Viewpoint

Maastricht Doesn't Matter – European Business Strategies Do

Tom Sommerlatte

European market integration has been one of the great economic success stories of the past 30 years. But the movement seems to have lost steam.

In fact, as the much-hailed „Europe '92" arrived, most European economies found themselves in severe recession. There is no evidence that the promises of the highly publicized Cecchini Report of 1987 will be fulfilled. And there is no sign of either the expected additional 4 to 7 percent growth in the European gross domestic product or the creation of 1.8 million new jobs. In fact, GDP growth is next to nothing, and trade is stagnating.

Yet from 1958 to 1990, trade within the Common Market exploded from 10 billion European Currency Units (ECUs) to close to 600 billion ECUs and from 40 percent of the total trade of the EC member countries to almost 60 percent. What has gone wrong since?

An Abdication of Responsibility

Essentially, managers of European companies have ceded too much responsibility for change to new (or newly powerful) political institutions. The industrial policy and research and technology development programs administered by these institutions are nightmares of inefficiency and parochial compromise. Worse, they tend to perpetuate outmoded industry structures by creating the illusion that European industry can strengthen its global competitiveness through public support and R&D funding without first overcoming its outdated structures.

What is needed is for European companies to pursue more European business strategies. To do so, they must overcome a number of structural and behavioral hurdles.

It is worth pointing out that there have been – and must be – two movements toward European integration: an economic and a political one. The original justification for European integration consisted of both economic and political considerations. Politically, the European Community was to foster the mutual understanding and peaceful cohabitation of the member states and thus prevent the catastrophes of the past. Economically, the Common Market was to provide European industry with an enlarged home market, generating economies of scale, and to overcome undue fragmentation in order to enhance the competitive potential of European companies in the world market.

Between 1958 and 1983, companies in Europe took the lead, following economic imperatives, while the political Europe followed reluctantly. Since about 1985, however, political institutions at both the national and the Community level have increasingly tried to seize the initiative, while business has fallen behind.

Why this reversal?

Outmoded Industry Structures

To understand what has happened, let's look at how we got into this situation. In the sixties, seventies, and up to the mid-eighties, most European companies aggressively increased their penetration in the EC market – either through rapidly growing exports or through a Europeanized logistics structure, with manufacturing and warehousing in several European countries. When the tariff barriers within the Common Market disappeared, companies managed to live with the nontariff barriers, which then gradually fell in recognition of a fait accompli. Europe prospered.

But eventually the point was reached where further increases in intra-European trade no longer made economic sense. Why? Because if a company in a given EC country tries to make up for a shrinking share of its traditional home market by doing more business only in the other European markets, it may find itself with the same (or even a lower) European market share – but at a higher cost than before. Therefore, real competitive advantage can arise only from growth over and above market growth, i.e., from Europe-wide structural change in the industry.

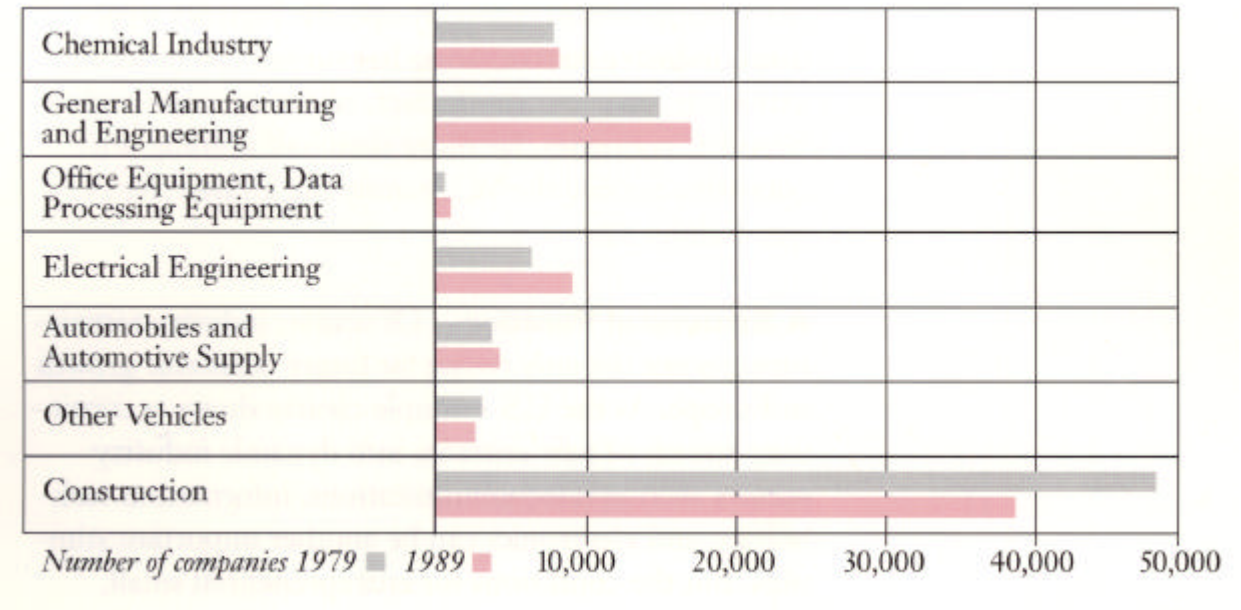
This means that the number of companies in a given European industry must diminish so that the surviving companies can grow faster than the market and also enhance their competitiveness in the global arena.

