manner in which national government actions have played a decisive role in the development and structure of the textile industry in specific countries and across the globe are given in chapter 3. Examples given are from the U.K. before 1945 (3.2. pp.135-147) and post 1945 (3.3. pp.148-170), from China (3.5. pp.186-188), from the U.S.A. (3.6. pp.189-196). In addition, examples of supranational political actions, principally through GATT and WTO, show how supranational trade restrictions have also shaped textile supply and demand patterns across the world (3.4. pp.172-185).

Perhaps the most notable individual examples given of the British government's effect on the structure and development of national textile industries are Edward III's import substitution policy (pp.135-136); the British government's redirection of the textile industry's R&D on chemical dyestuffs into R&D on explosives (pp.139-140, 143-144); the introduction of inter-war protection and "Empire Preference" (pp.145-147); and the British government's involvement in post Second World War textile industry restructuring, together with some of its ramifications beyond the textile complex (pp. 148-171).

China, as a command economy in the second half of the twentieth century, is an obvious example of government having a profound effect on its national

textile industry, but the Chinese government economic reforms after 1979 had a dramatic effect, not only on the structure and development of the Chinese textile complex but also on the supply and demand of cotton and man-made fibres throughout the world (pp.186-188).

In the United States government textile trade protection has played a significant role in the structure and development of the textile industry from 1789 to the present day. In 3.6., attention is drawn to the changes in U.S. government policy and some of its effects upon the U.S. textile complex and upon Mexico and the Caribbean states (pp.191-196).

All these examples of national government involvement in national textile industries had regional and sometimes global consequences. Edward III's policies were critical in the development of Flanders, Ghent and Calais. Now, China is a major supplier and the U.S. is a major producer and consumer of traded textiles. The national textile policies of both countries have a major and decisive effect on patterns of international and national textile demand and supply throughout the world.

At a supranational level the exclusion of textiles from GATT and the inclusion of textiles into the WTO has played a very significant part in shaping the structure and development of the global textile industry since the Second World War (pp.172-185). Here the complex and multidimensional nature of government intervention is briefly demonstrated including the effect of U.S. national politics on GATT and the WTO as well as the effect of the Multifibre Arrangement on regions, nations and firms across the globe.

Proposition 2.

Government is a direct and indirect component of firm, industry and national competitive advantage, and should be included in the relevant strategic management theory.

The relevance of government to any study of competitive advantage in the textile industry at local, national, international, industry and firm levels is clearly established in this thesis. The decisive and direct effects of national and supranational government activities upon the structure of the textile industry lead to the conclusion that the omission of government as a direct force on industry profitability results in an insufficient and unsatisfactory analysis of competitive advantage. In Porter's case the treatment of government-derived competitive advantage both in his five-forces analysis, industry-level SPV analysis and in his determinants of national competitive advantage, is insufficient. At firm level the operationalization of Porter's competitive advantage theory results in a partial and misleading analysis (2.1.1. pp.49-51 and 2.1.2. pp.54-58).

Government can be incorporated as a sixth, interactive, direct and indirect force into Porter's five-forces analysis of industry profitability and competitive advantage (2.2. pp.59-66).

Proposition 3.

Political non-commercial, principally government, activities produce externalities that impact, positively and negatively, upon firms in the form of political advantages and political disadvantages (PAs and PDs).

Government activities produce externalities that may affect the cost and differentiation structure of firms (2.3.3-7. pp.80, 85-91). These externalities may have advantageous or disadvantageous effects upon firm returns. An analysis of the impact of government PAs and PDs upon the firm, especially upon MNEs, leads to the development of the concept of political competitive advantage (PCA) developed in chapter 4. The ten case studies set out in chapter 5 are all examples of government policy or policy implementation impacting upon firm advantage and profitability.

Proposition 4.

PAs and PDs impact on firms asymmetrically because of the unique nature of firm-specific structures and networks. Some firms will gain politically-derived competitive advantages (PCAs) over others. PCAs are a subset of firm-specific advantages (FSAs) and operate over a wide variety of time horizons.

The incorporation of government as the sixth force in Porter's SPV industry level five-forces analysis is insufficient in the light of the development of RBV theory (2.3.2. pp.70-77).

The impact of such externalities upon firms is asymmetrical, according to their unique asset, capability and network structure FSAs (2.3.7. pp. 93-95). Politically-derived advantages are a subset of FSAs (2.3.8. pp.96-98). Some externalities will enhance firm profitability while others will reduce it. The impact of government-derived externalities may or may not affect firm profitability. As a result some firms experience greater politically-derived advantages (PCAs) or

disadvantages (PCDs) than other firms. The concept of PCAs is developed in chapter 4 (pp.202-238) and the case studies set out in chapter 5 illustrate PCAs and operationalize the PCA concept over a wide variety of time horizons (pp.250-299).

Proposition 5.

PCAs are firm-specific competitive advantages and can be efficiency-based, or non-efficiency, shelter-based.

The theory of efficiency underpins the concept of competitive advantage and superior profitability. The concept of less input for the same output, or more output for the same input, can be applied to both cost and differentiation competitive advantages (2.3.9. pp.99-105).

Chapter 4 shows how PCAs, in line with FSAs, may be divided into two principal categories, those that enhance firm efficiency and those that do not. From a firm perspective both sets can increase firm competitive advantage, producer surpluses and firm returns. Some PCAs are efficiency-based advantages and add value to the product or service by decreasing its cost and/or increasing its uniqueness to the consumer. Other PCAs are non-efficiency-based, and potentially increase firm returns by reducing competition and consumer choice, raising price equilibria and consumer costs. The former create efficiency-based superior performance, enabling the firm to offer superior value to its customers. Efficiency-based FSAs and PCAs can act as entry barriers to competitors and potential competitors.

Non-efficiency PCAs are shelter-based and rely on non-efficiency, politically-derived, firm-specific competitive advantages, that restrict customer choice, in order to generate superior returns (2.3.10. pp.106-110). Non-efficiency shelter-based advantages form a subset of PCAs. They can be derived from a wide range of political activities and are extended here far beyond shelter-based tariff advantages.

Cost advantages (lower unit input achieving equal unit output) are generally efficiency-based. Cost reduction enables firms to increase added value and, potentially, to increase consumer value by lowering price. Firms can differentiate both by increasing their efficiency and the uniqueness of their products and services, and/or by using non-efficiency strategies that reduce consumer choice and raise price equilibria.

The micro-economic concepts of efficiency, cost and differentiation, underlying Porter's theory of competitive advantage, can be developed without a strategic positioning view (SPV), industry-level analysis, based on the concept of firm-specific advantages (FSAs) derived from a combination of the resource-based view of the firm (RBV) and MNE internalization theory. This bridge between RBV and internalization enables the extended FSA/PCA strategic management concept to be firmly grounded in economics and international business theory.

Proposition 6.

In their quest for sustained and stable strategic competitive advantage, firms may

try to internalize and endogenize political advantages into PCAs.

In their quest for sustained and stable strategic competitive advantage, profit-seeking firms may seek to internalize or endogenize perceived exogenous advantages in order to try to optimize their firm-specific advantages (including PCAs) and thus firm returns (chapter 2, pp.74, 77-94; chapter 4).

In the case of politically-derived advantages, firms may design proactive strategies that signify attempts to internalize or endogenize in order to gain a higher degree of management control over the source of the political externality itself. Partial endogeneity can take place, signifying different degrees of internalization of the political activity into the firm hierarchy. However, truly proactive strategies require full internalization to the point where the firm's managers are confident that they are managing the source of the political externality on a sustainable basis.

Proposition 7.

Successful firms develop firm-specific advantages (FSAs) including PCAs that are manifested as superior returns and can be quantified.

A focus by firms on government is critical when trying to achieve desired levels of profitability and growth. Some of the forces that produce competitive advantage and superior returns are politically-derived advantages (PAs). PCAs are politically-derived, firm-specific, competitive advantages and are a sub-set of FSAs.

In addition to proactive strategies firms can gain some degree of control

over exogenous politically-derived externalities by devising appropriate reactive strategies that enhance positive PAs or reduce negative PDs. By devising better reactive strategies (for example by employing better tax consultants) firms can often increase firm returns.

The analysis of PCAs and PCDs should not be limited to proactive strategies. Reactive strategies to PAs and PDs are also very important. Firms can frequently devise reactive strategies that avoid the costs and hazards that are often associated with proactive political strategies.

