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**Strategies and recommendations for the new European
Economic Area**

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San Jose State University, 1994

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STRATEGIES AND RECOMMENDATIONS FOR THE NEW EUROPEAN ECONOMIC AREA

A Thesis

Presented to

**The Faculty of the Department of Economics and Business
San Jose State University**

In Partial Fulfillment

**of the Requirements for the Degree
Master of Arts**

by

Ludovic Lamy

May, 1994

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ABSTRACT
STRATEGIES AND RECOMMENDATIONS FOR THE NEW
EUROPEAN ECONOMIC AREA

by Ludovic Lamy

The formation of the European Economic Area (EEA) and emancipation of Eastern European countries have created in Europe potentially the largest developed market in the world. This will, undoubtedly, give rise to many new opportunities as well as uncertainties. This thesis explores the impact of the development of the Single European Market on U.S. businesses. The focus is on: (a) the changes in the European Community (EC), (b) the laws and practices that may affect U.S. exports, and (c) the U.S. business operating conditions in the EC. The result of this research shows a need for developing and implementing effective European strategies, including organizational issues. The telecommunications services industry is used as an illustrative example.

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CHAPTER 1. GENERAL INTRODUCTION

This thesis had its genesis in a few trips the author took to Europe (mainly France) during 1992 and 1993 while completing a master's degree at San Jose State University. He was increasingly struck by the ferment of change that seemed to be sweeping the European Community (EC) which includes: Belgium, Denmark, Germany, Greece, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and the United Kingdom. A persistent topic of discussion, evident both in the media and in daily life, was the Internal Market, more commonly referred to as the "1992 Program": the intent to create a Single Market within the EC by December 31, 1992.

By contrast, in San Jose there is little awareness of the emerging changes in the EC. This ignorance is reflected in conversations with students, friends and other acquaintances, in addition to the lack of media coverage. In response to the United States' limited interest and minimal understanding of the changes in the EC, and as a citizen of the EC far away from the focus of EC activity, the author decided to study the subject. After discussing the subject with the author's thesis committee member, he defined a research topic.

PURPOSE AND SCOPE OF THE STUDY

The purpose of this thesis is to study the expected impact of the Single European Market on U.S. businesses, with an emphasis on telecommunications services firms and to provide these businesses with a framework for action. It provides objective, factual information on the European Community's single-market initiative and a comprehensive analysis of its potential business consequences on the U.S.

The thesis primarily focuses on the following aspects of the Single Market Program: (a) The anticipated changes in EC and member-state laws and practices that may affect U.S. exports to the EC and U.S. investments and business operating conditions in

the EC; (b) the likely impact of such changes; and (c) the effects on the U.S. telecommunications services industry.

The thesis has been prepared with the following objectives in mind: (a) To persuade U.S. businesses that there are enormous business expansion opportunities as a result of the emerging Single European Market, and (b) to convince U.S. global firms that an active response to the circumstances arising from the Single European Market is necessary to protect existing markets and exploit new ones.

METHODOLOGY

The main sources of information used in this thesis are secondary ones found at the libraries of San Jose State University and the San Jose Public Library. Computer Indexes were widely utilized through ABI/Inform, Lexis/Nexis and Infotrac. Documentation concerning the European Community was obtained through the Delegation of the Commission of the European Communities and the Single Internal Market Information Service (SIMIS) of the U.S. Department of Commerce. Both of these services are located in Washington, DC.

LIMITATIONS

Relevant facts and theories tend to change as a result of the evolving conditions of global business. Therefore some of the references used in this thesis may become outdated. Moreover, the reader should be aware that daily changes and events in Eastern Europe create significant turmoil within the EC.

DEFINITIONS OF TERMS

Definitions of controversial terms nourish passionate debates and are broadly disputed. The following section will discuss different points of view concerning the concepts of international, multinational, and global corporation and related organizational structures.

Multinational Corporation

The internationalization of business and the consequent emergence of multinational corporations have been major trends during the past decades.

There is no single, agreed-upon definition of the multinational corporation since this kind of organization has evolved in complex ways which can be expected to expand in the future. However, according to Keegan (1989), the multinational corporation has three basic and constant features: (a) A multinational corporation may not necessarily do business in every country of the world, but rather considers opportunities throughout the world; (b) a multinational corporation has a considerable percentage of its assets invested in international business; (c) a multinational corporation engages its international production and plants abroad. Keegan (1989) points out that global marketing is the integration of the international and multinational approach where the objective is to create the greatest value for customers and the greatest competitive advantage for the company.

Jeanney and Hennessey (1992) apply the term “multinational” to all firms which (a) engage directly in business activities in a number of countries or markets as if they were local companies, (b) have a maximum amount of localization, (c) have a large variety of marketing strategies, and (d) view each country as a separate profit center.

Jeanney and Hennessey (1992) apply the term “global” to all firms which (a) create strategies on a global scale, (b) optimize performance worldwide, and (c) leverage commonalties across many markets.

To summarize and offer a broad definition, “international company” is a generic term to describe a world-oriented company, whereas a multinational firm is one type of international company. Its basic characteristics are its deep worldwide involvement and its global perspective in its management and decision-making.

Global companies pursue integrated strategies, look at the world as one market and move products, manufacturing, capital, or even personnel wherever it can gain an

advantage. The motive which drives the global company to take advantage of opportunities for growth and expansion is survival. Companies that fail to pursue global opportunities will eventually lose their domestic markets because they are pushed aside by stronger and more competitive global firms from abroad.

Throughout this thesis, the terms international, multinational, and global will be used interchangeably. The words affiliate and subsidiary are also used synonymously.

Organizational Structure

A multinational corporation, according to the previous definition, must cope with geographically dispersed operations, personnel from different cultures, and changing economies, political and financial environments. This brings new challenges. It also becomes obvious that the typical, purely domestic organization structure is unsuitable for multinational corporations.

The organizational structure of multinational corporations encompasses the three aspects of complexity, formalization and centralization (Robbins, 1987). The structure of multinational corporations differs from that of domestic corporations in the following manners:

1. A much higher degree of complexity reflects new factors such as the breadth of international activities, the firm's goals and strategies, the philosophy of the corporate management and the degree of internationalization.
2. There is a difference in the extent to which headquarters-subsidary relations are more or less formalized and/or standardized. As far as the staff managers are concerned, formalization closely refers to centralization.
3. Centralization is the more problematic issue facing multinational corporations as their worldwide dispersion accentuates the issues of control and autonomy. One question can be raised: to what extent should decision-making be concentrated at a single point?

As with a domestic corporation, the most important function of the organizational structure of multinational corporations is to facilitate an efficient decision-making process, a smooth communication within the corporation and a suitable framework for its strategy. Due to the multinational corporation's inherent enlargement of their scope, organizational structure becomes much more critical than within a domestic firm.

One of the main features of the multinational corporation is the involvement of its activities in many countries around the world. It is comprised of geographically dispersed units linked with a communication infrastructure emphasizing the shared issues of control and decision-making.

ORGANIZATION OF THE THESIS

This first chapter sets the stage for the thesis. It includes the purpose and the scope of the study, limitations, definition of terms, methodology, and organization.

Chapter 2 provides an overview of the development of the EC within a historical context. It also deals with the competitive environment found in the emerging Single Market and provides a comprehensive survey of the legislative development in the Common Market.

Chapter 3 tackles the need to improve the organizational strategies in the changing business environment within the EC.

Chapter 4 examines three different strategies for U.S. global firms to exploit the opportunities stemming from the move toward the Single Market: (a) centralized versus decentralized decision-making, (b) a regional approach, and (c) acquisition strategy.

Chapter 5 offers general recommendations and conclusions for U.S. global firms wishing to compete in the European Community.

Chapter 6 focuses on the U.S.-EC business relations in the area of telecommunications services industry to illustrate some potential strategies U.S. firms could use to enter the EC.

CHAPTER 2. BACKGROUND OF THE SINGLE EUROPEAN MARKET

INTRODUCTION

Currently, Japanese-American trade relations are grabbing most of the headlines. However, as the European Community (EC) edges closer to the realization of a single market, more attention is turning to the opportunities--and the challenges--likely to face Americans seeking to do business within the EC.

With rapid European integration, there is a growing interest in this emerging market of 345 million people destined to be the largest in the industrialized world. The dismantling of Europe's borders has attracted increased numbers of U.S. corporations to the Community. Many U.S. firms are looking to take advantage of the unified market, and are rapidly adopting a pan-European outlook and commitment. They must be prepared for the challenge of the post-1992 EC and plan new strategies.

The European Community is unique. It is the concrete expression of a common desire by the sovereign nations of Western Europe to work and live together. Over four decades, its member states have learned first-hand the advantages--and the constraints--of European integration. Since the creation of the European Coal and Steel Community in 1952, EC countries have gradually added a European dimension to their national structure in trade, economics and, more recently, politics.

As the European Community approaches the 21st century, it is fulfilling the ambitious dreams of its founders of 40 years ago to bring together the nations of Europe in peaceful union. Created in 1952 by six war-ravaged states, the Community is now a reality. Its 345 million people enjoy democratic freedoms and living standards which are matched by few other countries.

THE DEVELOPMENT OF THE EUROPEAN ECONOMIC COMMUNITY

Historical Development

With the influence of French politician Jean Monet, the European Coal and Steel Community established the framework for European integration in 1951. The original six members of the Community--Belgium, the Federal Republic of Germany, France, Italy, Luxembourg, and the Netherlands--subsequently signed the Treaty of Rome in 1957. The treaty formally established the European Economic Community (EEC). The principal aim of this treaty was to create a region with free movement of goods, people, services, and capital, and ultimately to form a political union.

