

Corporate Strategy and the Free Trade Agreement: Adjustment by Canadian Multinational Enterprises

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The strategic responses of four Canadian multinational enterprises (MNEs) to the Canada-U.S. Free Trade Agreement (FTA) are used here to examine Canadian corporate competitiveness. The predicted responses of the firms to the FTA were gathered using an analytical framework that assesses the diverging strategic needs of the firms. These predictions are then confirmed by data gathered through interviews with and questionnaire surveys of key firm personnel.

The impact of trade liberalization on the strategies of business firms has been the subject of a growing body of literature. The main contribution of Dunning and Robson (1987), a recent overview, is its analysis of the interrelationships between regional economic integration and the international expansion strategies of MNEs. Most of the managerially oriented literature on this topic is related to one of three issues: (1) the impact of free trade on the competitive position of firms vis-à-vis international rivals (see Magun, Rao, and Lodh 1987; Magun et al. 1988); (2) the effects of trade liberalization on the choice of entry mode to serve foreign markets, especially the choice between exports and foreign direct investment (FDI) and the degree of complementarity of entry modes (see, for example, Rugman 1990); and (3) the impact of the changed trading environment on the internal restructuring of MNEs, especially the transformation of subsidiaries from "miniature replicas" into globally rationalized business operations or "domestic" firms with world product mandates (see, for example, Hood and Young 1987). In each case, the regional economic implication of the restructuring process involves a shift from a Canadian national focus toward a global focus.

Little research has been done, however, on the need for strategic adaptation processes to be responsive to the diverging needs of the different strategic business units (SBUs) within one firm. Studies that have focused on strategic adjustment primarily discuss strategies at the corporate level, or perhaps at the level of a single plant or division (see Crookell 1987, 1989; D'Cruz and Fleck 1988a, 1988b; Rugman and Verbeke 1988, 1989, 1990; Rutenberg 1988; Wolf 1986, 1989).

The framework developed in this article assesses the diverging needs of the strategic business units on the basis of the perceived impact of trade liberalization on their firm-specific factors (FSFs) and country-specific factors (CSFs). These FSFs and CSFs are analogous to the Rugman et al. (1985) concept of firm-specific advantages and country-specific advantages. But whereas that work analyzed the performance of successful MNEs, we are dealing here with SBUs that might have been uncompetitive before, or perhaps after, the FTA. Thus, we have allowed for negative or non-existent country- or firm-specific factors.

The country-specific factors are interesting from a regional perspective. In spite of increased international economic integration, CSFs remain extremely important as a source of a firm's international competitiveness. But business firms can remain successful global competitors only if they build upon both FSFs and CSFs simultaneously. If locational advantages are reduced or non-existent, a corporation's success in the marketplace may be severely affected. The framework developed here—which is meant to be of direct use to corporate managers—integrates the internalization paradigm of international business from Rugman et al. (1985) with the strategic management perspective developed by Porter (1980, 1985, 1986).

This article has five sections. The first develops the framework utilized in the analysis, and section two introduces the four MNEs analyzed and presents our methodology. The third section discusses the positioning of the SBUs before the FTA. The projected impact of the FTA on the SBUs is then assessed in the fourth section. The final section summarizes the findings and presents the authors' conclusions.

Internalization Theory: Trade Liberalization and the Analytical Framework

A multinational enterprise is a firm that has production activities in at least two countries. Internalization theory, as developed by Rugman (1981), demonstrates that to be successful abroad an MNE must possess proprietary knowledge—that is, a firm-specific factor to compensate

for the additional costs (for example, for information) associated with doing business abroad. The theory also holds that subsidiaries are set up to serve the foreign market if the net benefits of internalizing the FSF (that is, its use within the firm) across borders are higher than the net benefits resulting from other modes of entry—for example, through the use of exports, licencing, or joint ventures.

From a regional economic perspective, the concept of country-specific factors is also important as each internalization decision takes into consideration the context of a specific location for the production operation. The CSFs of a nation include its factor endowments, market characteristics, and government regulations. A CSF always relates to a national characteristic with the potential for either a positive or a negative impact on a firm's competitiveness. It is reflected in the firm's ability to provide cheap products (low-cost strategy) or products perceived as unique (differentiation strategy) to its customers as compared to the products of rival companies, including other MNEs. It should be recognized that CSFs can differ from one region to another—even within one country. But in the context of bilateral trade liberalization between countries, we assume, for simplicity, that the impact of free trade on nationwide CSFs is more important than interregional changes in CSFs (or location advantages) within one nation. From a national perspective, only the total net impact of free trade on the economy (including the issue of adjustment costs) is relevant.

The analysis developed in this article is primarily at the micro level. The relevance of the concepts of FSFs and CSFs will be demonstrated through their use in the strategic positioning of four MNEs. The actual unit of analysis will be the SBU. Each SBU within one MNE can be defined as a set of product market lines sharing the same FSFs, and, within one firm, there may be different SBUs that depend in part on different types of FSFs. From a regional perspective, each SBU may face a specific set of environmental parameters determining, for example, its geographic scope and therefore generating a different bundle of CSFs.

