

WORLD MARKET SHARES OF ADVERTISING TNCS: INTANGIBLE
COMPARATIVE ADVANTAGE?

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Abstract

This study examines the link between the comparative location advantages of countries and the competitive position of national firms in world markets in industries in which competitive advantages are based entirely on intangible assets, which are not physically tied to any particular location. A model connecting world market shares as the explanatory variable with a set of potentially significant country intangible location advantages is tested on the advertising industry between 1977 and 1999. The findings show that the location advantages of home countries possess significant explanatory power for the country patterns in advertising. The paper concludes by drawing implications of these findings for firms and policy makers.

Key words: intangible comparative advantages, competitiveness, advertising, national origin

JEL codes: F23, M370, M210

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1. Home Country Resources and the Competitive Advantages of Firms

The link between the competitive advantages of firms and the resources of their home countries is intuitively appealing when both are based on tangible immobile assets. Firms based in countries which are comparatively well endowed with particular resources possess an initial advantage over firms of other nationalities in their access to such resources and in their knowledge of the way in which they can best be used (Dunning 1979). Over time, these initial advantages may give rise to related advantages in the form of new or improved production and marketing techniques, and organisational and managerial skills which, because of market imperfections, tend to become specific to the firms generating them, as competitive advantages. Hence, the comparative location advantages of home countries can be used to explain the nature and type of advantages that firms develop and the country patterns in world markets (Porter 1990, Reich 1996, Pauly and Reich 1997, Doremus et al 1998). Is a similar logic applicable when competitive advantages are based entirely on intangible assets, which are not physically tied to any particular location? Can the comparative location advantages of countries explain the competitive position of firms competing in such industries?

The theory of comparative advantage, which was the first attempt to link the competitive position of a country's firms in particular industries with the resources of their home countries, was developed to deal with tangible not intangible products. Attempts to apply this theory to international activity in the latter, most often formulated with reference to service industries, have not been conclusive. Some scholars have argued that, conceptually, no distinction needs to be made between tangible or intangible goods and services, and that there is no basis to assume that the principles on which comparative advantage are based

are different for industries in which advantages derive from intangible assets '*...the powerful logic of the theory of comparative advantage transcends these differences [between goods and services]*' (Hindley and Smith, 1984, pp. 380, 388; see also Stern 1985, Gray 1989).

Other researchers, however, argue that the doctrine of comparative advantage may yield limited explanations for international activity in services (Sampson and Snape 1985, Tucker and Sundberg 1988). The most important feature of services which is cited to support this argument is that international activity in these industries requires the movement of factors of production from the 'exporting' country to the 'importing' country in order to provide the service. The extent to which this movement follows the dictates of the comparative advantages and disadvantages of the countries involved is questionable (Deardorf 1985).

Several studies have illustrated the explanatory power of the comparative advantages of countries for the competitive position of firms when both are based on intangible assets. Sapir (1991) showed that the principles of comparative advantage apply to trade in service industries, and was also able to identify the intangible factors determining patterns of trade in particular service industries. Porter (1990) illustrated the impact of the configuration of national Diamonds, which is based mainly on intangible factors, on the international competitiveness of manufacturing and service firms alike. A number of studies have used this framework to analyse the changing competitive position of a country's firms in industries where advantages are based on intangible assets (see e.g., Jones 1993 on British banks since the 19th century).

Further support for these findings can be found in the fact that over time, the resources on which a country's comparative advantages are based change, and become more intangible themselves. In Adam Smith's theory, a country's advantages were based on the abundance of natural resources. For Ricardo advantages were associated with capital and labour. Mechanical inventions and the growth of engineering

knowledge expanded opportunities for the employment of capital, which later became a critical determinant of a country's comparative advantages. With the advance of industrialisation, the focus turned to technology as the most important determinant of efficient production. For Heckscher and Ohlin, technology was the main factor on which advantages are developed. The importance of these resources eroded later, as markets for natural resources became increasingly global, largely eliminating access to them as providing a competitive edge. The share of labour costs in total costs diminished with the replacement of labour by machines, and technology diffused rapidly among countries through licenses, the scientific community, and TNCs.

Efforts turned to extending definitions of the resources affecting a country's comparative advantage, and these focused mostly on intangible factors. Differences in workers' skills and consumer demand among countries have been cited as the factors influencing the competitiveness of countries in particular industries (Linder 1961, Vernon 1966, Porter 1990, among others). The ability of a country to provide a large pool of human capital has been suggested by other scholars as the most essential country determinant of firms' advantages (Romer 1990). Yet other scholars have maintained that countries influence the competitive advantages of their firms primarily through their institutional setting and its reflection on the organisational skill base of a country, the quality of the infra-structure, the financial sector and other institutions (Kogut 1993). These studies suggest that intangible, partly mobile, assets of home countries can provide a basis for the development of competitive advantages, in a manner similar to advantages which are based on tangible immobile assets. Hence, these intangible assets can be used to explain the country patterns in an industry just as they do in industries in which advantages are based on tangible assets.

In this paper, I seek to examine this proposition with reference to the advertising industry. In particular, I seek to answer two related questions: to what extent country comparative location advantages

explain the competitive position of advertising agencies in world markets?; and what are the country resources on which these firms build their competitive advantages? In the next section I establish a theoretical framework based on links between the competitive advantages of advertising agencies and specific country conditions which may facilitate their development. The following section is devoted to an examination of the explanatory power of this framework for the country patterns in the advertising industry over the last two decades. The paper concludes by summarising the main findings and drawing their implications for firms and policy makers.

