INTERNATIONAL EXPANSION OF SERVICE COMPANIES USING THE STRATEGY OF DELOCALIZATION

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The elimination of the constraints related to distance, service demand increase and service accessibility, from the perspective of their commercial capacity, have encouraged service companies to invest abroad, with the desire to identify new clients and to use their specific competitive advantages, and, for this reason, in this work, we shall present new delocalization models that could be used by the companies of the dematerialized economy to transfer some activities outside of their country of origin through the realization of a commercial presence (foreign direct investment - FDI) and their integration with the other entities of the network, in order to exploit the comparative advantages of the different locations.

Key words: delocalization, captive delocalization, FDI, back office services, integrated expansion, Boston Consulting Group model for service companies

JEL Code: M160; M130.

1. Introduction

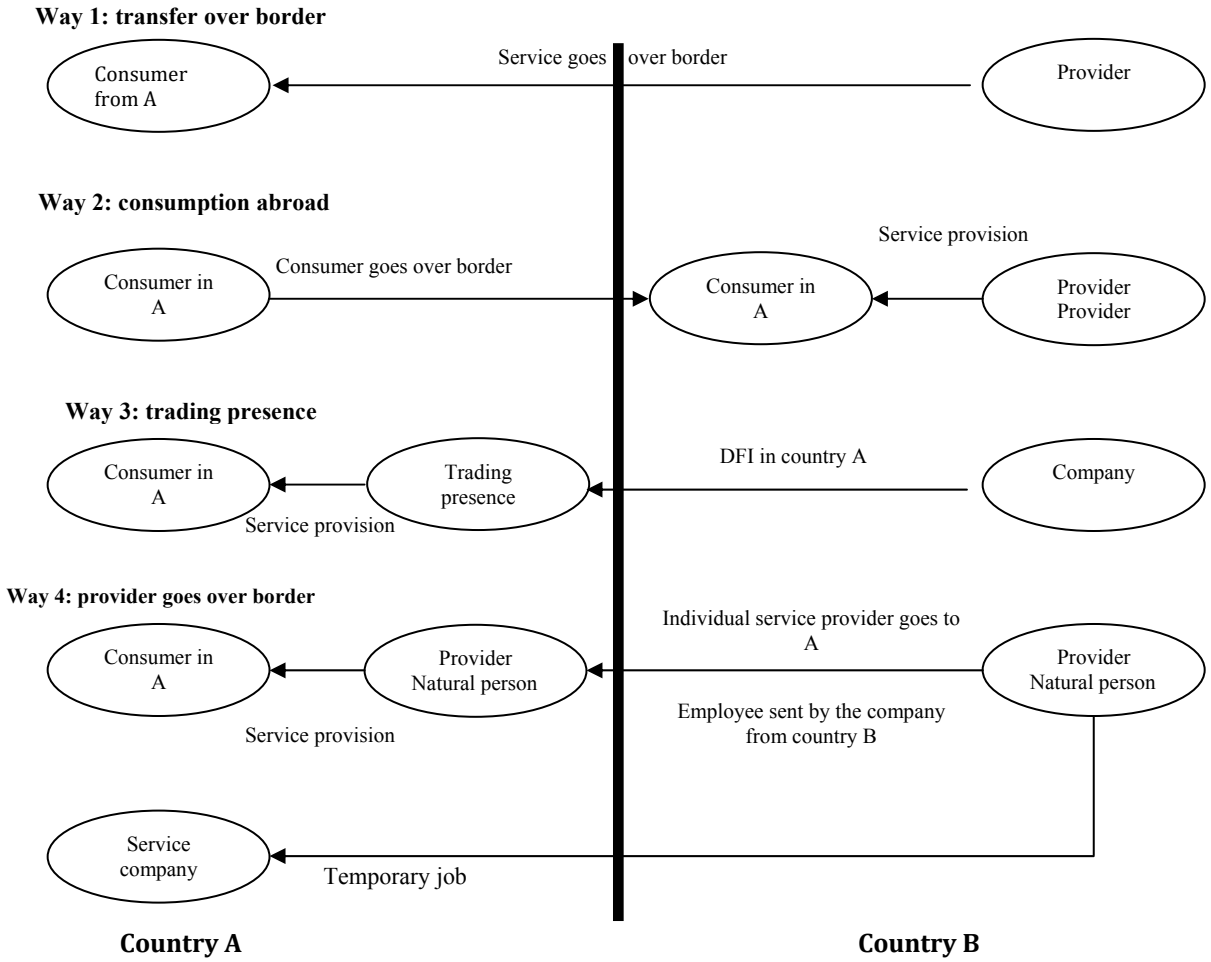
The array of services worldwide is diverse and corresponds to a large number of subsectors of services, with specific needs in terms of specialized skills and knowledge, usable on other markets as well. This leads to ways of internationalization specific to the different service activities. The way the enterprise balances the scales *"risk commitment/ profit control"* and chooses one of the numerous variants of the multi-country strategy only represents the demonstration of certain skills allowing the investing company to attain its goals. The General Agreement on Trade in Services (GATS) structures a taxonomy of the way services can be provided internationally (see Fig.1) allowing us to identify two major service internationalization types: *by international trade or under the form of a trading presence* (Constantinescu, L.M., 2010, p.45)