The eight cell PCA analytical framework enables firms to assess the degree of endogeneity or manageability that they possess over specific PCAs and PCDs and to devise strategies accordingly. Strategic management planning requires a holistic view of strengths, weaknesses, opportunities and threats, and any limitation of the strategic horizon reduces the ability of management to gain some measure of control over the future. By understanding the asymmetrical nature of the impact of PAs and PDs upon different firms, strategic management can gain PCAs over its rivals.

Firms with superior returns frequently possess strategies, planned or emergent, reactive or proactive, that enable them to use their unique structures and networks to convert PAs into PCAs. By reducing PDs firms can also gain comparative PCAs, in the sense that they experience fewer politically-derived disadvantages than competitors. The objective of a profit-seeking firm is to enhance its PCAs and decrease or eliminate its PCDs in order to increase its returns.

Chapter 5 illustrates how Coats develops reactive strategies in the face of government externalities that have a major impact upon its returns and, in some cases, develops proactive strategies that enable the firm to partially or wholly internalize and endogenize politically-derived externalities. Coats has developed unique capabilities in reacting to the many levels of government externalities (PAs and PDs) and in developing proactive strategies that create PCAs in its markets across the globe. While it is shown that efficiency-based PCAs are generally superior to non-efficiency-based PCAs in their ability to create sustained firm returns, Coats depends on non-efficiency PCAs that have given some profit centres substantial competitive advantages. Some of these non-efficiency advantages may endure over decades while some efficiency-based advantages have a very short time horizon. FSAs and PCAs vary from one profit centre to another. The identification, estimation and measurement of PCAs and PCDs at profit centre level necessitates the same combination of information and management skills that is required to assess all FSAs. Strategic management requires a holistic understanding of the forces that will drive a successful business model on a sustained basis.

6.2. Extension and Implications for Managers.

The case studies set out in chapter 5 illustrate the operationalization of the eight cell PCA matrix. Historical cases have been positioned on the matrix. In an academic or practitioner strategic planning exercise, hypothetical cases could be similarly classified.

6.2.1. Extension.

The background to this thesis is a study of the global textile industry that concludes that government plays a dominant role in the textiles and clothing markets at global, national, industry and firm levels. The Coats study of one company in one industry is clearly limited, but several of the case studies reflect MNE generic experience. More studies of Coats would be required to further demonstrate the comprehensive nature of the eight cell matrix.

Within the textile complex other companies such as Courtaulds or DMC could form the basis of single firm studies or multiple firm studies to be compared and contrasted with Coats' PCAs. It is a reasonable hypothesis that case studies similar to those from Coats could be selected to demonstrate the efficacy of the eight cell PCA matrix.

Other case studies are required from other industries and from non-governmental political sources. That government can have a substantial effect on firms from other industries, in line with propositions 1 and 2, is not difficult to demonstrate.

In the following very brief example from the tourist industry PCDs and

PCAs are derived from externalities (PAs and PDs) emanating from NGOs.

Tourist companies running cruises to Antarctica have formed a trade organization, the International Association of Antarctic Tour Operators (IAATO, website: www.iaato.org) in the face of increasing NGO and supranational governmental (Antarctic Treaty Organization) pressure to restrict, regulate and control Antarctic tourism. The interest of the NGOs, such as Greenpeace, increases costs and decreases the returns of IAATO members. But by showing a healthy concern for the environment, co-operating and pre-empting Greenpeace concerns, working with government-funded bodies (e.g. in the U.S.A. with the National Science Foundation, and in the U.K. with the Scott Polar Research Institute and the British Antarctic Survey), the IAATO has converted membership of its Association into an important differentiation advantage. The business of operating cruises in Antarctica is particularly vulnerable to uninformed environmental criticism and the IAATO, like many other trade organizations, has become a respected source of data and information. Specifically a strategy of open inspection and transparency to Greenpeace by some IAATO members has become a political competitive advantage and reduced the level of uninformed criticism, which prejudices passengers and potential passengers and reduces sales. IAATO now works with NGOs and governments in a partnership to preserve Antarctica, helping to conduct scientific surveys of the impact of tourism on the continent. In some cases, for example at the Antarctic Treaty Organization meeting in Madrid in 2003, the IAATO representatives demonstrated a much more detailed local knowledge than that possessed by the representatives of the

many national governments.

IAATO is a trade organization but this does not make its representatives or members incapable of wider concern. The human beings employed by Antarctic cruise companies are very similar to the human beings employed by governments and they have very similar environmental concerns. In some cases the IAATO members and their passengers act as an important environmental pressure group upon governments. The dramatic improvement in attitudes towards cleanliness and the preservation of historic sites at most of the national scientific bases in Antarctica over the last ten years owes much to the constructive criticism offered by tourist companies and their passengers.

As governments begin to look to IATTO and its members for reliable information and advice, so the reputation of IAATO and its secretariat become an important asset requiring careful preservation. Just as some of the government officials have particular hobbyhorses that rise to the top of their agendas, so the officials of IAATO inject their concerns into government agendas.

Since membership of IAATO is in the hands of its existing members, they are able to erect entry barriers and to gain important non-efficiency PCAs and enhanced returns. Some IAATO members have converted an NGO-derived, political disadvantage into an important PCA.

6.2.2. Implications for Managers.

In most cases it will prove possible to enhance PCAs or reduce PCDs. Costs and returns need to be carefully calculated and not merely in financial

terms. The moral and legal implications and the political risks also need careful assessment in terms of positioning on the eight cell matrix.

Varying degrees of successful implementation will result from the bounded rationality of players in both firm and government. As with market strategies, non-market strategies will meet with varying success, in terms of achieving profitability and sustainability, depending on the accuracy of the analysis, the detailed formulation of the plan, the level of implementation and the flexibility required to keep the strategy on course as the dynamics of the environment develop.

Successful strategy is measured here in terms of sustainable growth and profitability, realised net worth, profitability and cash flow. Since, in practice, the dynamics of any situation are subject to continual change, introducing new market and non-markets forces, it is difficult to measure the success of PCA strategies in isolation. In line with our focus on strategic outcomes rather than intentions, many of Coats' successes were unintended. However in this respect PCA strategic success is no different from market-derived success where forces are dynamic, shifting and overlapping, and interactive.

There is nothing intrinsically different about the value of enhancements derived from political non-market sources and those derived from non-political sources. Both enhance cost and/or differentiation advantages. Businessmen do not think, and do not need to think, about where exactly the foggy boundaries lie between the market and the non-market. It is however quite true that advantages derived from non-market institutions may require distinctive strategies. This is not

certain however. In many cases, gains in competitive advantage from market institutions and from non-market institutions have more similarities than differences.

The eight cell PCA analytical framework can be used by any firm, domestic or multinational, to gain a better strategic understanding of the effects of government on the firm. It is particularly useful for geographically diversified MNEs because cross-border transactions offer more strategic opportunities, both reactive and proactive.

All strategic managers in their quest for sustainable survival, profitability and growth should try to analyse the components of their actual and potential competitive advantage. There has been a general recognition among strategists that competitive advantage lies at the heart of strategic success. Internalization theory and the resource-based view of the firm have both emphasized the importance of the firm. Concepts such as information asymmetries, bounded rationality and opportunism have taken strategic management away from strict economic theory and firmly towards the social sciences, emphasising the importance and unpredictability of human behaviour in building sustainable, endogenous, competitive advantages based on efficiency, scarcity, durability, and inimitability. Fixed assets have been extended to include human assets, created assets, core competences and capabilities. Ownership has become ambiguous with the focus on intangible assets and appropriability (Itami, 1987).

RBV studies of the firm are still generally regarded as microeconomic studies within a wider macroeconomic context of an industry structure that pre-

determines the firm's ability to generate superior returns. Although the balance has shifted towards the firm's internal capabilities, the importance of industry structure has remained central to strategic planning. Internalization offers a bridge in that it can be used to explain how firms can influence industry structure by endogenization. The planned and emergent activities of MNEs, such as Coats, shape industry structure. Firms can move from one industry to another, and dominant firms can create new industries. The firm's external world is much greater and more complex than is revealed by the usual studies of industry structure. The firm is not just influenced by factors affecting its industry group or sub-group as if external factors were funnelled down to its level via its industry group. MNEs in particular are exposed to a multitude of external influences from countries and governments that are unique to them and to their specific structure and networks. Porter's five forces of industry profitability are an insufficient explanation of the impact of the external world on individual firm profitability.

