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Service Company Strategies in East Asia

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Summary

This report investigates the linkages between the home country business models of European and North American companies and their strategies in Asian markets. Our initial hypothesis, that international service industry business models and strategies have not yet converged as much as in the manufacturing industries, could not be confirmed. In contrast, our results show that the service companies basically follow similar patterns during their internationalization and expansion in Asia. After initially following their customers, their overseas success seems to depend much less on their sectoral strategies or international business models, than on their ability to adapt a strong home country business model to varying conditions abroad. Japanese service companies, on the other hand, which are still underrepresented in Asia, seem to remain too close to their original Japanese manufacturing customers.

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1. Introduction

Service industries are playing an increasingly important role in the “post-industrial” production models of all OECD countries. More and more value is added to products through outsourcing and through “off-shoring” of manufacturing jobs to low cost locations like China. This trend towards a “deindustrialization of OECD countries” (Pilat & Wölfl 2005: 6) will likely gain pace in the future because services are becoming a driving force behind globalization and international business relations.

- Logistics firms have long since stepped out of the back offices of their domestic manufacturers and are now providing international services on a truly global scale.
- Retailers have long since broken the boundaries of their domestic markets and consumer tastes, and are applying their sophisticated retail technologies in any market which shows growth.
- ICT firms are already preparing for the next step of globalization by shifting more and more research abroad, and by off-shoring entire business processes (like accounting, payrolls, billing) to their global IT centres in Bangalore, South Africa and Singapore.

So far, however, with the possible exception of financial services, international service industry business models and strategies have not yet converged as much as in the manufacturing industries. The U.S. has been the strongest force in service internationalization so far. The early shift from manufacturing to services in the domestic American economy seems to have given their service industries an international edge. In Europe, on the other hand, productivity gaps in most service industries are still significant, but E.U. integration is pushing logistics companies and retailers in particular into a higher gear of internationalization. In Japan, on the other hand, the great success of its international manufacturing industry has not yet resulted in a similar push for its logistics and ICT companies to internationalize.

In this report, we investigate the linkages between the home country business models of European and North American companies and their strategies in Asian markets. On this basis, we try to find out why Japanese companies are still underrepresented in Asia and what their disadvantages might be.

- What are the differences between the companies with respect to their strategies? How important was their “home country model” and how much did they need to adapt it to the conditions in Asian economies?

- How are the relations between service providers, home-country clients and host-country clients structured? Who follows whom, and who has the knowledge?
- What seems to be the reason for the greater success of Western service companies in Asia compared with their Japanese peers?

We have structured this report in three basic parts: first, we present the results across industries and try to prototype examples for the majority of companies and industries we investigated. In the second part, we present the results according to an initial sectoral classification of service sectors that expand overseas

- along manufacturing production networks,
- to target off-shoring and vertical-FDI integration for efficiency gains,
- to gain international market share,

Finally, we compare the results of our survey of Western service companies with the Japanese service industry.

2. Methodology

A key characteristic of this report's methodology is the combination of publicly available material and in-depth interviews with representatives from each firm. An extensive literature review was conducted to lay the theoretical foundations. Finally, a questionnaire was crafted and pre-tested before it was used to contact the companies.

The enterprises in this sample are characterised by one or more of the following:

- Being a global market leader or otherwise important by size
- Having a significant international presence
- Being relevant to public policy

To conduct these interviews, we researched the relevant service industries¹ and sub-sectors for sales records and foreign subsidiaries. We selected the companies with high sales results that are active in the Asia-Pacific region. As a result, we compiled a spreadsheet of more than 260 companies from Europe and the U.S.

We then categorized the companies according to 3 levels of priority based on size and degree of public awareness. In category 1 (the group with the highest priority level), we had 120 companies, and in category 2 about 80 companies.

These firms were contacted according to their ranking via mail and fax with the aim of identifying a contact person at their headquarters (HQ) or regional Asian HQ. In the case of Priority 1 companies, we intensified our efforts to establish a contact by calling, faxing and emailing. In the end, we managed to get 31 appointments with top-level executives.

All in all, we interviewed individuals from 28 major companies and institutions, some of them having different (regional) HQs.² Figure 1 gives the break-down according to country, Figure 2 the breakdown according to industry:

Figure 1

Country	U.S.	Germany	U.K.	France	Japan	China	Swiss	Sweden
Companies	5	10	4	4	2	1	1	1

¹ We excluded the financial industries because of their already achieved level of internationalization in the world's financial centres, and the different set of regulations they are subject to in their home markets and abroad.

² Of these companies, 15 are large in terms of revenue and their number of employees; the remaining 2 are medium-sized firms.

Figure 2

Industry	Business Service	Education + Research	IT	Leisure + Travel	Logistics	Media	Retail + Trade
Companies	7	3	5	2	5	2	4

These companies were visited and interviews conducted using our standardized questionnaire. In addition, we asked the executives about their opinions on appropriate service sector strategies for Asia. Fortunately, most executives were very forthcoming and frank - even when discussing strategic questions. The flip side of our investigative approach was, however, that we had to agree to non-disclosure rules for most of our interviews.

3. U.S. & E.U. Service Company Strategies in East Asia

Our results show that in the industries investigated, Western companies are following similar patterns during their internationalization and expansion in Asia:

1. Service industries in general follow their customers abroad.
2. Their strategies depend on their home-country business models.
3. Service companies need to closely integrate in their foreign markets.
4. Service companies expand their business bases in their foreign markets opportunistically.
5. Their success depends on the strength of their home country business model and their ability to adapt to competitive conditions in the host market.
6. They start to link their markets internationally and expand their business models.

In the following, we first discuss these patterns in general, before we try to focus in more detail on some specific sectors and cases.

1. Service industries in general follow their customers abroad

Starting with international trade, services have always followed customer demands when venturing into international markets. Trade, transport, information and finance are the most important services that followed – and enhanced – this pattern. Globalization is now increasing these trends because service customers have started to look for globally active agents. This process has, at the same time, broadened the service companies' international customer bases. ICT development leads to increased outsourcing in the manufacturing industries at home, and to a boom in off-shoring of production in Asia and other developing countries. This internationalization of production networks has become a benefit to logistics and IT firms. The firms are often spin-offs from major manufacturing corporations, but have long left any direct dependence behind, and actively search for new (manufacturing) customers in any major production location.

At the same time, globalization opens doors to as many new markets and potential customers abroad as it increases the competition for customers at home. The internationalization of large retailers is a good example of this development. The companies are increasingly betting their future on chasing customers for their particular trade in all international markets, or on gaining market share in fast

growing markets in general.

2. Their strategies depend on their home-country business models

Not surprisingly, companies use their successful domestic business models as a basis for their expansion abroad. In cases where companies have been following their domestic customers into international markets, it is this business model that determines their attractiveness to their original customers. In cases where companies target new customers in markets abroad, it is this business model that differentiates them and gives them a cutting edge against their foreign competitors.

In most cases, the companies have shaped their domestic business models through intense competition at home. Deregulation is an important factor here. It opens up opportunities, but increases competition. Deregulation in home and host countries was found in all the industries we investigated. International competition at home usually enhances company competitiveness further. The OECD, for example, states that "...foreign competition in the home market, even as potential threat, is one of the most widely cited factors that has determined company strategy in the case of Carrefour [,] Tesco [...] and Accor hotels" (Eröcal 2004: 15-16).

3. Service companies need to closely integrate in their foreign markets

When establishing their businesses abroad, companies need to closely integrate with their host markets. For their home country customers (in manufacturing), it is often this intermediary function between the home and the host market, or between the worldwide production models and the specifics of the supply chains in the customers' host countries, that adds value for the service companies' customers.

The successful adaptation of a company's business model to local conditions demands, among other things, an accordant adaptation of their human resource model. In our interviews, most companies said that they aim at localising the management of their subsidiaries or joint ventures after a short initial period.³ To find the appropriate (local) personnel for this step is, of course, one of the main challenges for the companies (BGC 2004: 4; Farrell & Grant 2005: 74), and topped the list in all our interviews. Often, companies further increase their exposure in the host economy by investing in training their employees and cooperating with universities.

³ For the hotel industry, research provides a contrary view, namely that companies that sell to overseas markets tend to have more expatriates (Wong & Kwan 2001: 301).

After adaptation of the business model to the new markets, the next step is to standardize business processes again in order to make them comprehensible and ready for regional expansion or outsourcing (Allweyer et al. 2004: 1).

4. Service companies expand their business bases in their foreign markets opportunistically

After successful localization, companies have a sufficiently adapted and standardized business model, and their local management looks ready to chase business opportunities – usually beyond the limits of organic growth. Most service companies start to attract local customers and follow these customers into their regional markets. At the same time, success usually leads to increasing competition with domestic competitors who start to copy the foreign companies' business models. The companies therefore try to expand their market share as fast as possible. Depending on their expertise and their markets, this usually requires fast takeovers of major domestic competitors, or the building up of a network of affiliates and franchises.

5. Their success depends on the strength of their home country business model and their ability to adapt to local conditions

As mentioned in Phase 2, during international expansion, companies remain under intense competition from other foreign companies that might have equally successful domestic business models. As mentioned in Phase 4, they are also confronted with intense competition in the host markets from local competitors who try to copy all applicable business processes and integrate them into their own processes and networks. The companies therefore need to develop their capability to learn and innovate in all their host countries (Williamson 2005: 42). For many companies, this also means expanding and linking their local R&D activities (Eröcal 2005: 17), and building effective regional headquarters or business centres. Last but not least, the companies need to increase their involvement in the host economies even further because their intellectual property needs to be protected. Many successful companies do so by establishing their brands domestically and by intense political lobbying (BCG 2005: 4).

6. Service companies start to link their markets internationally and expand their business models

The last phase, linking markets internationally and expanding the business model, often turns out to be accompanied by another wave of M&As. Eröcal (2005: 22) cites the examples of Accor, AXA, Carrefour and Vodafone who grew tremendously through acquisitions. The same holds true for other industries. In the logistics business, last year witnessed the mega-acquisitions of British Exel by Deutsche Post WorldNet, and the takeover of U.S. BAX by Deutsche Bahn came in January 2006. In consulting, BearingPoint re-organized after splitting from KPMG with a number of acquisitions, as did Accenture, the former Anderson Consulting. The result of such activities is true internationalization that often goes beyond what is necessary in the manufacturing industries.

Today, the international world of services looks very much like this:

U.S. consulting companies are providing advice and accounting services to European customers in Asia, whereas European logistics companies provide freight services for U.S. customers between Asia, Europe and the U.S., while Asian M&A transactions are managed by U.S. investment banks for whoever the acquirer might be.

4. Results by Strategy

In the following, we present our results according to general strategies. The standard differentiation between vertical, efficiency-seeking, and horizontal, market-seeking, FDI strategies has been developed largely for the manufacturing industries, which have been forerunners in FDI to Asia. Because of the different nature of service products, which usually cannot be stored and are produced in collaboration between service provider and users, service companies are almost always market-seeking – even if their service focuses on off-shoring and cost-cutting.

Even the IT industry, the only sector in our sample that actively promotes vertical integration and off-shoring, usually starts to attract regional customers in their off-shoring location from the start. As will be shown below, service companies will become much more active in off-shoring in the future; but for the time being, it seemed to be empirically more promising to us to add another category that focuses on services in Asia: services to off-shoring manufacturing industries. In this category we summarize logistics, business services and R&D. All of these industries are already actively seeking markets in Asia, but their first attempt has usually been about “following their domestic customers abroad.”

Our three categories therefore differentiate service industries that expand overseas

- along manufacturing production networks,
- to target off-shoring and vertical-FDI integration for efficiency gains,
- to gain international market share.

The activities of many service companies cannot easily be covered in a single strategic category, however. In the following, we therefore try to prototype our sectoral results as much as possible, and will comment on when and where the companies’ strategies do not fit into our original categories.

4.1. Servicing International Manufacturing Networks

Sample Structure:

Industries: Logistics - 5 companies/ IT - 5 companies/ Research and Education - 3 institutions/ Business Services & Consulting - 7 companies

Origin: 9 German, 3 U.S., 2 French, 1 Japanese, 1 Chinese, 1 Swiss, 3 British

The companies show a clear focus on localization of their businesses when entering the host country, but soon start to regionally expand their operations and to further internationalize. To do so, they rely on their international business models, and adapt only as much as necessary to local conditions. Appropriate international personnel and management are a key issue for these companies. The companies often start to shift their main business centres to locations where production conditions are the most promising, or their local customer markets are growing the fastest. Singapore, for example, has already become a major service hub, although it has very little manufacturing in its small market.