The creation of the European Economic Community under the Treaty of Rome was the first step in a major new advancement toward freer economic exchange. Its main provisions can be summarized as follows: (a) Tariffs, quotas and other barriers to trade would be gradually eliminated; (b) restrictions on the movement of services, labor, capital and business enterprises would be abolished and payments freed; (c) the members were to coordinate monetary and fiscal policies; (d) a common agricultural policy was to be established; (e) two investment funds would be established to channel capital from the more advanced areas to the less developed regions of the community.

Following the signing of the Treaty of Rome, trade barriers began to fall, thus contributing to Europe's strong economic performance over the subsequent fifteen years. In July 1968, all customs duties were removed for inter-EC trade and a common external tariff was established.

In January 1972, Denmark, Ireland, and the United Kingdom joined the EC. In March 1972, the "snake" exchange rate system was established, setting narrow margins for exchange rate movements among EC currencies, while maintaining fixed, but wider, margins against the dollar.

The period from 1973 to the early 1980's was marked by a slowdown in economic growth due to the oil price shocks in 1973-74 and 1979. Partly because of these events, integration slowed or even reversed, as member states levied new border taxes, reintroduced trade quotas, increased subsidies, and established indirect barriers against both outside countries and other EC countries. Nevertheless, the European Monetary System (EMS) was established in March 1979. Greece joined the EC two months later. Finally, Spain and Portugal became members in January 1986.

The movement toward integration resumed in the 1980's under increased pressures from international competition (from the United States and Japan) and high unemployment rates. In the mid-1980's, the EC launched a systematic program to eliminate trade barriers and create a single European marketplace. The 1985 White Paper, officially known as "Completing the Internal Market" established the program to create a single European marketplace for goods and financial services. Three hundred directives were included to eliminate barriers to the free movement of goods, people, services, and capital among the 12 EC member states. Ratified in 1986, the Single European Act adopted the White Paper, amended the Treaty of Rome, and set 1992 as the completion date of the Internal Market. However, beyond its symbolic value for the EC, the year 1992 did not see the completion of all directives for Europe 1992, but rather represented the beginning of a long-term unification process.

The Present Situation And The Tasks Ahead

At the end of 1992, the Community formally became a single market. Goods, services, people and capital can now move freely as if within a single state.

The EC nations ratified the Maastricht Treaty, signed in February 1992, which will to transform the single market into a European Union. The main characteristics of this union will be a single currency and a more federalized political structure. Parallel to the ratification process, the Twelve are setting new rules for financing the EC's priorities.

Over the next few years, the Community will welcome new members, several of whom have already submitted application bids. Others will follow. It will have a special task in supporting the difficult process of economic and political reform in Eastern Europe and the republics of the ex-Soviet Union. Its Mediterranean neighbors as well as other countries of the Third World are also looking to the Community for cooperation and financial support. Immigration pressures will test the limits of traditional EC hospitality.

The Integration Of The Different Markets

Since January 1993, people, goods, services, and capital are no longer restricted from moving freely across European borders. Following is a summary of the major remaining barriers to be removed in order to achieve full economic integration.

Labor Markets

A Community citizen is no longer restricted in exercising his rights of free movement throughout the Community. As for the rights of establishment for professional people, progress has been made. People should not find obstacles to work in a Member State other than the one in which they received their qualifications and experience.

Goods Markets

Technical barriers must be removed including differing health, safety, and environmental standards. Common standards in the procurement process will open up bidding on public contracts, which represent about 15 percent of the EC's gross domestic product.

The second type of barrier consists of fiscal obstructions, such as differences in tax rates. The EC proposes to standardize value-added tax (VAT) rates by establishing two ranges of tax rates.

The third type of barrier consists of physical barriers, or border controls. Truck drivers are already allowed to pass through customs by showing a single document.

Financial Markets

The EC is planning a single market for financial services. Capital controls will be eliminated, and banks that are licensed in one country will automatically be allowed to establish branches in any other EC country. Many kinds of capital market controls will be eliminated, and banks will be allowed to operate throughout the EC under a single banking license. Eventually, a common set of banking regulations will likely emerge within the EC.

The European Monetary Union will result in better allocation of financial resources, lower financial costs, and diversification of forms of investment and credit that will benefit users. In 1987, the European Commission acted upon increasing European cooperation by strengthening the European Monetary system mechanism. It also agreed to upgrade the community surveillance procedure, and to make more active and concerted use of all the available tools (i.e., intervention, exchange rate fluctuations and interest rate changes).

The process of monetary unification consists of three stages. The first stage came into effect on July 1990, a date coinciding with the deregulation of capital movements in several EC countries. Stage one is devoted to the improvement of existing procedures of consultation between member countries on both economic and monetary questions.

The second stage is scheduled to begin in January 1994. An actual bank called the "European System of Central Banks" will be set up, its role being to strengthen coordination of monetary policies, to "oversee the development of the European Currency Unit," and to get accustomed to the tools and procedures it will need when it runs monetary policy in stage three.

The third stage would consist of the development of a common monetary policy, the pooling of official reserves, the convergence of economic policies by reference to binding budgetary indicators, and the adoption of a single currency.

Like goods market integration, financial market integration is moving ahead to finally reduce burdensome financial regulations.

Obstacles To A Unified Europe

The European marketplace is fragmented with its multiplicity of regulations, economic conditions, cultural preferences, and tensions; therefore, members of the EC have difficulty in agreeing to new regulations. For example, Denmark voted against the ratification of the treaty of Maastricht in June of 1992. The French voted in favor of the treaty but with a weak majority.

In 1993, French opposition to an accord in the General Agreement on Tariffs and Trade (GATT) talks was placing unprecedented strain on the Franco-German alliance, which has been the cornerstone of the European Community for the past 40 years.

THE COMPETITIVE MARKET

This section describes the European market with its potentiality, the rules of the competitive game within the market, and finally, how U.S. firms can prepare for this challenge.

The European Market

The twelve members of the European Community are now the U.S.'s largest market for exports as it is shown in Table 2-1. In 1992, they bought 25 percent of the United States' exports, more than the 21 percent share of exports to Canada and substantially more than the 12 percent to Japan. Moreover, the EC nations buy high-technology exports. In 1988 some 45 percent of U.S. exports to Europe were classified as high-tech goods, while only 29 percent of United States exports to Japan fell in that category.

Europe is also a major destination of U.S. investment. In fact, the share of the United States direct foreign investment stock in the twelve member countries has risen from about 18 percent in 1960 to 41 percent in 1992.

Table 2-1. Merchandise Trade between U.S. and EC

YEAR	U.S. Exports to EC		U.S. Imports from EC		Trade Balance
	Billion of dollars	Percent of U.S. exports	Billions of dollars	Percent of U.S. imports	Billion of dollars
1960	06.0	29.2	03.5	24.1	02.5
1965	7.9	28.8	5.2	24.2	2.7
1970	12.3	28.5	9.7	24.3	2.6
1975	25.9	24.1	17.8	18.4	8.1
1980	58.7	26.2	37.9	15.2	20.8
1985	49.0	22.7	67.8	20.1	-18
1992	98.0	24.9	91.9	18.6	6.2

Source: Economic Report of the President, U.S. Census Bureau, Statistical Abstract of the United States (Washington, DC: U.S.G.P.O., 1993).

Table 2-2. U.S. Direct Investment In The EC

	1960	1970	1980	1985	1992
Direct investment in the EC (\$billion)					
Petroleum industry	1.6	4.7	17.2	16.4	18.8
Manufacturing	3.6	12.6	43.4	43.7	81.3
Banking, Finance, etc.	na	na	8.9	14.2	48.2
Other industries	.8	3.5	10.3	9.8	24.7
All industries	6.0	20.9	79.9	84.0	172.9
Total U.S. direct investment abroad	32.7	78.1	213.4	229.7	421.5
Percentage of total invested in EC	18.3	26.7	37.4	36.4	41.0
Estimated yearly sales by U.S.-owned affiliates in EC	29	102	392	412	447

Source: Economic Report of the President, U.S. Census Bureau, (Washington, DC: U.S.G.P.O., 1993).

The value of U.S. direct investment in the EC countries has grown substantially faster than the value of U.S. exports to the EC. Furthermore, in 1992, sales of U.S.-owned affiliates in the Community came to \$447 billion, compared with just \$98 billion for U.S. exports to the EC countries.

From an investment perspective, the EC is highly attractive to American companies. It is definitely "Opportunity Europe," not "Fortress Europe." European nations usually welcome foreign investors, the EC policy on competition is favorable for newcomers, and foreign firms established within Europe enjoy numerous opportunities to participate in shaping the internal market. Whatever problems the EC may hold for U.S. exports, it does hold great promise for General Motors, American Telephone and Telegraph, Merck, International Business Machines, and a long list of other U.S. firms with a strong presence in Europe (Friberg, 1989).

The European market is already the biggest export market for U.S. telecommunications suppliers. In 1988 the United States exported \$1.3 billion of equipment to the EC, compared with \$600 million to Japan and \$800 million to Canada. However, American exports to Europe could be much larger. The EC telecommunications equipment market, which amounted to \$175 billion in 1986, is expected to grow 67 percent by 1995 (by comparison, the U.S. market is expected to grow only 23 percent) (Hufbauer, 1990).