However, industry structures in Europe have remained highly fragmented. In fact, between 1979 and 1989 the number of companies per industry sector changed little (see Exhibit 1).

Therefore, when intra-European trade approached its saturation level in the mid-1980s, only half the economic model of market integration had been realized. Further economic progress was possible only through substantial restructuring of some key industry sectors.

Exhibit 1

Industry Structures in Germany, France, the U.K., Italy, Belgium, and the Netherlands, 1979 and 1989



The paradox of the current situation is that, although market integration is no longer the issue – and the real challenge is now the adaptation of company and industry structures – the efforts of the European Commission and, reluctantly, the governments of the EC countries are aimed at further enhancing trade and cross-border harmonization.

The conflict over the Maastricht Treaty was, therefore, largely beside the point. Monetary union, common industrial policy, and European research and technology development programs will not further what is most needed for the global competitiveness of European industry: the Europeanization of industry structures and marketing approaches.

Hurdles to Be Overcome

The initiative for this change has to come from European companies themselves. But unlike the rapid growth of intra-European trade and the relatively swift adaptation of company-specific logistics structures, industry restructuring has turned out to be an extremely slow process. In fact, of the investment flow from EC countries, far more than half is going into countries outside the EC, mainly the United States (see Exhibit 2).

A Structural Paradox. Of course, industry restructuring is not the only recipe for future economic growth in Europe. As the U.S. example clearly shows, a continuing stream of new entrants into dynamic industry sectors such as telecommunications, information technology, and electronics can be another important stimulus. But the conditions for entrepreneurial small, medium-size, and particularly start-up firms are poor in Europe because of cultural and language barriers, a lack of venture capital, and the parochial attitudes of many large buyers. So there is a structural paradox to be overcome: not enough small, dynamic enterprises, but at the same time, too many smallish established firms not poised to grow.