Logistics

In logistics, outsourcing trends clearly increase the logistics providers' responsibilities. To an ever increasing degree, they organise parts of their customers' supply chain. While logistics companies may have initially followed their customers, European and American providers are now operating global networks and increasingly work for foreign customers in host countries as well as in their home country. Integrated logistics providers in particular acquire local and regional market knowledge, and organize the supply chains accordingly. They diversify their customer portfolios and serve customers not directly related to their home markets. It is not unusual for a European company to deliver goods from Asia to North America – and increasingly for non-European customers.

All companies are among the top-ranking companies in their respective field and have headquarters in Germany. The HQ of one company used to be in the U.S., but the company was acquired by a German player. All companies have a world-wide network of subsidiaries and joint ventures. The companies generate between 15-35% of their revenues in Asia, with a small percentage of that in Japan. But – and this may be a difference to Japanese corporations – the customers (although mainly from manufacturing) are nowadays from all different countries, not only from the

home-country. Internationalisation is seen as a “must”, mainly because the companies are requested to accompany their clients (i.e., firms). But one company claimed it was the other way around – i.e., they “paved the way” to Asia for their customers. Two companies stressed that with the tendency towards outsourcing of logistics services, (non-Japanese) manufacturing companies to an increasing degree concentrate on their core business and invite the logistics service providers to expand their business.

All three companies have been active in Asia for more than 20 years now, and they are satisfied with the economic results of their engagement. Entry to the Asian market (just as market entry in general) is preferably done by creating wholly owned companies, or – where WOFEs are not possible – by joint ventures (JV). It was stressed that a majority stake in the JV is most important to secure management control.

The role of the Asian market is seen as slightly different. All companies see Asia first as a market (serving their home customers, but tapping new customers as well), but for company 01, Asia is also a source of innovation. It became clear that in the logistics business, outsourcing of the core business is impossible – but what is done is to outsource back-office functions (like accounting) or IT to countries with relatively lower wages.

The importance of innovation and R&D was stressed by all companies, be it in the software field (which is increasingly important for the industry) or in the interplay with other parts of the network. One company mentioned that brand protection becomes increasingly important, especially in the high-growth markets of Asia.

With respect to human resource management and management styles, all companies claimed to follow (basically) the same rules worldwide, with adaptations where necessary. All three companies aim at localisation of their regional management, leaving only a very limited number of expatriate managers in the respective countries. However, skilled personnel are seen as crucial for the companies, and since English language skills are a precondition of the industry, Japan along with developing nations was mentioned as problematic.

Market entry obstacles for these companies were seen in regulation rather than in the market or in other companies: Problems like customs inefficiency, tax problems, or the necessity to enter the market through joint ventures instead of subsidiaries was mentioned. Here, Japan was judged as fairly open and unproblematic.

IT Industry

In the IT industry, many companies clearly follow their customers to Asia. But the trend towards outsourcing and off-shoring gives an increasing edge to Indian and Chinese software companies and service providers, who try to attract foreign companies as much as possible. After serving their manufacturing customers in any location they might want to go, IT service providers are starting to outsource more on their own. Most IT firms keep a strong focus on their (home country) customers, and try to adapt their global business models as little as possible to local conditions.

However, this pattern might change in the future. Not only hosting and programming, but also entire business processes, like back office accounting and payroll, may become outsourced in the meantime. When running such services in their offshore centres, which are often at locations different from their manufacturing customers (Singapore, for example), IT companies often see the need for a stronger degree of localization to keep the services efficient, safe and stable. We therefore shifted the analysis of the IT industry into the “off-shoring and vertical integration” category.

Business Services and Consulting

Business services and consulting, including tax and legal services, are essential for manufacturing companies when they invest abroad. Usually, business service and consulting corporations already provide support for the enterprise’s decision to invest (or to not invest) in a certain country, since they possess know-how about these regions. They bring their home-country model into the new locations and start the business according to the rules they know. Of course, they also acquire knowledge by employing local personnel or tying-up with local firms, but, especially the large and internationally operating companies, are proud to have their global standards applied to all locations.

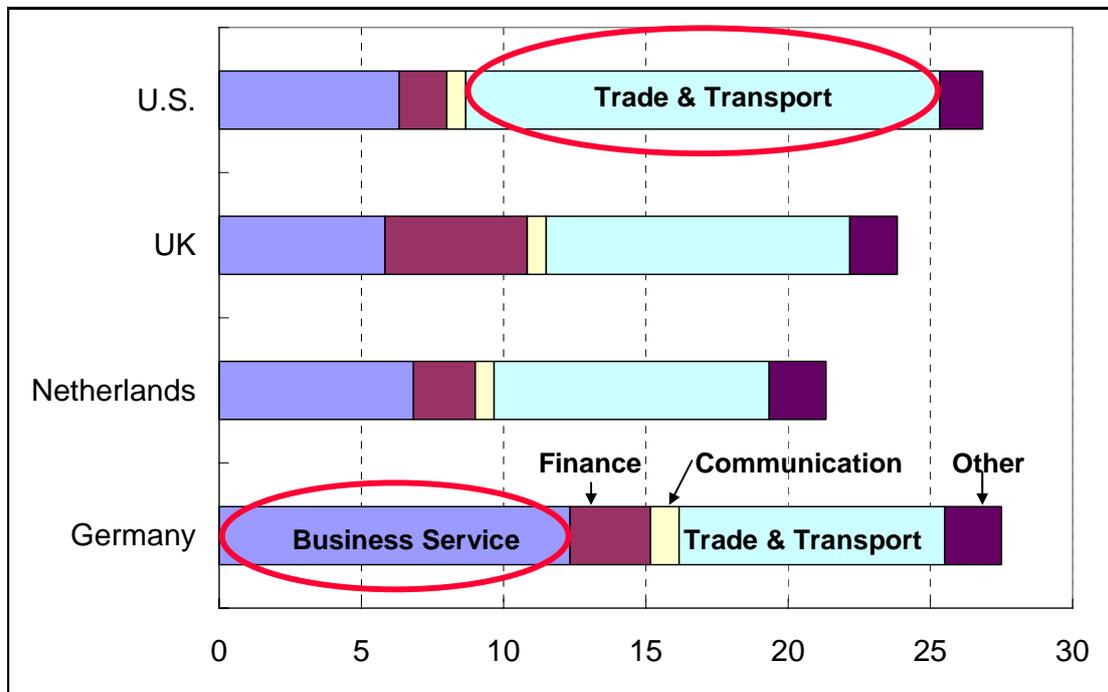
The global consulting markets currently undergo a phase of restructuring and uncertainty that was triggered by overcapacities in times of the internet bubble and is still linked with changes in clients’ behaviour towards stronger price sensitivity. Despite this development, the overall market is expected to increase: According to an IDC study from 2005, worldwide consulting spending that amounted to a total of approximately USD 47.9 billion in 2004 is expected to grow by 20% until 2009 – reaching a total of USD 57.5 billion. This corresponds to an annual growth rate of 3.7% (anon. 2005).

Another driving force is the saturation of markets in the West. North America is almost mature, and definitely the largest market for business consulting services, while Europe,

the Middle East and Africa show the highest growth rates and should surpass the Americas in terms of IT consulting spending in 2007 (ibid). Asia, despite remarkable economic growth, is still the “sleeping beauty” when it comes to noteworthy consulting activities.

For consulting companies, especially markets that enter major restructuring are interesting. As can be seen in the graph below, even the mature German economy is important because of industrial restructuring. The same is true for Japan, and for China, of course, but in the future many South East Asian economies will become interesting markets as well.

Figure 3 Manufacturing Intermediate Service Consumption



Source: © FRI 2006. Data from EU DG Enterprise (2004), p. 23-24

Note: Figures in percent by country.

Research and Education

Research has already become an international industry, while education is increasingly following in the same direction. At first, research accompanied investment of companies, but in the meantime outsourcing of research has become quite common. Further,

research companies also utilize the gap in wages and other costs between Europe (and the U.S.) and some Asian countries.

Singapore's internationalization strategy and industrial policy in particular has shown remarkable success in attracting international research and universities. Interestingly, educational institutions did not show much local adaptation of their business models and teaching curricula. Research institutions, on the other hand, seem to be following the patterns of most other successful service companies. They try to follow their worldwide standards and concepts but also try to adapt to local conditions and to exploit local potential (knowledge and innovation) as much as possible.

We started with the investigation of two business schools, one from the U.S., the other from Europe. Both have a campus in Singapore, opened in the latter half of the 1990's, and operate profitably. Actually, they did reach break-even fairly quickly. As for the reasons to set-up a campus in Asia, it was clear that both institutions wanted to get a foothold in the booming Asian education market. The reason to invest in Singapore, however, was mainly the Singaporean government's active support (driven by their plans to develop the city into an "education hub" and utilize the knowledge for the economic development of Singapore) gave certain incentives.

The business models were more or less unchanged – which is, of course, possible for business schools but may be more difficult for an ordinary university. Interestingly enough, customers (i.e., graduate and post-graduate students) do not only come from Singapore, but from all over Asia. Management styles were not changed either. Organisation 01 flies in most of the teaching personnel, while organisation 02 has a number of about 40 resident faculty (out of which 15 are of European origin).

Representatives of both institutions were eager to stress that for Singapore, there were no (regulatory) obstacles, but much support – in the decision-making phase, during the set-up and during operation. The government themselves provided the necessary information, infrastructure and other support necessary. And, even more important, there is far-reaching academic as well as economic freedom for the two institutions. Perhaps it should be mentioned that – despite all these positive effects – the Singaporean government still seems to prefer the national education institutions when it comes to funding, etc.

Asian integration is not much of a topic, and neither is the competition from Japan. In the field of education (especially management education), Japanese institutions still did not reach a level of internationalisation that would make them act on a global scale.

The research institution in our sample is an internationally operating German research institution that undertakes applied research – partly financed by the German government, and to a larger degree by contract research. Its headquarters are in Germany, and Asian branches are in Japan, China and Indonesia. A branch in Malaysia closed down recently. Besides these branches, there still exist a number of offices.

The institution has been active in Asia for more than 25 years (even in the People's Republic of China). About 20% of its revenues are generated abroad, and 5% of total revenue is generated in Asia. Although Japan used to be the strongest location in Asia, the growth rates in Korea and China are much higher. Asia is seen as a market, of course, but also as a centre of innovation. IPR protection plays a crucial role, since the “product” that emerges in this institution is knowledge, or intellectual capital. It should be mentioned that there are no fears where the transfer of technology to Japan is concerned, but the institutions avoid transferring the latest state-of-the-art technology to China or Korea.

Human Resource Management is not seen as very different from that in Germany. First, they were said to have no problems in finding qualified personnel. Second, there is basically the same set of rules for each office, but, according to different cultures and different needs, local adaptations are necessary and are practised.

Market obstacles were not seen, especially since the main business is the creation of knowledge (hardly affected by the distribution of suppliers), and lack of information is not a gap, but a business challenge. Regulatory obstacles were not mentioned either. The only obstacle mentioned was the geographical distance that would result in (relatively) increased costs.

4.2. Off-shoring and Vertical Integration

Sample Structure:

Industries: 5 IT companies

Origin: 1 US, 3 German, 1 French

Vertical integration is an important source of income for the IT industry. Companies often gain from outsourcing within their countries and from off-shoring when production and services are shifted abroad (Pilat & Wölfl 2005: 7, Allweyler et al. 2004, Müller 2004). But when service companies outsource in their own sector, the limits of off-shoring seem at first to be tighter than for manufacturing. The more direct contact with the customer required, the less the probability that a company will off-shore the function. Packaged software production is therefore an important target for off-shoring in the IT sector. Almost half of all employment in the software package industry could be resourced remotely (McKinsey Global Institute 2005: 23). The business software giant SAP, for example, has already put into operation development centres in Eastern Europe (Bulgaria, Hungary) and Asia (China, India) (Eröcal 2005:65; SAP Homepage).

IT Industry

IT integrators are continuously expanding the limits for service outsourcing and off-shoring. They not only off-shore software production and development now, but also run many applications, like SAP business packages, at their remote server plants. Increasingly, they also shift back office functions and other business processes to these remote centres. This almost directly translates into shifting service jobs abroad. More of their management and resources will therefore likely shift to these off-shore centres as well.

At present, a large-scale empirical research study undertaken by McKinsey states that off-shoring is a slow, rather evolutionary process (McKinsey Global Institute 2005: 27), however we think that this can easily change in the future.

