



BUSINESS STRATEGY IN EMERGING MARKETS

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May 2011

WHAT IS AN “EMERGING MARKET”? (PELLE, 2007)

- Fast growing economies: high GDP growth (usually more than 5%).
- Developing economies: low per capita income and poverty, but general improvement of living conditions (i.e. some African countries).
- Newly industrialized countries (NICs): closely approaching a developed status (e.g. Mexico, Brazil, South Africa).
- Emerging markets (EMs): low to medium GDP per capita (e.g. US\$ 2 to 15 thousand), high growth and likely “catch up” trend towards a more developed status.
- In the strategy literature, “emerging markets” have been generally referred to as non-fully-developed countries, oftentimes **with important institutional “voids” and poor infrastructure.**

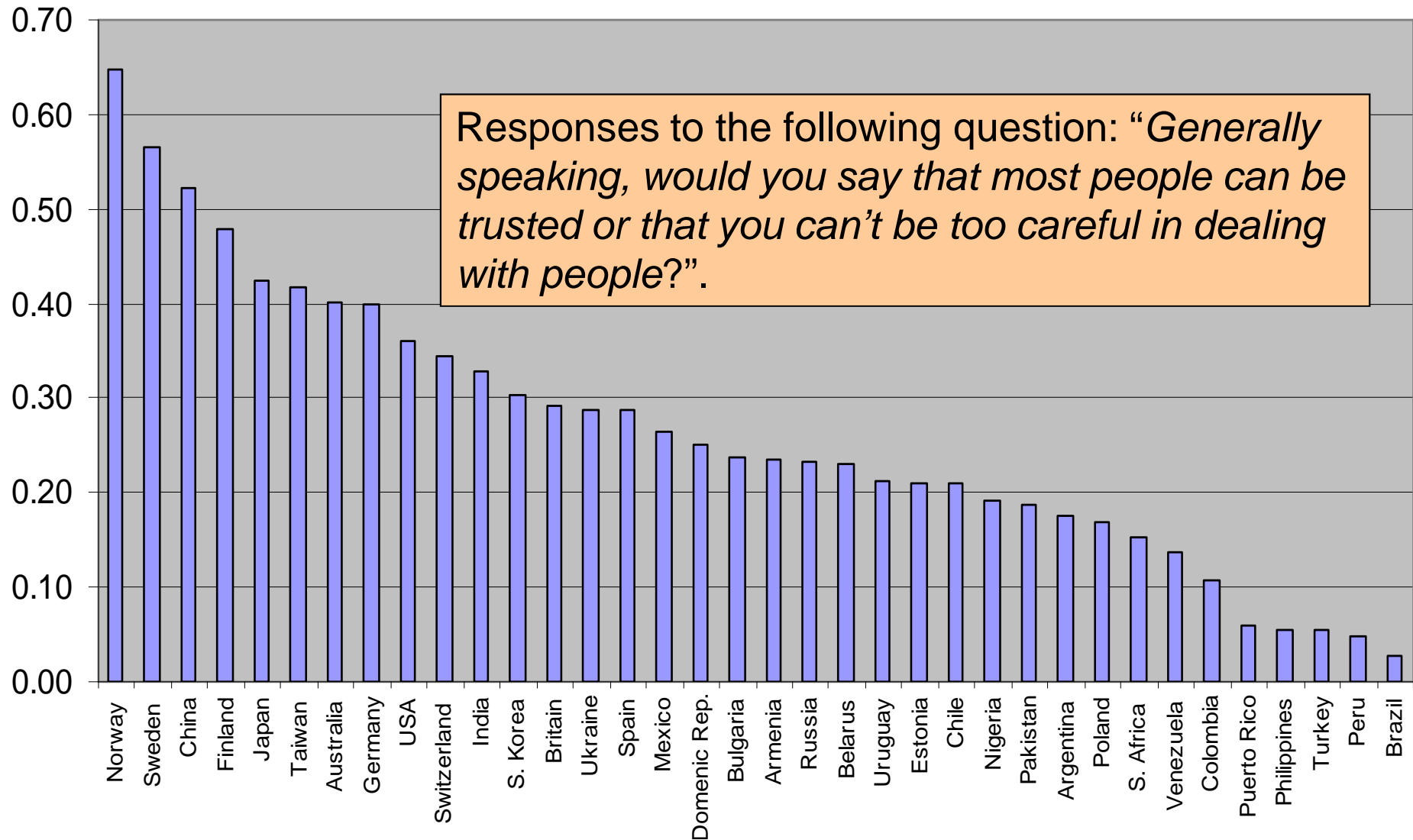
THE “BRICs” (GOLDMAN SACHS REPORT, 2003)

