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INTERVIEW

Does Expatriate Production Prejudice Exports?

Interview with Dr Gerd Tacke, Siemens AG, München

Increasingly, German firms are adopting the practice of setting up production units abroad. The public is not altogether in favour of this trend. It is argued that in so doing German industry is creating a stick for its own back and may possibly—in the long term—prejudice its own export opportunities. In an attempt to clarify these complex questions INTERECONOMICS* has talked with Dr Tacke, a member of the Board of SIEMENS AG., who has for many years been responsible for SIEMENS' foreign policy.

QUESTION: Dr Tacke, for some time there has been a marked tendency for German industry to set up production units abroad. Is this a 'retreat movement' by industry or part of a new business strategy?

ANSWER: It is impossible to generalise about this. It depends very much whether you are thinking of industrialised countries, semi-developed countries or developing countries proper. It also depends upon the structure of the particular industry or, indeed, of the particular firm. I am only competent to discuss the electrical industry and, more specifically, our own firm.

Considerations of cost are of prime importance in deciding to establish production units abroad. Expatriate production may be considered as a 'retreat movement' when high wage costs make it impossible to produce economically inside Germany. A location has then to be sought where manufacturing is cheaper. Industry manufactures where conditions are most favourable—and this, in itself, is a very healthy way of looking at things. Hitherto, however, this issue has not been a crucial one for the electrical industry. Things have not yet reached the point for us that the level of wages forces us to produce abroad.

QUESTION: Then what has been your motivation in setting up production units abroad?

ANSWER: One primary factor has been the following: let us consider the matter from the point of view of the entrepreneur, that is, that we want to maintain our share of the world market. World demand for electrical goods rises by about 7% p.a.; in Germany, however, the long-term trend is such that we shall be able to increase production by only about 3% by rationalising, since—also in the long term—there will be very little extra labour available. Thus, in order to achieve an equivalent rise of 7%, we shall obviously have to carry out an increasing proportion of our production outside Germany.

Secondly, a firm has to be of a certain size to survive. For instance, we can only cover our essential expenditure of about 500 million DM on research and development if our turnover is correspondingly high. This leads to a vicious circle: if we do not have a high turnover, we cannot cover our research and development costs. But if we relax our research efforts we cannot expect to maintain a high turnover in the long term.

GERD TACKE

has been member of the board of directors of Siemens AG for 16 years and is reputed as "foreign secretary" of the company. Tacke, who in the month of publication of this issue, namely on August 20, will celebrate his 61st birthday, studied economics and took his doctor's degree in Kiel before beginning his career with Siemens in 1932. The reconstruction of the firm's overseas organisation after the second world war is especially due to him. Today he manages the sales organisation in Germany and abroad, and at the same time is director of the Siemens central advertising department. The recipe for success, which Tacke recommends to the young generation—efficiency, solid theoretical knowledge in combination with long and hard "front experience"—has undoubtedly been best proved by himself in the various stations of his career.

* The interview was arranged by Dietrich Kebschull and Wolfgang Reissner.

A further reason is that direct exports of finished products are losing their importance to the German electrical industry, whilst the export of techniques—very specialised techniques and know-how—is gaining ground. For this we need, in those countries where we want to do business, a highly developed technical service and a fully utilised operations and sales-planning set-up. To achieve this one needs to be freed, to a certain extent, from the uncertainties of foreign trade policy—foreign currency permits or KfW (Reconstruction Loan Corporation) financing: the minimum turnover for efficient employment to capacity must therefore stem from factories in whatever country is under consideration.

Finally, it should also be said that combined deals can be done via foreign production. These are deals where a part of the order is manufactured by us, or with our assistance, in the purchasing country and the remainder delivered from Germany. Today, much business can only be done like this. We frequently have to produce certain items in our foreign plants to give an extra stimulus to our exports. Past events have shown that we can expect a large proportion of the import market only in those countries where we have built up our own production!

QUESTION: Does this reasoning apply particularly to the electrical industry, or can it be extended to other sectors as well?

ANSWER: It certainly does not apply to the electrical industry alone, but to other branches of industry, too. When a firm has a stake in a country because it manufactures there, it is much nearer the market than if it only has a commercial establishment in that country. The less developed countries, in particular, expect firms to whom they open their markets to invest, to create additional jobs and to bear the same risks as do national firms. A firm which identifies itself in this way with the

destiny of its host country obviously acquires a quite different 'image'.

QUESTION: May we now discuss the establishment of production units abroad as a means of increasing exports? In Germany, too, there are bodies which have specialised in export promotion, like AKA, HERMES and KfW (Export Credit Company, Hermes Credit Insurance Company and Reconstruction Loan Corporation). Is the establishment of production units abroad a sign that the measures taken by these bodies are insufficient?

ANSWER: No, it is not. Export business needs these bodies. The foundation of branch establishments is another way—a very promising way—of penetrating foreign markets. The two methods are not exclusive at all, but complementary.

QUESTION: Do not the concessions granted by young nations—primarily in the taxation sector—also constitute an impelling motive for the establishment of production units?