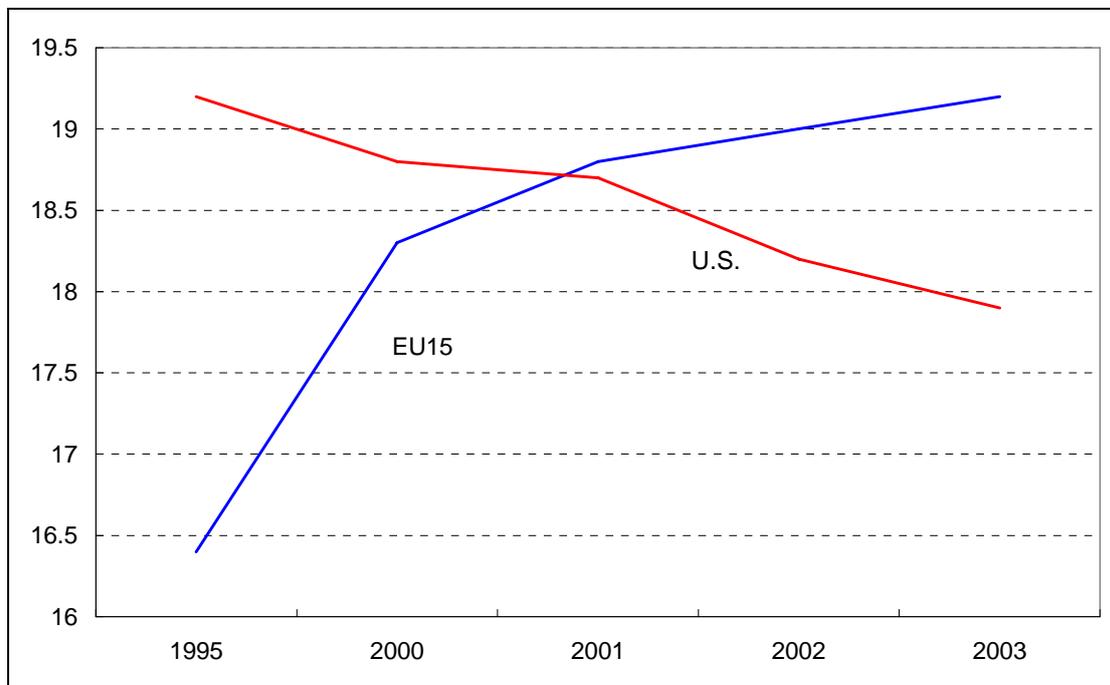
To an increasing degree, companies are outsourcing IT services and IT infrastructures. According to a study by the Deutsche Bank Research, outsourcing and off-shoring of IT reached a volume of USD 18 billion in 2003, and is expected to increase. For Germany alone, IT outsourcing is expected to grow by 70% until 2008 (Allweyer 2004: 1).

The companies that outsource IT service read like a “who’s who” of the Western

hemisphere: Siemens announced that it will pass software development to China and India, SAP is going to increase the number of software engineers in Bangalore to 2000, and General Electric follows Jack Welch's rule to outsource 70% of all possible processes, among them 70% overseas, and among those again 70% to India (Mueller 2004: 3).

The consequences of this development are obvious: the domestic IT industries in Europe and the U.S. are shrinking. According to a Gartner study, around 10% of the jobs in the IT producing industry and around 5% in the IT application industry in the U.S. have ceased to exist (Mueller 2004: 1). In Germany, it is expected that around 3.5% of the jobs in the IT industry will diminish due to outsourcing (Allweyer 2004: 1).

Figure 4 Share of ICT-intensive Occupations Potentially Affected by Off-Shoring



Note: Figures in percent.

Source: Welsum (2005), p. 190.

In the figure above, the impacts of off-shoring developments are quite different for the U.S. and the E.U. One reason certainly is that the E.U. is a late-developer in terms of industrial restructuring towards service jobs – that later might be off-shored towards Eastern Europe and Asia. Another factor is that the E.U. is often outsourcing within the E.U. – and not off-shore. But the most important factor certainly is that the U.S. is already quite active in terms of off-shoring many professions, including many

back-office jobs and R&D.

Clearly, the IT outsourcing market will become an increasingly important market for the E.U. as well because trends in technology development favour its growth. German Telekom, for example, has already shifted its focus in B2B services from providing an international infrastructure towards application outsourcing (hosting) services. Along with this trend, more and more business processes, like payroll accounting, can be and will be outsourced and serviced by IT integrators like T-Systems. The following chart provides an overview of the possibilities of horizontal and vertical ICT integration, outsourcing and off-shoring.

Figure 5: ICT-Integration Example: T-Systems Japan K.K.

	Telco, Media & Utilities	Manufacturing	Services	Finance	Public
Vertical Solutions	Billing BPO	Product Lifecycle Management	Online Services – Food Safety	Multichannel Insurance	eGovernment
		Supply Chain Management	Road Charging	Multichannel Banking	Public Security
				European Transaction Banking	
Horizontal Solutions	Managed Document Services	Finance & Accounting	HR BPO	Debt Collection	BPO
	Dynamic Infrastructure Services	Dynamic Computing	Dynamic Storage & Archive Solutions		IT
	Managed Desktop Services	Messaging & Collaboration Solutions	Managed Security Services		
	Dynamic Services for SAP® Solutions	SAP® Integration & Consolidation			
	Enterprise Application Integration	CRM	eHealth		
	MPLS	Hosted Services	Business Internet Access	Managed VoIP Networks	TC

Source: Soergel (2006).

The main destinations of the outsourcing processes are, besides Eastern European countries, India and China. Both show positive growth in the IT business: India's industry, for instance, grew by 30% in 2003 – the year when the worldwide IT industry suffered badly (Mueller 2004: 2). And the Chinese IT management services market will, according to the IT consultancy Gartner, grow at 21.8% annually from 2004 to 2009 (Gartner Inc.). Besides India and China, also Singapore can profit from that development: At \$1.9 billion, the IT service market in Singapore offers excellent mid- to long-term opportunities for service providers. The market is forecast to grow 9.1% through 2009. Key growth areas include central government IT infrastructure, IT

security and business continuity planning. (Gartner, Inc.)

The three companies in our sample all have some production and development in Asia. All companies use relatively similar business models for all their off-shoring locations worldwide. The companies are already attracting Asian customers as well and might further adapt to conditions in these markets if demand grows. For off-shoring, the major questions are a) how to manage an entity that develops (more or less) remotely, and b) how to find appropriate personnel. For the small company in our sample, the first decision is a question of finding appropriate M&A targets and hoping that the partner companies are handling the HR problems well. In addition to this, the bigger software company has to integrate its development centres. But even in this case, their off-shore development does not affect their core business significantly.

For the third company, a major communications and IT-integration provider, this basic stance might change in the future. As already noted above, IT integrators are continuously deepening the outsourcing and off-shoring of the services they provide. More of their management and resources will therefore likely shift to these off-shore centres as well.

4.3. Horizontal International Integration to Gain Market Share

Sample Structure:

Industries: Leisure & Travel: 2 company / Media & Information: 2 companies /
Retail & Trade: 4 company

Origin: 3 French, 2 U.S., 1 Japan, 1 Sweden, 1 German

Regional expansion is an important strategy for corporate growth (Schwenker & Bötzel 2005: 11). This can be due to a long-term corporate growth strategy, but often the trigger is intensifying competition in their home markets – as was the case for Accor for hotels or Carrefour and Tesco in the retail business (Eröcal 2005: p. 16, 39).

When venturing into foreign markets to gain market share, a company obviously needs to prepare for various degrees of localization of business and management practices. Strong international competition in their home markets is therefore an important determinant for later success abroad. According to the literature, the Asian business environment seems to be especially demanding for Western companies (Dhawan et al. 2000).

Our interview partners came from quite different industries, but they showed remarkable similarities with respect to their strategies for adapting business and HRM practices. They planned from the start to win new customers in overseas markets. They therefore had to research their markets carefully. The retailers in particular had the advantage that they were often already present in the target countries because of their sourcing needs for their home markets. In many cases, the trade representative offices could therefore be upgraded for market research and initial M&A or brown-field investments. In these cases, the companies were following their suppliers to find new customers.

One media and information service company in our sample had a similar advantage because it was initially following its international customers (especially from the financial industry). In most locations, the firm started by providing information from the location by sending journalists and hiring local reporters and professionals. From a certain level of market growth, it then started to actively target local customers, and finally provided news coverage in the local language with specific local news as well.

For market entry and the configuration of tie-up modes, the tendency is to create subsidiaries whenever possible – and to keep controlling interests when joint ventures

are required. With respect to human resource management, all companies attempted to localize management within the first few years after set-up. Regulations are one of the most important issues for the companies when they decide their business strategies. In most Asian countries, the companies were (and are) forced into tie-ups with local companies. Success therefore depended on their skills in keeping control of these JVs. Most companies chose decidedly opportunistic strategies for their market entry and growth.

The balance between their international business model (which gives the company a cutting edge), and their ability to localize (which makes internationalization possible) is therefore the most important feature of these companies. One of the best examples is probably Carrefour, which has been strategically decentralized and opportunistic in all of its markets. It has been very successful in partnerships in difficult markets like Indonesia and China because it was able to “play” its partnerships and expand its business beyond the limits of existing regulations. In developed markets, from the U.S. to Japan, however, Carrefour often had to retreat even after major investments because opportunistic chances in these markets are much more limited. The overall “uniqueness” of its hypermarket model or its retail technology, on the other hand, was not enough to give Carrefour a sufficient competitive edge against the domestic (or other foreign) competitors.

Media, film production, and information services have also been experimenting with off-shoring and vertical production lines, but this does not seem to have become a successful trend, however. Language, style and culture have so far prevented successful off-shoring of services like TV production and news editing.⁴ An exception might be the off-shoring of hand-drawn animation, or mass-produced Indian movies, but this does not yet play a major role for Western media and film companies.

Leisure/ Travel/Tourism

Asia is one of the huge markets for tourism – and a lot of international companies are engaged in this field. As our investigation shows, China is turning out to be a growing market for inbound and outbound tourism, but, of course, other nations also are.

Our interview with one of the leading chains shows that it is necessary to maintain

⁴ Disney produces movies in China, for example. But the products are targeted at the Chinese market. European news agencies have off-shored some news editing to Eastern Europe, but have problems with quality.

control of the business, but at the same time to localize management style. Regulation can be a problem, but the situation is improving. Japanese competitors are seen as less internationalized in the business itself, but as good investors.

Travel and tourism are factors of enormous (and growing) economic relevance. In 2006, the industry is expected to contribute 3.6% to the world's GDP, a share worth USD 1754.5 billion. Currently (2006) the industry employs more than 234 million people (Is this figure correct? It seems incredibly large) worldwide, and the outlook is promising. According to the World Travel & Tourism Council, the demand-side will double within the next ten years, and travel and tourism activities are expected to grow by 4.2% p.a. (WTTC 2006: 6). Among the different sectors that are distinguished, business travel is expected to show the highest growth: the WTTC estimates a rate of 3.6%. However, with a growth rate of 3.4%, personal travel and tourism does not trail far behind (ibid, p. 7).

With respect to Asia, adjustment in the balance of markets can be expected for the near and mid-term future. Japan, for instance, is number two in absolute terms of the travel and tourism industry on a worldwide scale, with a lot of people traveling inside Japan and outside. However, in the ranking of growth forecasts, Japan is only number 168! Here is a striking difference with China: In absolute terms, China is "only" number four, but with respect to growth forecasts, China is expected to show the second-highest growth rate from all countries dealt with in the WTTC. Number three in terms of growth will be India, currently ranking 22nd when measured by absolute size of the travel and tourism industry.

According to the forecast by the World Tourism Organization, China's travel and tourism industry (includes transport, accommodation, catering, and recreation) will take up to 8.6% of world market share to become the world's top tourism industry by 2020 (<http://www.wttc.org/2004tsa/frameset2a.htm>). Over the next ten years, the growth of travel and tourism demand in China is expected to make it a tourism world super power. The largest component of capital investment originates from the private sector in new facilities, plant and equipment, while the public sector invests in the new travel and tourism infrastructure. This level of spending represents a consistently brisk piece of investment in China for travel and tourism and expectations for increasing levels through 2016 at a strong rate of 8.3% per annum in real terms of total capital investment. This sends a strong message to travel and tourism operators abroad that China is set to attract new ventures. Future expectations for Hong Kong are nearly as strong, with estimated growth per annum at 7.5% through 2013 (10th position in ranking).