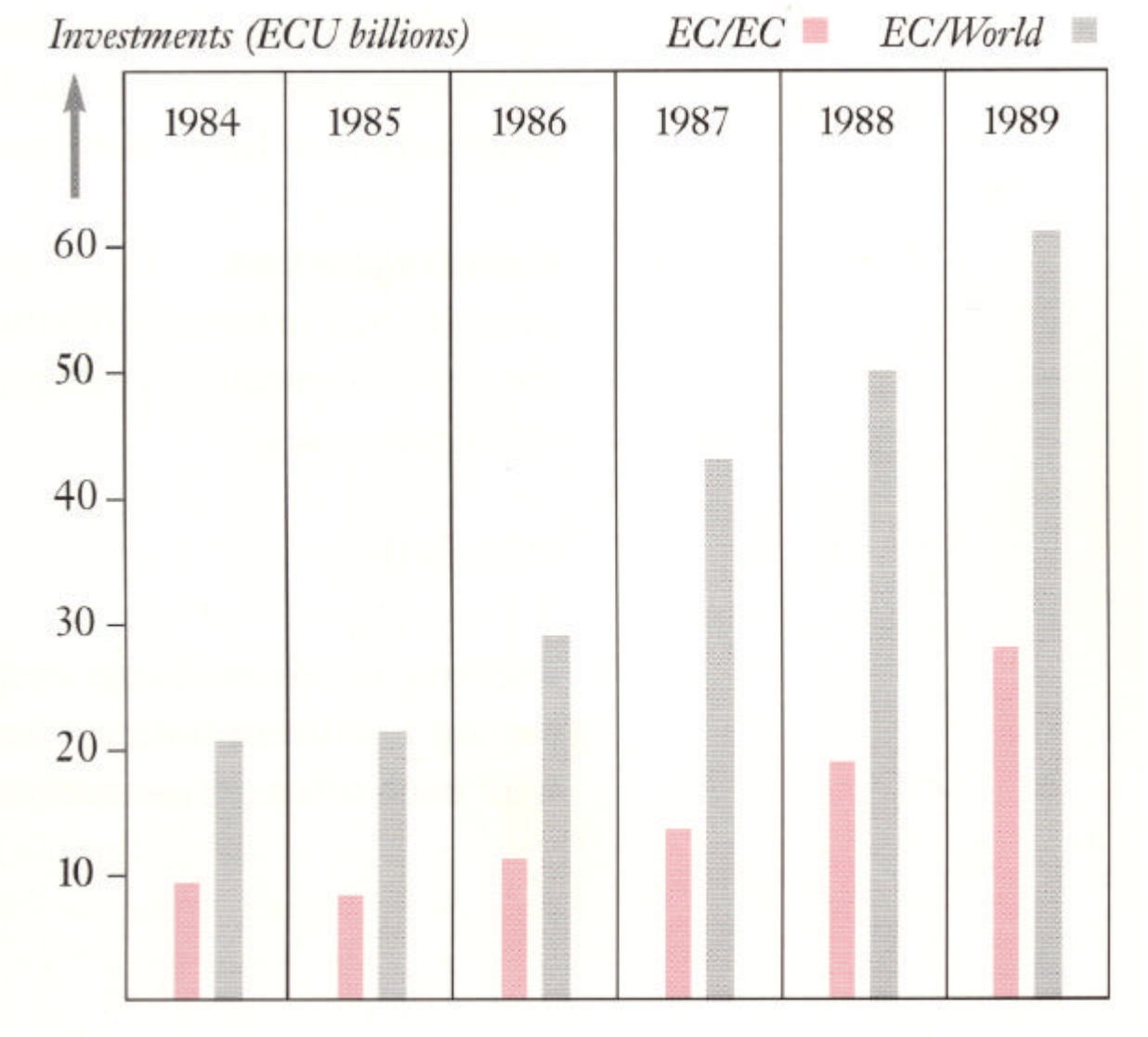
The danger of the Maastricht Treaty is that it diverts attention from the real issue. Monetary union may not be a bad thing, but the preconditions for achieving it (convergence of rates of inflation and of public debt in the member countries) are difficult to meet.

Nationalist Management. A major hindrance to Europe's corporate restructuring is the nationalism of its management and supervisory boards. We know from numerous consulting assignments over the last 10 years that our findings from a project for the European Commission in 1982[1] still apply: the leaders of EC companies are not ready to acknowledge the structural and behavioral consequences of the enlarged home market.

Most companies have established networks of sales subsidiaries in the EC countries. Many have relocated manufacturing and warehousing to better economically serve the European market. And many are procuring more actively from the most favorable sources in and outside of Europe. Nonetheless, they have persisted in defending their autonomy and maintaining their national identities.

Exhibit 2

Internal and External EC Investment Flows



In many cases, this persistence has become a matter of national pride. When Siemens acquired a stake in Plessey, British national interests made sure that the acquisition did not become a German takeover, but that British GEC was given an equal share in Plessey.

Moulinex's (France) takeover of Krups (Germany) was considered a defeat by many Germans. The difficulties arising from the Renault-Volvo deal stem largely from the issue of whether the French will control the joint operation or not. Siemens hastened to take control of the ailing Nixdorf and Daimler-Benz of AEG, to a large extent to keep „foreigners" out.