2. Literature review

According to the International Monetary Fund, "*FDI refers to those investments carried out in order to obtain an advantage in the long run in a country – other than that of the investor – his interest involving the participation to the management of the entity he invested in*". The development and the impact of technology on the optimization of the services' internationalization capacity and the deregulation of the service markets accompanied by the acceleration of the service flows liberalization are strong vectors of the international expansion of the service companies' activities, which have obliged the firms to initiate the process of identification of new markets in order to maintain and eventually to improve their competitiveness.

In this context, the international expansion process, especially for these companies, is determined by the local advantages specific to the country, resulted from the Direct Foreign Investment and a necessary condition for a firm to invest abroad is to get an ownership edge over the local market companies, via a deep knowledge of this market and the possibility of previous adaptation (J. Dunning, 1993, p.147).

Fig.1.Ways of providing services internationally according to GATS



Source: A. Bobircă, 2010, p.97

FDI is considered as the most complex way of developing or penetrating on the external markets for the companies by the following reasons (Dumitru, I., 2004, p. 187):

- **search of resources**: modernization of the resources' quality and existence of some local actors willing to promote in common the use of knowledge and/or of resources with a great consumption of capital;
- **search of markets**: increased need of being closer to the users in sectors with great consumption of knowledge and increased importance of the promotional activities undertaken by the regional and local development agencies;
- **desire of efficiency**: an environment favorable to private initiative and a high degree of competitiveness and cooperation among the enterprises;
- **search of strategic assets**: favorable opportunities provided in exchange for local tactic knowledge, ideas, access to different cultures, institutions and systems, and to different demands and preferences of the consumers .

At the beginning of the '90s, the weight of services in the world's DFI was around 50% and services represented 55%-60% of the annual global investment flows. Transnational companies represent the main way of penetration for the DFI, both in the developed and in the developing countries, as a natural consequence of the competitive advantage held by these companies in the process of globalization of the economic activities.

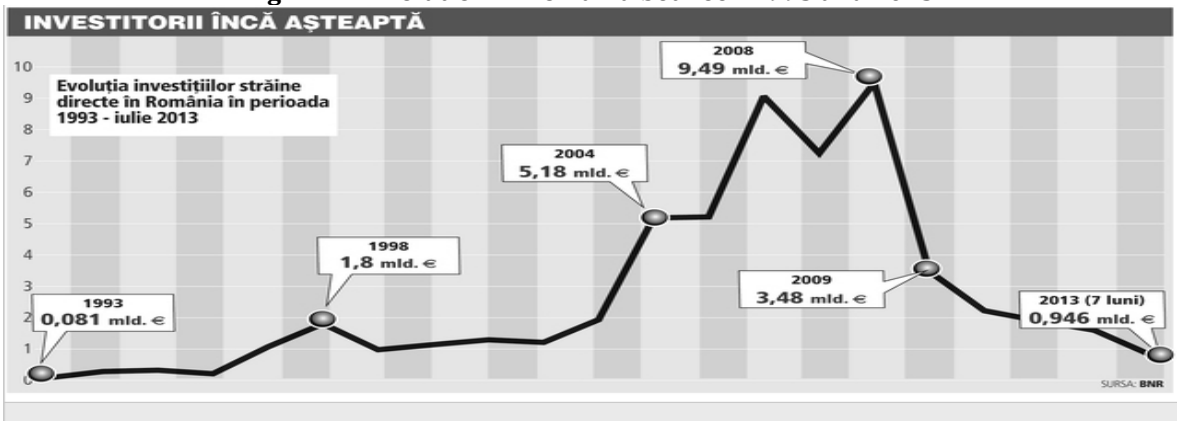
The access to the market is essential for the foreign investors, and even for the strategic ones aiming at long term goals regarding the expansion of the market for the products supplied by them, who want to build distribution networks with clear synergic effects, without omitting either the advantages of the low costs in the area of the FDI receiving countries. Also, a series of investors see, in this area of interests, an essential component of their own strategies. The low cost of the labor force, as well as that of

the material resources, is particularly attractive given the numerous failures triggered by an inadequate integration on a foreign market[28].