By including government, as both a direct and an indirect force, the contextual study of the firm is considerably widened. Governments are involved in most areas of human existence and this study has opened the door to further studies of the firm not just within a nation or an industry but within its real-world wider context. By using the concepts of profitability, location, efficiency, non-efficiency and endogenization the firm can focus on those external forces that have a significant impact on its survival, profitability and growth where reactive and proactive strategies can enhance competitive advantage and/or reduce competitive disadvantage.

CEOs rapidly become aware that strategic planning requires a holistic approach. Partial analysis is insufficient. It is the forgotten, the unknown and the unpredictable that usually cause the problems, not the known and manageable. The quest for competitive advantage therefore requires a constant attempt to reduce the former and increase the latter. Acts of God, such as earthquakes, cannot be prevented but they can be better understood and their effects perhaps mitigated. Chance is also having its boundaries reduced as humans increase their understanding of their world and its dangers. Government is no longer such a separate branch of human existence, as it must have seemed to the majority ruled by medieval monarchs, who possessed inherited rights, apparently derived from God. Managers should not regard government, along with chance, as a largely exogenous and indirect force. As governments increase in size and scope, as they become more democratic and more dependent on the non-political sectors of society, so the legitimate opportunities for influencing and partnering government are growing. Firms and government both employ management and the concept of efficiency used in this thesis, fewer inputs for the same outputs, can equally apply to government as to firms. There may well be cases where PCAs tip the balance in favour of the public sector production of goods and services and against the private sector. Both sectors have a part to play and while alliances between government and firms may increase the likelihood of corruption and need to be transparently regulated, alliance capitalism could also lead to greater efficiency, consumer benefits, wealth creation and economic growth.

Fortunately, in order to consider external opportunities and threats

holistically it is not necessary for management to embark on a philosophical study of the external world or even a comprehensive study of political science. The concept of competitive or firm-specific advantage can still be reduced to two key questions: why are my prices and costs as they are? and, what can I do to increase my added value on a sustainable basis? At this level it is clear that these questions must first be asked at the primary profit centre level, where costs and prices are analysable using primary documents. While the complex reasons for the existence of specific cost and price structures will not be revealed by the documents alone, it is impossible to explain their origins without reference to them at all. In the case of the MNE it is probable that some explanations, for example of prices, will be partly dependent on non-local factors such as global reputation. However, it is in the context of the particular advantage that global reputation gives to each profit centre, i.e. the price advantage resulting from the perceptions of its unique location-bound customers and potential customers, that the effect of global reputation on profitability must be analysed. Like most social science analysis, it is safer to progress from the particular to the general rather than the other way around.

At a minimum level PCA analysis enables firms to add government as a sixth force to Porter's other five forces of buyers, suppliers, new entrants, substitutes and rivalry. But PCA analysis extends much further, enabling managers to focus on the significant exogenous factors acting upon profit centre profitability that are not clearly reflected in a traditional five-forces industry-level SPV analysis. The RBV/internalization-based analysis approach has the great

merit that we do not have to limit ourselves to the notion of five or even six forces, we can extend the paradigm and experiment with the possibility that the forces acting on firm profitability are much wider and much more complex. The eight cell analytical framework enables MNEs to analyse significant PCAs and PCDs for their impact on profitability and efficiency, at and across locations, and over time. Understanding the source and nature of PCAs and PCDs should enable MNEs to assess the possibility of endogeneity and to plan reactive or proactive strategies accordingly.

Most firms are focused on continual efficiency enhancement in order to increase customer value, and simultaneously to increase their own added value. Efficiency-based strategies would seem to give firms the best chance of keeping ahead of the competition and being able to satisfy increasing customer expectations on a sustained basis. The reason that efficiency-based competitive advantages are superior to non-efficiency-based competitive advantages is not because they are more difficult to imitate. In fact it is usually quite easy to detect and imitate a competitor's efficiency-based advantages, for example in the supply chain. Cost-reducing efficiency-based PCAs are easier to spot than non-efficiency advantages that may result from obscure or unintended legislation or non-transparent relationships and networks. Efficiency-based advantages in competitive markets usually signify that a firm is at the leading edge of research and development and ahead in the quest for cost and differentiation advantages. This gives the firm a forward focus and the flexibility to adopt new and more efficient paths than its competitors. This can be contrasted with non-efficiency,

shelter-based advantages which may give a firm high profitability, over fairly long time horizons, but leave the firm vulnerable to the efficiency-based advances of competitors and new entrants and unable to respond rapidly, as in the case of Coats or many state-owned companies.

One of the problems that MNEs face is to find the balance between the standardization involved in scale and scope advantages versus increasing demands for flexible one-to-one consumer service (Chandler, 1990; Peters, 1992). The addition of PCAs into the analysis of competitive advantage and FSAs increases the emphasis on location-based analysis since many PCAs are to be found at a local and national level.

Another fundamental strategic task is to find the balance between going to the market and internalization into the firm hierarchy. This question has various manifestations but is most commonly encountered in the make/buy decision. The study of alliances and the growing alliance literature (p.97) will become even more important in further research into the implementation of PCA strategic analysis – what to do and what to avoid.

Few firms, however, formally analyse the impact of politically-derived, efficiency-based externalities on their profit centre returns, or formally compare that impact across profit centres. In the quest for isolating mechanisms, it is the impact on profitability and growth that counts for managers, not the perceived macro-level significance of the efficiency-based versus shelter-based market position gained by the firm vis-à-vis rivals. Firms will choose a particular political strategy, building upon a set of idiosyncratic resources that may then lead to

market-enhancing or market-closing outcomes (Verbeke and Bowen, 2002).

Some of the questions raised for strategic managers from this RBV/internalization-based PCA analysis are:

- i. Where are our key FSAs, PCAs and PCDs?
- ii. Where do our PCAs and PCDs fall within the eight cell PCA analytical framework, i.e. what is their impact on our profitability and growth? Which are efficiency-based and potentially increase customer value and which are non-efficiency-based and increase consumer costs? Which are wholly or partially manageable and which are beyond our control?
- iii. Do we need to make better use of our existing political advantages or should we try to acquire/develop new ones? What is our present PCA strategy, planned or emergent? Are we reacting correctly? What are the implications of a change in strategy?
- iv. Which PCAs are exogenous and which are manageable? Are reactive strategies sufficient or do we need to endogenize some government activities? In the case of exogenous PCAs and PCDs, how can we develop reactive strategies that will enhance firm profitability and growth? Are there any present or expected exogenous changes in government policies that could affect our political advantages? Are there ways of endogenizing government activities so as to reduce the risk of policy change, or, at the very least, to obtain as much advanced notice as possible?
- v. What reactive and/or proactive strategies should be pursued in order to enhance PCAs and reduce PCDs, both at profit centre level, and at the level of the

firm and its constituent units (product lines, geographic markets, divisions, subsidiaries etc...)?

vi. How can we unbundle our PCAs and PCDs in terms of their specific characteristics, i.e. what are the actual sources of the political externalities (PAs and PDs) that are leading to these PCAs and PCDs? What level of government or NGO is producing the externalities that are impacting on us (local, provincial, national, regional or supranational)? Do we have or do we need firm-specific political capabilities such as privileged linkages with specific actors in particular ministries, departments, NGOs, quangos etc? Who are the principal actors and decision-makers? Political advantages can take various forms, including better intelligence about political actors and opportunities, readier access to political opinion-formers and to decision-makers, and superior influence skills at handling the latter.

vii. Does the firm possess sufficient political expertise in specific geographical or functional units to manage salient political issues and actors and to develop reactive and proactive strategies in relation to the existing situation and to any anticipated change? Are there any changes in present or expected government policy that the firm should try to achieve, building upon its manageable political advantages?

viii. What changes in exogenous government activities can be projected? How can we get better information? Does our network include an expert and/or an insider? Where should we be extending our network and how? Are we investing time and money in useless networks?

Managers should focus on exploiting and developing those political advantages that have a substantial impact upon the profitability and growth of the firm. It should be noted, however, that many MNEs return less than 10% on sales, and on capital employed after tax. Relatively small changes in costs and prices can have a large impact on their performance.

ix. Are our PCAs and PCDs location-specific or of an internationally transferable nature? Do we have any formal mechanisms for developing and directing our political capabilities towards those areas where they may best enhance firm returns?