Cultural Issues. The number of transnational mergers in Europe is still small, and in most cases they are the result of emergencies rather than truly strategic moves.

Why is this?

We have to acknowledge tremendous differences among European business leaders. When they deal with each other across national/cultural boundaries, they have a hard time „speaking the same language" – in terms not of vocabulary but of connotations, values, and societal norms. They mistrust each other because they have experienced unpleasant surprises: commitments and promises not met, misunderstandings, unexpected actions and reactions.

In sales, manufacturing, and procurement, these surprises can be contained through meticulous contracts (even though the legal frameworks are very different). But when it comes to sharing responsibility in joint management

teams, establishing European identity, and taking into account different cultures, business leaders in the various countries shy away from making the jump.

So it is not surprising that the composition of most management boards and supervisory boards remain mononational. One of the consequences is that most companies first develop their products for their own national markets and only then adapt them to the requirements of other markets. And those few companies that have R&D centers in several European countries struggle mightily to agree on approaches and objectives. In the end, the headquarters culture nearly always carries the day.

As long as these behavioral and cultural barriers remain so pronounced – and as long as there are no fiscal and legal incentives to overcome them – industry fragmentation in Europe will persist. Companies will continue to suffer from scale disadvantages in global competition, not necessarily in the area of manufacturing (where critical sizes are coming down due to flexible manufacturing systems), but increasingly in R&D and marketing.

Anachronistic Laws. Strangely enough, the lack of European corporate law has not yet been recognized as a major obstacle. But it is anachronistic that a company has to follow different legal and fiscal regulations depending on whether it is a German „Aktiengesellschaft," a French „Société Anonyme," a British „plc," or an Italian „S.pA." It is absurd that a company wanting to incorporate operations in other EC countries in a restructuring effort must face prohibitive taxes because of fiscal goodwill evaluation. And it is a substantial obstacle to building a truly European corporation that profits and losses of individual subsidiaries in the various EC member countries cannot be netted at the corporate level. Compared to a similarly structured corporation in the United States, a European corporation has to bear a considerably higher overall tax burden.

But just as companies in Europe managed to build their European business rapidly despite nontariff barriers to trade, they could pursue a restructuring strategy despite the lack of European corporate law.

In this sense, Maastricht does not matter, but European business strategies do.

Creating European Business Strategies

What can European companies do to overcome the limiting effect of industry fragmentation?

We have identified six European business strategies that several companies in Europe (not necessarily of EC origin) have pursued successfully and that have helped them to substantially improve their pan-European market share:

• Transformation of their leadership cadres to be truly European, integrating different nationalities (e.g., ABB, Airbus, Arthur D. Little, Moulinex, Schering, Unilever)

• Acquisition and strategic integration of competitors in other EC countries (e.g., BICC, Bosch-Siemens Hausgeräte, BSN, GKN, Lucas, Moulinex, Schindler, VW)

• Optimization of European logistics (e.g., *Air* Liquide, Bosch, **GKN,** Henkel, Lucal, Philips, Schindler, SKF)

• Development of a European brand strategy (e.g., Agrevo, Bosch-Siemens Hausgeräte, Melitta, Moulinex, Schindler, Sony, VW/Audi/SEAT/Skoda)

• Creation of Europe-wide business units (e.g., Boehringer Mannheim, Bosch-Siemens Hausgeräte, DEC, GKN, Schindler)

• Formation of a network of European partnerships (e.g., Airbus, Ascom, Carlsberg, Hewlett-Packard, **KNP,** LVMH)

Increasingly, European companies will have to adopt such strategies to maintain their global competitiveness. Those that do not take the initiative to overcome their traditional monocultural stance will sooner or later find themselves left behind in an „open systems" world that requires larger structures and players.

„European Union" can derive its next growth impetus not just from efforts to achieve monetary union or from industrial policy, but from industry restructuring through more determined European business strategies.

[1] *Arthur D. Little, „The EEC as an Expanded Home Market for Industry," Report to the Commission of the European Communities, Brussels, 1982.*

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