The European Community is a growing market that will offer even more business opportunities in the future. While there will probably not be many new full members in the community, numerous nations will be associated by bilateral arrangements of various types. Agreements are likely to be negotiated establishing free trade ties with Switzerland, Finland, and some Mediterranean countries as well as with Austria.

On a more limited scale, the countries of Eastern Europe are also likely to have economic ties with the EC through trade expansion and liberalization. The net result will be

an expanded economic area in Europe, centered on the Community ("Redefining Europe", 1991).

By the end of this century it might be possible to envision a Europe of concentric economic circles: (a) The EC at the core; (b) several neutral countries and nations in the Mediterranean region, enjoying particularly close economic relations with the EC, along with frequent consultations with the Council of Ministers and European parliament on a range of economic and political matters; and (c) some East European nations, and perhaps even the countries that were formerly a part of the USSR, having arrangements with the EC that permit substantially increased two-way trade, along with investment treaties to encourage new and joint ventures.

Associate membership might also be possible for those whose reforms over time lead their economies to operate largely on the basis of market forces. This structure could form the basic architecture of the "common European home," with significantly high market opportunity potential. The sooner U.S. firms develop operations throughout Europe, the more likely they are to benefit from further economic agreements with other non-EC countries. These firms will then gain experience and be able to use the networks they have already developed within the European Community.

The European Legislation

Main Legislative Concerns

U.S. businesses should understand the roles of the various EC institutions in order that they will know how to influence these institutions. This section has been compiled from various sources, including: Roney (1990), U.S. International Trade Commission (1993), and KPMG Peat Marwick (1989).

The main EC institutions are: the Council of Ministers, which has final decision-making authority; the European Commission, which formulates policies and legislation and implements decisions of the Council; the European Parliament, which advises the EC on

policy development and proposals emanating from the Commission; and the European Court of Justice, which interprets the EC treaties and legislation.

The European Commission's major responsibility is to oversee the implementation of the EC treaties and applications of decisions by Community institutions. The Commission initiates EC policy by making proposals to the Council of Ministers and steers its proposals through the Council. It has extensive decision-making powers in the application of EC competition rules and anti-dumping procedures against imports into the EC.

The European Council includes the Heads of State and Government and the President of the Commission. The Council is the most important EC institution since the Single European Act introduced majority voting on most issues

The European Parliament is the only EC institution that directly represents European citizens. It serves as a public forum to debate issues of importance to the Community. The Commission must consult the Parliament before proposals are forwarded to the Council of Ministers for a decision.

The Court of Justice is the highest judicial body. Its judgments are binding on member states.

Influencing The EC Legislation

U.S. businesses can influence the adoption of EC legislation at many stages in the overall process.

Influence the Commission. The EC commission is a body of one thousand civil servants who fill functions comparable to those of the U.S. government. It is open to suggestions and welcomes discussions with businesses on how to improve the operation of the single European market.

Contact standard-setting bodies. Various standard-setting bodies play a fundamental role in preparing draft legislation. Advice on how a U.S. business can get

involved in developing standards can be obtained from the appropriate industry trade association. Two of the better known standard-setting bodies are the European Committee for Standardization (CEN) and the European Committee for Electrotechnical Standardization (CENELEC).

Influence the European Parliament. The views of the directly elected European Parliament are important and can substantially affect the terms of EC legislation. European committees report to the full Parliament which can either approve or reject the committee's findings. However the Parliament is usually heavily influenced by the committee's report.

Influence the Council. If enough Ministers disapprove a proposal it cannot be adopted. Though time consuming, approaching national administrations is often the best way to prevent the adoption of unfavorable EC proposals.

It is possible for U.S. companies to participate in these activities without maintaining a full time presence in the EC. Organizations such as the American Chamber of Commerce in Brussels have proven valuable in gathering and analyzing information, and can often lobby effectively on behalf of their members.

Competition Policy In The European Community

The European Community has consistently made competition policy a high priority since its creation 35 years ago. The Community has put in place a set of rules to make sure that firms compete on a fair basis throughout the EC. As competition and price-cutting do not always come naturally to firms whose first duty to shareholders is to maximize profits, rules also ensure customers get the benefits to which they are entitled. Historically, these firms often sought to form anti-competitive cartels to share markets between them or to keep prices artificially high or to block newcomers from breaking into their markets. Governments also distorted competition by subsidizing some firms so that they gained an unfair competitive advantage over their rivals. In the early 1990's, the European Commission investigated well over one-thousand alleged breaches of Community rules. It

has the power to order illegal practices to cease and to impose fines on the most serious corporate offenders.

Because the community has created a single market open to firms in all Member States, it has developed a single set of competitive rules which apply at EC level. These rules are aimed at safeguarding consumers by preventing companies and governments from behaving in ways which restrict competition. The rules applying to companies cover all firms--European and non-European--selling goods and services in the Community. Firms based outside the Community are in breach of the rules if any anti-competitive behavior they adopt is then implemented in the EC market.

The Impact Of The Competition Policy

In the air transport sector, prices have fallen sharply on routes where competition has been introduced, e.g., London-Amsterdam or London-Dublin. In telecommunications, the introduction of competition has stimulated the development of innovative customer-related services and a greater diversity of terminal equipment at lower prices.

Nevertheless, charges remain high for telephone services which are still largely under monopoly control, with considerable differences between Member States for the same service. EC charges over the same distance are higher than those in the deregulated American market. Within the Community, long-distance calls inside a Member State over a certain distance are cheaper than a call over a similar distance which crosses a national frontier. Cross-border calls are often between two and a half to three times more expensive.

Impact On U.S. Firms

The United States and Europe are already tightly linked in terms of economic interests. Nevertheless, the U.S. has not always shown much interest in European affairs. Washington has rarely commented on the EC's plans for monetary and political integration. At the 1989 economic summit responsible for coordinating aid to eastern Europe, the U.S.

subscribed only a tenth of the capital for the new European Bank for Reconstruction and Development.

Only a few number of large U.S. companies have plans to deal with the marketplace changes that will occur as a result of the greater economic integration within the EC. Many companies appear to be more concerned with the competitive impact the 1992 program had on EC companies operating in the U.S. than with the opportunities and threats that the 1992 program poses for companies competing in the single European market. Paul A. Brandstad, Booz Allen senior vice president and manager of the firm's national strategy practice, observed that "too many U.S. corporate managers are still not global in their thinking. When they do think internationally, they suffer from a U.S.-centric view, which finds its roots in the American-dominated post-World War II world economy" ("Faraway continent," 1990).

David B. Schoenfeld, vice president at Federal Express, has stated that "Even if a manager has no plans to do business in Europe, he should be aware that European companies will not stay on their side of the Atlantic" ("Unprepared for '92," 1989).

As the EC tightens its standards and eliminates inefficiencies, European companies will operate in an increasingly healthy market, and will be enticed to expand activities outside Europe. The challenges for U.S. companies include a changing business environment and stronger competition. The EC's aim in promoting a truly European market is not to have European industry eat up the internal market and savage each other in that internal market. The idea is to have a bigger, and better, and more efficient player, with which to compete at an international level.

Initially, European businesses will move from their traditional national bases across borders into new markets. In responding to the opening of new markets, the European private sector is developing new business strategies, new distribution systems, new

computerized support systems and new business alliances (Linville, 1990). American business should carefully monitor these trends.

There are some aspects of the single European market that may be of particular importance in their impact on U.S. businesses (U.S.G.O.P., 1993).

Intellectual property rights will be protected. The European Court of Justice has developed a set of rights that holds that property lawfully marketed in one member state can be freely marketed and protected in other states. This means that manufacturing and high technology companies must be aware of the various degrees of intellectual property regulations to protect themselves against infringement and to comply with the EC's complex rules on parallel imports.

Local content is a concept still being defined. U.S. firms intending to assemble products in the EC that have been manufactured elsewhere need to stay continuously abreast of EC regulations and Court of Justice cases pertaining to anti-dumping rules so as to avoid anti-dumping duties. The legal interpretations of these rules will undoubtedly require several years before they stabilize.

Fortress Europe or world trading partner. The Single European Program appears to provide free market access to companies formed according to the laws of the member states. However, manufacturing and high technology businesses should be prepared to face a variety of choices in how they perfect their access to the EC market. Whether they operate through a joint venture, subsidiary or branch will largely depend on the political sensitivity of the industry they are in.

Reciprocity will affect the right of establishment. Reciprocity requires that before a non-EC company can locate in Europe, EC companies must have the right to establish themselves in this non-EC country. The EC has guaranteed that existing subsidiaries in Europe will not be deprived of rights they have already acquired. Open to interpretation is how companies that were not in Europe before 1992 can establish themselves in Europe.

Merging with or acquiring an EC business could prove to be complex. Over the long term, their potentiality will be three sources of merger regulation: EC regulations, member state regulations, and regulations of the respective stock exchange. U.S. businesses intending to operate in the EC will need to periodically review regulatory and judicial developments.

CHAPTER 3. BUSINESS ENVIRONMENT ISSUES

January 1, 1993, marked the EC's self-imposed deadline for the completion of its internal market. About two hundred and thirty-three of the White Paper measures adopted by the EC Council were in force as of the beginning of 1993 (EC Commission, 1993). The unified market must be considered as an additional issue faced by multinational corporation managers in the decision-making process. The single market gives a new shape to the relations between parent and subsidiaries in multinational corporations and raises the issue of the appropriate degree of centralization versus decentralization.