ANSWER: Decisions about where to manufacture should not be made dependent upon conditions which, whilst attractive, apply only over a limited period. Tax concessions are all very well, but in choosing a location there are more compelling factors, requiring much more careful investigation. One single mistake in appraising a market, one single technical error, costs much more than can ever be compensated for by tax concessions. In the long term, the absorption capacity of a market, production, capital and personnel overheads, means of transport and opportunities to expand from national to international factories are of far greater significance.

QUESTION: In essence, exporting is a matter of price structures. With high fixed costs, therefore, would it not be better to create larger capacities in the parent firm so as to lower average cost and thus become more competitive in the export sector?

ANSWER: This would mean abandoning production abroad. That is too great a simplification. We have to do the one, without abandoning the other. Price is not the only argument. Apart from the other criteria favouring foreign production units, protection policy is also important. An example: India has a large and long-established cable industry. There is a general embargo upon the import of cables into India. From this are exempted only those types of cable which are not produced in India. So if we want to sell cables in India, we have to make them there. There would be absolutely no point in enlarging our cable works in Germany. It must be added that our capacities are also restricted by other factors and can only be increased by rationalisation.

QUESTION: Because of the large rise in German exports it has hitherto been possible to avoid a more serious recession of our overall economy. But if more goods are produced abroad, the base factories might lose orders to our foreign production. Our foreign production would be competing against our home production. Is this argument correctly stated?

ANSWER: That depends. For instance, if someone in the textile trade can manufacture his goods abroad on the same terms, whilst paying an hourly wage of DM 2,—to DM 3,—, it is no longer possible to manufacture for export inside Germany. In certain sectors, the level of costs in Germany makes it impossible to manufacture goods for export. Under these circumstances, the foreign establishment should be considered, not as a competitor, but as an emergency outlet. Such a factory is the consequence, not the cause, of the base factory's lack of competitiveness and without it the firm would lose foreign business.

Your argument does not apply, however, to the electrical industry in particular. We should never have experienced such a vigorous growth of our exports as in the last few years if we had not built up our foreign production. This

does not prejudice exports. On the contrary! In my opinion people should not make this kind of criticism. As industrialisation spreads, so the demand for high-quality industrial products rises.

QUESTION: Nowadays, in discussing production abroad, people distinguish between national and international factories. What is the difference between them?

ANSWER: The international factory manufactures predominantly for export to third countries and only to a lesser extent to supply domestic demand. We have an international factory in Bruges, for instance. It produces for the whole of Europe—and for EEC in particular.

A national factory, on the other hand, concentrates mainly upon the market of the country where it is situated. As long as it works to costs which are above international levels, its market has to be guarded against intruders by tariffs. I will quote you a practical example: if we build a meter factory in Pakistan, we can only run this factory at a proper profit if the difference between its costs and those of our highly rationalised meter works in Nuremberg is absorbed by tariffs. The national currency position may also dictate production in a certain country. For instance, the Argentine Government is a client of our national factories in that country. The Argentine Government prefers to pay higher prices, in its national

currency, for goods manufactured inside the country, rather than to sacrifice foreign currency for imports.

Decisions to build a national or an international factory are always dependent upon two factors: first, upon the entrepreneur's economic judgment and, secondly, upon the political situation in the country concerned.

QUESTION: Is production abroad a matter of seizing the chance to pioneer in developing countries by helping with their industrialisation at a very early stage, or is it primarily aimed at gaining a foothold in countries where firms already have an export market?

ANSWER: Both are equally important. After the War, of course, we were more concerned with regaining a foothold in foreign markets. In so doing, we used foreign factories, one might say, as keys to open up certain markets.

Today, as pioneers in the establishment of foreign branches in developing countries, we naturally take risks which are offset, in the short or long term, by commensurate prospects of profit. This is why we have never hesitated to take such risks.

QUESTION: The very recent example of Tanzania, however, shows quite clearly that in developing countries firms run particularly severe risks in setting up such production units.

ANSWER: Since the end of the War we have lost scarcely any of our investments in developing countries. We cannot base our action policy upon short-term political fluctuations. Our policy is to look well ahead. We endeavour to minimise such serious and intrinsic risks at the outset by giving very detailed consideration to the planning of new projects.

QUESTION: This talk has shown that it is impossible to generalise and to say that production units abroad necessarily imply that exports must be endangered. Could we go so far as to say that overseas production is the last stage of exports?

ANSWER: That is a difficult question, for the concept of 'exports' is growing increasingly hollow. What do we really mean by exports nowadays? What actually are imports? For instance, is it exporting when Philips shuttles its products hither and thither between its European factories? That is direct movement of goods, just like the movements between our Berlin works and our Munich works. Once the EEC customs and taxation barriers have completely disappeared, shall we still be able to talk of 'foreign trade' inside EEC territory? For one part of the world export will soon come to mean merely the transport of goods. When this takes place the expansion of manufacturing activities in developing countries may gain considerably in significance.

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