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Introduction to the Globalization of Production

Context

George Abonyi
Senior Advisor, CAREC Programme, ADB; and
Visiting Professor
Dept. of Public Administration and Executive Education Program
Maxwell School, Syracuse University



Challenge

- How to link CAREC *enterprises* more effectively to international markets
- Improvements in transport and trade environment: necessary but not sufficient
- Such business linkages also conditioned by competitive structure of global *industries*
- *Focus of this afternoon: how enterprises and industries are changing—international business*
 - Driven by “globalization”

From the morning -- Professor Kawai: “Production Networks and Supply Chains”

- Introduced this morning by Professor Kawai:
 - “The rise of production networks underlies East Asia’s industrial growth, export and integration”
 - “Multinational corporations’ strategy to locate different sub-processes in different Asian countries according to comparative advantage and to re-integrate them”
 - “As a result, much of the region’s trade is between MNCs in parts, components, semi-finished and finished goods.”
- This is “internationalization of production” playing out at the level of the region -- Asia

Module Objective

- *This section:* To become familiar with key forces “driving” the internationalization of production
 - Context for “production networks”
- *Next section:* To understand these networks and the global value chains in which they are embedded

Broad Context: Globalization

- Globalization is the product of a series of political, economic, technological forces that have accelerated since early 1980s
- *Our focus:* Effects of globalization through changes in organization and location of production of goods and services
 - Also transforming global trade and investment

Traditional View of International Business and Multinational Enterprise (MNE)

- Home Base (e.g. US, EU, Japan):
 - Most critical resources – research, technology, human capital, finances, etc.
 - Location of key suppliers
 - Location of developers/owners of complementary products and services
 - Strategically important market
 - Sophisticated customer base
- *Most products (e.g. jeans, phones) produced within borders of one country, often by one firm*

Beyond “Home Base” in International Production by MNCs: First Generation

- “Internationalization without production”
 - *exports of final goods*
- ‘1st Generation’ rationale for production off-shore
 - *Markets*: focus on protected domestic markets
 - Replicate “home country model” in new market
 - *Production inputs*: access to selected inputs
 - E.g. raw materials, later—low cost labour
- *Key role of final exports and FDI for integrating ‘emerging economies’ into global economy*
 - *Key driver of sustained growth and structural transformation of East Asian economies in 1970s-early 90s*

Today: Internationalization of Production

- Proportion of products and services conceived, manufactured, consumed entirely in one country—or in one enterprise--rapidly shrinking
- Globalisation is reducing the dominance of any single location in the production process
- Involves emergence of 2 interrelated factors:
 - *Global value chains (GVC)*, and linked to this
 - *International production networks (IPN)*
 - → *New forms of integration in the global economy*
- ***Changes the nature and role of international production, trade, and investment***

Examples

From Abonyi, G. "Linking Asia Together", Asia Wall Street Journal, 5 December 2000.

- **IT: Cisco Systems** is leading global supplier of routers, switches, and hubs for corporate communication networks. U.S.-based Cisco does none of its own volume manufacturing. Its products are assembled by independent "turnkey" contract manufacturers in California and Asia, components and services coming from a variety of independent international suppliers from Taiwan, Korea, Japan, Singapore, Thailand, Malaysia and U.S., within the framework of a well-defined production network.
- **Athletic Shoes: Nike's "Air Max Penny"** basketball shoe was designed in the U.S., developed by technicians in the U.S., Taiwan and South Korea, and manufactured in South Korea and Indonesia from 52 components supplied by companies in Japan, South Korea, Taiwan, Indonesia and U.S. All these suppliers are tied together by an advanced information and logistics system.

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WHY Internationalization of Production: Drivers of Change

- Policy liberalization
- Technological innovation
- Increasing mobility of capital
- Increasing competition

Policy liberalization

- *Policy liberalization*: integrating and expanding product markets, creating regional and global opportunities for firms
 - Fragmented national production systems transformed regional/global systems
 - Reduce import/export/investment constraints; liberalizing economies (e.g. deregulate, privatize)
 - expands options for location of production
 - expands markets, facilitating increases in scale
 - for both final products and components

Technological and Managerial innovation

- *Technological innovation: 'reduces distance' and time; and diversifies production options for firms*
- *Infrastructure/services: Transport, Telecom, IT*
 - lowers costs and extends reach of firm
 - allows fragmentation and dispersion of production
- *Supported by managerial innovation*
 - E.g. “just in time”, “lean manufacturing”
- *Innovation in production technology*
 - Some product/markets: lowers minimum efficient scale of production (e.g. garments, electronics)
 - E.g. Italian SMEs globally competitive with average 4-5 workers
 - Other product/markets: raises cost/risks of production (e.g. semiconductors; pharmaceuticals)
 - E.g. average cost of semi-conductor fab plant > \$ 1 billion

Increased mobility of capital

- *Increased mobility of capital: accelerating diffusion of technology, knowledge, financing*
- *FDI as key engine of global growth, transformation > growth in global output, trade*
- *Portfolio flows: From domestic to global capital markets*
 - Role of foreign financing of domestic enterprises
- *Implications for firms:*
 - ‘Outsourcing’ as reducing capital costs and risks for firms
 - Increasingly diverse (global) sources of capital
 - FDI increasingly by new types of players: ‘global suppliers or contract manufacturers’ (Flextronics)
 - For new types of reasons: “GVC-related”

Increasing Competition

- Simultaneous pressures for lower cost, higher quality, shorter delivery time, wider choice
- Forcing changes in firm strategy
- Changing structure of industries
 - *Some*: Consolidation for scale (semi-conductors)
 - *Others*: Greater geographic diffusion of production (garments, electronics)
- Competition increasingly involves networks of linked firms, not just individual enterprises
 - E.g. Toyota's "network" vs. GM's vs. Ford's vs.....

Implications: Transformation of International Business

- **Reorganization** of production
 - ‘breaking up’ of firms’ activities
 - Into elements (e.g. hubcaps) and/or particular tasks (e.g. design)
 - focus on ‘core competencies’
 - moving non-core activities outside the firm to suppliers
 - BUT not necessarily outside home country
 - Increasing control over supplier activities
 - *Note: MOST OUTSOURCING IS DONE AT HOME, e.g. Japan, US*
- **Relocation** of production
 - 20 years ago, relocation of production activities outside home markets/economies was not key issue
 - Integration of product markets opens options
 - Through ‘hardware’ and ‘software’ developments
 - Allows moving activities to geographically dispersed locations (within firm or outsourced to suppliers)

→ *‘internationalization of production’*

But...Options in International Business Strategy

■ Computers/electronics:

- **Dell** (US) focuses on ‘craft assembly’ and distribution and outsources manufacturing of all components globally.

BUT

- **Samsung**, the S. Korean vertically integrated electronics company that makes almost everything itself

■ Apparel/garments:

- Most **American apparel retailers** (e.g. Wall Mart, JC Penny, Liz Claiborne) outsource all their production globally

BUT

- **Zara**, a Spanish company makes more than half its clothing at home is fastest growing apparel retailer in developed markets.

■ *BUT evolution increasingly toward “GVCs” as organizing framework for international production*

- *E.g. UNCTAD industry/trade studies*