The unified market presents not only corporate management but also organizational structure with a most unusual challenge. There has been no previous experience where this kind of change has occurred in one of the world's biggest market areas. Many managers will find that their marketplace in Europe has changed, in a remarkably short amount of time, from a neatly segregated series of geographic markets into a highly confused and competitive marketplace. During this process all kinds of existing relationships and stable situations will become variables. According to David Mitchell (1989), "...many existing techniques and management habits will be as inadequate as a Second World War tank on today's battlefields."

Corporate management will have to cope with a myriad of new strategic questions enveloping the company in the process of change.

Approximately 280 pieces of legislation will be implemented by the European Commission in order to fulfill the provisions of the Single European Act. A new strategy for management will require focus on the following issues.

CHANGES AFFECTING THE BUSINESS ENVIRONMENT

Changes affecting the business environment can be characterized as either opportunities or threats. These changes are as follows:

Increased Market Opportunities

Overseas global competitors sensing a potential new market opportunity will enter the market with money and a determination to take a significant share. More market opportunities from a unified market are expected by executives. According to Sandra Vandermerwe (1989) and the Directorate-General (1988), multinational corporations expect: (a) a huge pan-European market receptive to standardized goods and services; (b) niches, previously small, to become larger and more lucrative; (c) products and services to get to markets more quickly, and therefore more rapid diffusion and shorter life cycles; (d) as a general rule, more homogeneous markets, but at the same time complex; and (e) the emphasis to switch from a national market focus to a regional market focus, i.e., not necessarily along political boundary lines.

The Threat Of Intensified Competition

With domestic corporations' concerns, acquisitions and joint venture arrangements will be more numerous as companies try to reach a viable market share. Family-owned concerns too small or too local to compete with companies accustomed to the European market, and not having a clearly defined and defensible small niche position, will be up for sale.

Vandermerwe (1989) and Larreche et al. (1989) highlighted "insiders" concerns about increased competition in their own long-held domestic markets. The most common concerns include: (a) unfair competition from state monopolies competing across borders; (b) the entry of competitors from other countries, some better equipped to operate in the new market; (c) fierce competition from the low wage countries; (d) the rise of new competitive groupings and large alliances as rivals; (e) competition from competitors from

other countries applying lower standards; (f) tough competitive pressure from third-party, high value-added, niche operators; (g) the emergence of supra-nations and supra-corporations and a consequent increasing gap between the smaller companies and the large global firms.

Certain to emerge is also the rapid intensification of price competition. In industries as varied as chemicals, consumer packaged goods, and financial services, there are massive price differentials between countries for the same products. A Volkswagen Golf before taxes in 1992 was 35% more expensive in Britain than in Denmark and 29% more expensive in Ireland than in Greece. A major European manufacturer of chocolate bars sells one brand for 26% less in Belgium than in France and Germany (Friberg, 1989). Vastly different tax rates can make disparities in final consumer prices even more dramatic.

Price variations of this magnitude simply have no justification in the costs of raw materials, manufacturing, or logistics. They are unlikely to prove sustainable in a more competitive environment. Opening borders to foreign producers will further increase competition.

Overall competition, as encouraged by EC policy, is becoming considerably tougher. The prospect of severe price declines (and the consequent impact on corporate earnings) is pushing industry after industry into a search for greater efficiencies. A search that will usher in a period of painful and dramatic restructuring. Sir John Harvey-Jones, former chairman of the U.K. chemical giant, Imperial Chemical Industries, has predicted that within ten years, half of Europe's factories will be closed and half of its companies will disappear through sales or mergers (Harper, 1992, p. 142). This forecast may be too dire, but the pain (as well as the efficiency gains) will be very real indeed. The frantic restructuring that followed airline deregulation in the United States and privatization of steel production and air travel in Britain offers clues to what Europe can expect (Friberg, 1989)

With multinational corporations' concerns, the unified market of 1992 will be extremely competitive. According to James O'Toole (1989), the Europeans will not stress the labor-intensive, consumer-product industries which multinational corporations have already lost to Asia. Instead, Europeans will concentrate on high technology, where the U.S. has enjoyed a comparative competitive advantage since the end of World War II. Moreover, there is reason to believe that this European challenge could be particularly effective as the recent incursions into the American market of Scandinavian, German, and French telecommunications producers, software purveyors, and other high-tech companies portend.

The Threat Of A Clumsy Transition And Non-Compliance

L'huillier and Vandermerwe (1989) indicate that some executives anticipate a lack of uniformity in attitude, knowledge, understanding and purpose. They see this as a potential threat to both their competitive ability and the whole system. The main trends include: (a) The possibility of double standards in some countries; (b) a lack of commitment and "full-hearted" support, for unification; (c) evasion and non-compliance of the new legislation; (d) a "piecemeal" approach due to lack of knowledge; (e) informal protection and blockages; (f) discrepancies in interpretation due to cultural differences and languages. European companies accustomed to thinking in local terms may find difficulties in adapting their thinking. According to David Mitchell, many are too aware of the differences in national cultures. Global competitors have the advantage of a mental approach unencumbered by too much distracting local knowledge; (g) insufficient education and preparation of managers; (h) delays in the dismantling of barriers, and differences in speed between countries and sectors.

The Threat Of Protectionism

According to Alberto Zanzi (1989), American businesses see the new single market as an opportunity and a threat. The hope of operating without the internal barriers is

tempered by the fear that once those barriers have been eliminated, the European Community will erect external ones to protect its market.

Indeed, the EC shows an instinctive protectionistic reflex reaction against outsiders. This could manifest itself in difficulties with imported components and in new competition from outsiders trying to establish themselves in the EC (Friberg, 1989). For example, France and Italy protect their domestic auto companies with strict restrictions on Japanese imports. Allowing the import market share in protected countries to rise to the European average of 15% would reduce local production for some auto makers by 50,000 to 200,000 cars per year, or between 3% and 10% of their worldwide volume (Friberg, 1989).

Meanwhile, European governments are growing less tolerant of anti-competitive practices. Most large chemical manufacturers, who are already world class competitors, are reluctant to redirect strategies.

However, this fear of fortress Europe may be understood as an overreaction to the crisis of self-confidence that followed the end of the Reagan "super dollar." Aarnoult A. Loudon, chief executive officer of Akzo N. V., a Dutch conglomerate that has been expanding its international marketing of chemicals, industrial fibers, paint and healthcare products asserts, "If we will really become protectionistic and really become Fortress Europe, that would be completely contrary to what Europe is set to do and why we are creating this single European market" (Melloan, 1989).

Kahle (1991) concludes that most problems and threats come from the difficulty of establishing fair competition and of overcoming national egotism.

CHANGES AFFECTING MARKETING

Market shares will have to be measured in averages across Europe rather than by individual countries. Competitive vulnerability may increase substantially.

Buyers in most sectors will seek out the cheapest source. This will mean that differential pricing among countries will no longer be sustainable. Trade purchasing

functions will acquire even more leverage as retailers consolidate fragmented situations and extend their chains. Some companies may also find that their long standing distributors have been acquired by somebody else (possibly a competitor).

According to David Mitchell (1989), distribution cost structures will also change drastically as national transport quotas are abolished and Europe-wide competition cuts rates. Previously cost-efficient arrangements could well become irrational and expensive. Advertising could be due for a reassessment as companies distinguish between national habits (which are reasonably easy to influence), and images (which are difficult and expensive to change). Hector Laing, the chairman of United Biscuits, argued long ago that: "the most important assets are brands" (Mitchell, 1989).

CHANGES AFFECTING ORGANIZATIONS

Organizations which have developed over a period of time in Europe on a multicountry basis or a matrix arrangement are in danger of looking more complicated and expensive than those of some of the powerful global players who will be attracted into the Euromarkets, and who may adopt a simpler approach (Mitchell, 1989).

Each part of the business system or value chain will have to be examined in case it has been rendered obsolete, irrelevant or non-competitive. This applies for example to all marketing functions, finance and manufacturing locations. The following should be considered:

1. Excessive bureaucracy: An excessive bureaucracy is also looming in the Europe of the 1990's. "Insiders" mention the possibility of excessive bureaucracy from regulatory bodies "enforcing" the system (L'huillier & Vandermerwe, 1989). They see this as the consequence of potential country-for-country authorities, rather than a single EC authority.

2. Saving of time and energy: However, European managers recognize that post-1992 EC will allow time savings, elimination of wasted energy, human resources, and money, that have, in the past, partly contributed to a loss of their competitive edge.

CHANGES AFFECTING PEOPLE

Even with the removal of physical border controls, a Community citizen may be restricted in exercising his rights of free movement throughout the Community. Even after he has crossed the frontier into another Member State, the Community citizen may still be restricted in what he can do there. A major set of problems arises from differences in recognition of degrees and certificates, to vocational training or to professional qualifications. Education, of course, remains primarily a matter of national policy, but the first steps have been taken to tackle common problems and to see how mobility can be improved by a coordinated approach. At the moment different approaches to education and standards mean that the qualifications of students are not yet always recognized in other member states. At the same time, multinational corporations will find it necessary to retrain or change their personnel. For example, purchasing officers and human resources executives will have to become Euro-wide in responsibility. The demand for Euro-executives may rise. Headhunters will put up the price and established companies may be vulnerable to the loss of key personnel (L'huillier & Vandermerwe, 1989).

