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Small, high cost countries' strategy for attracting MNCs' global investments

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Introduction

During the spring of 1992 and autumn of 1993 the two leading German auto makers BMW and Mercedes Benz invested US$400 million and US$300 million respectively in new production facilities in the USA's "boom belt"[1,2]. The plants will be located in South Carolina and Alabama along Interstate 85 which already hosts several multinational companies (MNCs), e.g. Michelin, Adidas, BASF, Hoechst, Matsushita, Toshiba, Nissan. In 1992 MNCs did control investments at book value US$2000 million while their foreign subsidiary companies' total revenue amounted to US$5500 million[3]. According to the same report 80 per cent of all technology transfer in the world and 30 per cent of world trade took place between MNC family-companies, i.e. intra-MNC trade. Some countries host more parent MNC companies than other. Table I ranks 21 countries based on their concentration of MNC parent companies.

International trade has traditionally been explained by comparative advantage. However, with the development of better communication, increased mobility and freer trade, global companies operating in global markets have occurred as a new phenomenon. Levitt[4] describes the development of international trade from export-based activities to globalization of markets by standardization of taste and preferences of so-called world products (e.g. Levi's, Canon, Sony). Chandler[5] explains the development of the global enterprise as a function of technological development:

> As the development of technology of production and distribution and the markets for products became more homogeneous, such competition (i.e. competition between managerial enterprises) forced the multinationals to acquire a broader, more global perspective.

Reich[6,7] on the other hand explains the development of the global enterprise and markets as a natural evolutionary process as the world trade has become more efficient through freer trade, freer investments and freer communication. The author claims that the question of who owns the companies in the countries is not the issue, rather, how these companies can contribute to the development

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Country	Number of MNC parent companies registered in the country	Country	Number of MNC parent companies registered in the country
Germany	6,984	Australia	1,036
Sweden	3,529	Denmark	800
Japan	3,529	Spain	744
Switzerland	3,000	Portugal	684
USA	3,000	Austria	679
France	2,056	Italy	263
Great Britain	1,500	New Zealand	201
The Netherlands	1,426	Belgium and Luxembourg	96
Norway	1,321	Ireland	30
Canada	1,308	Iceland	14
Finland	1,300		

Source:[3]

Table I. Countries ranked according to concentration of MNC parent companies

of new competences in the national labour force. Consequently nations may be categorized based on the competences and skills of the national labour force. In a cover story the Mexican worker is described as "smart, motivated, cheap – and a potent new economic force to be reckoned with"[8]. This may indicate that it is and has been Mexico's business policy to attract MNC by offering a highly competent workforce. According to Austin[9] national policies are dependent on four main factors:

(1) *Political* (stability, ideology, institutions).

(2) *Demographical* (population growth, age structure, urbanization, migration).

(3) *Cultural* (religion, gender roles, language).

(4) *Economical* (natural resources, labour, capital, technology, infrastructure).

The author concludes that government's growth strategy must build on the above mentioned factors, i.e. they become the government's raw material and starting point for developing national business or welfare policies. National goals and strategies expressed through national guidelines and implemented through instruments and institutions will influence the companies. This is in line with the traditional Mason-Bain paradigm. Companies' reactions (conduct) to these goals and strategies create a feedback loop influencing the national goals and strategies[10]. Some countries are more affluent than others with regard to economic factors and more interesting from an economic point of view with regard to demographical, cultural and political factors. Such differences make some countries more attractive than others from an investor's point of view. According to Doz[11] MNCs may think of the various countries as three different types of markets:

(1) *Strategic countries*: either because they are a key linchpin in a regional or global MNC strategy or because they give birth to new competitors.

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(2) *Tactical countries*: are typical markets either served by imports or by nationally autonomous subsidiaries.

(3) *Opportunistic markets*: where no commitments are made, but which can be served on a marginal basis as the opportunity arises, usually through agents.

Strategic countries or regions may also be categorized as "battle grounds of intense competition" and opportunistic markets as "backwaters with no competition". MNCs may pick battle grounds for certain parts of their value chain in order to increase efficiency or ability to innovate.