Country rank and GDP (billion US\$, current)				
	2003		2050 (predicted)	
1	USA	10,882	China	44,453
2	Japan	4,326	USA	35,165
3	Germany	2,401	India	27,803
4	UK	1,795	Japan	6,673
5	France	1,748	Brazil	6,074
6	Italy	1,466	Russia	5,870
7	China	1,410	UK	3,782
8	Canada	834	Germany	3,603
9	India	599	France	3,148
10	Brazil	492	Italy	2,061
11	Russia	433		

Source: Goldman Sachs (2003), reproduced in Pelle (2007)

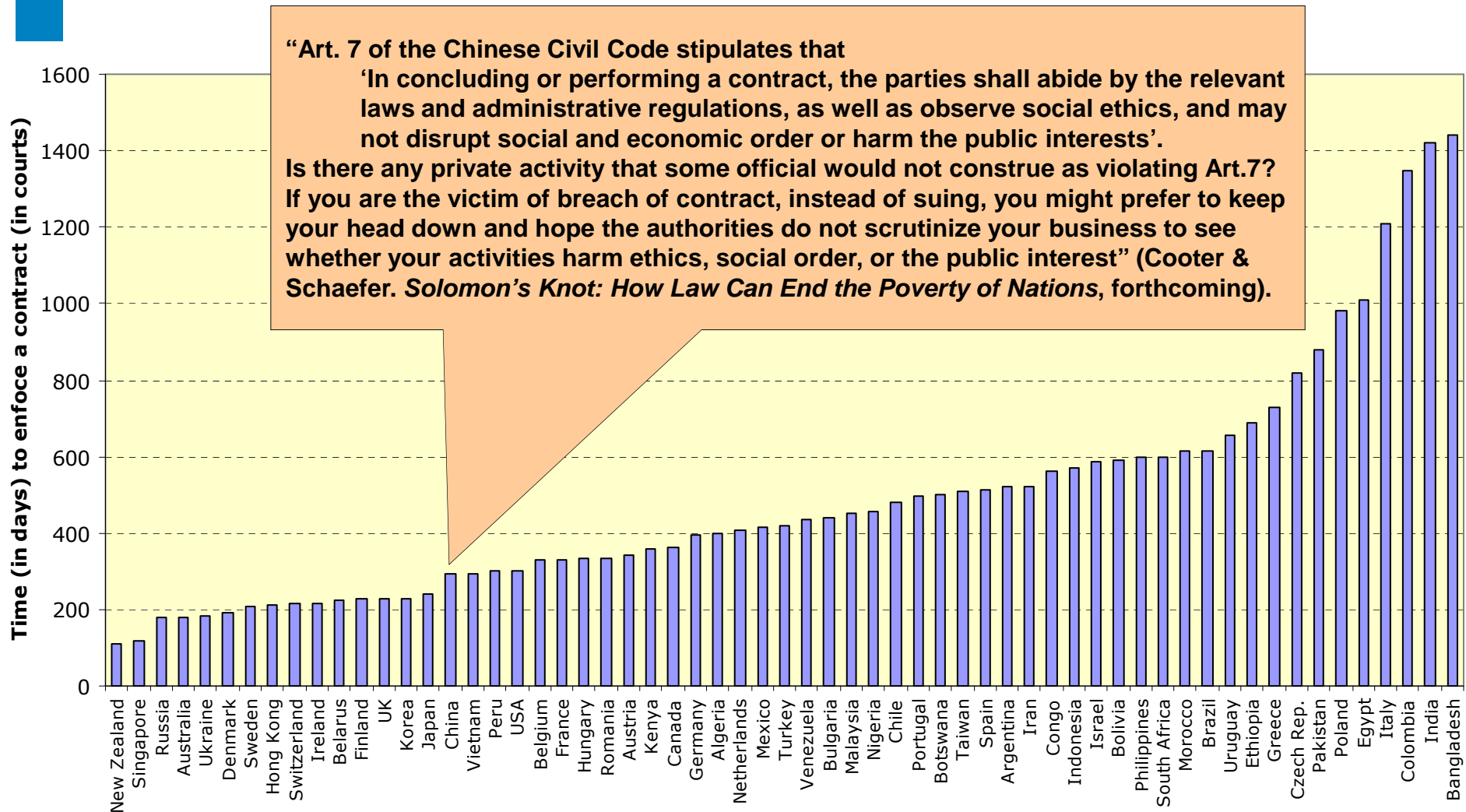
In 2010, GDP of US\$ 10 trillion. BRICs expected to contribute with 49% of the worldwide growth in 2011-2020.