From an internalization perspective, trade liberalization can have two main effects. First, it can either strengthen or weaken the country-specific factors. In the Canadian context, "strengthening" implies that the competitive position of operations located in Canada improves (for example, because easier access to a larger market improves the possibility of obtaining scale economies). "Weakening" refers to the deterioration of a firm's competitive position. Second, because the country-specific factors and firm-specific factors are interdependent, the impact of a change in CSFs on the FSFs of each strategic business unit must be analyzed. If the CSFs are strengthened,

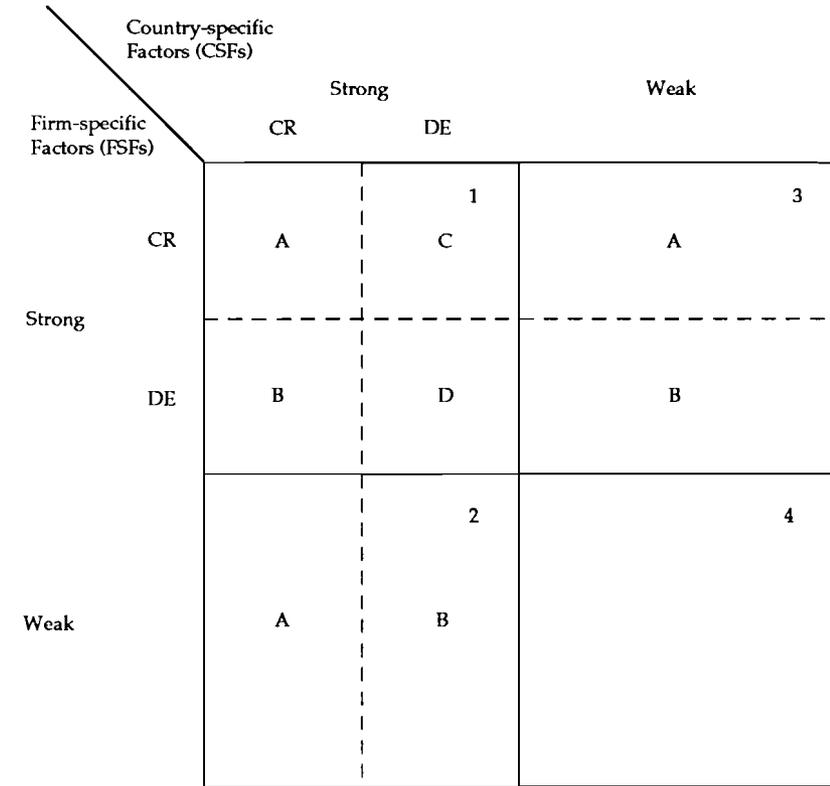
the improvement may be internalized into the FSFs of an SBU, and there may be a corresponding change in competitive position in terms of obtaining additional benefits of scale, scope, and the exploitation of national differences. But if the CSFs are weakened, this may affect the FSFs of an SBU by eliminating one of the building blocks of the FSFs (for example, a relative cost advantage is eliminated when foreign rivals with scale economies begin serving the Canadian market). The weakening of the CSFs may also occur when a government shelter is reduced in cases in which the shelter was used as a substitute for the existence of strong FSFs.

Depending on whether foreign direct investment (FDI) and exports are substitutes or complements, the geographical configuration of a SBU's operations may be altered after trade liberalization. This occurs in cases in which unnatural market imperfections, or trade barriers, rather than natural market imperfections, such as the public goods nature of know-how, are responsible for the choice of FDI over exports to serve a particular market.

Following the integration of the internalization model and the competitive strategy framework developed by Porter (1980, 1985, 1986), changes due to the FTA in each SBU's set of FSFs and CSFs can be analyzed in terms of their impact on the firm's potential cost-reducing or differentiation-enhancing capabilities. This will determine the MNE's capacity to pursue successfully a particular cost- or differentiation-based strategy both domestically and abroad.

The above analysis is represented in Figure 1. Each SBU of an MNE can be positioned in one of the four quadrants according to the relative strength of its FSFs and CSFs as compared with those of rival firms. The strengths of the FSFs and CSFs were determined by the authors on the basis of an ongoing cross-sectional assessment of the skills and environmental characteristics of the firms involved (for an early analysis, see Rugman and McIlveen 1985). A strong parameter implies the potential for at least average industry profitability and stabilization of market share in the relevant market.

Complementary information is represented in Figure 1 by the cost-reducing (CR) or differentiation-enhancing (DE) characteristics of strong CSFs and FSFs. Thus, quadrant 1 of Figure 1 is divided into four cells, each of which reflects the nature of the strong FSFs and CSFs. One SBU may be positioned in two or more cells of quadrant 1 simultaneously, depending on its FSFs and CSFs. Quadrants 2 and 3 each contain two cells, allowing determination of the nature of the strong CSFs and FSFs benefiting the SBU. A SBU can be positioned in both cells of either quadrant 2 or quadrant 3 simultaneously. Quadrant 4 contains SBUs with weak or non-existent FSFs and CSFs. The



CR = Cost Reducing
DE = Differentiation Enhancing

FIGURE 1 Competitive positioning of multinational strategic business units

implication is that such an SBU cannot survive over the longer term without the development of a FSF.

To assess the impact of the Free Trade Agreement on the strategic SBUs of an MNE, we examine whether the FTA will cause a shift in the positioning of the different SBUs in Figure 1. Such shifts can occur either directly, from a change in CSFs, or indirectly, through the impact of an external change on the CSFs or FSFs. For example, in the latter case a relative change in location of an SBU may affect the MNE's profitability and market share by changing its internal cost-reducing and differentiation-enhancing capabilities.

Four multinational enterprises were selected for strategic-positioning analysis at the strategic business unit level. The SBUs were then analyzed for changes in strategic positioning subsequent to

the FTA. The four firms—John Labatt Limited, Noranda Incorporated, Northern Telecom, and Nova—are representative of the set of the 20 largest Canadian-owned manufacturing MNEs studied in Rugman and Verbeke (1990). Given that Canada's major country-specific factor is its natural resource endowment, it is not surprising that half the firms in this set utilize this CSF. Of the remaining 10 MNEs, eight compete in mature product industries. The four multinational enterprises selected for analysis in this article possess an SBU in each of the major industrial sectors (forestry, mining, food and beverage, and high technology) spanned by the 20 MNEs.