The purpose of government trying to attract MNCs' global investments, is to stimulate the long-run growth and welfare for the nation or region. We will propose that from a MNC's perspective most small, high cost countries may be categorized as either tactical or opportunistic. Based on this, one would not expect a MNC to locate all its operations in one such country. For most MNCs the value chain consists of some activities not directly related to the primary functions. R&D is an example of an independent activity not connected to the rest of the value chain on a day-to-day basis. An integrated MNC is well equipped to locate loosely connected activities away from the main activities (upstream or downstream). Based on this we will propose that a MNC's competitive advantage becomes an issue of *how* rather than *where* the various activities are performed. Choices of configuration and co-ordination have to be made jointly, not only as functions of economic and competitive dynamics, but also as functions of government policies. In a given industry there appears a three-tiered structure, with integrated MNCs serving leading international customers, nationally responsive MNCs serving national customers, and national companies serving national companies. Small countries tend to have a majority of the latter group. A MNC's decision to locate one activity to one country may disrupt the three-tier structure. This threat may stimulate government to exercise a restrictive policy with regard to foreign companies' investments.

Governments have, however, increasingly recognized the very high opportunity cost of protecting strategic industries (e.g. defence industry, telecommunications) thereby reducing the utility for the inhabitants. Global industries imply national specialization among industries or within each industry; they limit the independence of each country, because it now has to produce from abroad a substantial part of the goods it needs. According to Doz[11] relying on the MNCs does not eliminate dependency either, because MNCs are likely to:

- keep their most advanced research at home;
- specialize their activities by country;
- try to avoid the diffusion of technology to the host countries.

As previously mentioned, the purpose of government trying to attract MNCs' global investments, is to stimulate the long-run growth and welfare of the nation. In attracting these investments host governments can assume an active or passive role. Doz[11] recommends that host governments adjust to MNCs' dispositions,

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i.e. assume a passive role. Encarnation and Wells'[12] strategy is somewhat more active in the sense that they recommend the use of incentive schemes in order to attract MNCs.

We will propose that none of these strategies will give the host country any sustainable competitive advantage in the market for MNCs' global investments. High cost small countries cannot offer large home markets or low cost input factors in order to attract MNCs. MNCs, however, may be attracted to the country or region due to competence (i.e. employees and buyers) and competitiveness (i.e. within the industry and within related industries) in the host country. We will propose that a high-cost small country, in order to attract and maintain MNCs' global investments, must, over time develop unique competences employed by a skilled workforce working for strong, dynamic industrial environments (clusters).

The model

The purpose of government (i.e. central and local) is to maximize utility for the inhabitants through services rendered. In order to finance the development of these services, government must develop strategies which will maximize both short- and long-term tax revenues without reducing the inhabitants' utility. This requires growth in the domestic economy. Companies and their employees generate taxes for the government through direct and/or indirect taxation. Government invests tax revenues in areas which will develop and strengthen national competitiveness and growth, i.e. education, research, infrastructure, etc. Important factors driving growth are dynamic clusters[13] and knowledge[14]. According to Reve[15] value adding in the private sector is a function of strategic understanding,