Continued efforts need to be made, through the development of capital market structures, to attract sustained capital investment in China's travel and tourism industry from domestic and foreign sources. The lack of effective domestic financing options limits the potential for travel and tourism companies to expand, make acquisitions, merge with other companies, spin off bad assets, exchange property rights, restructure assets and consolidate. For foreign tour operators, a joint venture with a mainland Chinese operation gives access to China's inbound market, its vast and fast-growing domestic sector and, ultimately, to Chinese outbound travellers. China's accession to the WTO/OMC has sparked off changes in this very restricted sector, and foreign-invested travel agencies have begun to handle inbound and domestic tours for some time, although, they had still been prohibited from involvement in outbound tourism.

The company interviewed is one of the major players in the leisure industry, with worldwide activities, including all major Asian countries. While Europe still is the main market that counts for most of the revenue, Asia makes about ten percent. The experience in Asia is sufficiently long, more than 20 years. The legal form of local entities in Asia differs, depending on the model. As a tendency though, saving control (or: controlling interest) is important.

Not surprisingly, the Asian market is seen as a market and not as an off-shoring or innovation centre. Market entrance demanded drastic action and investments because the name of the group was not known in Asia directly after the entrance. Even now, return rates tend to be low – which influences investments in the long run.

Home country links do exist, but a lot of customers come from the local industry. Internet-access and infrastructural aspects play an important role for the local people to book their stay in hotels.

The importance of innovation was hardly touched – with the exception that in China, a competitor tried to apply the same business strategy (and failed).

With respect to human resource management and management styles, the company claimed to apply the same principles of management (including accounting, etc.) to all places. However, human relations are special and stress the cultural aspect and the uniqueness of each location. The availability of skilled personnel is again a crucial point for the enterprise.

Market obstacles were seen in the large number of different licenses that some governments request (example of Thailand) and the danger of unfair competition (India

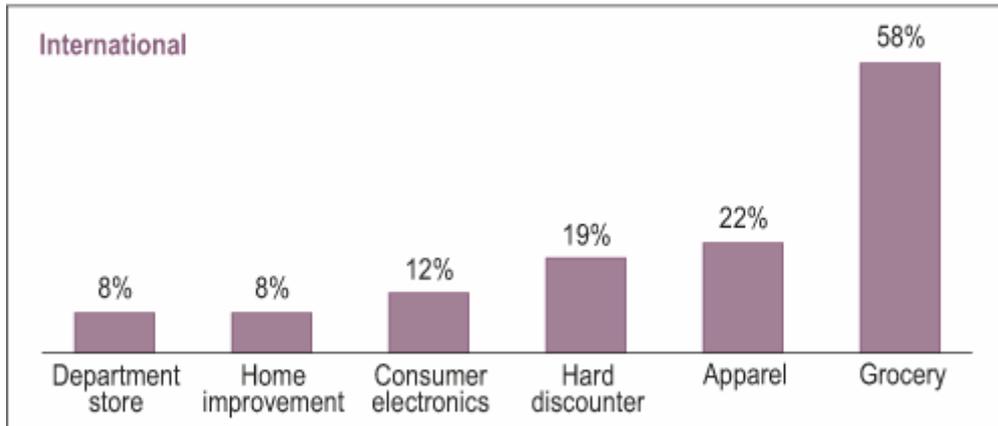
was mentioned). Regulation is always a topic when a company invests into another market.

Retail

In many major markets store saturation becomes a pressing issue for retailers. Being an early mover in terms of internationalization therefore produces tangible results. Early global movers are not only able to extend their sales and scope, they also become more innovative and improve their business models. Their sourcing representatives and networks for the home market and their distribution networks abroad often complement each other. The main message for the industry seems to be: retailers that are not yet global need to address this issue quickly.

Of the world's top 20 retailers in terms of sales fifteen operate globally. The top five retailers produce a full 33% of their sales outside their home markets. Among the top 10 players, 27% of sales come from international markets, while the next 10 retailers have just a 15% share of international markets?. But this is most likely only the start. The percentage of sales from international operations is predicted to increase because many retailers have not yet internationalized at all. Interestingly, U.S. retailers are the furthest behind the globalization curve. Just 44% of the top U.S. companies step beyond their national boundaries (A. T. Kearney 2005a)

Figure 6: International Sales of Major Retail Companies
Sales outside home market for top 3 players per retail segment in 2004



Source: Annual reports and A.T. Kearney

Source: A. T. Kearney (2005a).

Clearly, grocery retailers are the most advanced in terms of global expansion. Almost all other retail groups are far behind. Apparel retailers are expanding internationally as well, especially in Europe and Asia. Companies such as Spain-based fashion retailer Mango and Japan's Fast Retail have opened shops in key Asian markets. Hard discounters face at least as much local competition as retail grocers because their business model is popular in basically any market. But economies of scale are an important international advantage for these companies, so expansion will likely gain pace in the future. Consumer electronics retailers face rapid commoditization of their products and cutthroat competition. Many companies therefore remain focused on their regional markets. They now also face competition from internet retailers such as Amazon, Dell and eBay. But as in the case of hard discounters, economies of scale through international expansion and consolidation will likely drive more companies abroad. Home improvement stores have been staying close to home. But as IKEA, the home furnishings retailer, demonstrates, especially transformation economies like China offer huge opportunities. Through privatization, many new house and apartment owners are now lining up to improve their homes in a "westernized" way. Department stores are clear laggards: they have not yet tried to install their brand names on an international level.

For retailers not only scope is important during their international expansion. The companies are also increasingly able to gain additional innovative expertise. For example, Wal-Mart has already succeeded in building an information feedback loop

across its global operations and is implementing best practices within the U.S. market. It now has also shelves that facilitate replenishment from Brazil, shoe and bike merchandising techniques from Canada, wine and food displays from Mexico, and approaches to apparel selling from the United Kingdom (A. T. Kearney 2005a).

Information/Media/Entertainment

Media/Information Services seem to follow a clear trend: First, they follow their customers. In the next step, they localise and grow in the host country market opportunistically, finding new customers for their international business. Although media, film production, and information services are certainly experimenting with off-shoring and vertical production lines, this does not seem to have become a successful trend by now. Language, style and culture have so far prevented successful off-shoring of services like TV production or news editing.

According to PricewaterhouseCoopers' "Global Entertainment and Media Outlook", the entertainment and media industry in 2005 is in its strongest position since 2000. In 2009, worldwide entertainment and media spending is predicted to reach nearly USD 1.8 trillion. While entertainment and media companies remain somewhat cautious, there are many exciting opportunities in the marketplace and much the industry can look forward to.

In information services, growth is explosive in general but competition is intense. Many companies have not yet found an effective business model for marketing and selling their services over the internet.

Although different in the content they produce, the companies interviewed showed similarities with respect to their strategic choices. They follow their lead customers to Asia and localise in the next step. Asia is seen as one of the largest markets in the world that simply should not be ignored. However, there is the risk that the market will not reach the expected sales/scale, as was the case for one of the interviewed companies, which withdrew from that particular market.

Home-country links were the basis for the movement to the new location, but soon the local market including local customers became important. According to one interview, media industry companies have to adapt to local customs and habits more than other industries.

With respect to innovation, the tenor was that neither innovation in the software nor innovation as a process would play an important role. IPR infringement was no topic; however, finding personnel was. One of the two companies interviewed stated that the localisation of management is good for the long-term perspective of the company, but may be costly at the beginning, especially because the education of personnel takes time (and thus: money).

Market obstacles are, first of all, regulations that force media companies to tie-up with local companies when they enter a new market. The examples of Thailand and Korea were given, where a media company is still facing some restrictions with regard to the ownership. The access to information, however, was not seen as a problem – at least not in those countries where the press is free.

Having a look at Japan and Japanese competitors, our interviewees stated that Japan should not be underestimated. Japanese competitors may not be involved actively in the development of the market or may not be present there physically, but through their international contracts with local media firms they have access to all the information they require as necessary.

One media and information service company in our sample had a similar advantage because it was initially following its international customers (especially from the financial industry). In most locations, the firm started by providing information from the location by sending journalists and hiring local reporters and professionals. From a certain level of market growth, it then started to actively target local customers, and finally provided news coverage in the local language with specific local news as well.

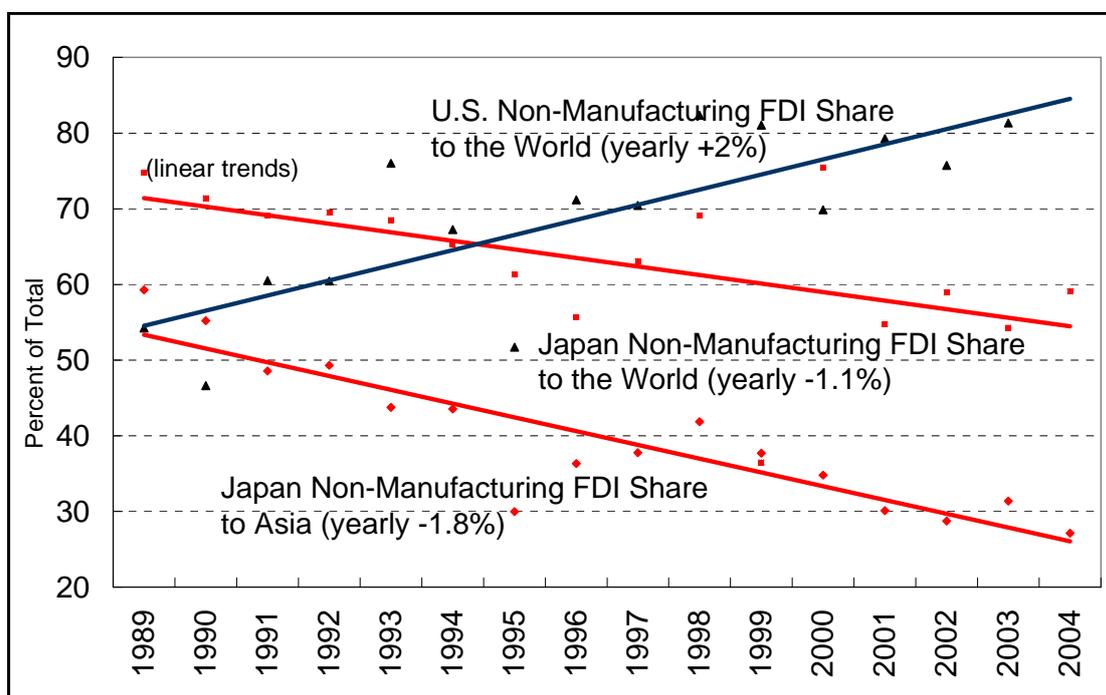
Based on this strategy, the company realized almost explosive market growth in almost all Asian markets, including Japan. Local competitors are not yet a major issue because they do not have the necessary international expertise, and are unlikely to gain such expertise for many years to come.

Contacts with universities are important to get the company known among graduates. Often, skilled personnel can be attracted from local competitors and other service sectors because in information services working for a foreign company to gain international expertise is a real asset for the employees.

5. Comparison with Japanese Service Companies

Japan's share of service sector investment abroad is only 69% of total FDI abroad, and the trend is getting worse. The situation is even more extreme for investments in Asia, which receives only 25% service investments of the total. Clearly, Asia is basically a manufacturing base for Japanese corporations. U.S. corporations, in contrast, invest 81% of the total in services abroad – and, as would have been expected, the trend has been increasing over the last 15 years.