In the case of Coats, the application of the eight cell PCA analytical framework would have enabled managers (local, regional and central) to:

- i. analyse, formally and logically, the effects of government upon the subsidiary profit centres.
- ii. to devise reactive and proactive strategies in order to create and enhance PCAs and to reduce PCDs; and,
- iii. to make comparisons between profit centres and competitors.

6.3. Contributions, Limitations and Suggestions for Further Research.

The principal contribution of this thesis is the new concept of political competitive advantage (PCA) developed in chapter 4. The main contention advanced in this thesis is that government has had, and still has, a profound effect upon the competitive advantage of firms, especially MNEs, and that this area of competitive advantage theory has been neglected in the literature. Without the formal incorporation of the effects of government upon industries and firms, the theory of competitive advantage is insufficient. As far as we are aware this is the first attempt to incorporate the effect of government into competitive advantage theory at doctoral level.

The challenge set at the beginning of this research was to ensure its relevance to strategic management practitioners. This is the first attempt to formally incorporate the concept of political advantage into strategic analysis and planning processes. The eight cell strategic analysis of the effect of government upon a firm in terms of firm-specific advantages in chapter 5 is ground-breaking.

This thesis has reached similar conclusions to Henisz (2003) with regard to the advantages to be gained from the management of institutional idiosyncrasies. However it goes much further in recognising that all firms are affected to some degree by their unique set of politically-derived PAs and PDs and to a greater or lesser degree can gain firm-specific advantages managing political government externalities. MNEs are particularly well placed to take advantage of cross-border idiosyncrasies because there are usually greater differences between nations than within nations. MNEs can gain further

advantage by learning from their experience across the world and by developing generic skills in order to increase politically-derived advantages and to reduce politically-derived disadvantages.

The recent focus of international business on the theory of the multinational firm is a notable exception because the two fields are now clearly overlapping. However it is not the intention of this thesis to attempt to make any contribution to recent international business theory. Similarly this thesis is concerned with the ways in which firms develop political competitive advantages (PCAs), and it does not attempt a wider study of the political economy of MNEs. Studies of the threats that government perceives from MNEs are only of interest here where they encompass a strategic management perspective. Competitive advantage has been principally studied at industry, national and firm levels. A further contribution of this thesis is to point to some of the practical problems that practitioner strategic managers encounter when trying to apply national and industry-level competitive advantage studies to firm-specific analysis and planning, and to show how the macro-level generalizations common to political analysis may be refined and focused into firm-specific advantages and disadvantages.

In addition this thesis demonstrates the following: (1) the importance of government in the textile industry, both at present and in the past; (2) the relevance of political competitive advantage at the national, industry and firm levels; (3) the complex foundations of political competitive advantage in practice (firm/government relations can be multilevel and multifaceted); (4) the difficulties

that MNE head offices have in correctly analysing and measuring firm-specific advantages; (5) the wide variety of time horizons within which political competitive advantages can remain relevant; and (6) the fact that political competitive advantages can be measured and quantified in terms of superior added value.

Politically-derived externalities have an asymmetrical impact upon firms, in the form of political advantages (PAs) and political disadvantages (PDs). These externalities can be classified into efficiency-based and non-efficiency-based advantages according to their effect upon the firm and upon the consumer.

Because firms have unique histories and structure, government-derived externalities impact asymmetrically. Some firms will gain more advantage, or incur more disadvantage, than others. These differences mean that some firms gain politically-derived competitive advantages (PCAs) over other firms.

Firms with the appropriate resources, competences and capabilities can convert PAs into politically-derived competitive advantages (PCAs) that increase firm returns.

Firms can also enhance the components of their superior performance (FSAs) by employing reactive and proactive strategies that will enhance politically-derived competitive advantages (PCAs) and reduce politically-derived competitive disadvantages (PCDs).

PCAs are a government-derived subset of firm-specific advantages (FSAs). FSAs act as isolating mechanisms giving the firm advantages. In total, FSAs form the superior profitability of the firm. The superior profitability of the

firm is the result of its ability to create superior added value. FSAs are competitive advantages i.e. the ability to create superior added value.

Superior competitive advantage encompasses the resources, competences and capabilities that one firm has over its competitors that enable it to produce superior added value. The superior added value of the firm has two components, producer and consumer surpluses. Producer surpluses are unlikely to be sustained unless the firm has the capability to enhance consumer benefits. Once consumer surplus becomes the focus of strategic management, efficiency and endogeneity, not competition, become the key determinants of profitability.

National and industry-level studies cannot adequately reflect the differential impact of government upon the primary unit of economic analysis, the firm. The impact of government activities upon the textile industry is manifested in the effect of PAs and PDs on the cost and differentiation advantages of individual firms. National, regional and global studies require the aggregation of firm-level data to a point where the specific sources of FSAs and PCAs can no longer be identified. In addition, local and provincial sub-national levels of government, that can have significant impact on the FSAs and PCAs of individual firms, are rarely revealed in national and industry-level studies.

The thesis provides an eight cell analytical framework that enables firm-specific, politically-derived advantages and disadvantages (PCAs and PCDs) to be analysed for efficiency, endogeneity (manageability) and profitability. The eight cell PCA analytical framework developed in chapter 4 enables strategists to identify and classify PCAs, as a sub-set of the FSAs that give the successful firm

its competitive advantages and superior returns. In the analytical process firms determine the size and location of their significant PCAs and PCDs. At a profit-centre level, PCAs and PCDs can be quantified or estimated and tracked to their specific political and government sources. This framework can be used to compare PCAs with those of competitors. In the case of diversified firms, similar profit centres can be compared. This is especially useful in the case of MNEs where different profit centres with cross-border locations experience significantly different PCAs and PCDs.

Political externalities (PAs and PDs) are dynamic both in terms of changes at source and in their impact upon the dynamic structure and networks of the firm. The eight cell PCA framework permits PCAs and PCDs to be classified according to their efficiency or non-efficiency origins and their impact on profitability to be tracked and analysed over time.

The eight cell analytical framework can be used by firms in the development of reactive and proactive strategies in order to enhance PCAs and to reduce PCDs. In profit-seeking firms all these strategies will aim to increase producer surpluses. Firms can choose to try to increase their returns by employing efficiency-based or non-efficiency-based strategies.

The claim that non-efficiency advantages lead firms to be less efficient and therefore to store up future problems in the face of potential efficiency-based competitors has been shown to be true in the case of Coats, but it is not inevitable. Chapter 5 illustrates the problems that firms can encounter if they are unable to separate efficiency and non-efficiency PCA sources and fail to develop the

different types of firm strategies required in order to optimize PCAs. In order to be aware of the dangers of relying on returns from non-efficiency, consumer-value-reducing advantages, it is important that each firm makes the distinction between efficiency and non-efficiency-based PCAs.

The study of consumer surpluses is a much less developed science than the study of producer surpluses but new communications and computer technology is enabling firms to study consumers as individuals and to better assess their perceptions of consumer surpluses and their decision patterns. Any firm study of PCAs and PCDs must also analyse and forecast the dynamic direct and indirect impact of government upon the perceptions and decisions of its consumers.

The impact of political externalities upon a firm's profitability and growth will not remain constant over time. Successful strategic management requires deep, holistic understanding of the dynamic forces acting upon profitability and growth. Managers are continually reminded that strategy is most often thrown off course by the unexpected. Government is a major source of unexpected and exogenous forces on firm profitability. Dynamic analytical frameworks and flexible organizational structures are required, in the face of increasingly complex and turbulent markets, in order to sustain a positive net balance of competitive advantage.

With better information and understanding, capable managers can devise better reactive strategies to optimize PCAs. Profitable proactive strategies can be devised in partnership with government. It is in the interests of both firms and government to increase efficiency-enhancing PCAs and to decrease efficiency-

reducing PCDs.

If however, governments produce non-efficiency-based PAs that firms can convert into PCAs that enhance returns, it can be argued that managers have a duty to their shareholders to optimize their PCAs by reactive and proactive strategies providing they operate within generally held ethical codes and the law. Equally, within the same codes, managers should try to mitigate the effects of efficiency and non-efficiency-based PDs.