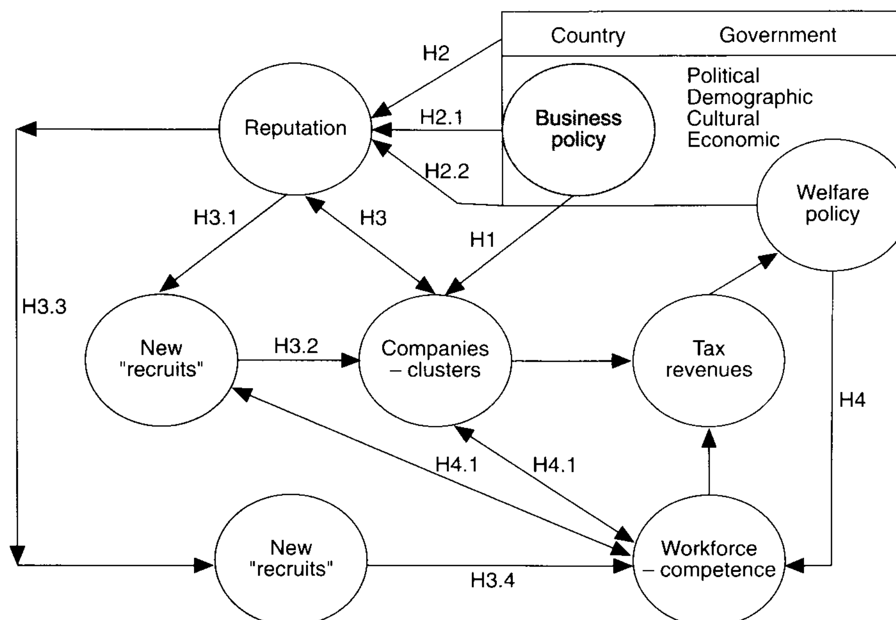

Figure 1. A cybernetic approach to small countries' strategies for attracting MNCs' global investments

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human resources, management, technology and development of competence and customer focus. Profitable companies and a competent workforce operating in a dynamic industrial cluster, become the two driving forces for growth in the domestic economy. These factors are outlined below.

Given the country's economic, cultural, demographic and political factors, host government business policy by influencing industry structure, is believed to affect companies' competitiveness (H1). Reputation is believed to be influenced by the country (H2), government's business policy (H2.1), and the welfare policy (H2.2) in the country. If companies within the country or region prosper as a function of Government's business policy, *ceteris paribus*, the clustering of these companies within the region will build a reputation of the region and the country as being the "hot spot" for particular industries. This will stimulate them to relocate to the region or country (H3). Reputation, as a function of country, business and welfare policy, is believed to be positively correlated to the country's or region's ability to attract new companies (H3.1) and people (H3.3). This is believed to strengthen the region's existing company (H3.2) and workforce base (H3.4). A well-designed welfare policy (H4) will, in the long run, create a net inflow of new employees to the country or region. Welfare policy is a relative perspective and a question of the country's or region's amount and quality of health care, education system, kindergartens, etc. A competent workforce possessing particular skills will be the driving force in establishing, growing and maintaining strong and dynamic clusters (H4.1). With an increase in profitable companies paying the market price for the input factors and a labour force in high demand, government's long-term tax revenues are maximized.

It seems natural to assume that a well implemented business and welfare policy will attract new and maintain existing companies and people in the country or region. In order to maximize value for the companies, government's business policy must be differentiated to reflect the needs of the companies within the industries and the differences between industries (see for example[16,17]). From a tax revenue perspective domestic companies or MNCs leaving the region will have an impact on the long-term tax inflow. Building on Hirschman[18] and Fornell and Wernerfelt[19] the long-term effect of reduction in tax revenue for "loose monopolies" can be calculated using the following notation. Let a fraction b of M companies receive public services which they consider less than satisfactory due to either subjective or objective disconfirmation[20]. A fraction of these dissatisfied companies, Mbv, will voice their dissatisfaction. The other fraction, $Mb(1-v)$, will not voice their dissatisfaction. A fraction of those who do not voice their dissatisfaction, $Mb(1-v)e$, will exit from the relationship whereas the other fraction, $Mb(1-v)(1-e)$, will remain loyal. Of those who do voice their dissatisfaction, a fraction, $Mbvq$, will exit from the relationship whereas the other fraction, $Mbv(1-q)$, will remain loyal after they have "cooled off". There is considerable evidence suggesting that the fraction of "customers" who remain loyal after they have voiced their dissatisfaction increases significantly if they have been exposed to professional complaint handling. A region's present tax

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inflow is a function of several factors, e.g. number of taxpaying companies and people, the size of taxable income of the companies and people, indirect and direct tax rates of companies and people, people and companies retention rate with regard to maintaining present location in the region, etc. Let us assume that for some reason the region's present retention rate (r_0) falls to a permanent new but lower rate (r_1). The consequences occurring from a marginal reduction in the retention rate (*ceteris paribus*) from r_0 to r_1 on the long-term tax inflow can be estimated using the formula for calculating the value of a geometrical row ($1/_{1-r}$). Let us assume that the companies $r_0 = 0.95$, i.e. the region must replace five out of 100 companies every year and $r_1 = 0.94$. The relative change in value between the two geometrical rows represents the long-term effect of change in tax inflow. Using the formula $1 - (1/_{(1-r1)}/1/_{(1-r0)})$ effects on long-term tax inflow, given $r_0 = 0.95$, can be calculated (see Table II).