2. Home Country Characteristics which may affect the Competitive Advantages of Advertising Agencies

The selection of specific home country characteristics for the analysis was based on a framework developed initially by Dunning (1979) and adjusted to professional services by Nachum (1999), which establishes links between competitive advantages of firms and certain resources and characteristics of their home countries. This framework allows the researcher to identify these characteristics of home countries which are most likely to affect the type and nature of the competitive advantages that firms develop and hence their competitive position in international markets. Table 1 lists the various links between the major competitive advantages of advertising agencies (as identified and confirmed empirically by Nachum, 1999) and specific characteristics of home countries. It also presents the operation measures which will be used in the statistical analysis and the sources of these data. In what follows, I discuss the theoretical rationale for these linkages and the justification for the choices of the operation measures.

2.1. Availability of large pool of qualified employees

Creative employees are a vital factor of production for advertising agencies. The advantages embodied in the employees are the most

important advantages for a strong sustained competitive position. Therefore the supply of this resource is crucial. The larger the pool of creative employees in a country, and the higher its quality, the better employees are available for an agency. Agencies based in countries with abundant supply of this asset will be better able to develop creative capabilities.

Abundance of qualified employees for advertising agencies is measured by:

1. The share of graduates in fine and applied arts studies in the total graduates in high education institutions. These fields provide the pool of employees for some of the most important activities (in terms of value added) implemented by advertising agencies (notably, art directors, media).
2. Wages paid to professionals (including business professionals and artists) relative to the country's average pay level. Wages are crude yet widely used operational measure for the quality of employees (for example Montgomery, 1991; MacDonald and Reynolds, 1994). They vary among professionals in a manner which reflects both levels of education and years of experience, the two most important determinants of labour quality.

2.2. Local environment facilitating creativity

Creative work is the essence of the creation of an advertisement, and it is where most of its value-added lies. Each advertising campaign is designed for a different set of clients' needs, and it has to be tailored to their specific situation by proposing new ideas and approaches. Hence, advertisements have to be different from each other, and this uniqueness is an essential part of their value creation.

Certain country characteristics may facilitate the creative capabilities of firms. Studies have shown how national systems of innovations

(Lundvall 1992) affect the innovativeness of firms within these countries. A large body of research suggests that the innovative activities of firms are shaped by the structural components of their countries which influence the accumulation and diffusion of knowledge required for innovation. Likewise, the creative capabilities of advertising agencies are likely to reflect certain national characteristics. For example, the amount and quality of art institutions in a country is likely to affect the creative capabilities of agencies because they can use the knowledge generated by these institutions as a basis for the development of their own creative capabilities. In a similar manner, advertising agencies originating from home countries which provide access to advanced and varied media channels may have better opportunities to enhance their capabilities than those deprived from such access.

Two measures are used as operations for local environment facilitating the creative capabilities of advertising agencies: 1. Consumption of cultural products (kgs. prints per 1000 inhabitants); and 2. Number of TV receivers (per 1000 inhabitants).

2.3. Size of home market

Large home markets may facilitate the emergence of large firms, because they provide advantages to firms which are able to benefit from economies of large scale. Firms can acquire capabilities required to manage activities on a large scale in their home countries¹. The empirical evidence for this proposition is, however, mixed. Several studies have found a strong link between the size of home countries and the propensity of firms to engage in FDI (e.g., Grosse and Trevino 1996), a finding which was interpreted as an indication of the impact of home countries on the size of firms, and subsequently on their ability to pursue international activity. By contrast, other studies have found the size of firms to be unrelated to the size of their home countries (e.g., Kogut 1992).

These contradictory findings are probably due to the fact that the link between the size of home markets and the size of firms varies across sectors, in line with two main sectoral characteristics. First, in industries where there are limited economies of scale, the size of both firms and countries is less important and there may not be a link between the two. Second, if the output is tradable, there can be a dissociation between the size of firms and the size of their home country. Firms based in small countries can reach minimum efficient scale and grow large by having access to export markets (Hirsch and Thomsen 1993). ABB, Philips, Nestlé, and SKF illustrate the dissociation between the size of firms and their home countries under such circumstances.

Neither of these conditions prevails in advertising, and indeed, the size of home markets seems to be an important factor enhancing the creation of size advantages of agencies. The main modality of servicing foreign markets in advertising is FDI (Nachum 1999), and the possibilities for compensation for small home market by foreign activity are limited because agencies based in small home markets often cannot achieve a minimum size needed to invest abroad. The size of the home market is often cited as one reason for the large size of US advertising agencies (e.g., West 1996). US agencies have enjoyed the advantages of operating in a market far larger than any other market (in 1996, domestic expenditure on advertising reached \$169, \$16 and \$12 billion in the US, UK, and France respectively (WPP 1996)).

In the following analysis, the size of home markets is measured by annual expenditure on advertising in a country.

2.4. Preference of home clients for a variety of promotion practices

Preference of home clients for a variety of promotional methods, as opposed to advertising alone, pushes advertising agencies to diversify and may give them competitive advantages derived from economies of scope.

Indeed, agencies of different nationalities were found to pursue different diversification strategies, in response to demand of their home clients (Nachum 2000). In the US 'total marketing' was an objective of advertisers, and US agencies have long adopted strategies of diversification such as 'The Whole Egg' (Young & Rubicam), and 'Seamless Marketing' (Grey). European advertisers to a lesser extent had an overall approach to marketing, and consequently most European agencies do not provide wide range of promotion services (Mattelart 1991). The traditional European approach viewed advertising as a separate discipline and, consequently advertising agencies were not engaged with other forms of promotion. Also today, diversification is common in Europe mostly among large agencies, such as Saatchi & Saatchi and WPP, and the smaller agencies tend to concentrate on advertising alone.

As an operational measure for home country attributes which facilitate advantages of scope, I use income per capita on the grounds that consumers' demand for differentiation of services and products tends to be associated with economic development and an increase in living standards.