The assessment of the strength and the nature of the FSFs and CSFs of each strategic business unit was based on such public information as annual reports and on other corporate documents. This assessment enabled us to place the different SBUs in the appropriate sectors of Figure 1. A second, similar analysis was then performed, taking into account the likely impact of the FTA on the positioning of these SBUs in Figure 1. Finally, the "likely impact" as determined by the research was compared to the actual expectations of the firms' managers in three of the four cases (Labatt did not wish to participate in the study).

Initial Positioning of the Four MNEs

John Labatt Limited

Labatt is a management holding company comprising operations in the food and beverage industry. The firm experienced sustained growth of assets employed and revenues (an increase of 78.1 percent and 93.2 percent, respectively) between 1985 and 1989, a period during which it was expanding geographically. Labatt is 96.9 percent Canadian-held; the principal shareholder is Brascan Limited, which in 1989 had a 41 percent interest, but Brascan intends to increase this to 50 percent. Within the two operating groups of Labatt—the Brewing Group and the Food Group—12 SBUs were identified.

Brewing Group. Before the FTA, the Brewing Group dominated an industry in which three firms accounted for 95 percent of sales. Indeed, the Brewing Group's market share increased from 36.8 percent in 1979 to 42 percent in 1989. Under the FTA, Labatt has successfully maintained its status in the beer industry because of its lobbying to maintain shelter. The firm is being forced, however, to respond to a global market and its resulting pressures.

Although the Brewing Group is attempting to enter foreign markets, its activities are, for the most part, centered on the Canadian market. Currently, the Brewing Group is located in quadrant 1, cells C and D, of Figure 1. The firm enjoys the country-specific factor of a protected market—the result of interprovincial trading restrictions imposed by the provincial governments. Its dual strong firm-specific factors are found in marketing skills, which are differentiation enhancing, and in provincial scale economies in the protected markets, which are cost reducing.

The Brewing Group has strong differentiation-enhancing and weak cost-reducing CSFs. Although the interprovincial trading restrictions have made it possible for Labatt to be a low-cost brewer in Canada, they also have forced Labatt to operate smaller and more inefficient plants as compared to its global-scale competitors, thus generating a negative cost-reducing CSF. But these restrictions have also enhanced the firm's marketing skills by creating an environment conducive to responding to regional tastes with regional brands and, thus, a strong differentiation-enhancing CSF.

Indeed, the brand loyalty enjoyed by the Brewing Group, along with its distribution network, act as effective entry barriers in the domestic market and may, in fact, have implications for the smallest regional production units of Labatt and other producers facing global competition. For example, one particular brand of beer in the Maritimes enjoys such a large market share that even if its market were subject to international competition, this brand could survive, and production would most likely stay in the Maritimes because of the small market and short production runs required. Such regional barriers to entry tend to partially offset the global cost disadvantage of Labatt Brewing.

The wine-producing unit, Chateau-Gai, had successfully entered the wine-based "cooler" market in Canada, but the operation suffered from the weak CSFs of high input costs and a relatively short growing season. The cost-reducing FSFs were weak as well because of a lack of scale economies. Moreover, for the wine product lines brand loyalty was questionable since Canadian wines do not in general enjoy a good reputation, even within Canada. This business unit, positioned in quadrant 4 of Figure 1, was sold in fiscal year 1989.

Food Group. The Labatt Food Group has strong marketing skills, and it has developed the distribution channels and brand identification aspects necessary for success in a competitive market.

Retail dairy market production units operate in Canada (Ault Foods) and the United States (Johanna Dairies). Although both producers possess differentiation-enhancing firm-specific factors, they

also both face a high degree of price competition, especially in the table milk market. In response to the latter, both divisions are rationalizing operations to further lower production costs. Ault Foods, which has a 35-40 percent market share in Ontario, has the capability to be the lowest-cost producer in its Canadian markets. In contrast, Johanna Dairies is faced with a cost disadvantage resulting from operating difficulties and the acquisitions of inefficient plants and emphasized by the highly competitive market in which it operates. Johanna has closed or modernized the inefficient dairies in an attempt to become a low-cost producer. The firm claims that its recently reopened Baltimore dairy is one of the most efficient in the United States. Both Johanna and Ault operate in an environment of strong differentiation-enhancing CSFs (high income, intelligent consumers, excellent media). But because of agricultural price-fixing in Canada, Ault is subject to a weak cost-reducing CSF, while Johanna enjoys a relatively strong CSF in this area. This would position Ault Foods and Johanna, respectively, in quadrant 1 CD and 1 BD of Figure 1.

Ogilvie, a grain-processing SBU, is difficult to position. Recent plant rationalizations indicate that its cost-reducing FSFs have been strengthened, and its exports to the United States have created the potential for economies of scale. Ogilvie most likely possesses dual strong FSFs, allowing it to become the largest producer of wheat starch and gluten in the world. Since domestic wheat prices exceed world wheat prices, Ogilvie is located in quadrant 1 CD of Figure 1.

Several American operations of the Labatt Foods Group derive their CSFs and FSFs from agricultural resources and marketing skills, respectively. The operations Chef Francisco, Delicious Foods, Oregon Farms, and the U.S. operations of Everfresh Juice are all located in quadrant 1 BD of Figure 1. The other American member of Labatt Foods, Pasquale, is in quadrant 1 ABCD because of its strong FSFs in distribution channels and in-store marketing skills, used particularly effectively in preparation booths and merchandising support. The cost advantage of Pasquale is a function of size and the related economies of scale. The Canadian operations of Everfresh Juice are most likely situated in quadrant 1 D because of the higher input costs in Canada relative to those in the United States. The strong differentiation-enhancing FSFs are derived from brand recognition and distribution channels.