The evolution of trading and of the intra-industrial DFI during the last 20 years demonstrates this phenomenon in the case of service companies; the internationalization of their activity was not dictated by the same imperatives, namely the maintaining of competitiveness. Exceptions are those sectors in which the weight of the output obtained based on the FDI is very high, for instance in finances, in the banking system, in some consulting categories, advertising and trademark hotels.

During the years that followed the adhesion to the European Union (EU), the index of attractiveness of the business environment in Romania (see Fig.2) grew from 59% (2005) to 66% (2008). Romania was considered one of the most attractive business environments in Central and Eastern Europe, along with Russia (the attractiveness index grew from 63% in 2007 to 72% in 2008) and Ukraine, which recorded an attractiveness index growth from 56% in 2007 to 67% in 2008 (Dobrescu E., 2008)

Fig. 2. FDI Evolution in Romania between 1993 and 2013



Source: author's adaptation of the Romanian National Bank Reports, 2013

3. Geographic reconfiguration through delocalization for the international activity of service firms

Out of the tendencies present on the world market in point of the international organization of the service activities, the geographic reconfiguration of the international activities of the service firms through the redefinition of the role and functions of the company's individual units determined, in the case of these firms, the appearance of new international expansion models (delocalization models). Any decision of the firm regarding delocalization supposes that a certain service function, provided previously inside the firm and on the market of origin shall be entrusted to a provider from an external market, which can be a form of FDI (internalization) or an independent provider (externalization).

According to UNCTAD (1994) and Boston Consulting Group (2005), delocalization, namely the process of transferring an activity outside the company's country of origin may take place by:

- delocalization (captive off shoring) towards a subsidiary/branch situated in a region with a cost advantage, a model permitting the firm to benefit of scale and cost advantages while maintaining the operational control of the delocalized activities.This process is also known under the name of internalization;
- externalization (outsourcing) – a model permitting the companies that opt for this type of geographic

reconfiguration of their activity to leave the operational control in the hands of other providers, in order to exploit the cost and specialization advantages of certain geographic regions.

In services, both the firms' ways of globalization and their competitive strategies are very heterogeneous, reflecting the idiosyncrasy of the FDI-related decisional factors regarding the strategic behavior model to be followed and/or the differences of opinion concerning the **moment and space of** action. However, in time, certain convergences of ideas have emerged, such as, for instance, the use, as a support of the FDI decisions, of the feed-back relation between the Ownership, Localization, Internalization (OLI) advantages and the strategic globalization behavior.

[28] A study realized, for instance, by the prestigious consulting group McKinsey proved that out of 116 acquisitions made by international enterprises, only 23% allowed the recovery of the investment made and the obtaining of a profit, while for 61% of the acquisitions the result was rather a failure than a profit (Bradley, F., 2001, p.368).

A firm's activity volume on the international market at a moment *t* may be regarded as a function of the OLI configuration at the respective moment and of the strategic answer adopted by the firm to the previous OLI configuration or to the modifications of the OLI variables.

According to the priority goal pursued, the strategies of penetration on the service market through DFI may be (C. Cristureanu, 2010, p.148): Client-Following Strategy (CFS) and Market-Seeking Strategy (MSS).

Client-Following Strategy refers to the actions of a firm following its clients, providing to them the same services/goods as those produced in its own country (e.g. an advertising company, a bank etc).

Market-Seeking Strategy is a strategy adopted by the service producing firms, meant to attract new external markets, by providing their services both to the national customers and to the markets of third countries (e.g. the case of a fast-food restaurant chain like MacDonald's, established in a franchise system in a country). The two strategies of penetration on external markets through FDI are influenced by the form of the transnational companies (TNC) – full ownership or co-ownership – adopting them and by the technology used to produce the service (hard or soft). Consequently, the first strategy is associated rather with the integral ownership of the TNC and the use of a soft technology, while the second strategy is used through the association of TNC with firms of the external market (eventually through the formation of mixed companies) and with the adoption of hard technologies the capital-intensive services.
The delocalization tendency of the service firms is largely supported by the evolution of the externalization process on the internal market, also, as in the case of the informational services, human resources services, accountancy and financial services.