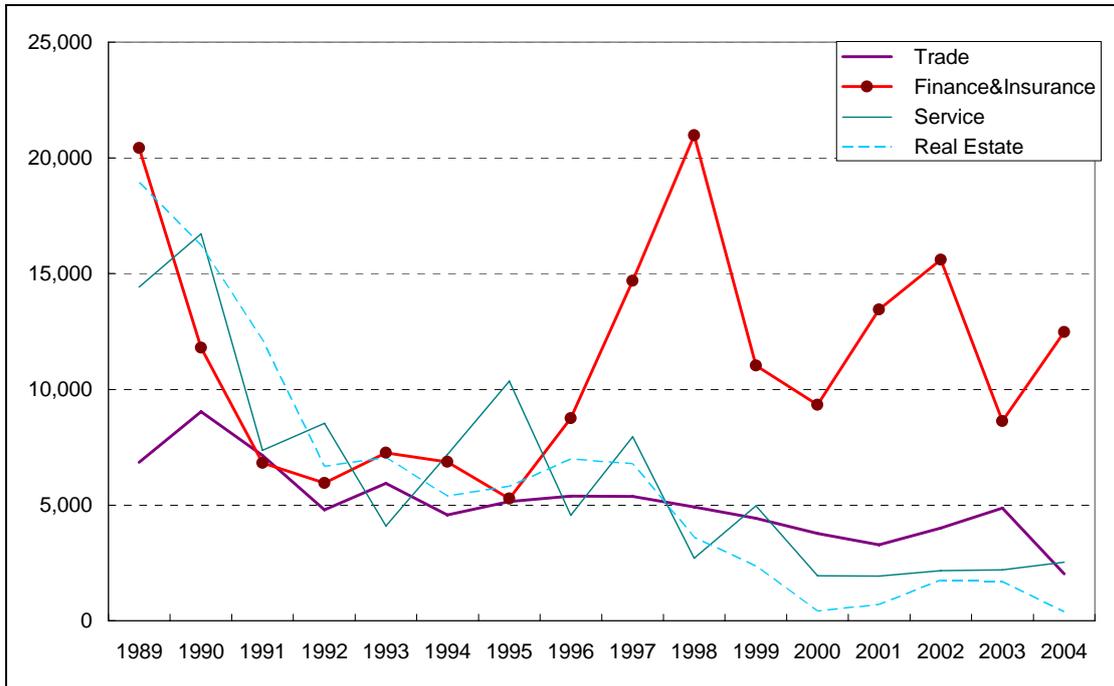
Figure 7 Japan vs. U.S. Non-Manufacturing FDI Shares



Source: © FRI 2006. Data from MOF (2005): FDI Statistics

Levels of service sector FDI from Japan to the rest of the world look almost more precarious when we disaggregate the major sectors. The by far highest share of FDI comes from the finance sector, as would have been expected. But the difference to the other sectors is striking. FDI in trade, services and real estate has actually been converging towards zero – where the other sectors that have not been plotted in chart almost are already.

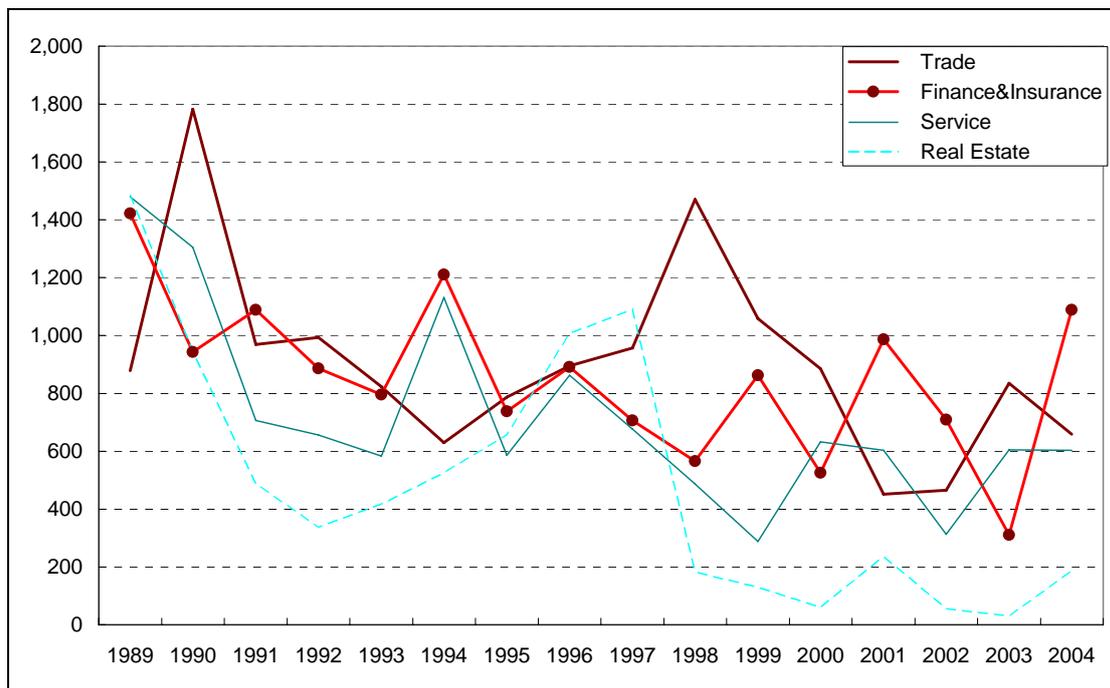
Figure 8 Japan's Outward FDI by Non-Manufacturing Sector (100 Mill. Yen)



Source: © FRI 2006. Data from MOF (2005): FDI Statistics.

Service FDI towards Asia looks more evenly distributed between the sectors – but only at a very low level. Over the last few years, not even the financial sector was interested in investing in Asia.

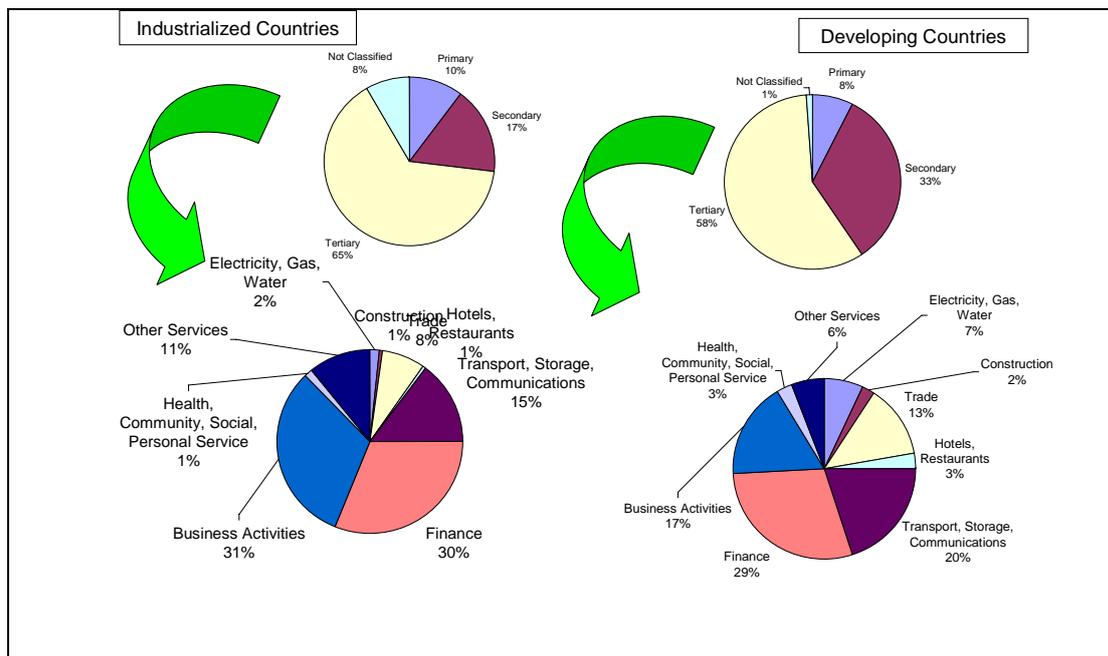
Figure 9 Japan's Outward FDI to Asia by Non-Manufacturing Sector (100 Mill. Yen)



Source: © FRI 2006. Data from MOF (2005): FDI Statistics

The differences with other countries become obvious when looking at worldwide inward FDI flows. In the two major country groups, industrialized and developing countries, non-manufacturing investments have by far the highest shares. Within the sector, finance is important, but its share is only about 30%. Business services, transport and communications, as well as trade, on the other hand, are almost as important as the financial sector in international FDI flows.

Figure 10 Worldwide Inward FDI Flows (2001)

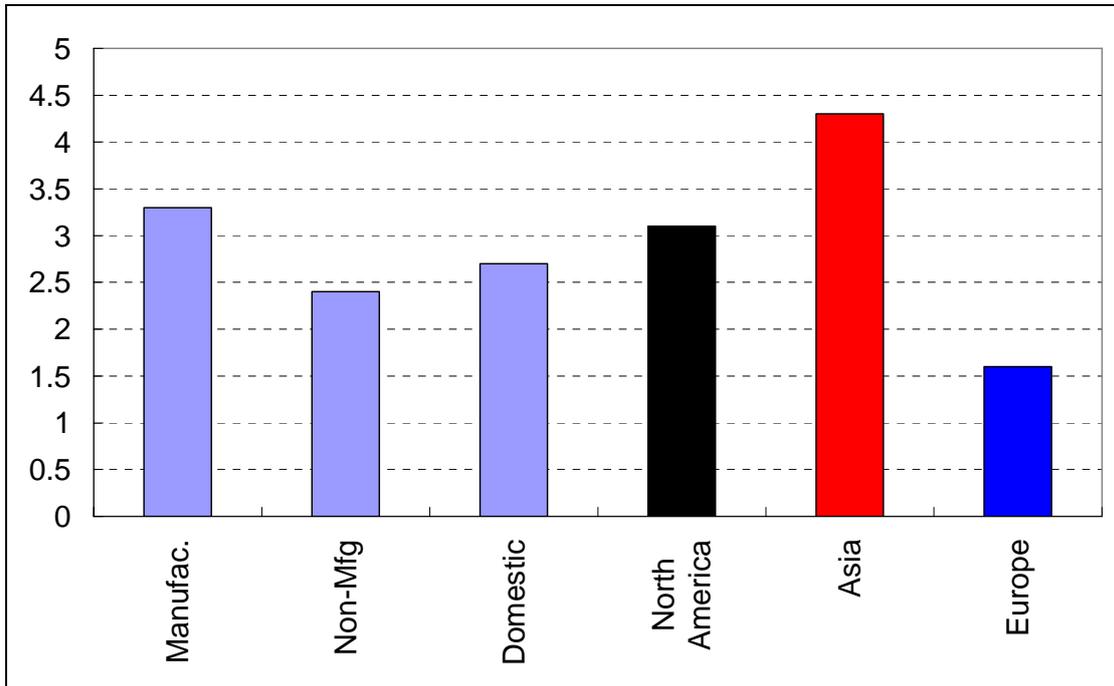


Source: © FRI 2006. Data from WIR (2003), p. 192.

Note: Positive replies of Investment Performance Agencies (IPA) for Asia and the Pacific by sector in percent.

One of the reasons for the preference of Japan's industry for manufacturing FDI is, of course, that profits of Japanese non-manufacturing companies abroad are still comparatively low (see graph below). In Asia, the difference is especially significant, not because the service companies' profits are necessarily lower here (we do not have any appropriate data), but because the profitability of the manufacturing sector in Asia is so much higher.

Figure 11 Profit Rates (Profit/Sales 2004)

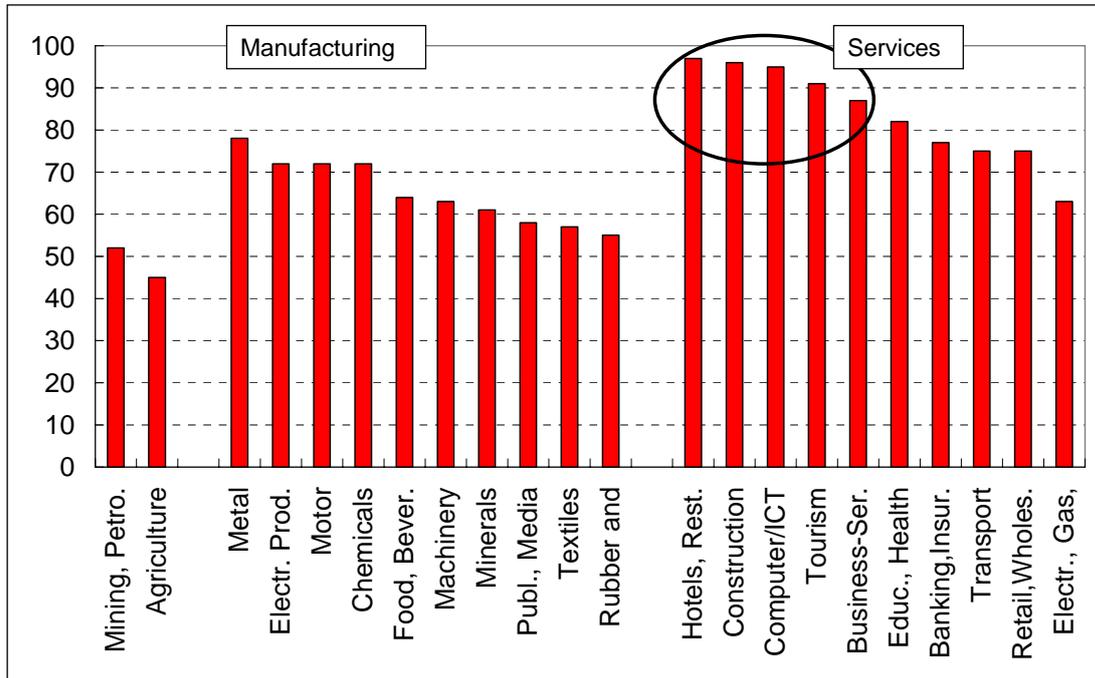


Source: © FRI 2006. Data from METI (2005).

