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Explaining Arab Manufacturing Exporters' Preference for Western over MENA Markets: The Key Role of Information Availability and R&D Spillovers

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Abstract: Despite several attempts to build trade agreements between Arab countries, evidence shows that little has been achieved. This conceptual essay proposes a comprehensive view of factors that could explain Arab manufacturers' preference for Western over MENA markets as export destination. On the one hand, information asymmetry and R&D spillovers can be seen as potential explanations. Arab manufacturing exporters are potentially driven by the existence of considerable stock of information on Western markets due to historical and colonial heritage, knowledge sharing with domestic exporters to Western markets and the active assistance conveyed by export promotion agencies. Such transparency can lower information asymmetry in Western markets relative to MENA markets and reduce risk perceptions among Arab manufacturing exports consequently. On the other hand, Western markets can provide a substantial advantage to Arab manufacturers who enjoy R&D spillovers. Arab markets lack the facilitative conditions that generate R&D spillovers, such as sophisticated and advanced production factors, existence of demanding customers, strong support and related industries, etc.

Finally, the paper states that the choice of Western export destination over an Arab market is expected to benefit firm's performance. The challenging competitive landscape in Western markets will exert high pressure on exporters to fit into Western markets through upgrading their offerings at different levels.

Keywords: *Arab manufacturers, Export, destination choice, R&D spillovers, information asymmetry*

Introduction

Efforts aiming at economic integration in the Arab region started in the late 50's (Hoekman and Sekkat, 2010). Despite the adoption of several initiatives – such as the adoption of the Greater Arab Free Trade Area (GAFTA) in 2007 – contributed to increase intra-Arab Trade by 20% after (Abedini and Péridy, 2008), evidence shows that Arab exporters still favor export destinations located outside the MENA region and especially Western markets. Most of intra-Arab trade initiatives have achieved limited economic integration. Except for Jordan, Syria and

Lebanon, most of Arab countries exported less than 10% to other Arab markets – including oil-related trade. However, differences in GDP per capita within the Arab region should have enhanced multilateral trade driven by product differentiation aiming to respond to various levels of income and preferences (Hoekman and Sekkat, 2010).

Our aim in this paper is to explore what factors could be responsible for steering manufacturing Arab exporters' market selection outside MENA region to western markets, despite trade agreements as well as institutional commonalities, geographic proximity and cultural convergence within this region. More specifically, this paper suggests that the availability of increased stock of information on Western markets as well as expected R&D spillovers could be responsible for Arab manufacturing exporters' preference for Western over Arab markets. The selection of Western markets is expected to have positive effects on the performance of Arab manufacturing exporters.

This manuscript is organized as follows: light will be shed first on those common factors assumed to explain market destination choice. Then, propositions will be provided in regards to what could restrain intra-Arab trade. Finally, concluding remarks will highlight future avenues of research.

Literature Review: Traditional models of market selection

Two patterns of markets selection are stressed in literature. The first is the expansive pattern that is based on the selection of markets psychically close to markets already been served by the company. The second is the contractible pattern that is applied by global companies and implying that most, if not all, countries could be penetrated by exporters irrespective of the psychic distance to markets where the company already operates (Koch, 2001). The first body of literature has been predominant in past decades. Psychic distance was defined by the Uppsala internationalisation school as 'the sum of factors preventing or disturbing the flows of information between firms and markets' (Johanson & Wiedersheim-Paul 1975, p. 308). According to Alon (2004), companies evaluate and prioritise most promising markets essentially in terms of market potential and of ease of entry: linguistic similarity, socioeconomic similarity, similarity in regards to level of income and promising perspectives of future growth.

Other studies have explored destination choice and provided a more comprehensive view about potential determinants. For Koch (2001a), there is a large spectrum of corporate objectives and decision criteria to consider in any market and market entry selection. Decision-making with respect to market and market entry may be based on formal decision process or on the discretion of an individual or a small informal group of people (Koch, 2001a).

In his comprehensive model, Koch (2001b) elaborated further and stressed three groups of factors: internal, external and mixed external/internal. Internal factors that have been argued consist in Strategic orientation; Stage of internationalization; Strategic objectives (global/local market shares, growth of global/local sales revenue ratio, profitability); Overseas market selection experience; Company international competitiveness and calculation methods applied (Methods based on risk-assessment versus methods based on benefit evaluation; methods based on the cost-logic versus methods based on degree of marketing control).

External/internal factors revolve around controlling resources and access to resources of other companies; Networking – affected by electronic commerce; Similarity/proximity of overseas markets especially in regards to psychic distance (length and strength of cultural and business links between home and host countries, stereotypes, familiarity with systems in foreign markets); Company market portfolio, congruity with current objectives and the external

environment (synergy perspectives, cost saving and risk reduction plans) and expansion sequence optimization (the most efficient and rewarding sequence of market expansion based on the anticipation of global market environment and future company resources, capabilities and competencies).