The eight cell framework has only been used here to develop the concept of political competitive advantage, but, *prima facie*, it also has the potential to serve as an analytical framework for the holistic analysis of all competitive advantages and disadvantages, and thus to replace Porter's five-forces analytical framework. The application of the eight cell PCA analytical framework to Coats in chapter 5 suggests that internalization theory and RBV at firm level provides a sounder and more comprehensive explanation of the role of government upon the textile firms and the textile industry than that provided by SPV theory.

Porter's five-forces analysis and his strategic management analytical framework was used by Coats as the basis for its global strategic planning exercise 1992-1994. It does not provide a sufficient methodology for firms to analyse the extent of their dependence on politically-derived competitive advantages. Industry definition problems in textiles further increase the complexity and reduce the usefulness of SPV as a strategic analytical framework. MNEs often avoid direct confrontation with other MNEs and so face only local domestic competitors in many markets. In the case of Coats, local and transferable

efficiency-based and non-efficiency-based advantages enabled them to command market shares in excess of fifty per cent in many countries. In such cases SPV competitor analysis is insufficient to explain competitive advantage; comparisons of FSAs, including PCAs, across subsidiary profit centres are much more important.

Study of Coats Viyella PLC and, in particular, study of the Porter-based, Coats Viyella 1992-1994 global strategic planning exercise, leads to the conclusion that the company's management were unaware of the extent to which it relied on political competitive advantages (PCAs) in its strategic quest for survival, profitability and growth. In particular Coats' dependence on non-efficiency, shelter-based advantages was essential to survival, profitability and growth in a wide variety of locations but it did not receive scientific analysis.

While the Coats Patons chairman was well aware of the problems posed by the changing nature of government policies (Coats Patons PLC, 1981), the new owners after March 1986, Vantona Viyella, appear to have been unaware of the extent of Coats Viyella's dependence on PCAs and made no attempt to warn shareholders (Coats Viyella PLC, various years). Some restructuring did take place in the U.K. and European thread mills but capital expenditure was rarely available and then only where the subsidiary could generate sufficient cash itself. Few profit-centre managers at Coats were, or are, aware of their dependence on PCAs for efficiency and non-efficiency cost and differentiation advantages and no attempt was made to quantify them. In the mid-1990s the failure to adjust to dynamic changes in PAs and PDs, and to quantify the extent of its dwindling

PCAs, overwhelmed Coats Viyella, contributing to the loss of £2bn of share capital and the resignation of Chairman and Chief Executive.

The use of the eight cell PCA analytical framework would have enabled managers to analyse the effects of government upon each subsidiary profit centre, and to track change. Managers could also have used this framework to devise reactive and proactive strategies in order to create and enhance PCAs and to reduce PCDs.

Understanding and quantifying firm-specific advantages is an essential part of the activities of successful profit-seeking firms. Chapter 2 concludes that attempts to devise new accounting practices based on the wider value chain concepts have failed. Chapter 5 suggests that existing profit-centre management accounts, together with capable profit-centre managers, management accountants and powerful computer systems, are capable of identifying and quantifying PCAs in exactly the same way as other FSAs are analysed in order to optimize costs and prices. Once identified and classified, PCAs can be quantified at profit-centre level and aggregated across the MNE.

Importantly, the PCA analytical framework is comparatively easy for managers to understand and to operationalize because PCAs and PCDs can be assessed at profit-centre level using the same tools that managers constantly make use of to analyse, estimate and quantify all the sources, and potential sources, of profit-centre cost and differentiation advantages and disadvantages. The eight cell PCA matrix provides managers with a dynamic and holistic analytical framework for PCA analysis. This framework enables firms to establish the nature and size of

their PCAs and to understand their impact upon their strategic quest for survival, profitability and growth. It can be used as a practitioner tool for the continuous tracking and revision of reactive and proactive strategies required to enhance PCAs. It provides the MNE with a location-based, value-chain, analytical framework for determining the size, efficiency basis, endogeneity and effect on profitability of politically-derived competitive advantages and disadvantages, that can be used to plan forward at individual profit centres, and to compare PCAs across them.

The implications of this analysis for all levels of government are widespread, but mostly beyond the scope of this strategic management thesis. The objective of democratic government should be to reduce PCDs to a minimum consistent with its democratic mandate, in particular eliminating PCDs that are unintended or due to the inefficient implementation of policy. There are good economic arguments, in terms of productivity, wealth creation and consumer value, for governments to push firms towards efficiency-based competitive advantages. This thesis has shown that on the contrary many non-efficiency sources of competitive advantage are currently fostered by governments.

It is in the interest of both firms and governments to enhance efficiency-based, politically-derived cost and differentiation advantages, because this will increase wealth creation, and provide the potential for the enhancement of people's material standard of living, which is the democratic wish of the vast majority of the human population of the world.

There are great dangers in trying to generalise too far from a study of one

MNE in one industry. Research across other areas of economic activity and other firms is required before these generalisations can be substantiated. It would appear however that firms could do well to incorporate PCA analysis into their strategic planning exercises. In particular, it is important for firms to distinguish non-efficiency shelter-based PCAs from those that will enhance consumer value. Governments could open a new and positive era of cooperative capitalism, or 'alliance capitalism' (Dunning, 1995), by analysing their activities in terms of impact on firm-specific superior added value i.e. wealth creation.

Measurement is important especially to strategic practitioners. Criticisms of quantification as being distracting to strategy, "putting the financial carriage ahead of the strategy horse" (Mintzberg, 1994, p.59), and the warnings against excessive number crunching in the Coats Viyella 1992-1994 strategy planning document (Coats Viyella, 1991) are, perhaps, meant to encourage deeper thought. However quantification is essential to those confronting shareholder expectations on a quarterly basis.

PCAs are not unique among FSAs in being difficult to measure. Few FSAs are subject to exact quantification although most MNEs can arrive at reasonably accurate estimates. Measuring net superior added value is relatively easy if existing accountancy conventions are accepted. Comparisons between the added value of MNE subsidiaries are relatively easy to make, since management accounts are often prepared on the same bases. MNEs can apply analytical frameworks and processes across their many profit centres and, often by trial and error, modify their systems until internal and external consistency is achieved.

FSA identification and segmentation is complex, but performance comparisons between subsidiaries can easily identify inconsistencies and areas for further analysis.

The measurement of profit is largely accountancy-based. MNEs have clear success criteria in terms of profits, net worth, return on capital and cash flow. While many economists, including Porter, are unhappy with the way in which accountants define and calculate economic performance, it is the only measure that is constructed from actual and detailed costs and prices. Kay has pointed out that accountancy can provide acceptable performance measurement, and can satisfy the various groups of firm stakeholders, by using the value added concept. The development of accounting methodologies for the measurement of competitive advantage, and specifically for Porter's extended value-chain analytical framework, has made little headway (Kay and Davis, 1990; Kay, 1993a, 1993b, 1993c, 1996; Partridge and Perren, 1994; Wallman, 1997; Whittington and Steele, 1998; Parsons and Corrigan, 1998).

By focusing on the profit centre the task of PCA analysis becomes much simpler than appears at first. Profit centre managers are accustomed to analysing costs and prices daily. Profit centres are continually projecting forward for budgets and forecasts. Strategic planning often consists of analysing alternative cost and price scenarios.

No attempt has been made here to calculate net PCAs in any one subsidiary of Coats or to aggregate net PCA across the Coats group. It is of course essential that such an exercise be undertaken as part of any further research. The

identification of FSAs and PCAs is a painstaking process requiring actual information and access to the profit centre managers responsible for each account. Verification requires comparisons with competitors and/or similar profit centres and is beyond the scope of this thesis. However the methodology is familiar to most profit centre managers, strategy and financial directors, and strategy consultants, who are accustomed to using accountancy-based strategic studies. I have consulted with financial managers and accountants and I am particularly indebted to Mr Jim McLean who filled in some of the gaps in my accounting knowledge with regard to Coats and worked with me on a pilot study.

Further research is required to test the robustness of the PCA concept. The eight cell PCA analytical framework needs to be applied to other MNEs in other industries.

If the PCA concept proves robust, firms will use it to analyse the impact of government upon them and, for the first time, incorporate all levels of government into their dynamic and continual strategic quest for survival, profitability and growth. An immediate area of research, already underway will be to extend the alliance literature (p.97) to encompass MNE/government alliances.

This strategic management thesis has not tried to incorporate PCAs into the economic and political theory of public ownership. Further research could profitably be undertaken and might start from a supranational point of view, e.g. World Bank (1995).