Before its sale and subsequent breakup, the Catelli SBU was engaged in the manufacture of groceries. The unit is positioned in quadrant 1 D of Figure 1 because of its access to agricultural products and its marketing abilities. Its differentiation-enhancing FSFs were strong given the brand names—Catelli, Habitant, and Five Roses—

and the distribution network of the unit. Its cost-reducing FSFs were weak because of the high domestic wheat prices set by the Canadian government; these prices put Canadian operations at a competitive disadvantage when compared, for example, with those of European producers. Expansion into the U.S. market through foreign direct investment may have helped offset the weak cost-reducing CSFs faced by Catelli by making it more cost competitive (it had four American plants), but because of its cost disadvantage, Labatt decided to divest this SBU.

Noranda

Noranda is the stereotypical Canadian MNE—a natural resource extractor encompassing the mining, forestry, and energy sectors. But the firm engages in activities that extend far beyond extraction: Noranda is increasing its output of value-added products; it is committed to a significant marketing effort; and it has diversified into such areas as fibre optics technology. Three of its four divisions (minerals, forestry, and manufacturing) have revenues in excess of \$1 billion annually, and the fourth division, energy, has grown significantly with recent acquisitions. These four divisions also constitute Noranda's core SBUs.

Minerals. In the minerals division, the most important country-specific factor is Canadian resources. Noranda's mineral deposits are close to major markets and to its downstream manufacturing facilities. The division has access to skilled labour, and it has internalized this CSF into an FSF, as illustrated by the productivity gains and cost reductions realized in many of its operations. These two factors are essential to any firm wanting to be a low-cost producer. Noranda states that cost is a function of ore grade, productivity, and technology (engineering expertise). The ore grades found in Canada—especially those employed by Noranda—are high, as are the skilled labour functions at the blue-collar level and in the engineering department.

Noranda Sales, which works closely with buyers to help them develop both new uses for Noranda's products and new markets, is moving the minerals division from a production orientation toward a customer orientation. This requires research and development and, equally important, prompt responses. The minerals division is internalizing the marketing function, and, since customer contact is essential for the firm to remain informed of market trends, brokers are now rarely used.

The weaknesses of the minerals division stem from the cyclical price structure of minerals, increased competition in the form of buyers

switching to new suppliers, and the replacement of minerals with plastics, ceramics, and so forth. This SBU builds primarily on its strong cost-reducing FSFs. It has recorded numerous productivity gains, but it has encountered a very competitive market. Because the division produces industrial output, it is difficult to differentiate it physically (and its promotion of its industry goods) from the other materials used in its place. This has the disadvantage of benefiting all mineral producers. Differentiation will most likely take the form of service—of becoming more customer-responsive by participating in product development and by supplying customer-specified inputs. Although in its publications Noranda emphasizes the need for further value-added production, examples of substantial progress in this area are few. The division seems to be having difficulty in switching from a low-cost strategy to a differentiation, or dual, strategy. It is now located in quadrant 1 A of Figure 1.

Forestry. Noranda's forestry division faces increased international competition, and it too is moving toward the production of higher value-added products. The main country-specific factor of this division is its resource base, which includes the FSF of its large cutting rights. The access to skilled labour in both the woodlands operations and the production processes is a strong CSF, internalized to an FSF. The division has strived to reduce costs and increase productivity in all areas of its operations. Its marketing skills are well developed, and research into new, high value-added production should increase profit margins and strengthen the degree of vertical integration (by internalizing knowledge and marketing skills). Because the division has strong FSFs and benefits from strong cost-reducing CSFs, it can be positioned in quadrant 1 AB. Unfortunately, the move by British Columbia to increase stumpage fees and the prospect of Quebec following this lead threaten the strong cost-reducing CSFs and may move the division to quadrant 3 AB. Thus, regional policy has a major effect on this firm.

Manufacturing. The manufacturing division is resource based and marketing oriented. In any discussion of its FSFs, Canada Wire and Cable and Wire Rope Industries must be separated from the rest of the division.

Canada Wire and Cable operates in a mature industry, although the company prefers to regard itself as dynamic because of its product and marketing innovations. Customers and competitors alike consider its operations among the best in the world because of the quality of both its products and service. The high-voltage cable business has benefited from the geography of Canada—the fact that energy has to

be transported across vast distances from source to user. Consequently, the firm's higher-voltage cable plants are on a world scale. The unit, specifically the higher-voltage cable operation, has dual strong FSFs, which place it in quadrant 1 ABCD of Figure 1.

Wire Rope Industries (WRI) has strong differentiation-enhancing firm-specific factors, the result of proprietary products, some of which are required exclusively by mining firms to meet their engineering needs. The firm's cost structure is higher than that of its competitors, but this is improving through plant rationalization and an expanded customer base resulting from the purchase of the wire rope assets of Greening Donald Company. WRI is located in quadrant 1 BD of Figure 1. The rest of the division (including an aluminum unit and Carol Cable) is subject to a very competitive environment. New competitors from low-wage countries are entering the market and reducing profits. These operations are positioned in quadrant 2 AB because they are faced with weak FSFs.

Energy. The energy division's Canadian Hunter Exploration Limited has been relatively successful in its explorations as demonstrated by its low exploration costs. It estimates that over the past three years its exploration cost per barrel of oil equivalent (BOE) has been \$3.50 compared with an industry average of \$8-\$9 per BOE. The division is positioned in quadrant 1 AC of Figure 1.

Northern Telecom

Northern Telecom is the only Canadian firm with sales exceeding the \$1 billion level that competes exclusively in a high-technology industry. Specializing in the design and manufacture of telecommunications equipment, this firm is the world's leading supplier of digital systems. Its expertise, coupled with a secure domestic market in Bell Canada (Northern Telecom is 52.3 percent owned by Bell Canada Enterprises), has contributed to the firm's past success.