Effects caused by changes in the retention rate are exponential (not linear) with regard to reduction in the long-term tax inflow. Even a marginal reduction in retention rate has significant effects on future tax inflow. Defining strategies and initiating projects which will address the fundamental issues of maintaining, increasing or avoiding reduction in retention rate, becomes necessary to any government given the formation of free trade associations like NAFTA (North America), EU (Europe) and ASEAN (Asia).

Discussion

Country and business policy

Traditional theory of international trade and comparative advantage is based on countries having different conditions for production, i.e. factor endowments. Classification of goods in order to analyse international trade and probable trends, are suggested by several authors[21-23]. Three types of goods are proposed:

(1) *Richardo goods*: products based on natural resources. Production is allocated between nations based on factors related to production.

(2) *Heckscher-Ohlin goods*: products based on mature technology which will be transferred to countries or regions offering the lowest factor costs.

(3) *Technology/competence goods*: goods produced by the most advanced nations. Some of these products may mature and become Heckscher-Ohlin

Present retention rate(r_0) (%)	New retention rate (r_1) (%)	Long-term effect on tax inflow by changing from r_0 to r_1 (%)
95	94	–17
95	93	–29
95	92	–38
95	91	–44
95	90	–50

Table II. Effects in long-term tax inflow when present retention rate is reduced from 95 per cent

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goods. However, due to the high degree of advanced technology and/or competence in producing these goods, they tend to remain within this category of goods.

Porter[24], building on both classical and neo-classical theorists and his own works from 1980 and 1985, introduces the "diamond" as a framework for analysing and understanding international trade and competitive advantage between nations. In the diamond, Porter broadens the definition of national competitiveness by introducing a set of interrelated factors:

- firm strategy, structure and rivalry;
- demand conditions;
- related and supporting industries;
- factor conditions.

The strength and magnitude of national industrial clusters defines competitiveness. The components of the diamond become the elements constituting what Porter terms "clusters" with "government" and "chance" as peripheral factors influencing the diamond. In this respect government influences (directly or indirectly) the various components of the clusters. According to Porter[24] productivity is the only meaningful factor with which to compare a nation's relative degree of competitiveness. Productivity is also dependent on the quality of the products which influences the price the product can obtain in the market. Competitive advantage of nations thus becomes an issue of the companies' internal efficiency and external effectiveness.

How can governments stimulate growth? There are three options with regard to improved competitiveness and growth:

(1) reduced increase in costs (taxes, factor costs);

(2) strong industrial clusters;

(3) a combination of (1) and (2).

Reduced increase in costs. In a global economy reduced increase in costs is primarily an issue of size of public sector, productivity and wages. In two government initiated studies[25,26] of a small, high cost country with a large public sector (Norway), several areas which may lead to significant improvements in efficiency and effectiveness were identified. There are reasons to believe that this may be the case in other countries too. Based on the need for increased efficiency in the public sector due to recession and unemployment, privatization has taken a new dimension over the last decade. In 1992 governments in about 50 countries sold US$69 billion-worth of state-owned enterprises[27]. This, according to the same source, is up US$328 million from mid-1980 and may double by year 2000 if all planned privatizations are realized. Another discussion which seems to emerge in several countries is discussion related to the size of the public sector and the quality of the services provided given the implicit tax burden private sector must carry. Downsizing the public sector by handing over public services to private

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companies may improve efficiency and thereby increase the utility for the users. Downsizing the public sector may also reduce the cost dilemma faced by many North European countries as they negotiate to attract MNCs' global investments.

Strong industrial clusters. Strong industrial clusters are, according to Porter[24], characterized by:

- competing companies;
- demanding customers;
- advanced factor conditions;
- related industries which are competitive;
- strong R&D environments.