2.5. Historical development of home demand

In the early development of an industry, the age of firms is often linked to the development of demand for their products and services in their home countries. This link may diminish as industries become older, due to entry and exit of firms during decades, but initially, firms are usually established in response to demand, and the role of home demand has been argued to be more important than demand elsewhere (Porter 1990).

Linder (1961) made a pioneering recognition regarding the critical impact of home demand on the development of national firms. Variation in demand across countries implies that production functions are not identical in all countries, but the production functions of goods demanded at home are the relatively most advantageous ones. Linder's

theory was extended by Vernon who argued that firms innovate in response to the demand characteristics of their home market (Vernon 1966). This is because firms are more likely to be aware of the possibility of introducing new products in their own market than elsewhere. Porter (1990) pursued this line of argument further and assigned a significant role for home country demand in explaining the competitive advantages of firms. Porter argued and illustrated that firms innovate and upgrade their capabilities in response to demand in their home countries, and foreign demand does not provide similar stimuli.

These arguments suggest that the age of firms is likely to be related to the historical development of demand in their home country. This link is evident in advertising. US manufacturers were the first to use promotion methods as a tool to increase the volume of their sales. In response to this demand, the first US advertising agency was established in 1840 (Fox 1984), and in the 1920s more than one thousand advertising agencies were operating in the US (Hower, 1949). In Europe, where demand for advertising developed much later, advertising agencies appeared only several decades later (Nevet 1982, Mattelart 1991). Also today, US agencies are, on average, much older than their European counterparts (Nachum 1999), a pattern which suggests that the link between the historical development of demand and the age of advertising agencies has not diminished with the maturity of the industry.

Elapsed time since investment in advertising reached 5 percent of gross fixed capital formation is used as an operation measure for the age and magnitude of home demand.

2.6. Availability and quality of business education institutes

Advertising agencies can benefit from the amount and quality of managerial knowledge available in their home countries, because they can use this knowledge as a basis for development of their own managerial capabilities.

A comparison between the US and the UK illustrates how the level of managerial knowledge in a country influences the managerial capabilities of national advertising agencies. In an analysis of the development of the large firms in the US and the UK, Chandler (1980, 1990) describes how slow UK firms were to adapt modern management methods compared to US firms. Already in the early years of the 20th century and even earlier, US manufacturers were concerned with the innovation and improvement of the basic techniques of mass production and mass distribution, and with the development of systematic top-level organisational and control procedures. Such managerial methods only began to be adapted in the UK in the 1930s, and usually they were borrowed directly from the US².

Parallel approaches to management can be observed among US and UK advertising agencies. In spite of the fact that any standardisation of the production processes stands against the very nature and essence of advertising, US advertisers have long made attempts to apply systematic managerial methods to their work, and to standardise the production processes in a way that provides some yardstick for quality control and allows them to apply similar practices world-wide. J Walter Thompson (JWT)'s 'T square', which was later replaced by the 'T plan', are illustrative. These methods were developed at the early decades of the 20th century and were meant to establish a systematic approach to the planning and production of advertising campaigns (West 1987). Other illustrations of this attitude are the attempts to provide identical purpose underlying all advertisements produced by an agency. Notable examples include Lasker's concept of 'salesmanship in print' and Rosser Reeve's 'unique selling proposition' (Ogilvy 1988).

UK agencies had no similar established methods. The personal views of their managers affected the styles of their advertising and the ways in which they were produced (West 1988). Many of the advertising methods which originated in the US were adapted by UK agencies in the 1960s and 1970s, just as manufacturing managerial practices were imported to the UK. For example, a variation of Reeve's 'unique selling

proposition' has been the cornerstone of Saatchi & Saatchi's approach to the production of advertisements.

The share of graduates in business administration studies in total graduates in a country is used as an operation measure for countries' abundance of managerial skills.

2.7. Involvement of the national industry in international activity

The advantages referred to above are important for the competitive position of any firm, regardless of the geographic scope of its activity. In addition to these, there are some other advantages arising specifically because a firm is operating in multiple markets. Such activity allows a firm to take advantage of international differences in factor endowments and markets, and to diversify risks. It offers wider opportunities, by providing more favoured access to, or better knowledge about, information, inputs and markets (Dunning 1993).

The international activity of advertising agencies, and hence their ability to benefit from advantages of multinationality per se, is linked, to a certain extent, to the level of internationalisation of their home clients. Advertising agencies (as many other professional service firms) use their home clients as a vehicle for their own international expansion and they expand abroad in order to service their home clients in foreign markets (Terpstra and Yu 1988, Li and Guisinger 1992).

This phenomenon of following home clients abroad was particularly common among US agencies in the early stages of their international expansion (Weinstein 1974, 1977). JWT's agreement with General Motors in the 1920s is a well-known example of an international expansion of an advertising agency which was pushed by its client. According to this agreement JWT opened an office in every country where General Motors had an assembly plant operation or distributor. As a reward General Motors placed all domestic and international advertising exclusively with JWT (West, 1987, Merron 1991). The

expansion abroad of McCann Erickson was similarly pushed by its major client Standard Oil (UNCTC, 1979). The 'following the client' motivation has characterised the international expansion of McCann Erickson ever since, as expressed by the senior executive of its international operation: *'McCann-Erickson has grown internationally in parallel to key international clients....it has not been our strategy to open an office in a new country and then look for clients. We generally open offices to serve existing clients who have become active in these markets'* (Kim 1995, p. 14)³.

The importance of the push from the clients has diminished in more recent decades, and the international expansion of advertising agencies has increasingly shifted from client-following to market seeking, and has been driven by their own strategic motivations independent from those of their clients (see Li and Guisinger 1992 for evidence based on several service industries). Yet, in some cases the push from the clients still acts as an important factor, particularly beyond the entry of advertising agencies into markets which are entirely new for them (Kim 1995).