Note: Figures in percent.

Another important reason for the strong focus on manufacturing FDI in Asia certainly is the strong desire in many manufacturing companies to restructure their operations at home, and to off-shore as much of parts production as possible. Although this might be justified from the current corporate perspective, it also means that many Japanese companies are losing out on business chances in Asia. The following graph, for example, shows that most experts in international Investment Promotion Agencies think that the Asian service sector will offer the more promising investment prospects.

Figure 12 Positive Investment Promotion Agency Replies for Asia & Pacific (2006)

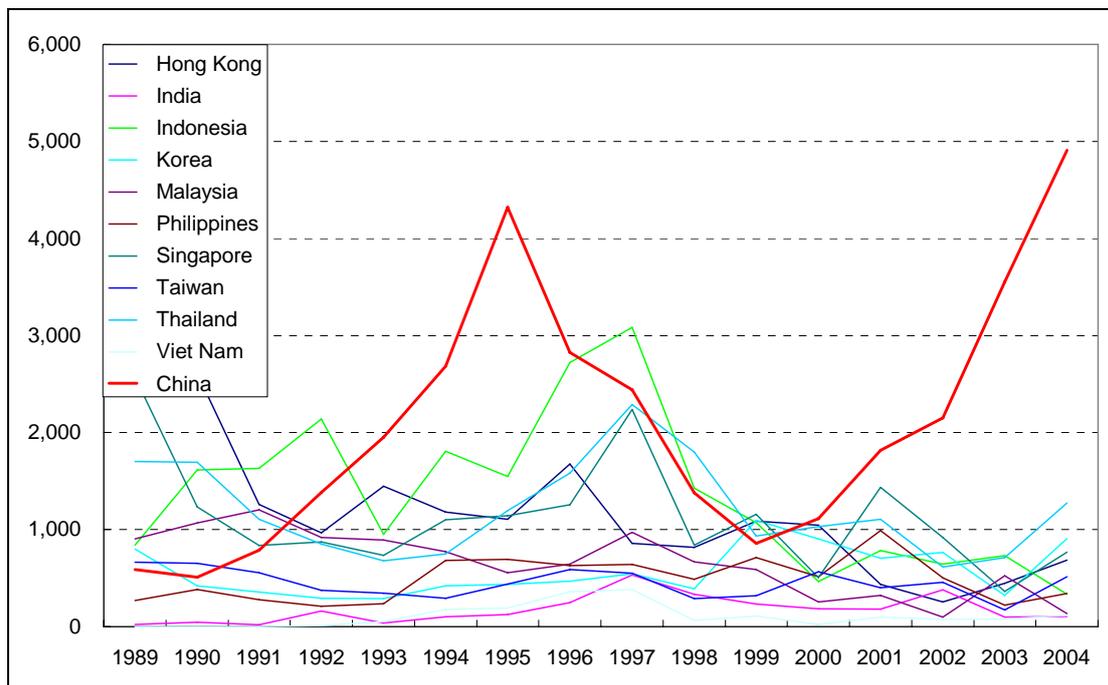


Source: © FRI 2005. Data from UNCTAD (2005), p. 37.

Note: Positive replies of Investment Performance Agencies (IPA) for Asia and the Pacific by sector in percent.

Another development is important: overall FDI from Japan has been mainly flowing into China over the last few years. Japan's FDI into the rest of Asia has not yet recovered from its breakdown during the Asian crisis, as the following graph shows.

Figure 13 Japan's Outward FDI to Asia (100 Million Yen)



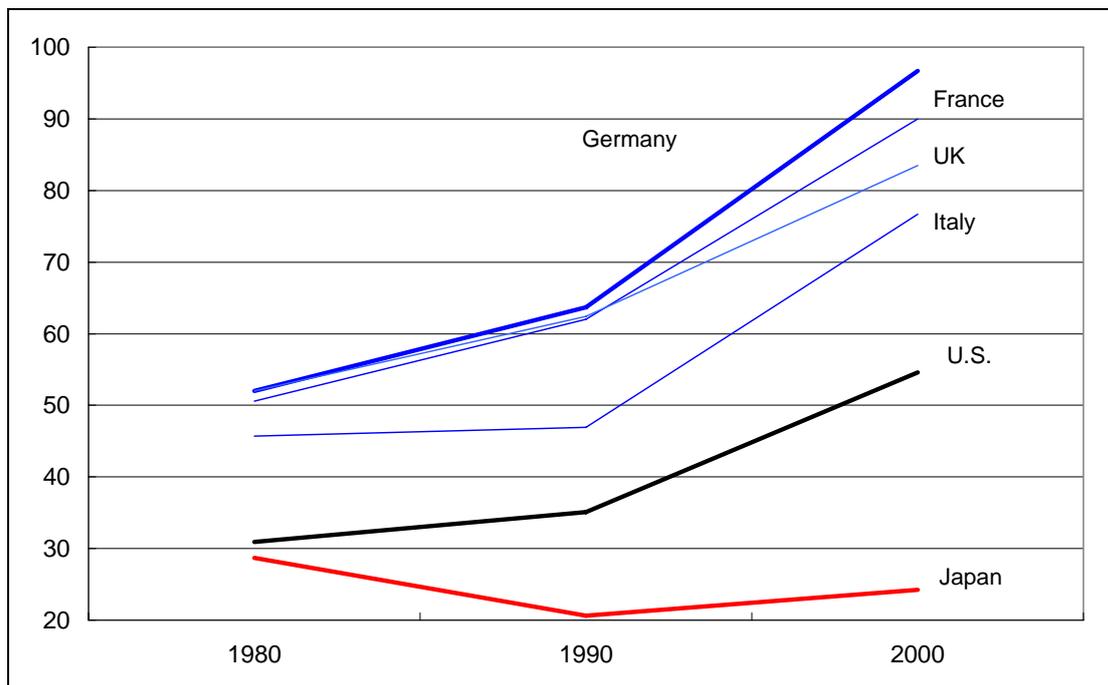
Source: © FRI 2006. Data from MOF (2005): <http://www.mof.go.jp/english/fdi/reference01.xls>.

The strong drive of Japanese companies towards China is clearly due to their preference for building up manufacturing centres in Asia. The service companies simply seem to follow major car and electronics makers to these locations.

This observation fits well with what most of our interview partners mentioned: Japanese service companies seem to remain too closely linked to their Japanese customers. Furthermore, Japanese firms seem to have little interest in exploring new clients. Basically, they seem to miss out on steps 4.-6. of the general expansion patterns in Asia (see section 3), supposedly the main drivers of business success abroad. We assume that market conditions in the home market play a role in this process.

In Europe, for instance, companies are already facing an intensifying internationalisation process due to the formation and enlargement of the European Union. Trade and competition are therefore increasing not only over the borders, but also within the countries. Merchandise trade in comparison to value added in the graph below is an indicator for this development.

Figure 14 Ratio of Merchandise Trade to Merchandise Value Added (Percent)

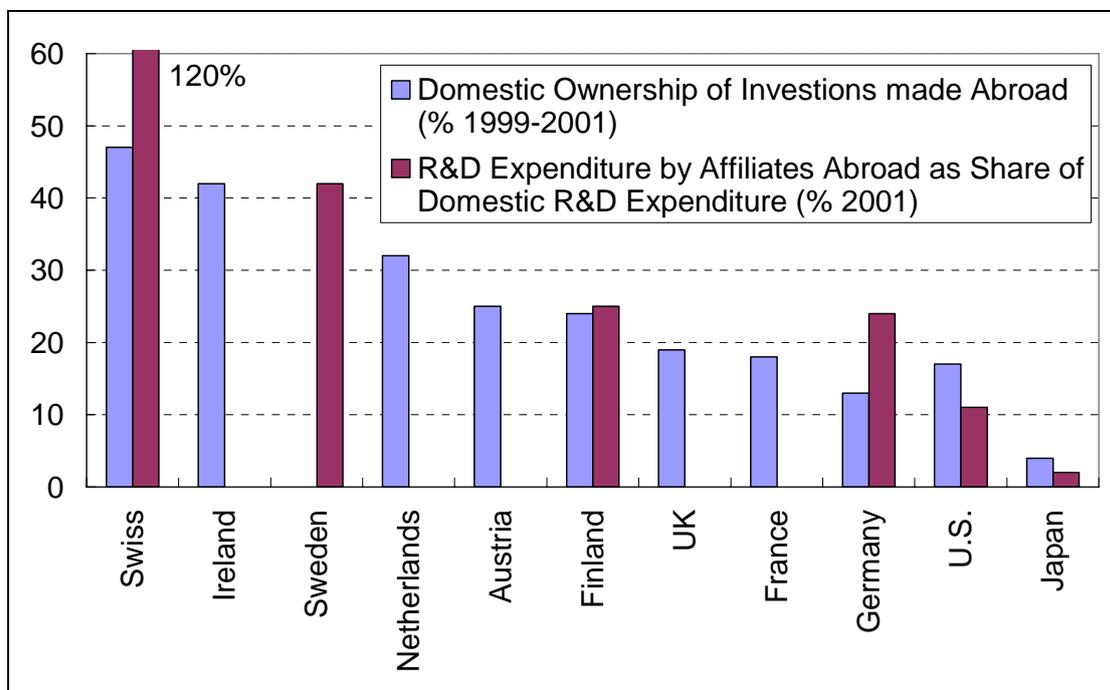


Source: IMF (2002): WEO - Trade and Finance p. 128.

The U.S., in contrast, has experienced strong international investment in its home market, which has increased international competition. In the meantime, the Free Trade Zone with Canada and Mexico has also increased the reach of U.S. service companies beyond their already huge domestic market. In many ways, these differences are also visible in the corporate strategies and in the data. U.S. companies often have excellent international business models and outstanding productivity levels in the service industries. European companies, on the other hand, often seem to be more successful with localization and (regulatory) opportunism. In logistics, for example, the most efficient providers are U.S. companies, but internationally the biggest players are now European companies. Similarly, in retail Wal-Mart is the world's most successful company, but European retailers can often challenge the company in overseas markets and become more successful there – as Carrefour has demonstrated in China, for example.

The following figure gives an indication for an important reason of the international success of European companies – although their productivity levels are often still comparatively low. Corporations in E.U. countries are actively chasing internationalization chances, and invest high shares of their R&D expenditures abroad.

Figure 15 R&D and Inventions Abroad



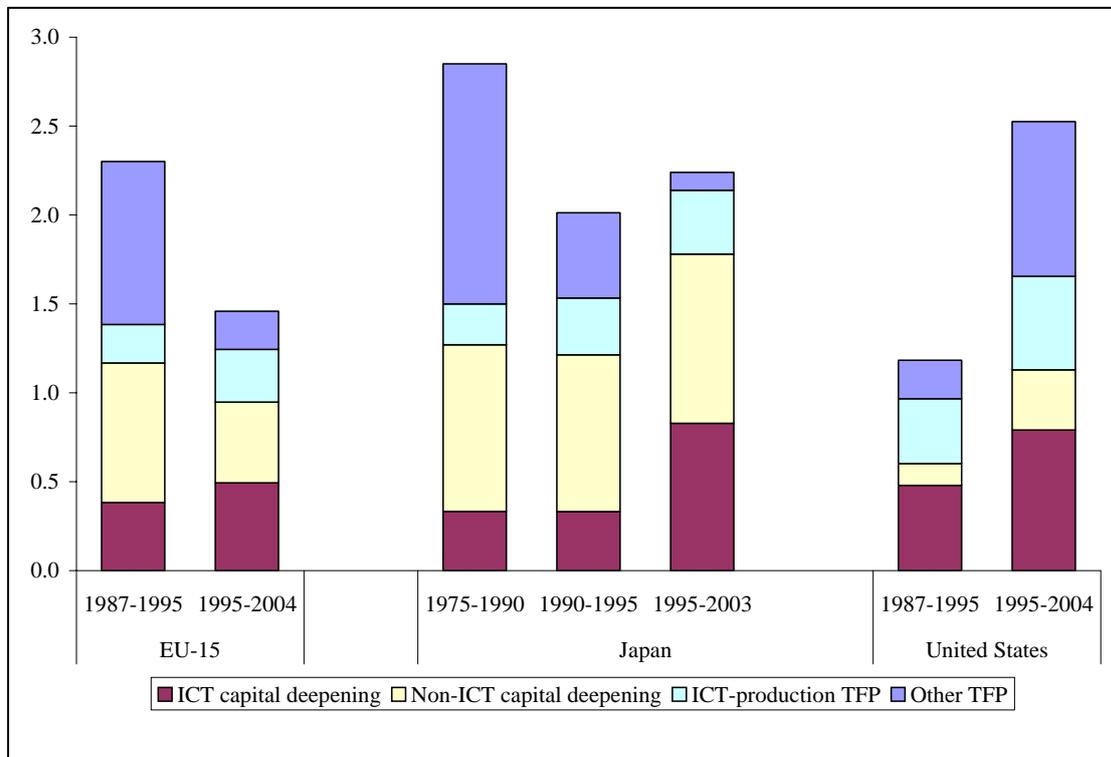
Source: © FRI. Data from OECD (2005). (Martin, I cannot correct the graph, but check out 'Investions' above. This is not a word. Presumably it should be 'Investments'.)