In line with Porter[24], Reve *et al.*[28] it is recommend that in order to improve competitiveness, Norway ought to stimulate areas where there are strong industrial clusters. In the case of Norway clusters are few and hard to define since the number of companies in each cluster is low. Strengthening existing clusters is a task for the government. Identifying new clusters is, however, a task for the market not the government. Based on the natural formation of clusters, government stimulates the development of competence within industries experiencing the highest performance. In order for the market to identify companies and industries with a real growth potential, businesses must be allowed to compete on equal terms.

Business policy and companies

Growing international interdependence puts a greater burden of adjustment on national economies. In an international environment of freer trade and freer investment, a national economy's structure must adjust more quickly to the relative changes in competitiveness of various national industries. Governments' concerns towards global industries are not undifferentiated, they focus on specific issues raised by growing international interdependence, and the need for economic adjustment that results from this interdependency. Adjustment needs are most keenly felt around maturing and declining industries with the social woes that develop around emerging industries, and around industries that question the wisdom of globalization in light of their strategic significance.

The relationship between a MNC and the host government can be operationalized using Coleman's[29] formulation of strategic position as a function of the parties' mutual interest and control over the MNC's domestic production. This is outlined below:

$$\text{Strategic position} = \frac{\text{MNC interest in host country production} \times \text{National control over MNC production}}{\text{National interest in MNC production} \times \text{MNC control over host country production}}$$

Host country interests are primarily influenced by a MNC's relative ability to offer employment and tax revenues, improve the balance of trade and contribute

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to domestic economic growth. MNC control is restricted by the type of investment. Labour intensive production and easy transfer across national borders provides the MNC with more control due to host governments' fear of unemployment. According to Kogut[30] capital intensive facilities are more difficult to liquidate. This increases host government's control.

MNCs' investment policies are influenced by international trade and industrial conditions. Host country policy is shaped by a number of domestic, political and market forces. Consequently the interaction between a MNC and host government is affected by the imperatives facing both parties.

Doz[11] claims that MNCs operating in a global market, will choose locations based on the cost of input factors. According to the Heckscher-Ohlin theorem, global MNCs will be attracted to countries experiencing a relative cost advantage in the input factor on which the MNC is most dependent. The factor cost advantage should entice MNCs to turn the country into an "export platform" to the mutual benefit of the MNC and the country. However, while integrated MNCs may abide by set rules, they are unlikely to let any national government gain a say in how they run their operations, within the framework of pre-negotiated and agreed-on guidelines. Unless the government manages the evolution of its industry structure and relative factor costs positions together, the country may find itself with a portfolio of ageing MNC investments, likely to loose their competitiveness on world markets resulting in a large-scale MNC exodus. Many global industries populated by MNCs are often characterized by complex manufacturing processes, sensitive to economies of scale and experience. The most logical MNC competitive response to maturity is to integrate operations across borders. According to Doz[31] governments are concerned that integrated MNCs may quickly respond to shifts in the relative cost factor competitiveness of various manufacturing locations by relocating their manufacturing facilities in different countries.

In the market for MNCs' global investments, high cost, small countries will experience a handicap, i.e. no large home market or cost factor advantage. A question one may raise is whether these countries should engage in the market for MNCs' global investments. We will take the perspective that MNCs' investments will contribute to the development of competitive advantage for high cost, small countries building or strengthening the nation's industrial clusters, skills and competences. These countries will engage in international trade with high priced products founded on the use of advanced technology and competence rather than cheap input factors.

Reputation

According to the cover story of *Business Week International*[32] several regions in the USA are known to have a concentration of certain industries, e.g. "Silicon Prairie", Illinois; "Medical Alley", Minnesota; "Optics Valley", Arizona; "Laser Lane", Florida; "Ceramics Corridor", New York; "Telecom Corridor", Texas. Apparently some regions have a reputation of being "hotter" than other regions in certain areas. This raises the issue of what attracts certain industries to specific regions. In marketing, reputation is a well-developed concept. Reputation, brand

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or name of the product influences the buyer's purchasing decision, i.e. a good brand stimulates purchasing by simplifying decision rules. In this context reputation or brand becomes an issue of attitudes and beliefs with regard to: brand awareness and recognition[33], customer satisfaction and loyalty[17]. Products made in one country and sold in another carry a "made in" notation on their label. This notation can be an information cue for potential buyers and may or may not figure in the selection of one brand or product over another. Reputation or brand may be aggregated to macro level through the concept of country of origin. According to one study[34] the country of origin concept has at least three dimensions that figure in decision making:

(1) a marketing strategy dimension;

(2) a corporate strategy dimension;

(3) a public policy dimension.