Managing directors could find themselves becoming coordinators and national representatives of their companies. They will remain company leaders but they will have to share authority with Euro-executives. The companies employing sophisticated position evaluation systems may find that the removal of key strategic decisions reduces the points rating of national executives for salary review purposes (O'Toole, 1989).

This section examined the Internal Market Program and how it impacts U.S. companies. It pointed out specific changes U.S. firms are facing with the development of "1992," e.g., changes in organization, marketing, people, and distribution. It will, thus, be important for U.S. companies to develop strategies for competing in the "new Europe." The next chapter looks at the different strategies global firms are developing in response to the competitive trends in the single European market.

CHAPTER 4. ORGANIZATIONAL STRUCTURE FOR THE SINGLE EUROPEAN MARKET

Generalizing about how various companies are responding to the single EC market is difficult because the European program impacts different sectors in different ways. Despite these variations, the analysis conducted for this research revealed several common threads in corporate strategies. This chapter examines three distinct strategic options for U.S. global firms to exploit the opportunities stemming from the move toward the Single Market: (a) decentralized decision-making, (b) acquisition strategy, and (c) a regional approach. These options are not mutually exclusive, but each focuses on a different aspect. The first section highlights the need for global firms to adopt a decentralized decision-making structure in order to face a looming, stronger and unified Europe. The second section presents the acquisition approach as an attractive tool for expansion in the EC. According to Friberg(1989) a wave of mergers and acquisitions is sweeping the continent. Many of these mergers are attempts by companies to consolidate strengths in core markets before expanding across the continent. The third section is an overview of the regional approach, focusing on the management implications.

TOWARD DECENTRALIZATION

In a survey of CEOs from 400 companies worldwide, the majority have introduced a strong element of decentralization into their decision making process and organization. About three-fourths of the survey respondents believe that decentralization improves the functioning of the company. Yet they also felt that it imposes a special management challenge in terms of ensuring uniform strategic vision and cooperation among different subsidiaries (Dreyfus, 1992).

The Single European Market offers management a good opportunity to seize a competitive advantage by focusing on the key areas that offer the greatest reward for skillfully applied change. This change means adopting the appropriate structure and choosing between centralization or decentralization for managerial decision-making. In a unified and highly competitive Europe, centralization presents serious limitations which have been stated as follows: (a) the headquarters may be too remote from the scene, (b) the headquarters may not be sufficiently aware of the key parameters in the national environment and competition, (c) the headquarters may impose overly rigid control, (d) the headquarters may impose unrealistic objectives and strategies on overseas affiliates, (e) the headquarters-imposed plan may not obtain enthusiastic support from the subsidiary (Hodgetts & Luthans, 1991).

Taking into account the variations between national markets, there is a need for decentralization. Indeed, many European-based organizations are prepared to enter a new competitive battle in the relatively demanding conditions of segregated markets. The elements of an effective organization to capitalize on opportunities in the EC include: (a) A division of the company into clear business units, each having their own objectives; (b) an organization and control system designed so that there is minimum need for referral from one division to another or to the headquarters; (c) a preference for duplication rather than complexity; (d) a realization that it is evolving into a single market with no borders; (e) the use of maximum spans of control so that people will be forced to concentrate on essentials as well as ensuring minimum levels in the hierarchy; (f) central services which serve the operating units.

The worldwide dispersion of the multinational units stresses the obvious constraints of distance, time and travel cost. Moreover, there are serious cultural barriers including language, beliefs, and attitudes. During the eighties, multinational corporations continued to expand--especially U.S. multinationals--and the problems of the decision-making

process, including issues of centralization versus decentralization were extensively discussed. An urgent need for responsiveness can be seen from the following (Hodgetts & Luthans, 1991): (a) The subsidiary is closer to the scene and more familiar with specific crosscurrents in environmental and competitive changes; (b) the diversity in consumer tastes, distribution channels and advertising media between countries requires that the subsidiaries be sensitive to national parameters; (c) the subsidiary executive is more likely to formulate realistic objectives to achieve goals which take into consideration local variables than is the multinational management; (d) self-initiative is more stimulating and challenging.

On the other hand, there may be significant drawbacks to decentralized strategic planning: (a) Executives of the subsidiary may have too narrow a perspective and may not sufficiently consider the company's worldwide objectives, policies and top management's point of view; (b) they may be too deeply immersed in the day-to-day operational problems to give adequate attention or emphasis to strategic planning of their divisions or affiliates; (c) the subsidiary tends to develop and optimize sub-goals; (d) complete decentralization denies the subsidiary the breadth of resources of the parent organization.

Many U.S. firms lean toward decentralization, pushing decision making down the line and getting the lower-level personnel involved (Hodgetts & Luthans, 1991).

The single European market has underscored local, regional, and national differences in consumers' tastes and preferences. As it brings down EC barriers in particular, and as business becomes more global in general, production and distribution for many companies are more likely to become more centralized, but marketing and sales will become more localized (Harper, 1992).

The greater the amount of product and service diversification, which is the case in Europe, the greater the need will be for decentralization. The move toward decentralized operation is the logical organizational response to the effect of modern technology on the

interaction between individuals within a company and between divisions of that corporation.

The last ten years have seen an increasing trend away from rigid, top-heavy managerial hierarchies and a swing toward more flexible and independent divisional operations within the firm (Devinney & Hightower, 1991).

Devinney and Hightower (1991) conclude that the ideal European company is flexible and decentralized. They present three key strategies for achieving a smooth transition from a centralized to a decentralized corporate structure. They cite the Allen Bradley case, in which reorganization reduced the number of layers in management by several folds and which organized operations and sales by country with pan-European overview. Burgenmeier and Mucchielly (1991), Calori and Lawrence (1991), and Dreyfus (1992) give many examples of successful moves toward decentralization.

At GE, the entire second and third echelon of management was removed in the mid-1980s. Staff functions were redefined dramatically from monitoring, control and approval to facilitating the job of line managers through partnership.

The current trends in the management of multinational corporations facing the Single Market resist classification under neat headings like centralization or decentralization. Indeed, centralization varies greatly according to the various functions. The degree to which the subsidiary will be centralized or decentralized depends on the various functions of the company, ranging from marketing to personnel function.

THE ACQUISITION APPROACH

In the challenging 1990's, the most common trend for multinational corporations willing to change their structure towards decentralization of control is the acquisition approach. Most companies will find themselves unevenly positioned across Europe with heavy concentration in some countries and not in others. In some cases they will have unbalanced inter-EEC export positions, leaving their flanks exposed to all kinds of

competition. Most of those companies are trying to correct this situation by means of acquisitions. In anticipation of a more unified market, the organizational structure of multinational corporations is on the verge of major changes. A wave of mergers and acquisitions is sweeping the continent.

Carlo De Benedetti's battle for Belgium's Societe Generale or the bidding war between Nestle and Jacobs Suchard for Rowntree, the British chocolate maker, was unthinkable a few years ago. Pearson and Elsevier, the British and Dutch publishers, joined forces to deter Rupert Murdoch (Friberg, 1989).

Many of these mergers are attempts by companies to consolidate strengths in core markets before expanding across the continent. Banco de Bilbao and Banco Vizcaya, Spain's third and sixth largest banks, have combined to form the only Spanish bank to rank among Europe's top 30. European companies outside the Community are making similar moves. Altogether, there were 140 "national" mergers between June 1, 1984 and May 31, 1985 among the top 1,000 companies of the European Community. The comparable figure for 1987 and 1988 was 225 (Hill Samuel Bank, 1989).

In addition to this wave of consolidation there has been an acceleration of "cross-border" combinations from fewer than 50 between June 1, 1984 and May 31, 1985 to well over 100 between 1987 and 1988 (Hill Samuel Bank, 1989). These deals represent the strategic bets European Chief Executive Officers are placing on the evolution of a truly unified market. Nestle has acquired a cluster of food companies in Europe and in the United States, including Buitoni, Rowntree, Hills Brothers Coffee, and Carnation. In consumer electronics, where global competition is especially intense, the Dutch giant Philips has acquired Grundig, the German television manufacturer, while France's Thomson has acquired Thorn EMI's British television operations (Hill Samuel Bank, 1989).

Among the top 1,000 firms within the EC, the total number of national, community, and international mergers (including majority acquisitions) was 596 in 1990-91 compared to 415 in 1986-87 (EC Commission, 1992, p. 416). The number of mergers and acquisitions involving foreign firms (both within the EC and with third-country companies) outnumbered purely national mergers in 1990-91. This contrasts sharply with 1987, when national combinations were more than twice as numerous as international ones. Among foreign buyers, the most active countries were the U.S. (40 percent of the total), Switzerland, Sweden, and Japan (EC Commission, 1992, p. 417). A study indicated that cross-border acquisitions in the EC during the first 3 months of 1992 were up by a substantial margin ("Europe's sale," 1992).

Advantages

Acquisition seems to be an attractive approach, according to James O'Toole (1989), because it saves the time and the effort required to establish a wholly owned foreign-production facility strategy. Instead of starting from scratch, the multinational corporation will deal with an existing and controlled market and use contacts and previous strategies developed by the national company. Consumer target markets as well as laws, governmental restrictions and fiscal policies are already known and identified.