Finally, external factors suggested by Koch (2001b) include country market potential; Competitive significance of the market (importance of positioning in lead markets - market with intense competition, demanding customers, larger sales potential and loose regulatory system - in order to reinforce firm's skills and capabilities and expand to third markets) and anticipated risks of overseas market (along with ownership, operating and transfer risks, Koch calls for the inclusion of managerial perception of risks and the reliability of risk estimates).

Conceptual Framework: Potential Reasons for low intra-Arab trade

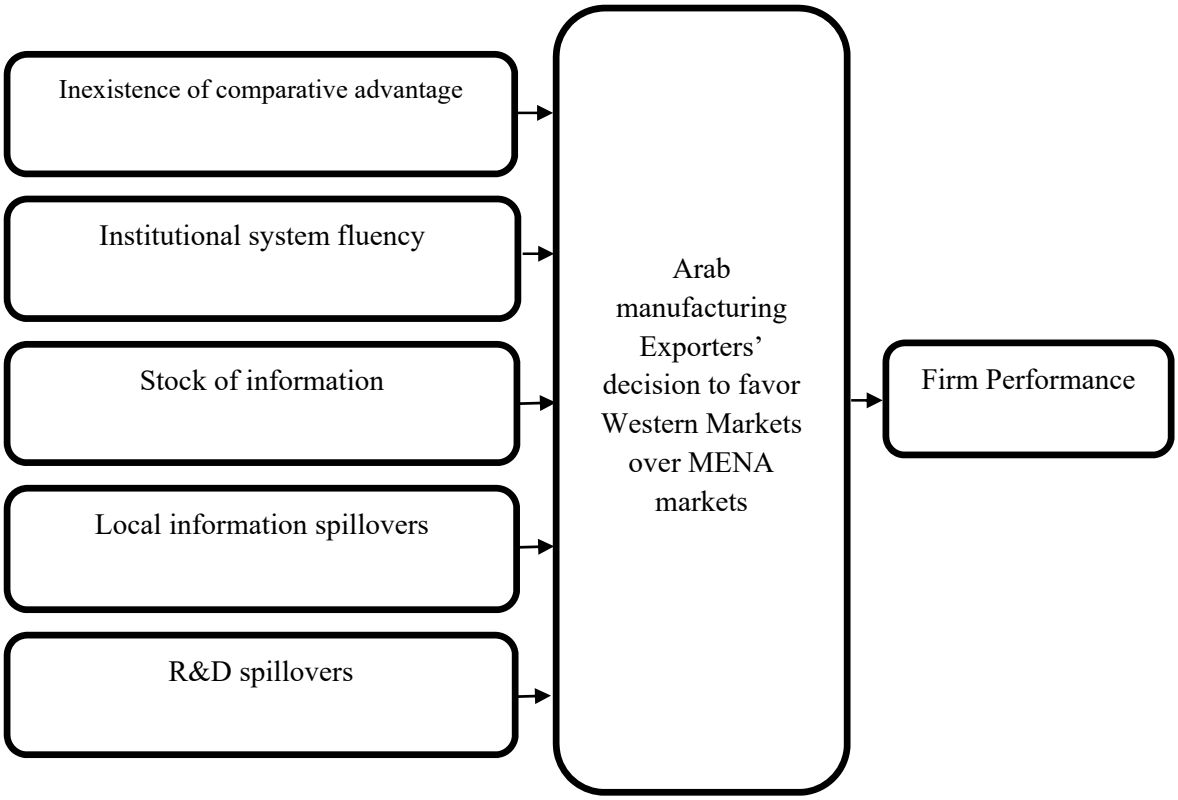
Limited evidence is provided in literature to say which of those factors could explain the low level of intra Arab trade despite trade agreements and all similarities between Arab nations. The study carried out by Hoekman and Sekkat (2010) emphasizes that the limited market size in most of Arab countries and the lack of comparative advantages could explain this phenomenon. As a matter of fact, limited Arab economic integration is due to the existence of small markets in Arab countries and to increased industrial similarity among them. As such, the inexistence of substantial comparative advantages between Arab countries leads them to compete on the same export markets. This study pinpoints also institutional framework in Arab countries. Different policies are responsible for the limited intra-Arab trade such as the restrictions in land transport services, the arbitrary changes in document requirements, surcharges and discriminatory taxes, the lengthy processes of customs clearance and inspection and the bureaucracy due to unreasonable number of documents and signatures needed.

Proposition 1: The inexistence of comparative advantages between Arab economies explains Arab exporters' preference for Western over Arab markets.

Proposition 2: Fluent and effective institutional system in Western economies explains Arab exporters' preference for Western over Arab markets.