Marketing strategy. This dimension lies within the traditional marketing domain. It reflects the frequent use of a brand's origin as a key element in the marketing strategy of many companies. The "made in" label is used because manufacturers believe the customer:

- holds some views about the origin country and its competences;
- considers the country origin itself as a distinct and useful product attribute in making brand choices;
- shares the manufacturer's enthusiasm about its reputation.

Successful use of the "made in" label may, however, limit the MNC's ability to shift operations to other countries.

Corporate strategy. This dimension goes beyond marketing. It involves the interaction between overall corporate strategy and "origin" laws in the destination country. MNCs producing in low cost countries which sell their products in markets where the countries of origin do not carry prestigious reputations, will use brand names rather than "made in" labels.

Public policy. Countries with trade deficits or developing infant industries, may want to protect their domestic producers. This protection may take the form of legislation, negotiations or promotions aimed at generating preferences for domestic products. This may lead to hostile policies being adopted towards MNCs locating their activities in the country or region. On the other hand, governments may welcome MNCs' global investments in order to reduce trade deficits or unemployment. In general the threat of introducing MNCs can be used by governments to stimulate efficiency and effectiveness within national producers.

Reputation, satisfaction and loyalty

Nations and governments enjoy different reputations. Companies or people operating or living in a country or region have experience of the business and welfare services offered by that government. They base their satisfaction with the business and welfare policy on perceived service quality. Companies or people

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located or living outside of the country or region have no experience of the business policy or welfare policy offered by the government in that country or region. Their decision with regard to making use of the capability in the country is partly based on the country's or region's reputation and advice from people who may have expertise.

There are reasons for believing that the services provided by the host country government are infrequently used by the companies in the region. Andreassen[16] found in an analysis of private companies' satisfaction with the business policies of the local government of Oslo, a positive correlation between reputation and satisfaction (0.77), reputation and loyalty (0.44) and no significant correlation between satisfaction and loyalty. Satisfaction with the public services is believed to influence companies' decisions with regard to maintaining their locations. Improving government's performance (i.e. increased number of businesses maintaining their present location) can, according to this study, best be achieved by increasing the score of reputation since this factor has the highest impact on company loyalty. Based on this one may hypothesize that customer loyalty based on satisfaction with government's services is relatively stronger than customer loyalty based on government reputation.

The marketing implications of this proposition are fundamental with regard to developing a business and welfare policy. Frequent interaction implies that the government has developed a relationship with the users. The user's motivation for interacting frequently with the government, given alternatives, is primarily based on satisfaction with the services. This satisfaction is a reflection of the perceived service quality. Frequent use and high involvement builds expertise with the user. Using Fishbein's attitude-toward-object model one would conclude that the user has a positive attitude towards the service.

In the latter part of the proposition the opposite scenario may be the case. The interaction between government and users is infrequent. This may be explained by avoidance or the nature of the need for the service. In the case of public services one may claim that both explanations may be applicable. In the absence of experienced service quality, the user's perception of the services provided is more based on the general attitudes and beliefs of the supplier or service category. This predisposition with regard to attitude may influence his evaluation of the service and consequently his overall satisfaction.

Based on the research done on the subject of country of origin some authors[23] are of the opinion that there is enough evidence to claim that:

- the "country-of-origin" effect exists;
- both consumers and industrial buyers are affected by "made in" images;
- "made in" stereotypes can be changed.

High cost small countries can, given a positive reputation, capitalize on the concept of country of origin. This effect may, in the eyes of MNCs, increase the attractiveness of one country over another with regard to investments. The fact that an MNC establishes itself in a country with some or all of the value chain activities, may

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in itself initiate a positive spiral thus strengthening the clusters of the country. This may lead to people looking to employ their expertise being attracted to the country or region; a net increase in the number of companies in the country, with added value, numbers of employees and tax revenues increased.