Gradually, as the independent service providers of the internal market become international, the probability of delocalization grows and so, services that were traditionally obtained on the internal market are delocalized and externalized. The data processing services, the soft production, the processing of the different financial products are activities being now externalized towards the economic agents of other countries, and which are then retransmitted to the contractor electronically.

The dramatic decrease of the costs for the Information Technology, considered the "engine of the service revolution" allowed the developing countries to use their relative cost advantage and provide distance services through electronic transmission. The result was that many services are already traded in this way by the developing countries (J. Nielson, D. Taglioni, 2004, pp.221-222, quoted in A.Bobircă, 2010, p.157).

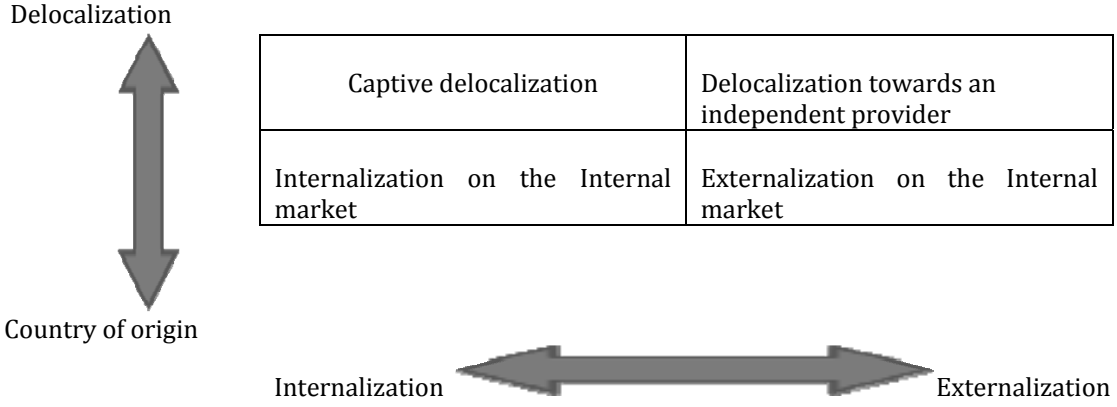
For business services, includinging a great part of the firm's "back office" functions (e.g.: data introduction and organization, editing, customer lists management, telemarketing, distance secretariat, website design), back office operations and customer relation services can be externalized and a large number of TNC have externalized their soft production and service providers from countries such as Romania, Russia, Hungary, Philippines are trying to penetrate on this market on which India is a leader.
At the same time, the appearance of some "low cost" service providers is another factor that determined the TNC option towards delocalization, as it is easier to identify a service provider for domains where a subcontractors' market has already been created (e.g. soft development).

Delocalization towards India of the activities of the European firms takes place especially through externalization, while towards the area of Central and Eastern Europe, the preferred solution is internalization (A. Bobircă, 2010, p.162).

In the case of some large-size activities for which the work volume is important, the delocalization is justified only if sufficient scale economies are obtained; similarly, in the case of some small-size firms, where the recruitment of individual qualified service providers is difficult, the externalization to a specialized, acknowledged firm proves to be a better solution.

Considering that the geographic expansion of the service firms business internationally depends on the type of international organization of the activity (internalization, externalization), on the service firm's general system of objectives and on the attractiveness of a country's market (based on the expected growth rate and on the size of the market of a certain product/service), the specialists of Boston Consulting Group in 2005 proposed an integrated expansion model in service firms (Fig.3) integrating two criteria: location choice (vertically) and organization type (horizontally).

Fig.3. Integrated geographic expansion model for service companies



Source: A.Bobircă, 2010, p.163.

4. Conclusions

The location-related advantages that different countries can provide to the companies of the service sector in the modern dematerialized economy have evolved and the arguments in favor of some new international geographic expansion models for the activities of these firms have to do with the correlated effect of the governmental policies of the countries benefiting from DFI in the sense of the deepening of the deregulation and liberalization processes of the service markets, and also with the technological progress that has led to the improvement of the service trading capacity, both on the internal and on the international market.

The multilateral liberalization of the international trading in services has been determined by:

- proactive factors: the location-related advantages of the countries in transition/ developing countries. DFI as a determining way of trading services generates specific advantages for these countries, and the know-how and managerial practices are adopted gradually by the local firms;

- reactive factors: industrial activities requiring intensive labor force from the developed countries are relocated in the countries in transition/ developing countries based on cost considerations.

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