Governments could use PCA analysis to better understand their impact on the efficiency-based wealth-creating process and to work in closer partnership

with firms. They could also use the eight cell PCA framework to better understand the non-efficiency advantages that their widespread activities are creating, and that are providing opportunities to firms, especially MNEs, to increase their returns through increasingly sophisticated non-efficiency-based strategies. A better understanding of the nature and incidence of government activities on the wealth-creating process at its primary level could enable shareholders, managers, academics and politicians to devise mutual-interest strategic partnerships in order to help spread the benefits of environmentally sustainable wealth creation to peoples across the world.

6.4. Methodological Limitations.

Following the detailed review propositions above, certain limitations in the methodology must be noted. Research primarily limited to one industry is partial in the sense that generalizability of the PCA concept beyond the textile industry would require data sets from other industries and firms. The PCA concept would be strengthened by inter-firm and inter-industry comparisons (for example between Coats and Courtaulds, and between Coats and Unilever). Generalizability would require inter-industry and inter-firm data and comparison.

It is also difficult to generalise from personal interviews where the respondents are answering different questions, although semi-structured interviews allow the interviewer to probe and to reach a high degree of validity, albeit in a subjective context. The research would be considerably improved by the addition of formal recorded interviews. It is likely that access could now be obtained and a formal Coats-approved study carried out without compromising individual managers or restricting the scope of the research.

It is clearly acknowledged that the ten case studies were generated as a second stage, after theory formulation, in order to operationalize the concept. Further research is required to test the validity of the eight cell PCA framework as a means of operationalizing the PCA concept. A further set of interviews is required where government as well as MNE views are elicited.

The failure to quantify PCAs in line with proposition 7 is a serious limitation of the research. Verification and validity would be increased by further quantitative research in the form of PCA measurement. Although the researcher

(using internal company data and with the help of ex-Coats Financial Director, Jim McLean) satisfied himself that PCAs can be measured or estimated on the same basis as other FCAs, this is not sufficient. A further research project is required with access to subsidiary accounting data. It should however be noted that accountants have neglected the field of accounting for competitive advantage and that at present there is no generally accepted research methodology in this field (Parsons and Corrigan, 1998; Partridge and Perren, 1994; Wallman, 1997).

APPENDIX - Supplementary Information.

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1. J & P Coats Ltd and Coats Viyella PLC – History.

The application of the concept of political competitive advantage (PCA) is tested upon Coats in chapter 5. Coats is one of the UK's oldest MNEs and the world's largest manufacturer and distributor of sewing thread with subsidiaries in sixty-three countries and worldwide sales (Bowen, 2001; Dong-Woon, 1995, 1998).

J & P Coats was renamed in 1960 and after further U.K. textile acquisitions the name was adjusted to Coats Patons PLC in 1967. After over 150 years of independence Coats Patons was acquired by Vantona Viyella PLC in 1986 and the core thread interests formed the Thread Division of Coats Viyella PLC. In 2001 the company was renamed Coats PLC and a strategy of disposing of the non-thread interests was pursued. In 2003 Coats PLC was acquired by Sir Ron Brierley's Guinness Peat Group for £414m cash.

Coats, as by far the most important producer of sewing thread in the world, has always attracted the interest of governments, especially those pursuing the early stages of economic growth via textiles in order to develop employment and exports. Governments in developed countries also take a major interest in their textile industries. The U.K. government has played an important role in the formation of J

& P Coats in the early nineteenth century, of Coats Patons in the mid-twentieth century, and of Coats Viyella in 1986.

The story of Coats' rise to global pre-eminence begins with two families based in Paisley, Scotland – the Clarks and the Coats – who built separate cotton thread firms in the early nineteenth century. Weavers in Paisley at this time had begun to reproduce the beautiful Indian Kashmir shawls using French silk threads. The Clark family had a thriving loom equipment business and sold silk threads for the warp on the looms. In 1806, Napoleon blockaded Great Britain and under the Berlin Decrees French silk exports to Britain were prohibited. Patrick Clark created a method of twisting cotton yarns together to produce a thread which was so strong and smooth that it could be substituted for the silk. Stronger cotton threads were manufactured that could replace the linen and silk threads for hand sewing as well. The Clarks opened the first factory for making cotton sewing thread in 1812, next to the Hammils in Paisley which consists of a band of hard volcanic rock running across the river bed and forming a waterfall. The force of water flowing over the Hammils powered two mills, one at each side of the river. The small thread production business established by the Clark Brothers expanded steadily throughout the nineteenth century.¹⁹

In 1802, James Coats (1774-1857), a weaver, set up in the silk business, laying the foundation of the company that was later to become J & P Coats Ltd, Thread Manufacturers, Paisley. ‘Canton Crape’, a crepe made from silk, had been first manufactured in Paisley in 1760 by Humphrey Fulton, and hence both the

¹⁹ Coats Archives, and www.paisley.org/paisley1/history/intro.php

raw material and the skilled labour were readily available. Coats and another manufacturer, James Whyte, had limited success and they joined in partnership, eventually successfully producing 'Canton Crape' in such quantities as to virtually corner the market. On James Coats' retirement in 1830, the management of the manufacturing department passed to his partners and his son William. The thread business was transferred to his sons James (1803-1845) and Peter (1808-1890) and the firm became known as J & P Coats. Another son, Thomas Coats (1809-1883), entered the firm as a partner and each of the three brothers had knowledge of a different area of expertise: James in manufacturing, Peter in merchandising, and Thomas in engineering.

Coats had participated in the industrial revolution which introduced technology to textile manufacturing, raised productivity geometrically and brought scale advantages that lowered prices and created a worldwide mass market in cotton textiles that was dominated by British companies for over one hundred years.

The company expanded rapidly during the 1830s, both at home and overseas, and by the 1840s it had established a foothold in the U.S.A. For twenty years the selling department of the J & P Coats American branch of the business was managed by Andrew Coats (1814-1900), a younger brother of James, Peter and Thomas. The U.S. Civil War exposed the logistical problems of importing thread from Scotland and in 1869 J & P Coats purchased an interest in a mill in Pawtucket, Rhode Island. Manufacturing was expanded in the U.S.A. between 1870 and 1883, managed by James Coats Jr., son of Peter Coats.

Production at Paisley expanded quickly with new markets opening up at home and abroad. As protectionist tariffs spread around the world J & P Coats built mills in Russia, Germany, Austria, Hungary and Spain.

In 1883, J & P Coats became a private joint stock company of family shareholders and in 1890 the business was floated as a public company, with a capital of £5,750,000 and an average annual profit for the preceding seven years of £426,048. James Coats remained unmarried, but a number of the sons of Peter and Thomas Coats entered the firm as partners. With the death of John Clark of Clark & Co in 1896, J & P Coats acquired Clark & Co, and Brook of Meltham and Chadwick of Eagley Mills, Bolton, England.

Like the Coats family, the Clarks had also been active in the U.S.A. In 1896 the Coats' and the Clarks' American interests were consolidated although they retained separate identities. The Spool Cotton Company became the sole selling agent for both companies. In 1952 J & P Coats and the Clark Thread Co. merged to become Coats & Clark Inc.

By 1900 J & P Coats Ltd had a market value of £22 million and approximately 25,000 shareholders. The company, still with its headquarters in Scotland, had 17 production centres, 60 branch houses, 150 selling depots, and around 21,000 employees throughout the world. The U.K. workforce totalled around 11,000. One of the key leading figures in the company at this time was the very successful Foreign Sales Manager, Otto Ernst Philippi. Philippi visited and extended the agent network in South America. In March 1901 Coats established its first South American subsidiary in Argentina and today has manufacturing

operations throughout South America. By 1919, J & P Coats was the second largest public company in the U.K. with a market capitalisation of £45m (Chandler, 1990, p.289).

In 1960 J & P Coats expanded beyond thread, with the acquisition of Patons and Baldwin Ltd, and the company became known as J & P Coats, Paton & Baldwin Ltd. In 1965 they acquired a controlling interest in the Pasolds group (Pasold, 1977), which included 'Ladybird' children's wear, 'Donbros' knitwear, and 'Chilprufe' garments. In 1967 they acquired both Dynacast Precision Engineering and Jaeger fashions. In June 1967 the company was renamed Coats Patons Ltd. In 1986 it was acquired by Vantona Viyella, and became the thread division of the newly created Coats Viyella PLC.