Note: Figures in percent.

Van Ark (2005) for example argues that in an increasing global environment it is important that countries learn from each other's experiences about how growth relates to investment and innovation. For Japan and Europe, the comparison with the successful U.S. is especially important. Compared to the U.S., Europe's and Japan's growth problems since 1995 are a reflection of a slow - admittedly too slow - adjustment process towards a new industrial structure.

To better understand the causes of Europe's and Japan's productivity slowdown in comparison with the U.S., van Ark breaks down labour productivity first into contributions of capital and total factor productivity (TFP), and second into industry specific contributions. For TFP, the resulting story is the rapid acceleration of "other TFP" growth that cannot directly be attributed to capital deepening or improvements in ICT production. This "other ICT" growth in the U.S. is most likely the result of the more productive use, or application, of new technologies in the U.S., which has not been matched by Europe or Japan so far.

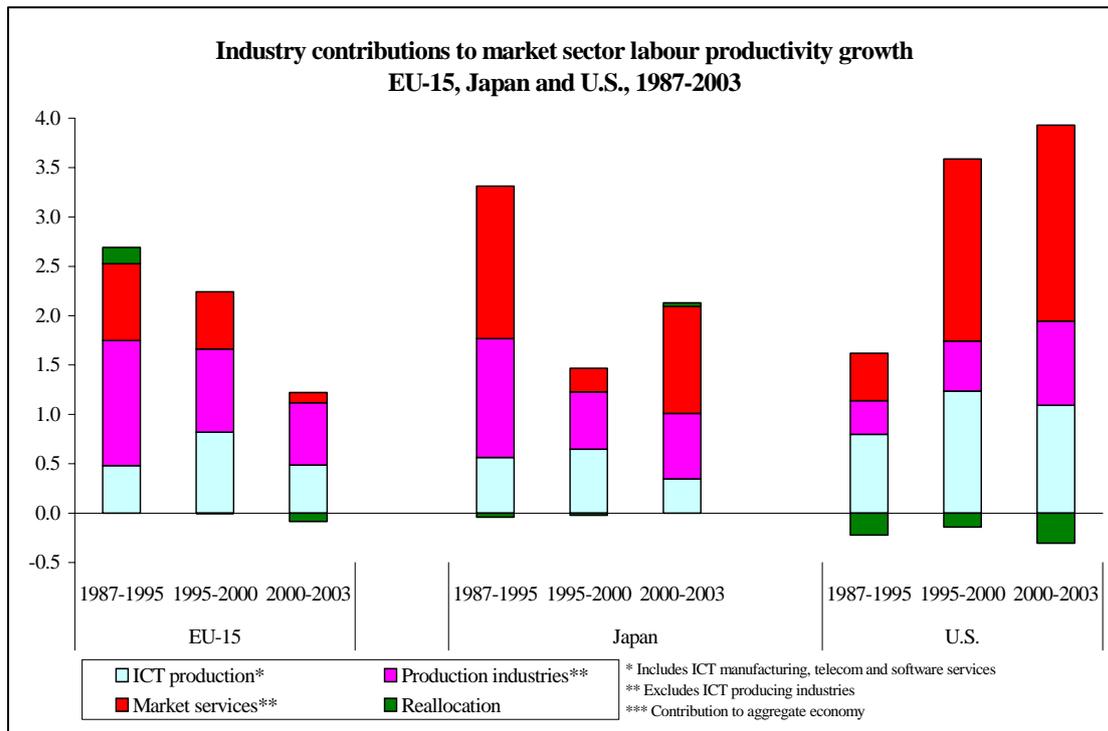
Figure 16 Contributions of Capital and TFP to Labour Productivity



Source: Van Ark and Inklaar (2005); Jorgenson and Motahashi (2005).

Secondly, as the following graph of industry contributions to labour productivity growth will show, it has been the acceleration of productivity growth in market services in the U.S. that has had the largest impact on labour productivity growth since 1995. The contribution of productivity in the production industries, in contrast, has had a much more limited effect (see the following graph).

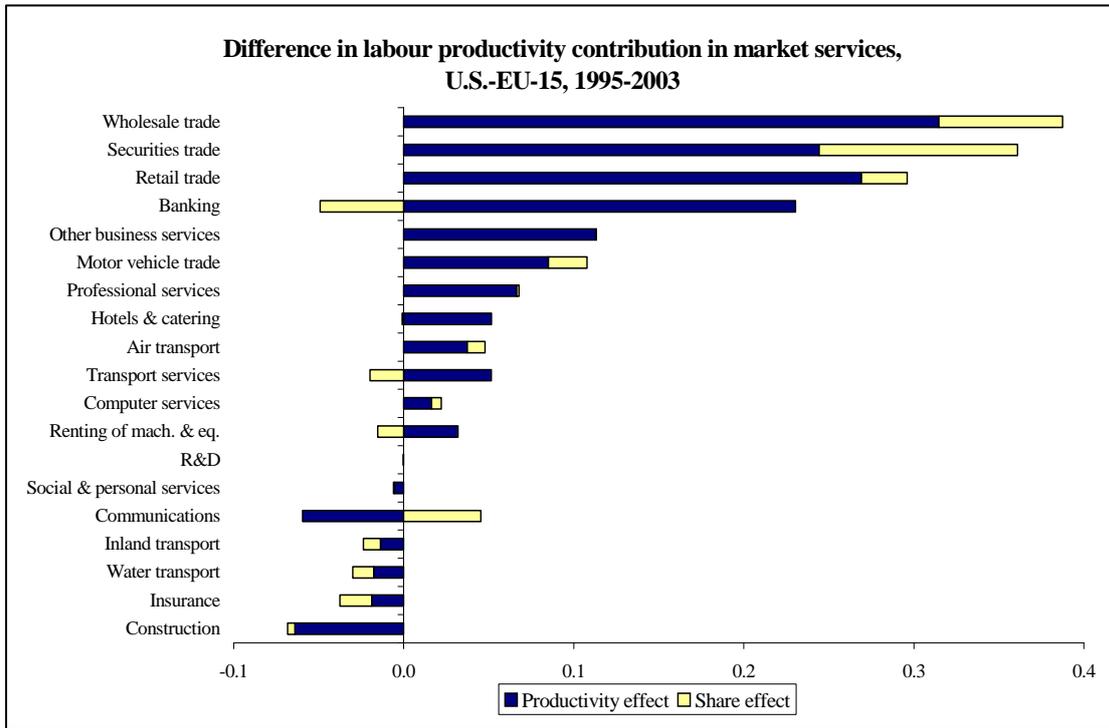
Figure 17 Industry Contributions to Market Sector Labor Productivity Growth



Source: Van Ark and Inklaar (2005) and www.ggdc.net.

In contrast to the U.S., Van Ark argues that Europe has almost lost all productivity growth in market services, while Japan, after a very bad period for 1995-2000, has fortunately improved somewhat. Productivity growth is still well below the U.S., however. When further breaking down the contribution of individual market services to productivity growth, he finds that the biggest negative growth differential between the U.S. and the E.U. can be found in six industries, concentrated in trade and finance (see the following graph).

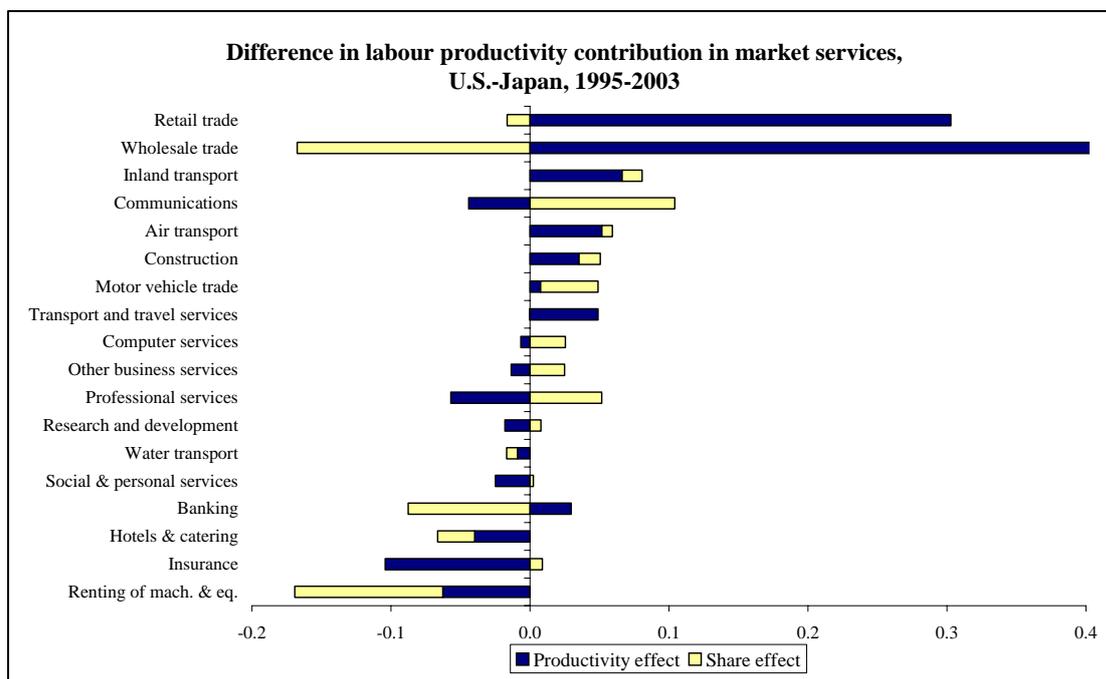
Figure 18 Difference of Labor Productivity Contribution in Market Services



Source: Van Ark (2005).

Japan, in contrast, shows only large productivity disadvantages in the retail trade and wholesale trade sectors. Otherwise disadvantages are fairly small, and in some industries (communication, professional services, insurance) Japan has even productivity growth advantages (see the following graph).

Figure 19 Difference in Labor Productivity Contribution in Market Services



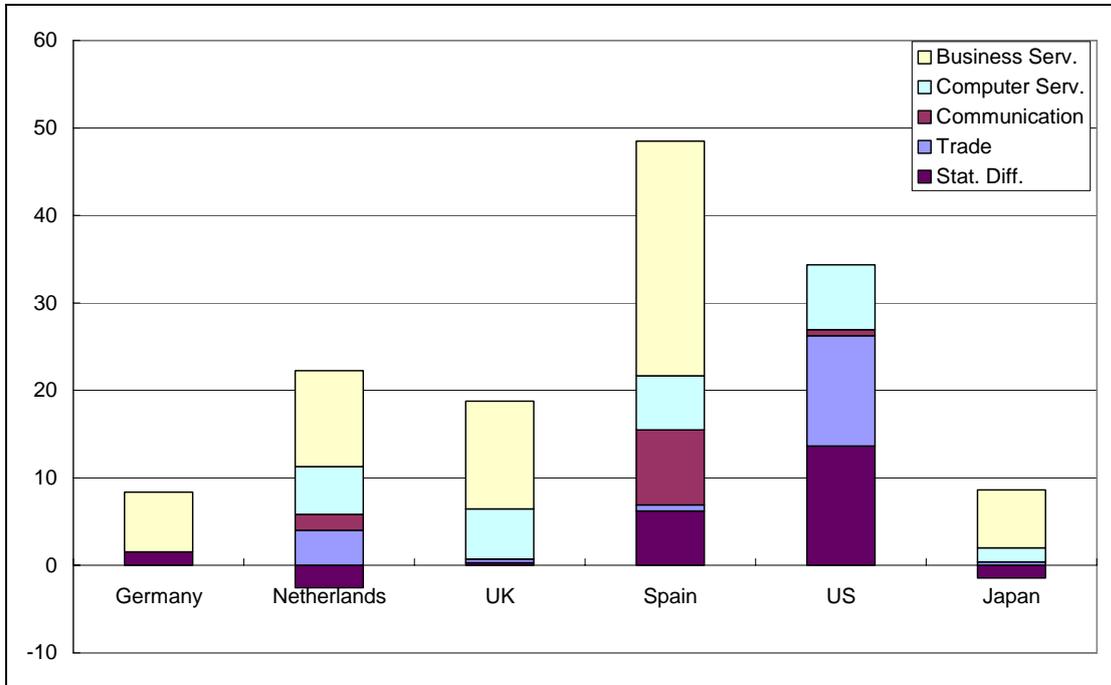
Source: Van Ark (2005).