The 'push' from home clients is more common in some countries than in others, and it explains, at least partly, differences in the intensity of international activity among advertising agencies of different nationalities. This push has been particularly typical in the US and is regarded as a country specific explanation for the international success of US agencies (West 1996). European and Japanese TNCs to a lesser extent push their advertising agencies abroad. Rather, they tend to prefer local agencies in the countries in which they establish operations.

FDI outward stock (total and as % of GDP) is used to measure the involvement of a country's industry in international activity. FDI, rather than exports, is used since it is the former which affects the international expansion of advertising agencies, while the latter usually has limited, if any, effect. I use stock rather than flow figures because FDI tends to have an accumulated impact on advertising agencies, as they serve their

clients long after the initial investment was undertaken. The discussion above suggests that the impact of the international involvement of a country's firms on the competitive position of advertising agencies might be difficult to predict a-priori, and I make no predictions.

2.8. Role of national governments

Government policies cannot be matched with any specific source of competitive advantage, but directly or indirectly they affect all of them⁴. Governments have a wide array of policies which influence the location advantages of their countries and subsequently the competitiveness of firms. They have the ultimate power to shape the system under which resources are organised, and they control the signals which trigger a response by firms, which in turn affect their competitiveness. As producers or consumers, governments affect the supply and demand of both immobile and mobile resources and capabilities, which in turn affects the competitiveness of firms. Their actions can influence the structure of industries and the nature of competition, and affect the types of firms that participate in them (Dunning 1994).

In addition to their overall impact on the location advantages of a country, governments influence advertising more directly in two main ways. First, through their influence on the education system and the scientific life in the country. The supply of qualified employees depends mostly on the national educational system, and this is secured in most countries mainly by governments. Second, through regulations of various forms. Particularly influential in advertising are governments' restrictions on telecommunications, broadcasting, cable TV and other media channels, and regulations related to consumer protection in relation to matters such as misleading advertising, health and ethical issues. Technological developments which have eliminated the ability of government to control media channels within their jurisdiction, have abolished much of the power of governments to restrict advertising agencies in these areas.

Government expenditure on economic services (as a percentage of total government expenditure) is used as an operation measure for the effect of national governments on the home environment. It is expected to have a positive association with the dependent variable.

3. Some Suggestive Evidence

Figure 1 presents the national origin of the leading advertising TNCs world-wide over the last two decades. The presentation is based on the shares of national agencies in the top 50 by numbers (that is, the number of agencies from country X divided by 50), and of the total gross income of the top 50 (calculated as the share of the combined gross income of agencies from country X in the total gross income of the top 50 in a given year).

Several related patterns emerge from the presentation in Figure 1. First, the number of countries whose TNCs appear in the list of the top 50 has increased considerably over time. While in the 1970s and early 1980s TNCs originating from only 5 countries comprised the list, this number has doubled during the 1980s and 1990s. At the same time, however, the patterns described in Figure 1 are quite stable, with TNCs from the same few countries dominating the industry during the entire period analysed. No country has left the list, and the new countries that entered have occupied only a moderate position. Second, the share of US TNCs, which have dominated the industry during the entire period analysed, has declined considerably. US TNCs in 1977 accounted for almost 80% of the top 50, but by the 1990s this had diminished to only 40%. Although there was a recovery in 1999, it was still less than 60%. Third, the industry has been dominated by developed country TNCs, and although in recent years there is some representation of developing country TNCs, the latter have not reached a significant position. The existence of internationally competitive advertising TNCs seems to be associated with the general level of development of a country.

In what follows I seek to examine the extent to which the set of country characteristics summarised in table 1 provides an explanation for the patterns emerging from Figure 1. I start with a qualitative evaluation of the relative position of home countries in terms of these attributes and attempt to relate them to the country patterns described in Figure 1. I then test these linkages more systematically, using statistical methods.

The country patterns in the advertising industry appear to be related to the comparative location advantages of home countries. With few exceptions, the countries which are home for a large number of leading agencies are more locationally advantageous, along the critical factors in advertising, compared with countries whose agencies have not reached a significant position.

The dominant position of US agencies in the industry reflects favourable conditions in the US relative to those in other countries. As discussed above, domestic expenditure on advertising has been far higher in the US than in the other country, and so has been the share of business graduates in total graduates. The industry developed in the US long before it did in any other country (Nachum 1999, table 3.4). The one area in which the US is less advantageous than other countries is in the international involvement of its industry (adjusted to the size of countries). However, the US was leading in terms of the relative size of its FDI outflows in the decades following the Second World War, during which time the majority of US agencies expanded abroad (Wilkins, 1974).

As noted above, US TNCs have lost some of their dominant position in the industry during more recent decades. This change seems related to a relative decline of the US's location advantages as other countries caught up. Conditions in the US have been quite stable during the period analysed, but it seems that the conditions in other countries have improved faster than those of the US. For example, expenditure on advertising increased only slightly in the US from the early 1970s to the

1990s, but it grew much faster in countries such as Japan, Italy and South Korea (Nachum 1999, table 3.4).

Japanese agencies take the second position in the industry, but unlike their Western counterparts, they have developed international activity only very recently, and to a limited extent (Nikkei Weekly 1999)⁵.

Several characteristics of the Japanese home market suggest possible explanations for this phenomenon. First, Japan had relatively low levels of outward FDI, especially in the 1970s, when Japanese manufacturers preferred export over FDI as a mode of servicing foreign markets (Ozawa, 1994, 2000). Thus, Japanese agencies could not expand abroad, following their home clients. Furthermore, cultural differences between Japan and the main markets in which Japanese advertisers have been active inhibit the transfer of Japanese advertising abroad. Japanese ads are known for their cultural specificity (The Economist, 1993). Japanese TNCs that advertise heavily abroad - in cars and electronics - have tended to rely on local agencies to help them cope with cultural sensitivities. Hence, they have not pushed their agencies to expand abroad in order to serve them in foreign markets.