Northern Telecom has introduced the notion of "effective use of time" in an attempt to gain a competitive edge on its competitors. This ambitious policy has produced results: manufacturing time has decreased to approximately half that required two to three years ago; both inventory and overhead have decreased; and customer satisfaction levels have improved (Merrills 1989). The reduction in manufacturing time applies not only to production time for existing products but also to development time, including that for product enhancements and new product development. To achieve this, the company formed cross-functional teams made up of R&D,

manufacturing, and marketing personnel. The team approach avoids or reduces many of the difficulties encountered in the previous approach in which R&D might have sent a prototype to manufacturing only to have it rejected or to see marketing place particular design demands on it at a later point. This new approach has implications for both types of FSFs: the reduced operating costs assist the cost-reducing FSFs, and the increased response to customer requests, as measured by customer satisfaction, enhances Northern Telecom's differentiation-enhancing FSFs.

Northern Telecom is difficult to analyze because it markets its major product lines across all of its geographic divisions. Since revenues and operating earnings are reported by geographic segment—but simply revenues are given for product lines—only the geographic operations can be placed. Four SBUs can be distinguished: Northern Telecom Canada Ltd., Northern Telecom Inc., Northern Telecom World Trade Corp., and Bell-Northern Research Ltd.

Northern Telecom Canada Ltd. Northern Telecom Canada has dual strong FSFs. Its status as a low-cost producer and price leader is sustained by its consolidation programme in North America and by the time management programme just mentioned. The differentiation-enhancing FSFs are derived from quality products and service excellence, as well as from an intense marketing programme. The latter firm-specific factor has been enhanced by the internalization of country-specific factors. The firm's excellent R&D staff partially stems from the CSF of the large skilled labour pool in Canada. But more important to the development of marketing skills has been the firm's relationship with Bell Canada, which gave Northern Telecom the foundation on which to enter world markets. Although the affiliation with Bell Canada has endowed the firm with a stable selling base, the volume of sales is still inadequate to support substantial R&D or permit economic scale production. Furthermore, government support for R&D in Canada lags behind that of other industrialized countries. Because of its lack of strong cost-reducing CSFs, the firm has maintained a niche in the narrow field of telecommunications, placing this SBU in quadrant 3 CD of Figure 1.

Northern Telecom Inc. The American operation, Northern Telecom Inc., also enjoys strong firm-specific factors, which stem from the strengths of the Canadian parent base. These FSFs are based on marketing expertise, quality products, and service excellence. The strength of the FSFs is evidenced by the fact that Northern Telecom Inc. increased its sales volume of most products despite an extremely competitive market characterized by price discounting. Given the size of the

American market, the firm can realize economies of scale. Coupled with the availability of skilled labour, this tends to ensure strong cost-reducing CSFs. But the differential treatment of indigenous versus foreign firms with respect to government procurement and R&D support has negative implications for its CSFs. Overall, Northern Telecom Inc. is located in quadrant 1 AB of Figure 1.

Northern Telecom World Trade Corp. The European and Pacific operations of Northern Telecom benefit from the same FSFs as the North American operations. Although such advantages may not have been developed in these overseas operations, they have been effectively transferred from North America. The problem for these two units lies in weak CSFs, the result of the differing government procurement policies and technical requirements of many countries. Northern Telecom tries to minimize these negative aspects by directing foreign direct investment to politically stable countries, by developing joint ventures and licencing agreements in less favourable environments, and by exporting to the riskier countries. But until government-owned systems direct procurement toward other than their traditional suppliers, Northern Telecom World Trade will remain in quadrant 3 AB of Figure 1. Northern Telecom's new relationship with STC PLC of Britain, however, may move its European position into quadrant 1 CD. The same possibility exists for its joint ventures in France and China.

Bell-Northern Research Ltd. Bell Northern Research is at a cost disadvantage because of poor R&D support in Canada and its exclusion from American programmes. In addition, its research base is smaller than those of its competitors, reducing the potential for economies of scale or scope. Its differentiation-enhancing FSFs are strong but subject to decline: the firm has maintained an excellent research department, which has kept the firm competitive. Unfortunately, the firm faces such difficulties as a small revenue base, confinement mainly to North America, maturing products, and exclusion from American government support, a factor that could affect its ability to attract qualified scientific personnel and fund R&D. Its country-specific factors are dual weak, but they could improve.

Nova

Nova represents the energy and petrochemical industry in this set of Canadian multinationals. The energy and petrochemical units of Nova are, as separate entities, billion-dollar players in their respective markets. The six SBUs identified—pipeline and gas marketing,

petrochemicals, basic petrochemicals, rubber, plastics, and petroleum—have experienced a range of impacts from the FTA and thus are interesting subjects for analysis.

Pipeline and Gas Marketing. The deregulation of natural gas prices has prompted the pipeline and gas marketing division to develop marketing expertise in addition to its transportation proficiency. The unit is vigorously pursuing the American market where it is subject to intense competition. But it has not abandoned the challenge of reducing costs through better control; it recognizes that higher volumes also lower costs through scale economies. The division has strong cost-reducing and weak differentiation-enhancing FSFs. The same analysis holds for the CSFs—the cost-reducing CSFs are strong, and the differentiation-enhancing CSFs are weak. Thus, the division falls in quadrant 1 A.

Petrochemicals. The petrochemical business is best examined by product line since not all units possess the same FSFs. In particular, a distinction must be made among Nova's petrochemical operations, Polysar's basic petrochemical unit, and the polymer division.

Nova's petrochemical unit has an agreement with the Alberta government that guarantees Nova's supply of ethane at a regulated price—another demonstration of the impact of regional policy on a firm's competitiveness. This agreement was reviewed in 1988, but, despite opposition to the agreement by competitors and the Energy Resources Conservation Board which recommended elimination of Nova's special status, the government decided to continue this arrangement for existing plants.