Concluding remarks

Independent development of a national industry requires a large domestic market. Smaller countries trying to accelerate their development may have no choice but to attract MNC subsidiaries. Attractiveness is based not only on factor competitiveness and size of home market, but also on privileged access to a nation's competent and skilled labour force and the nation's good reputation. Larger countries may benefit most from global industries by retaining and bargaining access to their domestic markets, while smaller countries benefit most from free trade. Small countries lack bargaining power *vis-à-vis* MNCs and they need to offer better incentives than larger countries and impose fewer performance requirements in order to attract MNC investment. They also tend to rely more on factor protection rather than on commodity protection in their incentive package, which is contrary to the favoured tool of larger countries. We have tried to argue that a small, high cost nation may improve its bargaining power by actively developing highly competent and dynamic industrial clusters. The ability of MNCs to locate activities which are within their total value chain but are not directly related to their primary activities may make it attractive to invest in these countries. The goals are to improve R&D and product design in order to compete successfully for the business of professional and demanding customers in the country or region.

Government policies, goals and strategies affect the mode of entry of MNCs. Governments also affect co-ordination within MNCs. By demanding responsiveness (purchasing policies) they may exclude integrated MNC subsidiaries from the public sector market. Governments are traditionally mainly interested in social and political performance (autonomous local decision making, safety of supply, location of technology to cover risk of embargo). We propose that governments may also be interested in MNCs due to their impact on national companies and industries by introducing more professional players into the market. This may help build strong dynamic clusters in the long run. One may, however, expect hard lobbying activity from the local players in order to avoid this planned increase in competition between the players in the local market.

The need to deregulate or privatize public services or markets will be reduced if the public services offer high utility (i.e. satisfaction) to their users. If, however, the public sector does not manage to offer high utility, questions must be raised about management competence or the guidelines under which public enterprises operate. Privatization and deregulation are two solutions. Based on others and previous work[35,36] Fornell[17] proposes to introduce a systematic measure of public services' ability to satisfy their users through the services they offer. An index (satisfaction score 0 to 100) expressing how various services are rated by

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their users, would introduce both incentives for improvement and work as a mechanism for increased competition between public services.

Kohli and Jaworski[37] claim that industries and companies are customer oriented if they market differentiated products and services reflecting heterogeneous customer preferences. Public services have a tradition of offering undifferentiated services. However, as described earlier, listening to customers will bring valuable information with regard to service development. This will increase customer orientation which may lead to the reduced exit of MNCs from the region. According to Osborne and Gaebler[38] there are several ways public managers may listen to the voice of the customer. Some may be:

- customer councils;
- customer interviews;
- customer service training;
- quality guarantees;
- inspectors;
- ombudsmen;
- complaint tracking systems;
- toll-free numbers.

The true challenge raised by host governments to MNCs in the 1990s may be more organizational than economic. The days when governments discussed whether (and how) to ban MNCs are gone, but the organizational difficulties of dealing with very complex and differentiated conditions for resource configuration and co-ordination may impose their own limits on MNCs' growth and success. If this is the case, MNCs will be very careful in configuring the value chain. Only activities within the chain which are of strategic importance to the MNC's sustainable competitive advantage (SCA) will be located outside its main area of operation being upstream or downstream activities. R&D, product design and development may be categorized as being of strategic importance to the MNC. In this lies the challenge for high cost, small countries in attracting MNCs' global investments. Good reputation, an attractive business and welfare policy and development of a competent and skilled labour force employed by dynamic industrial clusters are attractive factors for MNCs pursuing innovation in order to develop and maintain SCA. Based on this, one may conclude that the unit of analysis for understanding international trade and development, and consequently the market for MNCs' global investments, is the companies within an industry, the clusters, and not the country as such. The country or region, however, will through its business policy form the arena in which the companies compete. In this respect the government of any country or region may influence its own tax revenues by developing a business policy which attracts certain industries and companies based on a highly competent workforce. The workforce finds it attractive to (re)locate to a country or region based on different aspects of the quality of life there. In this respect a win-win strategy is developed for all parties.

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