Second, Japanese attitudes towards media buying restrain the transfer of some domestic advantages overseas. Unlike in the US and Europe, where the creative work is regarded as the activity in which most of the value added of agencies lies, in Japan media-buying is seen as the core of the business and the advantages resulting from close ties with the media are most important for competitive success (The Economist 1993). Such ties are more difficult to establish in a foreign country, and thus create a barrier for international expansion⁶.

UK agencies have substantially improved their position in the industry during the period analysed to become the third most important player. There were no UK agencies among the top 50 in 1977, but in the following decades, UK agencies came to occupy a leading position. These patterns might be attributed to the early dominance of US

agencies in the UK, which prevented the development of local agencies, and to the inability of the latter to take advantage of seemingly favourable local conditions.

Expenditure on advertising in the UK grew rapidly from the late 1950s onwards, in response to accelerated competitive pressure (Nevett 1982). However, the main beneficiaries from this growth were US agencies, which established themselves in the UK during the post World War Two years. The wider range of services offered by US agencies, and their experience in working for larger and more international clients, made them attractive for UK advertisers who preferred them over the local agencies (Murdock and Janus 1985). Until the early 1980s, US agencies constantly increased their position in the UK, through a combination of natural growth and acquisitions (West 1987), and UK agencies remained small and underdeveloped.

Nor had UK agencies been able to benefit from the strong involvement of UK industry in international markets and to develop an international activity of significant magnitude. The UK has traditionally had a larger outward FDI flows than any other country in the world (Dunning 1983, Nachum et. al, forthcoming). Furthermore, the leading UK TNCs are active in the branded, highly differentiated industries (for example, Unilever, BAT, Guinness, Cadbury-Schweppes), which have the highest advertising to sales ratios, but this did not provide a push for the international expansion of UK advertising agencies. Two reasons explain why UK agencies did not follow their clients abroad. First, unlike their US counterparts, UK TNCs did not use global marketing strategies but rather encouraged affiliates around the world to appoint local agencies. Second, until the post World War Two years much UK outward FDI was directed towards the Commonwealth countries and was concentrated in the exploitation of natural resources, where there was less, if any, need to advertise. UK FDI later changed its destination towards mainly the US and Europe, but the US market offered the most advanced local advertising services, so there was no reason for UK TNCs to bring their UK agencies with them. The European countries in

which UK TNCs were active were dominated by US advertising agencies, and UK TNCs used their services.

From the late 1970s onwards, however, local UK advertising agencies started growing at accelerated rates and many of them have reached a position in which they can compete successfully with US agencies not only in the UK but also in world markets. While this change might be associated with several developments in the UK which took place around this period (for example, increases in the availability of creative employees, domestic investment in advertising and outward FDI stock: (Nachum 1999, table 3.4), it seems to be related, in part at least, to the emergence of Saatchi & Saatchi, which was founded in 1973 and became the largest agency in the world in 1985. The meteoric rise of Saatchi & Saatchi, which was largely due to trading the agency's shares on the City's stockmarket (Kleinman 1987), encouraged other agencies to go public and illustrated the economic value of advertising to stockholders. Subsequently, the UK industry evolved from a fragmented industry made up of small agencies, mostly owned by their managers who were also the top professionals, to an industry dominated by large publicly traded agencies (Svieby and Lloyd 1987). The incorporation of UK agencies provided them with resources necessary to extend their size by acquisitions, to expand their international activity rapidly, and, as the presentation in Figure 1 shows, to acquire a dominant position in the industry⁷.

Another notable change in the national distribution of the leading advertising TNCs is the emergence of developing country agencies. This change can probably be attributed to the economic development of these countries, which has been associated with an increase in income per capita and a whole set of related factors, notably education levels, advertising expenditure, and often more liberal government policies. Also the international involvement of these countries has increased as a result (e.g., UNCTAD 1999), facilitating the development of international activity of domestic advertising agencies.

In order to test more systematically the link between the comparative location advantages of home countries and the country patterns in the advertising industry, I construct a model, establishing a causal link between market shares of national agencies as the dependent variable and a set of potentially significant explanatory variables. The model is of the general form:

$$C_{jt} = f(HC_{jt}) + E_{jt}$$

where:

C – Competitive position

HC – Vector of home country advantages (summarised in table 1).

j – Home countries (j = 1....m)

t – time (t = 1....n), n=6 (1977, 1980, 1985, 1990, 1995, 1999)

E – Random error term.

The dependent variable – competitive position of a country's agencies – is measured by the number of agencies among the leading agencies world-wide. This measure is used as a proxy for world market share, as more appropriate data which are not available. Included in the analysis are all countries whose advertising TNCs appear in the list of the top 50 agencies world-wide in the years analysed (as summarised in Figure 1).

Since advantages are only meaningful in relative terms, all explanatory variables are measured relative to those of the other home countries of the leading TNCs in a given year⁸. Ideally, the independent variables should have been measured with a time lag from the dependent variable, to allow for a period of time which might be required to turn favourable country conditions into firm-specific

advantages. However, some of the data are not available for such a long time span and a time lag is not introduced.