Nova has strong cost-reducing and weak differentiation-enhancing FSFs. The petrochemical division has increased capacity and reduced costs through scale economies and productivity gains. Its marketing efforts also aim to reduce costs by striving to increase market share and maintain economic scale production.

The weakness of the polyethylene segment lies in the distance of its Alberta-based plants from major users of the product, although this weakness is countered by the unit's proximity to feedstocks. The marketing arm of the methanol operations has tried to penetrate the market for such value-added products as a blend of methanol and unleaded gasoline for automobiles, but the unit still emphasizes scale economies as a means of reducing costs. Polyethylene is sold internationally—but mainly as a commodity—so there is little emphasis on marketing. Nova attempted to improve its differentiation ability through the purchase of Polysar in 1988, a move meant to enhance its downstream, value-adding activities and

differentiation-enhancing FSFs (see next section). Because the petrochemicals division benefits from strong cost-reducing CSFs, it is positioned in quadrant 1 A of Figure 1.

Basic Petrochemicals. Polysar's basic petrochemical unit is an interesting contrast to that of Nova. According to Polysar, for feedstock and feedstock transportation costs it is at a competitive disadvantage with the American Gulf Coast producers, but the firm counters this with lower electricity costs, proximity to a large American market from its southern Ontario operations, and flexibility, especially in using alternative feedstock based on current market costs (crude oil or natural gas). The elimination of tariffs and the location advantage with respect to buyers will definitely enhance its competitive position, and the fact that it is a division of Nova should help it secure feedstock at favourable prices. Its recent purchase of a catalytic distillation company gives the unit the technology for the low-cost construction of a petrochemical plant and the ability to operate it as a low-cost production facility. Polysar's FSFs are cost reducing as determined by its ability to use the least expensive feedstock source. The division is increasing its output of higher value-added products and may improve its differentiation-enhancing FSFs in so doing. Additional efforts to strengthen these FSFs involve basic petrochemical R&D, which few of its competitors undertake. Because the division has strong cost-reducing and weak differentiation-enhancing FSFs and benefits from strong cost-reducing CSFs (human resources and location advantage to buyers), it can be placed in quadrant 1 A of Figure 1, although a shift toward quadrant 1 AB is anticipated.

Rubber. The rubber operation of the polymer division is emphasizing higher value-added products. Its synthetic rubber products are sold throughout the world, with the automotive sector accounting for approximately 75 percent of sales of which 80 percent is to tire manufacturers. Global marketing expertise is improving with the production of such specialty rubbers as nitrile, an oil-resistant butyl rubber for high-performance tires. The research department has invented TORNAC, a heat and oil nitrile rubber that sells for 10-15 times the price of conventional oil-resistant rubbers. The rubber operation has strong CSFs and strong differentiation-enhancing FSFs. Its FSFs are both process oriented (R&D) and marketing based (specialty products, new applications, increased sales effort in the Asia-Pacific region). The division is moving away from commodities and is attempting to focus on specialty, high value-added products as outlined above. Part of the division's strength lies in its quality

technical service, both before and after sales. Another differentiation advantage lies in its ability to innovate for commercial gain on the basis of existing products without having to purchase a new technology. The rubber unit is lower cost than its European-based competitors, equal in cost to its American competitors, but higher cost than its Japanese competitors. Its CSFs, in the form of excellent engineering personnel, are strongly differentiation enhancing, and so the operation is in quadrant 1 D of Figure 1.

The rubber division was sold to Bayer AG of West Germany in May 1990, for \$1.48 billion. The acquisition gives Bayer's rubber operations, which were not globally integrated, production facilities in, as well as access to, the North American market. Nova benefits through debt reduction, which should improve profitability and enhance efforts to strengthen the competitive position of its basic petrochemical and plastics operations.

Plastics. The plastics operation has grown through acquisition and, consequently, has too many plants. It is anticipating a rationalization that will reduce the number of production facilities from seven to three or four. Concurrent with this plan is one to expand its Sarnia, Ontario, operations to take advantage of the proximity to: (1) a feedstock source (basic petrochemical plants), and (2) buyers in the northeastern United States, who have taken on new importance as a result of the elimination of tariffs on the unit's output. The plastics operation is stressing higher value-added products. The differentiation-enhancing FSFs are derived from both process technology and marketing skills, but these FSFs are relatively weak. Nonetheless, given the strengths of the rubber operation's FSFs and the transferability of these skills, the plastics division sees an opportunity to develop strong differentiation-enhancing FSFs. The division is now located in quadrant 2 AB. This positioning indicates that the firm must restructure or exit. It is now restructuring, building upon the FSFs of other divisions.

Petroleum. The petroleum division is subject to the same unstable pricing environment affecting all other petroleum producers. Recent announcements by the governments of Canada, Alberta, and Saskatchewan about financial support for a heavy oil upgrader plant for Husky (Nova has a 43 percent ownership position) have, however, tended to reduce the impact of pricing uncertainty. Because the division has strong cost-reducing and weak differentiation-enhancing FSFs and is currently benefiting from strong cost-reducing CSFs, it can be placed in quadrant 1 A.

Other Business Interests. All of Nova's other business interests depend on skilled human input, especially its consulting and research activities. Novacorp, a consulting firm, and Nova Husky, a research firm, most likely possess differentiation-enhancing FSFs. Grove, a manufacturer of valves, relies on cost-reducing FSFs (this division was sold to Grove Management in June 1990). Novacorp and Nova Husky emphasize technological expertise and attempt to differentiate themselves as innovators in this area. Both firms have strong differentiation-enhancing and weak cost-reducing FSFs, although their CSFs do not provide them with a competitive advantage. Thus, they could be positioned in quadrant 3 B of Figure 1.