It is very important to recognize that in Europe and Japan the productivity differential in the trade sector means that both countries are lagging behind in the service industries that are the biggest investors in ICT. This has important implications for innovation policies: R&D-intensity targets, for example, are not as important for services as they are in manufacturing. To facilitate service innovation, there seems to be little room for targeted innovation policies in general. Instead, the productive USE of ICT must be improved by investments to improve the quality of the workforce, by investments into the physical and technological infrastructure, and by incentives to improve the value chain through more competition and innovative interaction between services, suppliers, and clients (Van Ark 2005).

The astonishing result of this analysis is that Japan's services are not so much backward in terms of productivity – especially when compared to Europe. During the current phase of development in Asia, however, the international service sectors that are expanding the most in East Asia are retail and wholesale. And in these two sectors Japan has a considerable productivity gap. Future service sector policies would therefore be well advised to further promote deregulation in these sectors. Hopefully, this would also increase the incentives to focus more on R&D in these sectors – as is the

case in the U.S.

Figure 20 R&D Expenditure in Industry 2001

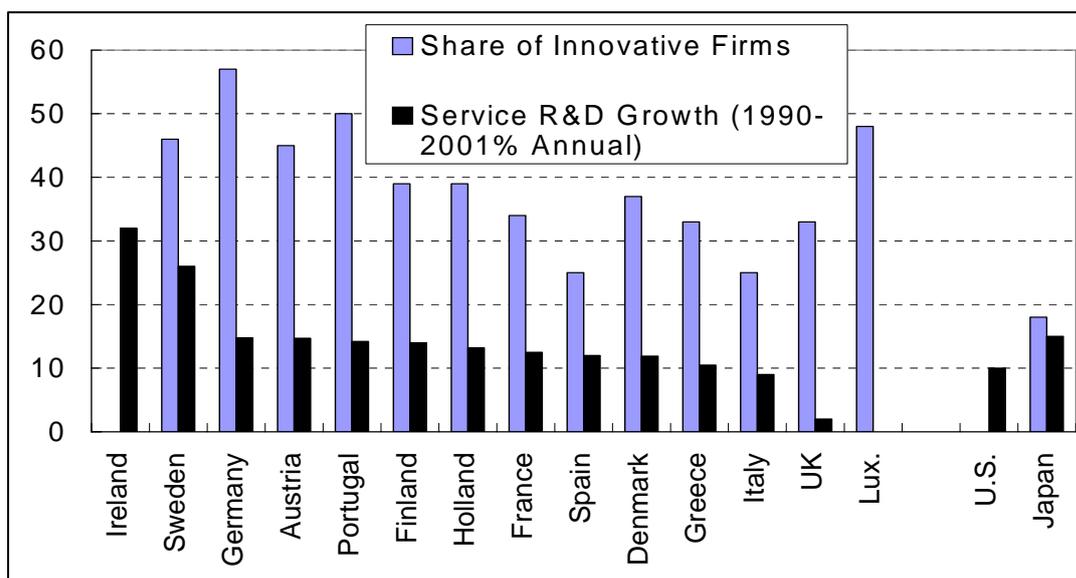


Source: © FRI 2005. Data from EU DG Enterprise (2004), p. 42.

Note: Figures in percent of total.

For Japanese service companies, a lack of internationalization and of competitive pressures in the domestic service sector might be the main obstacle to their expansion abroad, however. A key difficulty is to find qualified Japanese personnel with language abilities and the experience to work for globally operating service companies. Domestically, most statistics also show that Japanese service companies are lagging behind in terms of innovation capabilities, although investments in R&D are increasing fast in the meantime.

Figure 21 R&D Growth and Share Of Innovative Firms

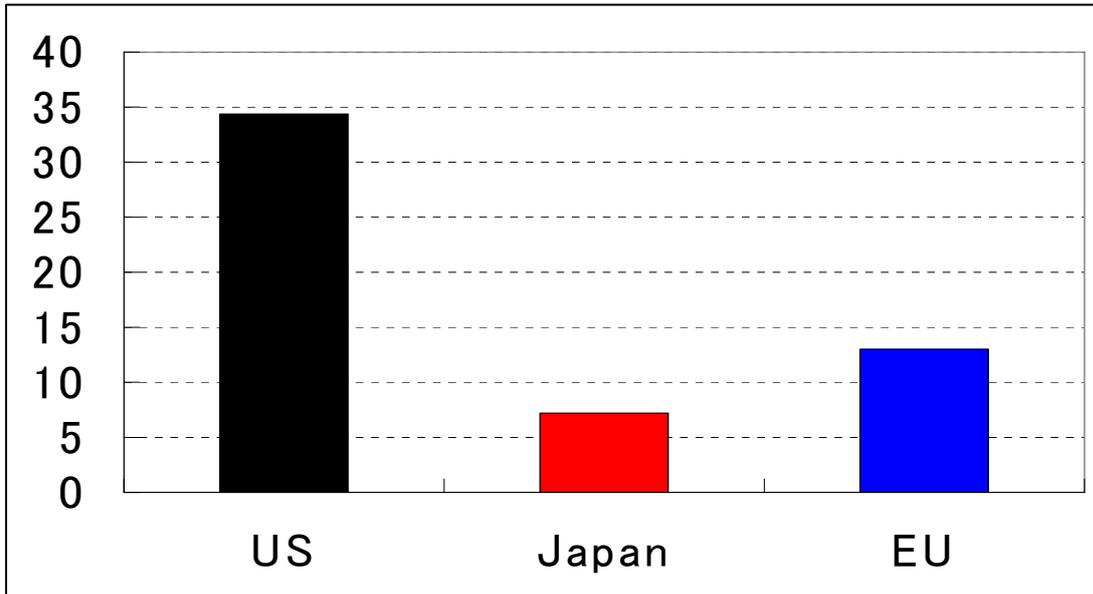


Source: Source: © FRI 2005. Data from OECD (2005).

Note: Figures in percent.

Low levels of competition and slow deregulation might be a reason for this disadvantage as well. Additionally, the successful internationalisation of Japan's manufacturing industries, and the comparatively low level of outsourcing from these industries, might keep Japan's service industries away from venturing abroad on their own as well. In other words: Japan's business services might still be an integral part of the value chain in manufacturers like Toyota – so their interface with other (potential) customers and their incentives to develop independent technologies and innovations remains limited. One indicator for this innovative gap is the expenses for service R&D within the business sector.

Figure 22 Share of Service R&D in Business R&D



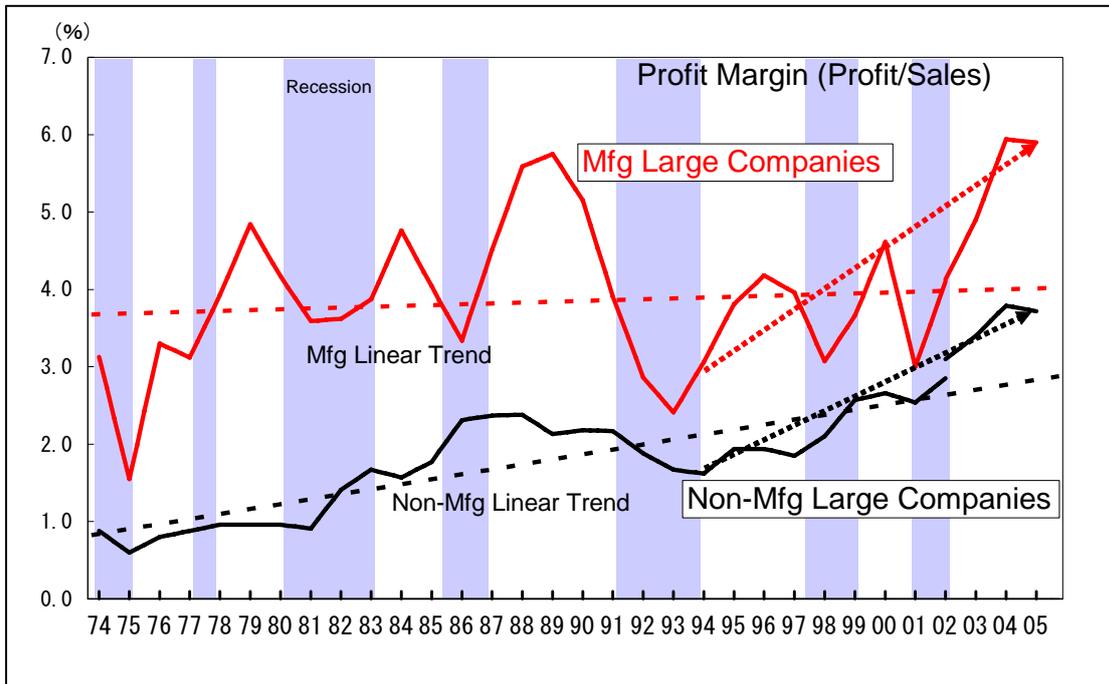
Source: © FRI 2005. Data from EU DG Enterprise (2004), p. 44.

Note: Figures in percent.

All our interview partners refused to write off their Japanese competitors, however, and stated that their Japanese competitors should not be underestimated – especially in the Asian markets.

Hopefully, this optimism among some competitors is for a good reason. Fortunately, the following, and final graph, already provides a positive outlook for the potential of Japan's service sector to improve its competitiveness.

Figure 23 Japan Domestic Profit Rates by Sector



Source: © FRI 2005. Data from BOJ (2005.07.01): Tankan Survey June 2005.

While Japan’s manufacturing corporations have focused on restructuring at home and the building up of international production networks abroad, the non-manufacturing sector has increased its restructuring efforts as well, and is now well on the way to close the profitability gap to the manufacturing sector. Japan’s infamous “Dual Economy” between productive export-producers and unproductive domestic-services might therefore soon become an issue of the past.

6. Conclusion and Policy Recommendations

International competition in the home markets seems to be one of the most important factors for the success of service companies during international expansion. But even domestically highly successful business models or advanced technologies do not guarantee success in overseas markets. Services are a “people business,” as most of our interview partners stressed.

Especially during the entry phase in developing markets, management needs to find the right business partners, adjust strategies to adverse regulations, and lobby the governments. To balance such opportunism with internationally applicable business models and innovative technologies is probably the greatest challenge for management in all service sectors.

This necessary balance of successful home country business models and abilities to adapt to local conditions abroad might be an important reason for our second important finding: service companies’ strategies seem to diverge more by region than by sector. Throughout most sectors, companies first follow their customers, start to expand opportunistically and regionally, and finally link and expand their network and business models.

In Asia’s often highly regulated and diverse environments, the technological strength of U.S. service companies seems not to have been a decisive advantage compared to the ability of European companies to grow opportunistically. Japanese companies, on the other hand, still seem to be at a disadvantage on both accounts. Low levels of outsourcing and service sector innovation at home, as well as low levels of domestic internationalization might work against the companies compared to their Western peers.

But Japan’s services industries are not so much backward in terms of productivity – especially when compared to Europe. During the current phase of development in Asia, however, the international service sectors that are expanding the most in East Asia are retail and wholesale. And in these two sectors Japan has a considerable productivity gap. Future service sector policies would therefore be well advised to further promote deregulation in these sectors.

For Japanese service companies, a lack of internationalization and of competitive pressures in the domestic service sector might be the main obstacle to their expansion abroad. A key difficulty is to find qualified Japanese personnel with language abilities and the experience to work for globally operating service companies. Domestically, most statistics also show that Japanese service companies are lagging behind in terms of

innovation capabilities. Low levels of competition and slow deregulation might be a reason for this disadvantage as well. Additionally, the successful internationalisation of Japan's manufacturing industries, and the comparatively low level of outsourcing from these industries, might keep Japan's service industries away from venturing abroad on their own as well. In other words: Japan's business services might still be an integral part of the value chain in manufacturers like Toyota – so their interface with other (potential) customers remains limited.

The disadvantages of Japan's service industry abroad therefore need to be tackled at home. Further deregulation and internationalization in Japan's domestic services seem to be the key for facilitating the necessary innovation through outsourcing and for increasing the chances for Japan's young management to develop the necessary international skills.

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