Disadvantages

Firms which venture in the EC should be well prepared in order to recognize the existing problems. The EC Commission adopted a proposal for Community-wide merger control. While admitting that a certain level of business restructuring would be inevitable, and indeed welcomed in order to match the Single Market program, it also stated that "It must be insured that the restructuring process does not result in structures which jeopardize the maintenance of effective competition" (Canna, 1988, p. 40). According to the proposal, contemplated mergers will have to be handled promptly. The Commission also noted that "mergers resulting in the establishment or strengthening of a dominant position

are incompatible with the Common Market". The proposed new regulation would require companies to give the Commission prior notification of large scale-mergers and would provide Commission officials with broad investigative powers. Although mergers could be prohibited if they either give rise to or strengthen a dominant position in the EC, the Commission can be expected to authorize mergers or acquisitions that would improve European productivity, distribution, or economic growth.

The Commission's efforts to gain control over mergers or acquisitions have been slowed down by member state opposition. Generally member states have been reluctant to let the Commission veto mergers they consider important to their national interest. At the same time, those member states with existing merger legislation have been unwilling to see their authority superseded by community-level legislation. According to Mosbacher (1989), "although the regulation provides for a "one-stop" procedure, it is not clear that all mergers would be free from challenges by member states." This problem of "double jeopardy" regulation could create legal uncertainty for foreign companies and specially U.S. companies seeking mergers in post-1992 Europe.

Some observers are also concerned that provisions allowing the Commission to approve mergers could make regulation a tool for industrial policy to discriminate against foreign mergers with European firms.

An Acquisition Strategy To Meet The Challenge

In order to meet the opportunities in the EC, a global firm which chooses to implement an acquisition strategy should characterize the following: (a) Have very clear, and above all, realistic ideas on what is going to be achieved by an acquisition in terms of post-1992 positioning; (b) have decided what is going to be the reporting status, degree of integration, and management changes; (c) devote time to communicating both with the acquisition's and the parent's employees, to ensure that expectations and speculation are controlled and that objectives are clearly understood; (d) avoid getting trapped into the

“must win” syndrome when competition develops to buy the targeted company; (e) avoid adding complexity to the organization (Devinney & Hightower, 1991).

THE REGIONAL APPROACH

For many companies, decentralization is not an appropriate strategic response to the emerging unified EC market. The options will depend on whether: (a) The company’s main experience comes from a country approach; (b) the company has historical, cultural or language links with specific countries; (c) the company already has extensive skills and experience across the EC. Businesses are pushing aggressively to rationalize their own operations and lock in the decisive advantages of continent-wide operations. BSN, the French food giant, which has pursued some acquisitions, built a yogurt plant near Lyon (France) that supplies the entire European market. Jacob's Suchard, the Swiss packaged-foods manufacturer, consolidated production of individual brands in specific factories to gain manufacturing scale. It recently closed one plant in Stuttgart (Germany) and another outdated facility in Paris and transferred production to plants outside of Basel and in Strasbourg. Meanwhile, it has equipped its remaining factories with state-of-the-art automation and flexible manufacturing systems to drive costs down even further (Friberg, 1989).

Reynolds Metals (U.S.) has reevaluated its European organization and is creating a strong central European base in order to coordinate its operations across the Continent. While many companies are looking at the value of having regional headquarters as a response to economic integration in the EC, Reynolds believes that Europe’s irrepressible economic, political and cultural diversity makes a European-based central management team essential (Dreyfus, 1992).

U.S.-based Loctite Corp. has divided the world outside the U.S. into three regions where its activities are focused. Each is managed by a regional vice president. Managers responsible for country operations report to the regional head (Dreyfus, 1992).

The regional approach is another potential strategy for meeting the organizational challenge. Devinney and Hightower (1991, p. 160) added that the move toward regional operations is most likely to occur in industries where production and distribution techniques are subject to economies of scale. Whereas, the retail operations and the demand for variety by customers, perhaps because of cultural differences in the EC, lead to more local marketing and service. In this section, the objectives of a regional approach and its implications for management will be developed on the following issues (Daniels, 1986, pp. 27-31).

Resources

The establishment of a regional office allows for the combination of resources from a group of countries' operations. For example, if resources from small subsidiaries are pooled for such functions as data processing, sales or marketing, fewer people are needed than if there were counterpart services performed separately in each of the countries.

Communication And Control

As far as communication and control between the subsidiaries and the headquarters of multinational corporations are concerned, it is easier to gain region-wide cooperation by staffing a regional office with personnel largely from the countries in the area than by imposing directives from corporate headquarters back in the United States.

By moving a group of corporate managers to Europe, the company can further save the time necessary to make connections across the Atlantic, prevent efficiency losses due to "jet lag," and overcome the problems of communications through different time zones. Managers can also be on the spot very quickly in case of trouble.

It is obvious that country operations would gain greater autonomy with fewer directions from managers at a regional or corporate level to managers at the country operating level. Daniels (1986) points out that with the regional headquarters, the company can better assure the achievement of its aim and also that its new product ventures will have

synergistic benefits with operations throughout the region. The establishment of a regional group allows a very fast dissemination of information from country to country. Because of the growing market homogeneity within the region, it is expected that there will be a growing ability to transfer successful practical experience from one countries to another. Regional management can quickly centralize results from all the countries in the area and communicate ideas and directives. If this information had to go through corporate headquarters the process would be too slow and corporate management might have to deal with too many countries to be able to grasp their common operating possibilities.

Reporting Structure

Another reason for establishing a regional office is to consolidate country operations by increasing the size of the reporting structure. A spokesperson would represent the European operations on corporate level committees to push for resources and day-to-day assistance. Otherwise, European expansion possibilities might be overlooked because of too much attention being paid to larger and more powerful corporate entities.

Public Relations

A major reason for the establishment of the regional office is the consolidation of public relations efforts. A unified external relation approach can result in a more complete message than if each of the subsidiaries, each product, or each country group were to take on the duties separately.

CONCLUDING COMMENTS

Finally, companies must develop flexible organizational structures and revise their information, reporting, and control systems to reflect the new competitive realities. Jacobs Suchard, for example, has overhauled its management structure, which was based on a hierarchy of business units, divisions, and country organizations. Computerized reporting systems and a new emphasis on entrepreneurship have enabled the company to eliminate an entire layer of management and establish direct contact between a 50-person head office and

all country general managers. Jacobs Suchard now reacts more quickly to local market needs and provides greater autonomy to its managers around the world (Friberg, 1989).

Being prepared to face the challenge of the Single European Market means adopting an approach of strategic positioning, focusing, control, organization and acquisition. However, as with any change process, in order for the transition to work the commitment must come from top management.

This chapter looked at how U.S. companies are organizing themselves for the single EC market. It discussed the move from centralized to regional headquarters, and the merger and acquisition strategy. The research showed that these strategies were the most popular among U.S. companies for dealing with the single EC market. The next chapter offers more general recommendations for U.S. global firms competing in the “new Europe.”

CHAPTER 5. GENERAL RECOMMENDATIONS FOR U.S. GLOBAL FIRMS

RECOMMENDATIONS

In general, developing single market recommendations should be easy. Companies simply need to know what the regulatory changes are, how they will affect the nature of their business, and the likelihood that such changes will be introduced. With this combination of information one can determine the appropriate recommendations. But alas, European reality is not so accommodating. The regulatory changes are not a given within the European bureaucracy, and if firms cannot understand the law's intent, understanding its outcome is even more difficult. Therefore the path to developing concrete recommendations is less certain.

Any recommendations must be based on an understanding of one's market, company, and external environment:

1. In the dynamic EC environment, the first recommendations are flexibility and adaptability. No one quite knows what direction that the single European market program will take with regard to any specific industry, and the events in Eastern Europe show how precarious world political and economic events can be. There has always been speculation that integration within the European Community will fail once a major recession hits some of the more critical players. A good example is the failure of the European Monetary System in August 1993. A company should have strategies made up of major scenarios and it should have considered the likelihood of each scenario and should have formulated its most likely response to each scenario such as the Single European Market (SEM) works, the SEM fails, the SEM disappoints, and the United States of Europe becomes a reality.

2. A second recommendation is seeking standardization and rationalization but respecting diversity of products and services. The reduction of non-tariff barriers between EC countries is a factor which allows companies to rationalize production, more efficiently map out distribution networks, and seek out the similarities in markets that can be initially exploited by existing products.

U.S. firms should have a local presence and stay close to consumers to respond faster to changes in taste and demand. The abolition of frontier controls between EC member states makes possible a pan-European manufacturing and distribution strategy, but differences in the various national markets will persist for many years. Products need to be tailored to local tastes and preferences.

U.S. firms should avoid their “wait and see” attitude. Future market changes should not trouble them, and their confidence should be based on the belief that all competitors will face the same problems. They also have little time to spend in order to follow the latest developments of the EC.

Many factors indicate the need for a proactive strategy by U.S. companies. As the EC market grows, more bilateral arrangements between non-EC countries are likely to be established. Less competitive European companies will disappear, giving opportunities for more competitive companies to take over the markets. Finally, particularly U.S. companies can already expand and benefit from their competitive advantage in some key areas such as telecommunications and information services, air services, semiconductors industry, public procurement, and direct marketing.

In fact, a U.S. company wishing to expand operations in Europe must go through several steps of increased awareness. Being thoroughly informed is the first step: What is Europe? With what will it provide the company? How will it affect the company? Self-assessment is the second step: What are the company's goals? Does Europe 1992 offer the company opportunities or restrictions to pursue its goals? Decision-making is the third

step, should the company expand its operations in Europe? Should the company initiate any change in order to remain or to become competitive?