Positioning the MNEs under the FTA

This section analyzes how the SBUs discussed above adjusted to the Canada-U.S. Free Trade Agreement, which became effective 1 January 1989. The FTA both eliminates tariffs and reduces non-tariff barriers (Economic Council of Canada 1988). Several economic sectors are exempted from the FTA, however, including the brewing industry. This industry is characterized by relatively small, inefficient plants—the result of interprovincial trade barriers. If it had not been exempted from the FTA, this sector would have been subject to extreme cost disadvantages or substantial adjustment costs in response to free trade. In other words, interregional impediments to trade within Canada have a substantial impact on strategies to adjust to the FTA.

John Labatt Limited

If Labatt Brewing had to face global competition, its cost-reducing firm-specific factor would be lost. Currently, Labatt and another brewery, Molson-Carling O'Keefe, operate small, inefficient plants to comply with provincial restrictions on the beer trade. Although this represents an effective entry barrier in a protected market (as demonstrated by the licencing and producing arrangements with foreign producers), in a global context such a CSF would have a large negative impact on the competitiveness of the Canadian brewing industry.

Entry barriers exist in foreign markets, of course, including distribution channels (especially the closed houses in Europe). These prevent economies of scale and cost competitiveness on a global basis. Labatt is attempting to hurdle the European entry barriers through partnerships with regional brewers in the United Kingdom, and it

entered the home consumer market there in June 1989. The group also has a 70 percent interest in Birra Moretti, the third largest brewery in Italy.

The FTA has no direct effect on the brewing division and, consequently, its strategic direction. But the status quo in the Canadian brewing industry is unlikely to remain in effect because of the recent GATT findings against provincial discrimination in the pricing of foreign wines and other beverages. In addition, the merger of Molson and Carling O'Keefe increases pressure at the provincial and federal government levels to liberalize trade in the brewing industry within Canada and internationally.

Although company statements indicate Labatt prefers the current Canadian market environment, the firm is still acutely aware of the implications of global competition. As demonstrated in 1989, imports of low-priced American beer could reduce (at least temporarily) the domestic industry market share or, at the very least, dramatically reduce profit margins. Labatt would no doubt respond to such an environmental shock by reducing the number of its production facilities and becoming internationally cost-competitive.

The FTA is not completely responsible for Labatt's divestiture of Chateau-Gai. The poor positioning of the firm before the FTA indicated that the division would have to be restructured or divested. This factor, in combination with the FTA as well as the GATT decision against discriminatory wine pricing in Canada and the need to comply with the ruling, contributed to the firm's decision to sell the division rather than to restructure it to make it competitive.

The FTA will alter the position of Ault Foods since its low-cost status will disappear after the elimination of import tariffs on American dairy products. Thus, Ault Foods can be placed in quadrant 1 D. As long as the import quotas on many dairy products (as defined by the Import Control List set forth by the federal government) are maintained, however, Ault will be able to continue its current low-cost strategy vis-à-vis other Canadian competitors. Should the quotas disappear, forcing Ault to become cost-competitive relative to American producers, Labatt could import into Canada from its Johanna Dairies division, which is expected to become more cost-efficient from rationalizations. This is paradoxical as it implies that the U.S. operation, now faced with a weak cost-reducing FSF, could after developing a strong cost-reducing FSF export to the market where Labatt now benefits from a strong cost-reducing FSF that is likely to be lost after trade liberalization.

In response to the elimination of tariffs under the FTA, Ogilvie is rationalizing, although the industry remains protected because of import controls on wheat and flour (to be eliminated when producer

subsidies are equalized between the United States and Canada). Ogilvie also maintains American mills so that it, like Ault Foods, could import into Canada from the United States if its Canadian plants lose their cost advantage.

All of Labatt's American-based SBUs are unaffected by the Free Trade Agreement. They benefit from low-input costs and the potential to realize economies of scale, which, when coupled with strong differentiation-enhancing FSFs, enable the firms to continue their current strategic plans.

Given the increasing investment by Everfresh Juice in the United States, its competitive position in Canada will probably remain strong based on the substitution of imports for domestic production in response to increased competition. In other words, this strategic business unit will remain competitive in spite of the weak cost-reducing CSFs and FSFs of its Canadian operations—the result of its linkage with U.S. operations. From a regional perspective, this demonstrates the ability of some multinational enterprises to benefit from the use of strong CSFs in one location to compensate for weak CSFs in another location.

Noranda

The introduction of the FTA will benefit Noranda minerals by improving the cost position in the United States of many of its alloys and augmenting its attempts to move to higher value-added products. As for those alloys that encounter high nominal tariffs (and in some instances extremely high effective tariffs such as the 300 percent effective tariff on zinc alloys), the Free Trade Agreement enables Noranda to process them in Canada as opposed to shipping the ore concentrate to the United States, remelting it, and producing the alloys. The elimination of the intermediate step lowers production costs, and the integration of production in Canada facilitates the division's move to higher value-added production and the ensuing development of marketing expertise. Thus, the FTA provides the environment for Noranda minerals to improve its potential to move from cell 1 A to cells 1 AB, with dual strong FSFs. As this was its goal before implementation of the FTA, the division was an enthusiastic supporter of the agreement.

The FTA will have little impact on the current FSFs and CSFs of Noranda's forestry division. Any positive change would require a mechanism to avoid administered trade actions such as the softwood lumber decision in which the Canadian government imposed an export tax equivalent to the countervail duty that the United States was proposing (for an analysis, see Rugman and Porteous 1988; Rugman and

Verbeke 1989). This factor will tend to preserve the strong cost-reducing CSF.