A major difficulty associated with any empirical and theoretical attempt to establish a link between the characteristics of home countries and the competitive performance of national firms is the direction of the causal relations between the two. The theories related to the link between the locational advantages of countries and the competitiveness of firms are dominated - explicitly or implicitly - by the assumption that causality goes from the countries to the firms (see Nachum 1999). Historically, this assumption was correct. In classical and neo-classical conceptualisations of the economic world, where firms were perceived to be small and atomistic, they could not have had an individual impact on the resources of their countries. Rather, they were passive users of these resources. This assumption is less appealing, however, in an economic world in which industries are dominated by a few very large firms, and it is particularly problematic when these large firms are based in small home countries. Under such circumstances, firms may shape the location advantages of their countries to a larger extent than the other way around. What complicates things further is the possibility of circular and cumulative causation, where one variable affects the other which in turn affects the first one and so on (Drakopoulos and Torrance 1994). The assumption underlying the model constructed above is that causality goes from the conditions in home countries to the competitive position of firms. Other possible causal directions are discussed in some detail in Nachum 1999, chapter 9.

Table 2 presents descriptive statistics and correlation coefficients of the explanatory variables included in the model. It also shows the hypothesised association with the dependent variable, with all variables, except outward FDI, expected to have positive association.

Independent sample t-tests suggested that the missing value patterns are non-random, and therefore they were estimated based on existing observations. A model was constructed based on all variables for

which all observations were available, and it was used to estimate missing data. Although the correlation coefficients in table 2 were relatively small in most cases, it does not ensure a lack of multicollinearity between the independent variables (Hair et al 1995). Indeed, given the nature of the variables, it would be expected that there is some collinearity between them. Hence, partial correlation coefficients were calculated, to isolate the effect of individual independent variables on the dependent variable after the predictions shared with all other independent variables have been removed (Hair et al 1995). The variance inflation factor (VIF), which tells about the degree to which each independent variable is explained by the other independent variables (Hair et al 1995), was also calculated. Large VIF values indicate high multicollinearity (suggested cut-off point is 10 (Studenmund 1992)). Table 3 presents the results of the estimations of the model, by means of multiple linear regression, including also the partial correlation and VIF statistics.

The analyses in Table 3 show that home country comparative location advantages explain a high proportion of the variation in world market shares in advertising, suggesting that the impact of home countries exists also in this service industry, where competitive advantages are based entirely on intangible, partly mobile, assets. Examination of individual explanatory variables, which provide insights into the specific country characteristics which are important, show only some of them to be significant. Most surprising is the non-significance of advertising expenditure, which might be explained by multicollinearity, as the high VIF of this variable suggests. In contrast with a-priori expectations, both measures of outward FDI are highly significant, implying that over the period analysed the international involvement of home clients had exercised positive effect on the international expansion of advertising agencies.

4. Concluding Remarks

The qualitative and quantitative analyses conducted in this paper suggest a strong link between the competitive position of advertising TNCs and the comparative location advantages of their home countries. A set of home country conditions was found to possess strong explanatory power for world market shares (the proxy being the share of a country's agencies among the top 50 agencies world-wide) in advertising. This suggests that the comparative advantages of countries are important determinants of the country patterns of international business activity in an industry in which advantages are based entirely on intangible factors, whose ties to any particular location are not self evident.

These findings provide support to those who maintain that country specific forces, stemming from institutional and cultural sources, continue to exert effects on firms (e.g., Porter 1990, Kogut 1993, Nachum 2000, Dunning and Lundan 1998). If the impact of home countries can be established for such an industry, one can make the case that it is more than likely to be found in industries in which factors of production are tangible and immobile.

The findings reported here have important implications for both firms and policy makers. As home countries partly affect the ability of firms to create competitive advantages, also when the latter are based entirely on intangible assets, home-based factors, which are external to firms and mostly not under their individual control, should be considered in the strategies of firms. These findings assign a significant role for governments, as they suggest that the factors affecting the competitive position of national firms are, to a certain extent, tied to conditions in the home countries, on which governments exercise an important influence. The persistence of such influence when competitive advantages are drawn entirely from intangible assets suggests that the impact of government policies is not limited to the factors of production which can only be exploited within their national borders, but also

includes those which might be exploited by firms outside the country in which they were initially developed. This suggests a different, and maybe greater, role for governments than ever before, because their policies are directed towards the creation of intangible assets such as human capital, stocks of all kinds of knowledge and organisational systems, where government impact can be greater than on the amount and quality of given natural assets.

Notes

1. The focus here is on the size of markets, but there are country characteristics other than size of markets which affect the size of firms (Kogut 1992, Dunning 1979). These include national attitudes towards mergers, conglomerations and industrial concentration, the prevalence of subcontracting and vertical integration, and the general national approach towards internalisation.
2. One outcome of these differences can be seen in the development of management education in the two countries. The continued demand for trained managers in the US led the country's most prestigious universities to open business schools in the late 19th century. In the UK, top managers were usually the owners, and the middle managers were recruited from the firm's ranks, so there was little demand for systematic training. Indeed, the first business courses were offered in the UK only in the 1960s, and it was not before the 1990s that Oxford and Cambridge opened business schools.
3. An important implication of this pattern of internationalisation is that the location advantages of host countries were largely irrelevant in this process. The clients selected the locations for their activities, based on their evaluation of the relative advantages offered by different locations, and the agencies followed them. Only later, when the importance of the 'follow the client' motive diminished, were the location advantages of different countries taken into consideration in agencies' choice of location for their international activities.
4. A somewhat similar conceptualisation of the impact of government policies is found in Porter (1990), where the role of national governments is considered as an external factor which

shapes the overall structure and efficiency of the Diamond, rather than being an attribute of it.