Already, in the 1981 Annual Report the new Chairman, W.D. Coats, had clearly warned of the problems that would be faced by Coats Patons as the European textile industry readjusted to the breakdown of MFA. He commented that his predecessor, Willy Henry, had had to “deal with all the problems of the U.K. textile industry as well as many difficulties in other parts of the world. ...While our main problems in Europe are directly related to a downturn in the textile trade they are also partly structural. It is now thought that in the industrial stitching trades there will never be a return to former levels of activity. Each of our European companies is formulating plans to adjust its activities to foreseeable market demand; under European legislation and conditions, the implementation of these plans may be lengthy and costly, but we are confident that we shall be able to restore our operations to their former profitability – albeit on a lower asset base.”

While he correctly foresaw the problems of plant closures in Europe, especially in Italy, he was overoptimistic about the return to former profitability.

MFA was also blamed. "The most difficult problem is knowing whether there will be a market for any given product in ten years' time (due to the ever-changing rules of the Multifibre Arrangement), and it is only by being in sophisticated, specialist areas, or in close contact with the ultimate consumer that a high degree of confidence can be generated."

Vantona Viyella was an amalgamation of U.K. clothing companies whose individual histories encompass the complex development of the U.K. textile industry, especially cotton textiles, since the industrial revolution (Wells, 1968). In the 1950s David Alliance (now Sir David Alliance) arrived in England from Iran and in 1956 bought Thomas Houghton (Oswaldtwistle) Ltd, a firm of cotton goods manufacturers. In the 1960s and 1970s Alliance continued to acquire firms in the declining U.K. cotton clothing industry. The purchase of Vantona in 1975 gave him a platform to target the U.K.'s largest textile firms. At the beginning of the 1980s there were four large British textile companies - Carrington Viyella, Coats Patons, Courtaulds, and Tootal Group. Coats Viyella (CV) was formed when Coats Patons was acquired in 1986.

CV sales in 1991 were nearly £2bn, almost half of which were thread sales. The common measure of profitability in Coats' profit centres was operating profit divided by net assets (ROCE), both before and after interest and local taxation. In 1991 CV had 61,055 employees of whom 30,770 were employed in the U.K.

By 1991 the old structures were being reorganized into product divisions:

Thread.

Sales £840m, Operating Profit 73m, Net Assets 527m, Employees 31,844.

Clothing.

Sales £351m, Operating Profit 16m, Net Assets 77m, Employees 11,946.

Homewares.

Sales £284m, Operating Profit 13m, Net Assets 122m, Employees 7,868.

Fashion Retail.

Sales £151m, Operating Profit 2m, Net Assets 58m, Employees 4,625.

Precision Engineering.

Sales £105m, Operating Profit 17m, Net Assets 36m, Employees 1,744.

Yarns and Fabrics.

Sales £217m, Operating Profit -2m, Net Assets 112m, Employees 4,787.

In 1991 Coats (the Coats Viyella Thread Division) had sales of £840m and an operating profit of £73m. This represented 43.1% and 57.9% of the total sales and operating profit of the entire Coats Viyella Group. Coats' net assets were valued at £527.1 (Craft Threads £202m, Industrial Threads £300.5m and Zip fasteners 24.6m), 50.7% of CV Group total, with a return on capital employed (ROCE) of 13.75%.

For the Coats Viyella Group (CV) as a whole, operating profit (£111.4m) after net interest (£20.5m) and tax (£36.9m) and excluding a surplus of £84.5m

resulting from the disposal of a subsidiary, was £54.1m (£53.5, 1990). Total CV net assets £1039.7 and ROCE after interest and tax 5.2%.

CV, in 1991, illustrates many of the complexities of firm-level study (Pettigrew, 1985, 1990; Pettigrew and Whip, 1991; Huber and Van de Ven, 1995). While clearly in the textile industry CV encompassed products that had very little in common and few obvious synergies, such as thread, carpets, and high fashion. It also had a non-textile division in precision engineering called Dynacast that had grown out of Coats' expansion into metal and synthetic die-casting for sliders for zip fastener manufacture in Coats and Clark Inc, the Coats subsidiary in the U.S.A. Although small, Dynacast had a return on net assets of 48%, by far the highest in the group, and had found a niche die-casting small intricate precision parts, e.g. one-piece car-door locks for the automobile industry, in small manufacturing units expanding around the world.

Coats has no one global competitor across its whole product range. Coats' principal industrial thread competitor had been Tootal's thread subsidiaries (formerly English Sewing Cotton), operating in 25 countries but selling in many more, and acquired by Coats in 1990.

On the 'domestic' thread side (thread for home sewing, including embroidery threads) Coats' principal global competitor was the craft division of Dollfus Meig Cie, France's largest textile company and the largest manufacturer of printed textiles in the world. Each overseas unit, especially the core thread subsidiaries, many of which had been established for well over a hundred years, had its own unique structure and competitive position.

Most of Coats' thread competitors were small and local, operating in one country or within a small geographical region. Some of these, for example in the U.S.A., were formidable competitors in highly competitive markets, operating under strict government competition policy. Other local competitors were at best duopolies, but the market structures were often controlled by Coats' dominant market shares.

Coats is an ideal firm for global strategic analysis since similar products are sold in nearly every country in the world and manufactured in more than fifty countries using similar technology. Thread is consumed directly or indirectly by 99.8% of the world's population. Thread manufacture is a complicated process since sewing thread has to be balanced, dye-fast and capable of resisting high tensions and temperatures in industrial sewing processes.

Even within the thread industry there are separate product areas with completely different market structures. Coats' thread business is comprised of four main groups. Three of the groups provide a business-to-business service: 'industrial' apparel producers, 'semi-industrial' apparel producers (including cottage industry) and a third very diffuse group of Coats consumers that can be broadly described as industrial, non-textile, consumers of thread. The fourth group of consumers are direct buyers of cotton and synthetic threads, including embroidery threads, for consumption in the home. This group were traditionally thought of as 'domestic' consumers, principally housewives, but in the developed world the emancipation of women and rising standards of living have changed the emphasis from home dressmaking and apparel repair to a burgeoning craft leisure

activity.

The acquisition of Coats by Vantona Viyella was a strategic disaster for Coats. In addition to the restructuring, closure and modernisation faced by Coats in its manufacturing units across the world, the Vantona Viyella clothing companies were unlikely to survive having been rendered uneconomic in the face of competition from the Far East and reductions in British and European protection.

In 1991 Coats Viyella PLC undertook a 1992-1994 global strategic planning exercise closely based on Porter's competitive strategy analysis and using his five-forces analytical framework (Porter, 1985). This exercise included every subsidiary of Coats Viyella, and instructions together with a copy of Porter's book were sent to every senior manager, with details of how to apply the strategic planning exercise to every profit centre, with an especially abbreviated procedure for the smallest. The result was startlingly unsuccessful. After 1994 Coats Viyella lost £2bn in market capitalisation and not only dropped out of the FTSE 100 index but right down to the FT Small Caps index. The CEO, Neville Bain, departed in 1997 and the Chairman, Sir David Alliance, in 1999. By 2001 Coats had recovered sufficiently to re-enter the FT 350 index.

In September 1997 the group reported a 12% decline in first-half pre-tax profits to £41.5m and warned that second-half operating profits were unlikely to exceed those of the previous year. In December 1997 Coats Viyella PLC announced that it would split into two parts. One would focus on the industrial threads and precision engineering business, the other on Coats Viyella's retail activities.

On 6 September 2000 it was announced that the Group was refocusing its activities in order to concentrate on Coats' global thread operations and was disposing of all the activities of the Viyella division, except the retail business of Jaeger and Viyella. Sir Harry Djanogly, Chairman, Coats Viyella, said: "This corporate activity demonstrates the Board's determination to arrest and reverse the decline in shareholder value. It reflects the management team's success in realising fair value from non-core assets and building on the strength of Coats' global thread operation. The Board is resolved to focus its management and financial resources on the Coats business which has potential to produce long term attractive returns."

In 2000 Coats Viyella took the decision to stop making clothes for Marks & Spencer and Luc Vandeveld (Chairman and CEO of Marks & Spencer) threatened legal action, claiming that in the five weeks to 8 November 2000, Coats had lost the company £6m of knitwear sales. The irony of this was not lost on those who had watched Dawson International's attempt to obtain legal compensation from Marks & Spencer when it was dropped as a supplier.