The dual strong FSFs of Canada Wire and Cable will not be altered by the FTA. Wire Rope Industries may be able to improve its cost structure through scale production, although its strong differentiation-enhancing FSFs remain intact under the agreement. The other operations of the division still face exit or restructuring after the FTA is implemented. The agreement offers them only marginal assistance in reducing costs through scale economies because these operations are already located in the United States. The development of product differentiation skills remains a priority for the aluminium unit, and Carol Cable has been divested.

The benefits of the FTA for the energy division will take the form of a positive atmosphere among its American customers, but implementation of the agreement will not change the position of the unit in Figure 1. Although there is potential for increased sales volumes to the United States, which could result in lower per-unit production costs, the division already possesses strong cost-reducing FSFs.

Northern Telecom

The FTA does not alter the position of Northern Telecom Canada in Figure 1 and thus requires no direct strategic response. The FTA could enable Northern Telecom Inc. to develop dual strong country-specific factors if it were granted equal access to government procurement and support, but because this is still uncertain any prediction of a move toward quadrant 1 ABCD would be speculative. The FTA does not affect the position of Northern Telecom World Trade. Although the dual weak CSFs of Bell Northern Research might improve under the FTA, it is unlikely that this SBU would be able to move out of quadrant 3 B of Figure 1.

Nova

The Free Trade Agreement, with its provisions for energy contracts, guarantees Nova a strong cost-reducing CSF because it allows for larger volumes and reduced unit transportation costs. But the agreement has little or no impact on the pipeline and gas marketing unit.

The FTA will not alter the cost structure of the existing facilities, but it could cause Nova petrochemicals to further emphasize global markets and leave the northeastern United States to its sister operations (Polysar) in southern Ontario and the United States (see below).

The reduction of tariffs will benefit the styrene operation of the basic petrochemicals division. It is reconsidering its target market and plans to focus on the northeastern United States. The prospect of increasing the gains arising from the FTA and becoming a dominant force in this market has impelled the operation to evaluate the construction of a low-cost production facility. Thus, the agreement will not greatly alter the position of the division, but it could strengthen the firm's FSFs if the new plant becomes reality.

The FTA has a neutral effect on the rubber division for two reasons. First, the tariffs on synthetic rubber are already zero for most products, and, second, the division is globally competitive and integrated and intends to continue exploiting its existing competitive advantage in the marketplace. The rubber division will continue operations under the ownership of Bayer AG.

The Free Trade Agreement has focused attention on the plastics division and its need to restructure. It is currently positioned in quadrant 2 AB.

The FTA will have a neutral effect on Husky, although it could encourage the development of the firm's differentiation-enhancing attributes. The FTA does not alter its position in Figure 1, nor does it encourage or require Novacorp and Nova Husky to develop new strategic initiatives. Grove will also continue its current low-cost strategy but under management ownership.

Conclusions

Although only four Canadian MNEs were examined here, the number of their strategic business units substantially increases the number of observations. As we have seen, most SBUs were well positioned before and after the FTA. The questionnaire/interview process with the management personnel (excluding Labatt) confirmed the positioning of the SBUs before the FTA, and the strategic reactions of the SBUs to the FTA confirm the predictions based on the strategic framework developed in this article. Adjustment costs have been minimal and easily absorbed by the units.

Of all the SBUs discussed above, only four were poorly positioned after (and before) the FTA: the plastics operations of Polysar, the aluminum and the American cable operations of Noranda, and the wine division of Labatt. At Nova, the plastics operation is restructuring to become cost-efficient. Noranda is attempting to reposition its aluminum business through the creation of production differentiation attributes, and it has shed its American cable segment. Finally, Chateau-Gai was divested by Labatt. These events are

consistent with the model, which predicted restructuring or exit: currently, the first two SBUs are developing new FSFs, and the parent firms chose to exit from the last two operations.

The case studies presented here emphasize the need for SBUs in mature industries to be cost-competitive. The resource-based firms, building on the country-specific factors of location in Canada, experienced depressed commodity prices as a result of excess capacity on a global basis. They now perceive that to remain operational (not necessarily profitable) they must be low-cost producers. This situation is paralleled on the high-tech front by Northern Telecom's confrontation with reduced margins in the maturing digital switching industry and the subsequent development of its cost-reducing/efficiency-enhancing programmes.

The situation in the resource sector is further aggravated by the relative decline in Canada's CSFs (the choice forests have been harvested and the best ore bodies mined), which was not discussed in this article, and by the introduction of new technologies by competitors, which reduces the relative strength of FSFs (for example, the oxygen bleach process in pulp and paper technology). The long-run operations of the commodity producers are threatened, and, at best, the future of these operations is unattractive because of low margins.

This discussion has revealed the common experience of the resource-based SBUs: they have evolved from low-cost commodity producers to cost-competitive, high-margin, value-added marketers. This transformation is continual: several firms that have made advances are still striving to improve product differentiation skills in conjunction with their efforts to maintain cost-competitiveness in commodity production.

Clearly, as global competition reduces margins, cost-competitiveness is essential in mature or maturing industries. But even the lowest-cost producers in mature industries will exhibit low attractiveness in the long run, thus prompting these firms to shift to the development of differentiation-enhancing FSFs and the expansion of value-added activities. This implies that the FTA, when interpreted as an institutional adjustment to the reality of increased global rivalry, does not automatically enable multinational enterprises to improve their competitive positions based on the economic principles of regionally based comparative advantages. Only when CSFs are internalized into FSFs, which are then renewed continually at the SBU level, can global competitive success be achieved. In contrast to Porter (1980, 1985), we conclude that a dual emphasis on cost reduction and differentiation enhancement does not mean firms will become "stuck in the middle". In the long run such an emphasis leads to global competitive success.

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