5. Interestingly, when Dentsu, the largest Japanese agency, tried to expand internationally in the late 1980s, it did so by way of joint venture (as a part of HDM, a joint venture with Young & Rubicam and Eurocom) and strategic alliances (with a US sales promotion agency and with the European advertising network Collett Dickenson Pearce: Kim 1995). These entry modes are less common among Western agencies and were selected by Dentsu because of lack of confidence in its ability to handle international operations on its own.
6. In the past there was another important factor which further hindered the international expansion of Japanese agencies, namely the Japanese attitude towards exclusivity. In the US and Europe there was a long established 'rule of exclusivity', according to which agencies were unable to service competitors of their clients. This rule prevented local expansion, particularly in the areas in which agencies obtained substantial knowledge and experience, and facilitated international expansion which offered growth opportunities in areas which were not available at home. Japanese agencies were not constrained by the exclusivity rule because in Japan agencies are able to handle competing clients, and they had no incentive to go international in order to escape exclusivity (West 1996). With the increased globalisation of competition, however, the 'rule of exclusivity' is becoming obsolete, because it applies only to competitors based within the same country, while the most relevant competitors of many global firms are based elsewhere.
7. These developments raise important questions regarding the link between the conditions of home countries and the competitive position of national firms. First, is the development of the UK advertising industry in the late 1970s and early 1980s a result of

the changing conditions in the UK or rather a process which received its main push by the activities of a single agency - Saatchi & Saatchi? If the latter, does it suggest that individual agencies can develop competitive strength which is not directly related to the resources of their home countries? And what is the role of individual agencies in shaping the location advantages of their home countries? Second, why did US, rather than UK agencies benefit from the favourable conditions in the UK in the 1960s and 1970s, and what caused the change which took place from the late 1970s onwards? Under what conditions do favourable location advantages facilitate inward FDI rather than the emergence of competitive local firms? A detailed discussion of these questions is beyond the scope of this paper. I discuss them in length in Nachum 1999 (chapter 8 in particular), and Nachum 2000a.

8. The denominator for this calculation should have been based on data for all countries world-wide. However, such an approach would require resources which were not available for this task.

TABLES AND FIGURES

Table 1. The link between competitive advantages of advertising agencies and home country characteristics

Major competitive advantages of advertising agencies	Home country characteristics favouring such advantages	Operation measures of home country characteristics ^a
Advantages embodied in qualified employees; the ability to recruit and retain the best employees	Availability of a large pool of employees in the relevant fields; quality of employees	1. Graduate students in communications and arts as share of total graduates 2. Wages paid to professionals (including business professionals and artists) relative to the country's average ^a
Creativity; ability to acquire advanced knowledge and access to sources of inspiration	Local environment facilitating the development of creative capabilities; production and consumption of cultural products; access to variety of media channels	1. Consumption of cultural products (Kgs. prints per 100 inhabitants) 2. Number of TV receivers (per 1000 inhabitants)
Size of firms	Large and standardised home market; liberal attitudes towards merges, conglomerates, industrial concentration; dynamism of the market	Advertising expenditure (% of GDP)
Product differentiation	Preference of home clients for variety and product differentiation; acceptance of advertising and other persuasive marketing methods.	Income per capita (\$)
Age of firms, as it is associated with first mover advantages and the establishment of reputation	Historical development of local demand	Time elapsed since advertising expenditure reached 5% of gross fixed capital formation ^c
Managerial and organisational capabilities	Availability and quality of business education institutes	Share of graduates in business and management studies in total graduates
Advantages associated with multinationality per se	Involvement of national industry in international activity	Outward FDI stocks (total \$ and % of GDP)
As it affects the various advantages above	Role of national governments; intervention and relationship with firms; incentives to create advantages.	Government expenditure on economic services (% of total government expenditure)

Sources of data: World Bank, *World Development Report 1995* Oxford University Press; UNCTAD, *World Investment Report* United Nations, Geneva and New York; UNESCO, *UNESCO Statistical Yearbook* UNESCO, Paris; ILO, *Yearbook of Labour Statistics* ILO, Geneva; Roper Starch, advertising database; Zenith Media database.

^a Explanatory variables for the 1999 dependent variable are the latest available, which in some cases leaves a gap of up to two years with the dependent variable.

^b The classification of professional industries has changed during the period analysed. In the 1970s and 1980s data were classified according to the ISIC rev 2 and the data refers to category 2. In the 1990s the classification is based on ISIC rev 3, and the data refers to category K.

^c These data were excluded from the statistical analysis because they cannot be operationalised in a longitudinal analysis.

Table 2. Hypothesised causality, descriptive statistics and Pearson correlation coefficients of the independent variables

Explanatory variables (expected direction of causality)	Descriptive statistics		Correlation coefficients									
	Mean	Std. Deviation	Graduates Arts	Advert expend.	Graduates Business	Outward FDI \$	Outward FDI/GDP	Wages	Govtmt	TV	Culture	
Graduates Art (+)	3.274	1.667	1.000									
Advertising expenditure (+)	21,559.521	33,054.726	.032 (.885)	1.000								
Graduates Business (+)	12.824	6.864	.337 (.135)	.450 * (.031)	1.000							
Outward FDI \$ (?)	168,607.216	213,128.510	.157 (.464)	.805 ** (.000)	.369 (.084)	1.000						
Outward FDI/GDP (?)	10.382	8.640	.179 (.382)	-.033 (.848)	.144 (.484)	.236 (.159)	1.000					
Wages (+)	1.127	.228	-.099 (.706)	.454 * (.039)	.622 * (.010)	.317 (.123)	-.140 (.506)	1.000				
Governments role (+)	8.816	3.143	-.019 (.942)	-.198 (.377)	-.139 (.536)	-.286 (.208)	-.376 (.077)	-.434 (.138)	1.000			
TV (+)	512.731	158.710	-.050 (.809)	.735 ** (.000)	.288 (.154)	.645 ** (.000)	.188 (.245)	.198 (.342)	-.315 (.144)	1.000		
Culture consumption (+)	27,500.536	13,774.422	.228 (.262)	.544 ** (.001)	.488 * (.011)	.456 ** (.005)	.202 (.211)	.601 ** (.001)	-.098 (.657)	.386 * (.013)	1.000	