A hallmark study conducted by Brewer (2007) has revisited the determinant power of psychic distance in foreign market selection. This study proposes an information-based measure of psychic distance which comprises the measure of information flow between firm's environment and target market. This measure explains why Australian exporters expand to East Asian markets despite country, cultural and business differences. These differences have been previously used in literature as a sole surrogate to measure ease of information flows, yet with no empirical support. Indicators included in the psychic distance index comprise commercial, political, historic, geographic, social (culture, sporting and linguistic preferences) ties between current and target markets, as well as the information stock and level of development of the target country. Brewer (2007) demonstrates that psychic distance, as comprehensively measured by the proposed index, is strongly negatively correlated with export market selection outcomes of Australian firms. With reference to this point, export promotion agencies can play a significant role in reducing information asymmetry about Western markets. The evidence comes from Uruguay where export promotion activities helped Uruguayan companies in exporting to new destinations within Latin America and Caribbean countries. Export promotion agencies help local exporting companies in accessing valuable information on key foreign markets (Martincus and Carballo, 2010).

Fig 1: Conceptual Framework



In sum, the availability of information on Western markets facilitated by increased commercial, political, historic, geographic and social ties between Arab and Western nations are likely to affect Arab exporters' market selection. Despite all similarities between MENA markets and existing trade agreement, markets in this region can be regarded as uncertain and characterised by significant information asymmetry.

Proposition 3: The existence of large stock of information about Western markets explains Arab exporters' preference for Western over Arab markets

In addition, research evidence points out the role of information spillovers supplied by domestic competitors who export to a specific destination. Being in an industrial agglomeration wherein several exporters are serving the same destination market is likely to increase the probability to export to the same destination (Silvente and Giménez, 2007). In this regard, it is noteworthy to mention that most of export activities in manufacturing sectors are achieved within outsourcing agreement between Western companies and Arab suppliers. Therefore, information spillovers disseminated by those firms can encourage other companies from the same industry to reach Western markets. The study of Silvente and Giménez (2007) indicates no evidence that information spillovers from multinational companies or from local exporters belonging to other industries can have the same positive effect (Silvente and Giménez, 2007).

Proposition 4: Information spillovers supplied by to domestic competitors exporting to a specific Western destination explain Arab exporters' preference for Western over Arab markets

Lack of R&D spillovers from host Arab countries could be suggested as a second explanation to limited intra-Arab trade. Companies driven by R&D spillovers prefer exporting to countries that are technologically advanced. The marginal impact of R&D spillovers on Spanish manufacturing firms' export ratios is larger for firms exporting to EU and other OECD

countries in comparison with firms serving less developed countries. EU and other OECD countries are assumed to be more technologically advanced than Spain (Barrios et al., 2003). Barrios et al. (2003) expect the effect of R&D to matter more for exports to technologically advanced countries such as other EU and OECD countries. This is because Spanish exporters have to improve their own technology first in order to be able to compete on these markets successfully, while lower level of technological sophistication may suffice for exports to less advanced countries." (Barrios et al., 2003, p.492). They consider that lower level of technological sophistication may suffice for exporting to less advanced countries. Thus, the technological level of the destination market matters. However, the effect of R&D spillovers emanating from MNEs on exports to EU and other OECD countries is greater than the effect of domestic Spanish R&D spillovers (Barrios et al., 2003).

Proposition 5: R&D spillovers more accessible from Western countries explains Arab exporters' preference for Western over Arab markets.

Finally, if information spillovers and desire for learning are advocated as determinants factors in market selection choice of Arab manufacturing exporters, this study expects that exporting beyond Arab trade agreement zone would be a profitable choice. For instance, Irish manufacturing exporters who ship their outputs beyond traditional UK destination achieve higher turnover, pay higher average wages and are more productive in terms of turnover by employee. Authors assume that Irish manufacturing firms exporting beyond the UK face higher trade barriers and to overcome them, they need to be more efficient and more competitive (Ruane and Sutherland, 2005). If the same logic will be applied, Arab exporters will need to increase their efficacy and efficiency to meet the challenging business environments in Western markets. This could have positive implications on their performance indicators.

Proposition 6: Exporting to Western markets increases Arab manufacturing exporters' performance indicators (turnover, average wages, and employee productivity)

Conclusion

This study states a bunch of factors likely to explain Arab manufacturing exporters' decision to market their products outside MENA trade agreement area. Beyond traditional explanations pinpointing lack of comparative advantages and institutional fluency and effectiveness, this paper argues for information asymmetry in Arab markets and R&D spillovers generated from the exploitation of Western markets. Regarding information asymmetry, this paper includes an important dimensions widely overlooked when it comes to discuss Arab manufacturing exporters' inclination to select Western markets, which is the outsourcing agreements they are fulfilling in those markets. This is likely to augment information stock Arab manufacturing exporters have about Western markets.

In addition to that, R&D spillovers disseminated in Western countries could be a reason that motivates Arab manufacturing exporters to choose those markets. Arab economies are not reputed to have a strong technological infrastructure and a competitive environment that could stimulate innovation processes among firms.

This conceptual work will open future avenues of research. First, an empirical study is needed to validate aforementioned research propositions. Tunisia and Egypt can be selected as fields of study. Both have strong economic interdependence with European markets especially through outsourcing. Second, an explorative study can be conducted also to explore further determinants.

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