U.S. companies planning on setting operations in Europe should consider two factors of importance: success requires a significant investment of money and time, as well as a need to act early. As other U.S. or non U.S. companies develop their distribution network and become more efficient, opportunities for newcomers are disappearing. Early newcomers will benefit from the inevitable momentum that the EC is providing: EC post-1992 is still not unified, and in the near future new restrictive policies may be erected. Unexplored new markets exist where no company has yet built long-time expertise. In Europe where resistance against change and outside culture is strong, early positioning is again the guarantee for a better local integration of U.S. companies. Aggressiveness in new market prospects, new comprehensive marketing strategies, increased knowledge and acceptance of cultural diversity, are major elements of a winning business strategy of expansion toward globalization. At the operating level, an in-depth understanding of the European market in terms of business habits, communication, and culture, is essential for U.S. companies to better meet the need of European customers as well as understand the strategy of European competitors. U.S. companies that lack this energy of transformation (or constant self-reassessment) will in the long term be at a disadvantage, at home or in foreign markets, against foreign companies that will be empowered by the new challenges and opportunities offered by Europe 1992.

Because further developments of the European Community are yet not known, and the precise timing of planned policies is unsure, U.S. companies must develop flexible strategic plans in order to deal with this uncertainty. For those which are now expanding operations in Europe or will be doing so in the near future, immediate decisions are full of consequences. The year 1993 is marking the beginning of the Single European Program. It

may also be one of the last chances for U.S. companies to implement a successful business strategy at the European level while facing low or reasonable levels of competition.

Only firms prepared for the post-1992 EC changes will be able to take full advantage of the opportunities that the single European market offers. Organizational and environmental factors will have to be examined in order to build a competitive strategic plan. While the post-1992 EC will bring competitive challenges and opportunities for most companies, others must be aware that their market share could be jeopardized.

The EC is considering discriminatory treatment of U.S. firms in some industries (such as trucking and television broadcasting). In other industries (banking, insurance, and investment services) the EC may condition foreign access on the basis of reciprocity. In addition, European companies are working to become more competitive in their own market. A Single Internal Market Information Service (SIMIS) has been set up by the U.S. Department of Commerce to inform companies of all the developments in the EC and to help with export promotion and with assistance in resolving problems.

The organizational structure of multinational corporations must also adapt to face the new unified market. A purely domestic structure is unsuitable for its operations; the most important function of multinational corporations in the 90's will be to provide an efficient decision-making process, smooth communication within the corporation, and a suitable framework for executing its strategy. The need for integration is much more apparent in Europe than elsewhere because of the close proximity of countries, the vast transportation network connecting them, and the lack of trade restrictions. Two strategies have been developed in this thesis to meet the need for integration (a) the acquisition approach and (b) the regional approach. Some restrictions stemming from the EC Commission and member states' legislation can be a real obstacle in the way of an acquisition approach. The regional approach seems an attractive strategy for U.S.

multinational corporations to gain region wide integration. Regional supervision is often needed because what happens in one country is more apt to spill over into other countries.

Typically, any change process in a company requires heavy involvement from the top management. Developing the competence and capacity to change people within the organization is a vital element in the creation and maintenance of a competitive advantage. The need for businesses to think about a strategy for training their staff to take advantage of the new opportunities is even more important. The choice of the manager will also be paramount.

The Single European Market offers tremendous opportunities and exciting challenges. It also offers real threats. Multinational corporations that ensure all efforts are directed towards realizing opportunities and meeting threats will be the winners. Any strategy will include training and cultivating a corps of mobile and energetic managers.

Moving from general recommendations to a more particular case, the next chapter presents strategic issues relevant to one of the high growth industries: The Telecommunications Industry.

CHAPTER 6. TELECOMMUNICATIONS SERVICES: ISSUES AND RECOMMENDATIONS

To bridge the topic of the development of the EC and U.S. business, this chapter focuses on the impact of European unification on U.S.-EC business relations in the area of telecommunications services.

The telecommunications services sector is particularly important because of the relationship to other service sectors such as financial services, banking and air transport services. Therefore, this section concentrates on the telecommunication services even though it is important to remember that there are big markets for both telecommunications services and equipment. Experts still argue about whether trade in telecom services could be envisaged without liberalization of trade in equipment.

DEFINITIONS

The U.S. Federal Communications Commission regulates and defines telecommunication services as follows:

1. Network facilities including equipment that permits the provision of services over networks open to all users.
2. Three types of basic public services: (a) telephone services, including local, long-distance and international services; (b) simple document transmissions, including telegraph and telex services, and for some authorities, simple fax transmission as well; (c) basic transport and leased circuit services. These services involve no manipulations of the content or format of a message. No potential customer can be excluded from networks that deliver these services, and these networks may be obliged to provide universal service.

2. Enhanced (value-added and information) services can include voice, data, or video services involving substantial manipulation of format on public or private networks. Electronic and voice mail systems are good examples.
3. Overlay facilities provide services such as cellular telephone mobile data and fax services, remote pager systems, airplane telephones and navigation systems.
4. Integrated Services Digital Network (ISDN) and Integrated Broad band Communications (IBC) provides a mix of voice, data, and video. IBC is the second generation and requires great bandwidth.
5. Private Networks provide all services within the firms (e.g., IBM, GE). These networks are often global.

U.S. INDUSTRY ANALYSIS

Telephone Services

The U.S. telecommunications services industry serves more than 88 million households and 30 million businesses nationwide and the U.S. Department of Commerce (1993) estimates that the U.S. telecommunications services industry's revenues will exceed \$184 billion in 1993. Revenues generated by international telecom services will increase by about 14 percent and reach approximately \$12 billion in 1994.

One hundred and sixty-one Local Access Transport Areas compose the U.S. common carrier network. The Local Exchange Carriers manage communications within a Local Access Transport Area and long distance carriers control telecommunications among Local Access Transport Areas (U.S. Industrial Outlook, 1993).

Seven Bell Regional Holding Companies that control 22 local Bell Operating Companies, plus GTE, Sprint, Southern New England Telephone Company, and about 1300 smaller, independent local telephone companies provide local telephone services. AT&T, MCI, Sprint, Wiltel, Metromedia/TTT, Cable & Wireless, Advance

Telecommunications, Allnet, and more than 400 smaller carriers provide long distance services.

Use of the telecommunications network continues to increase rapidly in the U.S.. The volume of interstate telephone traffic has more than doubled since 1989. On an average business day, there are about 9.5 billion minutes of telephone calling. The U.S. telephone network is composed of more than 15,373 central telephone offices and 143 million telephone access lines (Federal Communications Commission, 1993).

Key market segments in the domestic long distance and local services include measure toll service, 800 and 900 number services, wide area telephone service, private leased lines data communications, Integrated Services Digital Network and enhanced services.

Data Communications And Value-Added Network Services

The market for data communications services is evolving, driven in part by a growing demand for contracting with party vendors for wide-area networking, local area network interconnection, data processing, and value-added network services. Value-added network can provide services such as electronic mail, credit card verification, store-and-forward multipoint facsimile service, point-of-sale transactions, electronic data interchange, database access and overall private network management. Some main U.S. providers are AT&T Easylink, Prodigy, GE Information Services, BT Dialcom, and Compuserve. The applications' specific enhanced services provided by the value-added carriers today will remain a high growth market that will increasingly attract foreign owned telecom companies to provide those services to and within the U.S..

Cellular And Radio Services

The U.S. cellular industry topped 10 million subscribers and reached revenues of \$7.8 billion in 1992 (Cellular Telephone Industry Association, Dec. 1992). Industry revenues should continue to increase as higher capacity digital networks are implemented. Long

distance carriers (Sprint purchase of Centel and AT&T purchase of McCaw during 1993) gained entry into the cellular arena, increasing competition and expansion.

Although still in an early phase, wireless services will increasingly compete with wireline services, as capacity is expanded and advanced service capabilities are added.

International Competitiveness

The importance of the international telecommunications market and a growing demand for services in this sector have caused an increasing number of U.S. domestic long distance telephone carriers to expand providing international service. Multinational corporations using excess capacity on their private network are also entering the market.

U.S. telecommunication services providers remain the most competitive in the world. Of particular importance is the lengthy lead enjoyed by U.S. firms in providing value-added data communications services, such as wide-area networking, electronic mail, and data processing. The U.S. market supports a much greater number of private communication networks than any other country.

However, the U.S. lags behind several industrialized nations in some categories of public telecommunications infrastructure such as average investment per line and deployment of such technologies as digital switches (Telecommunications in the Age of Information, 1993). The U.S. also lags behind major leading partners in some important technologies such as Integrated Services Digital Network and Integrated Broad band Communication.

Major segments of the international telecommunications services market include the international message telephone services, the traditional telex and telegraph record services, international value-added network services, and specialized services such as private line, virtual networks and Integrated Services Digital Network. Foreign investment in the U.S. telecommunications market is limited by laws restricting foreign firms from owning more than 25 percent of any common carrier that uses the radio spectrum (Federal

Communications Commission, 1993). Currently, U.S. revenues from international telecom services are estimated to reach nearly \$12 billion in 1993, up from \$10.5 billion in 1992 (Federal Communications Commission, 1993).

International message telephone services revenues account for more than two-thirds of that total. One particularly explosive area will be data communication services, which should have experienced growth rates of 19 percent or more during 1993 as the demand for computer connectivity and wire-area networking developed rapidly. Cellular telephone revenues will increase to \$9.75 billion up about 30 percent (National Telecommunications and Information Administration, 1993).

