Evolving into centres of excellence

by Dr Helena Barnard

An entry-level car in the USA comes standard with air-conditioning, clock radio, power steering and a 1600 engine, not to mention a high standard of reliability! Consumers in advanced countries have a lot of money and many options to choose from, and they are very demanding.

The initial products of the automaker Hyundai were simply not acceptable to the USA market. The USA operations bled money. They only survived because of nearly a decade's worth of bankrolling by the South Korean government. Today, Hyundai is profitable, but it still serves the low end of the USA auto market. To overcome lingering perceptions of poor quality, vehicles are sold with a ten-year comprehensive warranty.

However, the USA experience has been invaluable. Over time, the combination of sophisticated customers, well-developed supplier networks, access to skilled researchers, engineers and technicians and a lot of hard work by Hyundai has resulted in a high-quality product. This has translated into a much stronger position for Hyundai, not only in the USA, but, perhaps more importantly, in their core markets, leading developing countries like India, China and South Africa. In other words, Hyundai's operations in the USA have become a centre of excellence that can be leveraged by the entire firm worldwide.

The experience of Hyundai in the USA is potentially relevant to firms from South Africa. Operations in the developed world can serve a crucial purpose as centres of excellence for firms from developing countries. To better understand such centres of excellence, I looked at the factors that affect the sharing of expertise between the subsidiary in the developed world (focusing on the USA) and its parent at home. My research suggests that when firms expand into more developed countries, they start a long and demanding, but potentially very rewarding, learning process.

It will no doubt frustrate managers – who thrive on making things happen – that many of the elements of the learning process cannot be hastened. For example, age and size matter. The longer a firm operates in the USA and the larger the subsidiary becomes, the greater the steady flow of knowledge to headquarters. In fact, when a firm first expands to the developed world, it is counterproductive to try to force the subsidiary to formally share its knowledge with the parent company. Initially, the subsidiary needs all available resources to simply survive in the more competitive market.

Firms are more likely to succeed if they first develop international experience.

At a strategic level, the match between the home and host country is important. If the institutions in the home and host countries are very different, it is hard to apply the lessons learnt abroad. Thus, Sasol is likely to find it easier to benefit from its presence in the USA than the Saudi Basic Industries Corporation (SABIC), one of the world's leading manufacturers of chemicals, fertilizers, plastics and metals in Saudi Arabia. Given our long-shared history, South African firms are likely to find the United Kingdom a more accessible host country than the USA.

In terms of industry, developing country firms paradoxically benefit more the less competitive the industry is in the developed host country. Why? The developed world benefits from a well-developed education system, solid technological infrastructure and a sophisticated customer base, and even its "less" competitive industries can give South African firms a run for their money. The globally leading industries of the developed world are simply so far ahead that they can crush most firms from developing countries. Think of a gifted matriculant being thrown into an MBA class. Although the student has the potential to eventually make a success of the MBA, the necessary background knowledge is still lacking.

The learning process in the developed world is not cheap. Business scholars talk about the "liability of foreignness". There are significant start-up costs, pressure on profit margins and the ever-present issue of currency volatility. Another important but often overlooked cost factor is the fact that firms abroad have few contacts in business. While we are on our home turf, we constantly use our connections to make things happen. Finding out which deals are really happening or how the competition is interpreting a new law is as easy as calling an old university buddy.

Lacking these contacts, firms abroad must rely on transactions, rather than relationships, to get access to knowledge. This is a heavy burden on firms; both in costs paid and in missed opportunities. Centres of excellence emerge when subsidiaries in the developed world recognise that apparently everyday transactions are, in fact, a gateway to building new relationships. They leverage their contacts with suppliers, distributors and employees to help them understand their demanding new location.

Of course, the lessons learnt by the subsidiary are only useful if they are shared with the rest of the firm. The most productive way of sharing knowledge is informally: working on projects together, engaging in joint problem-solving meetings, and even merely making regular phone calls and sending regular emails. If meaningful communication channels between the parent and subsidiary company exist, work-related insights will be shared. The single most useful action the parent can take is to assign a headquarters-based mentor to decision-makers in operations in the developed world. The subsidiary will then have a sounding board to bounce off ideas about the challenges of the demanding new market, and headquarters will have immediate insights into the lessons that are being learnt, or need to be learnt.

South Africa, China, Russia, India, Brazil – the leading developing countries of the world – are all emerging from (in most cases self-imposed) economic isolation. The internationalising firms from those countries are starting a learning process that the global leaders started a century ago. However, my research has left me optimistic about the potential of firms to benefit from expansion into more developed countries.

It is a challenge to operate in the developed world, and firms must be realistic about their financial and human resource base. Failure is a real possibility. Firms are more likely to succeed if they first develop international experience and strengthen their financial position in less demanding locations. Firms do succeed in the developed world, and when they do, their success tends to benefit the firm as a whole.

***Dr Helena Barnard** completed her PhD in management at Rutgers University with a dissertation on how developing country firms use foreign direct investment to the developed world as a mechanism for upgrading. She has published, among others, in* Research Policy*, the* Journal of International Management*, and the* International Journal of Technology Management*. She is currently based at the Gordon Institute of Business Science of the University of Pretoria where she continues her research on the effect of local excellence and foreign connections in the learning and upgrading of developing countries.*