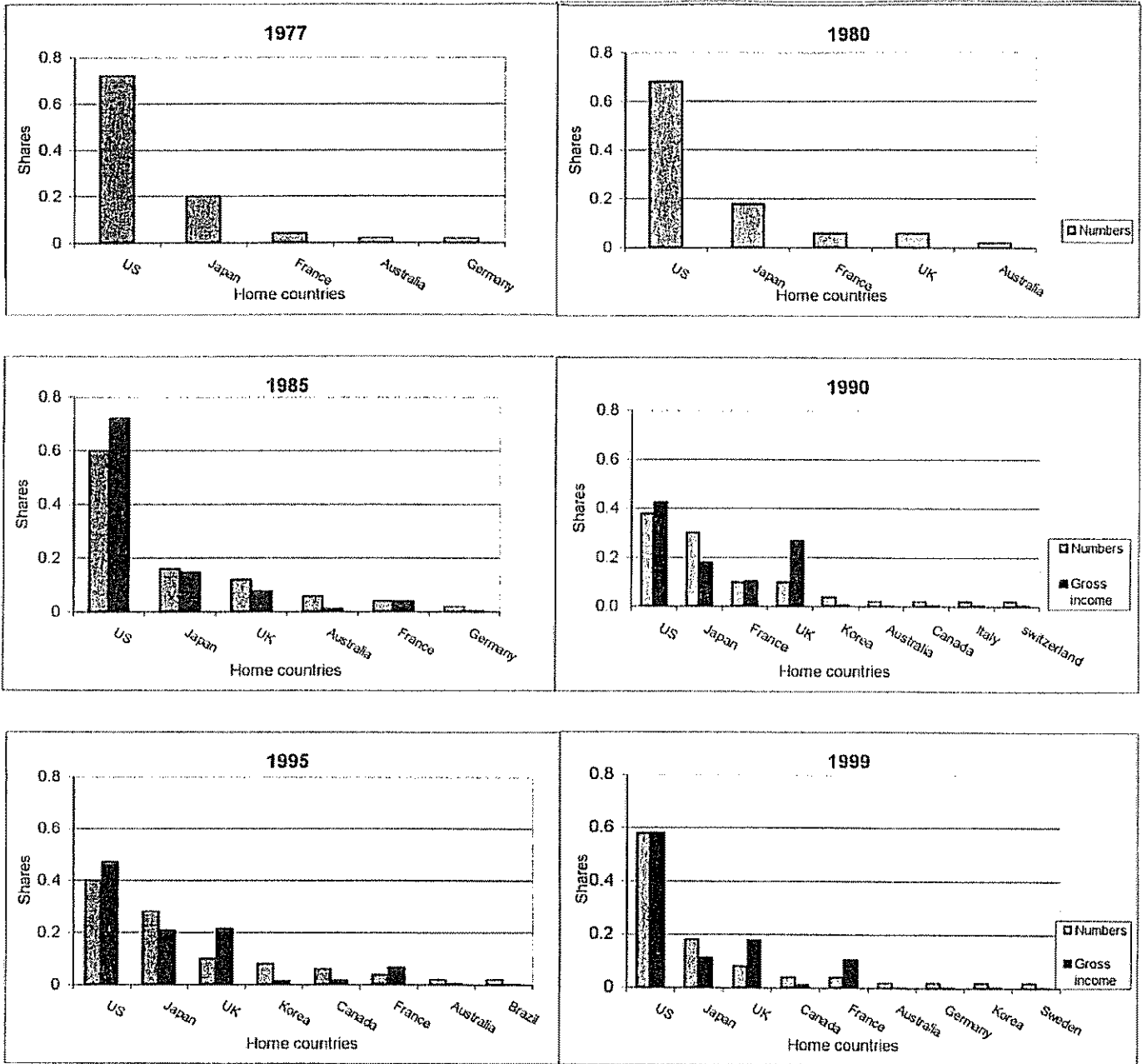
* Correlation is significant at the 0.05 level (2-tailed).

** Correlation is significant at the 0.01 level (2-tailed).

Table 3. Estimation of a model linking world market shares with home country characteristics
Regression statistics

Constructs	Operation measures	Unstandardized B Coefficients	t	Sig.	Partial Correlation	VIF
Abundance and quality of home employees	Graduates arts	-.113	-.156	.877	-.026	8.429
Abundance and quality of home employees	Wages	9.485	2.223	.032	.343	10.833
Size of home country	Advertising expenditure	2.572	.835	.409	.136	21.752
Abundance of managerial skills	Graduate business	6.665E-02	.334	.741	.055	9.938
Abundance of managerial skills	Graduate business	6.665E-02	.334	.741	.055	9.938
International involvement of home clients	Outward FDI total \$	1.945E-05	3.067	.004	.450	3.322
International involvement of home clients	Outward FDI % GDP	.339	2.733	.010	.410	3.449
Sophistication of local demand	Income per capita	4.821E-04	2.714	.010	.407	13.353
Home government role	Government expenditure on economic services	-.147	-.434	.667	-.071	12.424
Home government role	Government expenditure on economic services	-.147	-.434	.667	-.071	12.424
Access to variety of advanced media channels	Number of TV receivers	3.385E-02	3.709	.001	.521	11.926
Consumption of cultural products	Newsprint consumption	1.955E-04	1.984	.055	.310	11.640
Adj. R ²		0.726				
Standard Error		5.999				
F		13.453				
Sig. F		.000				

Figure 1. The national origin of the leading advertising TNCs world-wide, 1977-1999
 (Shares in the top 50, by numbers and of total gross income*)



Source: Advertising Age, various issues.

(*) Gross income data for 1977 and 1980 are not available, and hence the analyses of these years are based on numbers only.

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