EUROPEAN ISSUES

The European Community is gradually opening its telecommunications market to greater competition, triggering an upheaval that is intended to bring down traditionally high telephone rates and improve services. The European telecommunications market is almost the same size as the U.S. market with 118 million lines and 1991 revenues of \$137.5 billion. Analysts are predicting that it will be the fastest growing major industry of the decade, with total revenues expected to more than double to \$312.5 billion in the year 2000 (Telecommunications, 1993, p. 25).

Peter Cowley (1990) stated that although the Europe 1992 process significantly increased competition in the European telecommunication market, it is today less open than the U.S. market has been since the settlement in 1984 of the federal antitrust suit against American Telephone and Telegraph Company.

Until the 1980s, the law precluded the participation of major U.S. firms in the European telecommunications sector. Also, until 1984, U.S. law forbade the largest U.S. telecommunications firm, AT&T, from selling either services or equipment internationally. In 1984, AT&T was forced to divest itself of its local provider subsidiaries but retained its U.S. long distance service businesses.

Shortly following the AT&T breakup, the Europe 1992 initiative opened the possibility of new opportunities for U.S. telecommunications firms in Europe. The structure of the telecommunications industry in Europe has been one where state owned monopolies provide virtually all services and each monopoly relies on a small number of suppliers for provision of equipment. In the larger European nations, these suppliers have usually been national firms that have enjoyed a monopoly status for their principal products. Some examples are Siemens in Germany, GEC and Plessey in the UK, CGE and ITT in France, Philips in the Netherlands, and Olivetti in Italy.

Europeans often justify their voice services monopolies by noting that each EC member is no bigger than a regional Bell Operation Company that enjoys a monopoly on local services. One consequence of these national monopolies and near monopolies has been failure of EC countries to develop the economies of scale and scope at either the level of service or equipment manufacture that can be found in North America. As a result, both European private customers and business enterprises have historically paid higher charges for poorer service than have their counterparts in Canada or the United States.

There are a number of European ventures of the Regional Bell Operating Companies, most taking the form of alliances with other firms. Bell Atlantic has a consulting agreement with the telecommunication services of France, Italy, the Netherlands, and West Germany concerning network management. Bell Atlantic has also made arrangements with Telephonica of Spain and British Telecom, plus is involved in a joint venture with IBM and Siemens to develop so-called intelligent networks. BellSouth has an interest in a British cellular telephone concern. Pacific Telesis is involved in R & D in Spain while U.S. West holds a part of Mercury One-2-One, the UK network.

The Bell Operating Companies will continue their ventures in international telecommunication markets. To date, they have concentrated on investing in foreign private

telephone company opportunities, and providing mobile radio services, cable television and data communications.

RECOMMENDATIONS AND STRATEGIES

In the EC, as the national Telecommunications Administrations own and operate the highly developed local and long-distance infrastructures and have tremendous political and economic power, it is unlikely that deregulation of carrier services and therefore, open competition will occur in the immediate future. However, European legislative and regulatory liberalization is well under way and implementation should be complete by 1998. The following are strategies that U.S. telecom companies should consider when attempting to enter the European market:

1. Rerouting communications traffic. By rerouting traffic to the U.S., a European telecommunications operator affiliated with a U.S. telephone company can boost profits of the U.S. company. Because EC directives have no direct rules about international basic telephone services and because a monopoly is legal on the European side, there are no barriers for a U.S. firm that owns telecommunications services on both sides of an international connection between two countries. This service involves connecting two parties on the public network but circumventing the Post Telephone and Telecommunications' long-distance switched services, which charge higher prices. The European operator affiliated can also refer customers to its parent U.S. company for enhanced services that it does not provide or it provides at higher prices. For example, AT&T Communications Services in Brussels is considering setting up a network for corporate clients.

2. Using call-back operators. Another strategy that could result in a relevant share of the overall market for international telephone service is using the so-called call-back operator. By using the difference between the charges asked by the European operators and the U.S. operators, opportunistic telecom firms seeking to arbitrate differences in call

charges on particular routes can undercut international call charges. The customer calls an access number on a specially adapted switch in the U.S.. The switch automatically calls back to a number, predefined by the account holder, who is then given an open line. Alternatively, freephone (reverse charge) numbers are used. Thus, the importance of partnering for U.S. firms with European operators is clear.

3. Implementing calling-card services. Calling-card services are another way to break the monopoly of long-distance telecommunications companies. Such services have been aimed at people traveling abroad seeking to call home. In principle, calls to and from any country can be made using the card. For example, AT&T's USADirect, MCI's Call USA, and Sprint's Express each provides a local-access number to connect callers to one of that carrier's U.S. operators. Customers' payments are usually lower than rates charged by foreign concerns. These services benefit travelers who want to call from one non-U.S. country to another. Using MCI's World Reach program is cheaper to call from Paris to Singapore for 15 minutes by routing the call through a U.S. switching center than by dialing direct.

4. Developing wireless communications. U.S. firms have a window of opportunity to compete with local Public Telecommunications Operators because most EC countries follow the duopoly model in granting cellular licenses. Generally speaking, private interests have been allowed to participate mainly in niche markets. Wireless is one of these niches. The growth of mobile communications will dominate industry headlines over the coming years. In the wireless market, U.S. operators should move in where they will find their best opportunities. For example, BellSouth was selected and took a stake in COFIRA, the international consortium that operates the second nationwide cellular network in France.

5. Developing strategies for wireless communications. The following marketing strategies could be used by U.S. operators after being awarded a cellular license. They

could subsidize low equipment prices to gain new subscribers and then charge a slightly higher rate than going market prices for the services to counterbalance. They could offer packages designed to accommodate the price sensitivities and varying needs of a widening array of customers. For example, customers could choose among options with high per-month fees and low per-minute costs, or low monthly fees and high per-minute charges. They could also offer special per-minute rates at non-peak hours and other innovative packages to encourage higher usage. A good example will be a frequent user program similar to the frequent flyer program promoted by some airline companies.

6. Developing satellite communications. Satellite services are another way to attack the European market. Especially Very Small Aperture Terminals (VSATs) seem to provide an ideal method of bypassing Post Telegraph and Telecommunications operators. A sophisticated two-way product, VSAT is well suited to business networks that need to transmit high-speed data to and from multiple locations. The entry costs are low and networks can be deployed quickly.

7. Realizing investments. By realizing investments, U.S. firms should take advantage of all opportunities as soon as they become available. Privatizations are examples of good opportunities. Privatizations of national public telecommunications operators are likely to take place in the next three to four years. Already, the remaining government stake in British Telecom was sold off in the summer of 1993. Germany, Denmark, and the Netherlands are all proceeding with privatization sales. Several of the other EC member states are thinking of privatizing their public telecommunications operators.

8. Selling communication space. Through the selling of space on private networks, U.S. firms hope to capitalize on growth because services are likely to be the faster growing of the two major telecommunications market segments in the EC over the next ten years. Some major users of telecommunications services, mainly large multinational corporations,

have been by-passing the public networks. They have been installing private networks to link up their own operations and sometimes the operations of their major suppliers and customers. The by-pass networks provide voice transmission, but they can be used to provide services such as electronic mail, data or video data transmission. For example General Motors, IBM, General Electric, and Hewlett-Packard all own by-pass networks worldwide.

U.S. telecommunications services firms should team up with these U.S. global companies. The U.S. telecommunications services firms will bring their expertise and knowledge of managing such large networks. The alliance owning and operating these networks will permit to sell space to outside users by lowering the charges for leased lines for data transmission. This low-cost strategy will out-perform competitors and will attract customers.

9. Creating partnerships. U.S. firms that are already active and successful in European markets have established strategic alliances with strong local firms. In addition to offering an established market presence and access, the local partner can offer political leverage. This partnership is an essential factor for success in public sector contracts, as well as financial support for research and development, manufacturing and marketing requirements. By common experience, the best partners may also be customers and/or competitors in other markets.

10. Determining the country of entry. As a country of market entry, the UK is advantageous for the following reasons. First, the UK market is closer to the U.S. market in terms of culture, language, social organizations, and business practices. Second, the UK is the country which to date has most vigorously pursued competition in telecommunications services. It has clearly exceeded the guidelines laid down by the EC. As far as overall market liberalization is concerned, the UK still tends to be in the forefront.

Strategy Issues To Consider

1. Value-added services and information services are relatively new and required more advanced standardized systems. For example, many voice-mail packages require touch-tone phones. However, because many European telephone sets are rotary, these packages are not well adapted to the European market. Therefore these packages require a product adaptation, especially in Greece, Spain, Portugal, and Ireland.

2. Western European markets remain very diverse. U.S. firms must gain specific market knowledge of targeted countries. The character of the national markets varies widely. At one extreme, a country like Greece which is 15 to 20 years behind most of the rest of the EC's sophisticated telecommunication market, represents a huge unsatisfied demand for basic equipment infrastructure. At the other extreme, the EC represents broad market opportunities for value-added services.

3. Strong historical experience gained in the competitive U.S. market provides U.S. firms with a tremendous advantage as they introduce their equipment and services in Europe. However, cases are also to be noted where U.S. firms have acquired new expertise through European ventures that are then transferred back to the U.S. domestic market. Cable TV-delivered telephone services, developed in the UK, is one significant example.

U.S. telecom firms hope that regulators in Europe will allow them to do there what they have done so well at home: make telecommunications a powerful economic driver and achieve the level of excellence that a global economy demands.

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