Unable to compete with Dollfus Mieg et Cie in craft threads, in December 2000 Coats Viyella PLC announced the completion of the acquisition of the industrial sewing thread business of Dollfus Mieg et Cie, following receipt of clearance from the French competition authorities. The underlying agreement echoed previous market sharing practices between the two MNEs who had divided up world markets between them.²⁰

At the same time Coats Viyella PLC announced the disposal of four non-

²⁰ Source: Nicholas Wallaert, ex President, DMC U.S.A.

core assets from the Viyella division. The disposals comprised the knitwear business of Straven Ltd, which was sold to Richard Roberts Ltd, the licence to the Ladybird brand sold to Woolworth PLC, the rights to certain shirt brands sold to Aditya Vikram Global Trading House Ltd, and Ewart Liddell Ltd, the manufacturer of fine Irish table linen, sold to Arda Ltd. The combined proceeds of these four disposals amounted to £21 million and were to be used by the Group to reduce bank indebtedness.

At the Coats Viyella PLC Annual General Meeting in May 2001 the name was changed to Coats PLC. Sir Harry Djanogly, Chairman, Coats Viyella PLC, said: “The shareholders are being asked to approve the change of the company’s name to Coats PLC, transferring the name and brand used by the thread division to the entire Group. This virtually completes the transformation of the Group into a focused global thread business. Good progress has been made with the withdrawal from the Group’s other businesses. Negotiations are in hand for all those businesses that remain for sale. Coats’ global thread business delivers four-fifths of the Group’s revenues and the operations employ 30,000 employees in 63 countries. Following the progress made in 2000, we remain confident that in the medium term Coats’ unique global reach, together with the most comprehensive service capability in the industry, will allow it to make further improvements in trading performance.”

In June 2002 it was announced that Guinness Peat Group PLC had bought 8 million Coats PLC ordinary shares which increased its stake in the company to 165 million shares, or 23.3%. In September 2002 Coats PLC announced that it would

sell its Fashion Retail Division (FRD) comprising the Jaeger and Viyella clothing brands, and that HSBC Investment Bank had been appointed to conduct the sale of FRD.

Martin Flower, Chief Executive, Coats PLC, said, "To continue to add value for our shareholders, Coats must focus exclusively on thread, the core area of expertise in which we are the global market leader. Jaeger and Viyella have bright futures, but their potential is most likely to be realised by an owner with the skills and resources found in the U.K. fashion retail market place."

On 13 February 2003 the board of Coats announced that it had received an approach from a group of shareholders led by investment company Guinness Peat Group PLC regarding a possible cash offer for the company. Avenue Acquisition PLC announced a £427.26 million recommended cash and convertible stock offer for Coats PLC.

The board of Coats PLC recommended the offer from Guinness Peat. The cash offer of 58.5 pence per share valued the company at a little over £414 million. The offer was made by Strand Partners on behalf of Avenue Acquisition, a consortium that included GPG (U.K.) Holdings PLC, a subsidiary of Guinness Peat Group PLC, RIT Capital Partners PLC and Chapman International Investments Ltd. Avenue Acquisition already owned 25+% of Coats' shares and had undertakings for a further 12+%. Coats shareholders were to be offered 56 pence per share, plus a special second interim dividend of 2.5 pence per share if the offer became unconditional. Coats Chairman Sir Harry Djanogly said: "This offer will enable the Group to move forward and continue the successful implementation by

current management and employees of the thread strategy currently in place. The price being offered represents fair value for shareholders and will therefore be recommended by the Board.”

Coats PLC announced preliminary results for the year to 31 December 2002 showing Thread sales of £923m (2001: £938m), and Thread operating profit before reorganisation cost of £77m (2001: £73m). Profit before tax £45m (2001: £23m). Net operating cash inflow up 16% at £101m. Net debt reduced by £24m to £104m. Investment in new capacity in lower cost markets, particularly China, and the acquisition of a minority stake in India and of a competitor in Brazil strengthened positions in key markets.

Sir Harry Djanogly stepped down as Chairman of the Board and Coats announced that it would apply to the United Kingdom Listing Authority for the cancellation of the listing of its ordinary shares on the Official List.

On 16 October 2003 the *Guardian* announced that “the Financial Services Authority has stepped in to stop textiles group Coats from becoming a private company after preference shareholders complained that they were being forced to accept an 'inadequate' £11.8m offer for their shares. ...The U.K. Listing Authority, part of financial regulator the FSA, yesterday declined a request from Coats to delist its preference shares. 'There are issues relating to the delisting that we need to explore further,' said a spokeswoman. The company was bought this year by a consortium, including corporate raider Sir Ron Brierley's Guinness Peat Group (GPG), but its preference shares are still traded on the market. Preference shareholders are entitled to a special dividend ahead of ordinary shareholders.

Earlier this month GPG's holding company launched an 81p-per-share offer for the preference shares of Coats, saying it intended to delist the shares from the market. The preference shareholders claimed that they were entitled to 112.5p per share in the company's articles of association, according to Charles Groves, an executive at JO Hambro Capital, which owns 42% of the preference shares. The UKLA have delayed delisting pending an enquiry. In spite of this hiccough Coats has returned to its original form as a thread company although without its crafts, embroidery and domestic threads interests. As a focussed industrial thread company with sales in excess of £700m, and potentially of £1bn, there are high expectations that Coats should now be able to concentrate on finding a new and sustainable business model that speedily repays the investment of the Guinness Peat Group and goes on to write another 200 years of history."

2. Interviewees.

In the course of my research I have spoken to the following Directors and Managers of Coats Viyella PLC (CV) and its Thread Division (Coats). I am particularly indebted to Jim McLean, ex-Financial Director of Coats and of Dynacast International.

Job titles are as of January 1992, i.e. at the beginning of the Coats Viyella Global Strategic Planning Exercise.

Sir David Alliance, Chairman CV
 Neville Bain, CEO CV
 Berkeley Cox, Research Director
 John Duthie, Finance Director, Coats Industrial
 Martin Flower, CEO Coats Thread Division
 Richard Gilmore, Strategy Director CV
 Patrick Helmer, CEO Coats Crafts
 Michael Henderson, Marketing Director, Coats Crafts
 Ian Jury, IT Director
 David Russell, CEO Coats Industrial
 Russell Walls, Finance Director CV
 David White, Finance Director, Coats

Douglas Allan, CEO Brazil
 Candido Bogliciano, CEO Uruguay
 David Chandler, CEO Coats Crafts France
 Steve Dance, CEO Ecuador
 Roberto Dazzi, Logistics Manager, Coats Argentina
 Colin Drummond, CEO Coats Dominican Republic
 David Gilchrist, CEO Industrial Germany
 David Gilliver, CEO Crafts Germany
 Peter Goodwin, CEO Australia
 Arthur Grosset, CEO Crafts Brazil
 Nick Langford, Finance Director, Hungary
 Ollie Lauren, CEO Venezuela
 Ronnie MacNiven, CEO Industrial Brazil
 Peter Manns, CEO South Africa
 Jim McLean, Finance Director, Brazil, (later F.D. Dynacast International)
 José Nascimento, Production Director, Perú
 Max Perks, CEO Chile
 Tony Ponsford (Junior), Marketing Director, Argentina
 Michael Pratt, CEO Crafts U.S.A.

Antonio Predelli, Coats Industrial Italy
John Shaw, CEO India
Tom Smith, CEO Industrial U.S.A.
David Staveley, CEO Canada
Meric Ulgen, CEO Turkey

Also:

John Bowen, Esso (Flanders, 1964)
Andres Brailovski, DMC Argentina
Arthur Edbrooke, ICI Argentina
Clive Fieth, Reckett and Colman, Argentina
Jeff Hewitt, Electrocomponents PLC, formerly CV Strategy Director
Thomas Hudson, ICI Argentina
Nicholas Kuenssberg, ex CEO of Dawson International; ex CEO Dynacast
David McIntosh, Personnel Manager, Coats U.K.
David Miller, Personnel Director, Coats Patons and Coats Viyella PLC
Rory Miller, Liverpool University
United States Congressman John Spratt, South Carolina
Nicholas Wallaert, CEO DMC U.S.A.
Russell Walls, BAA PLC, formerly CV Finance Director

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