CROSS-COUNTRY "TRUST" LEVELS



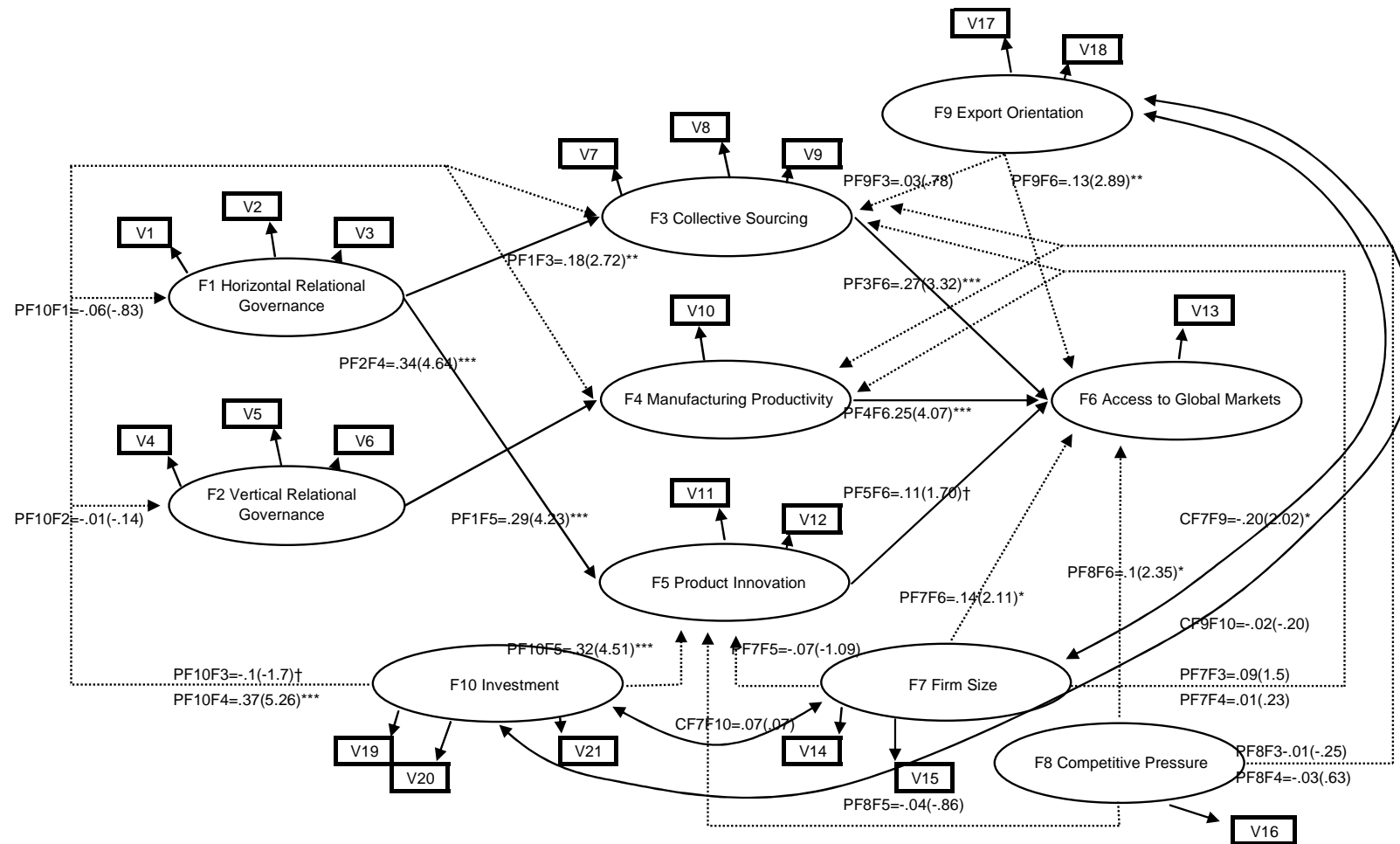
Source: World Values Survey, 1995-97.

CONTRACTUAL ENFORCEMENT: CROSS-COUNTRY COMPARISON



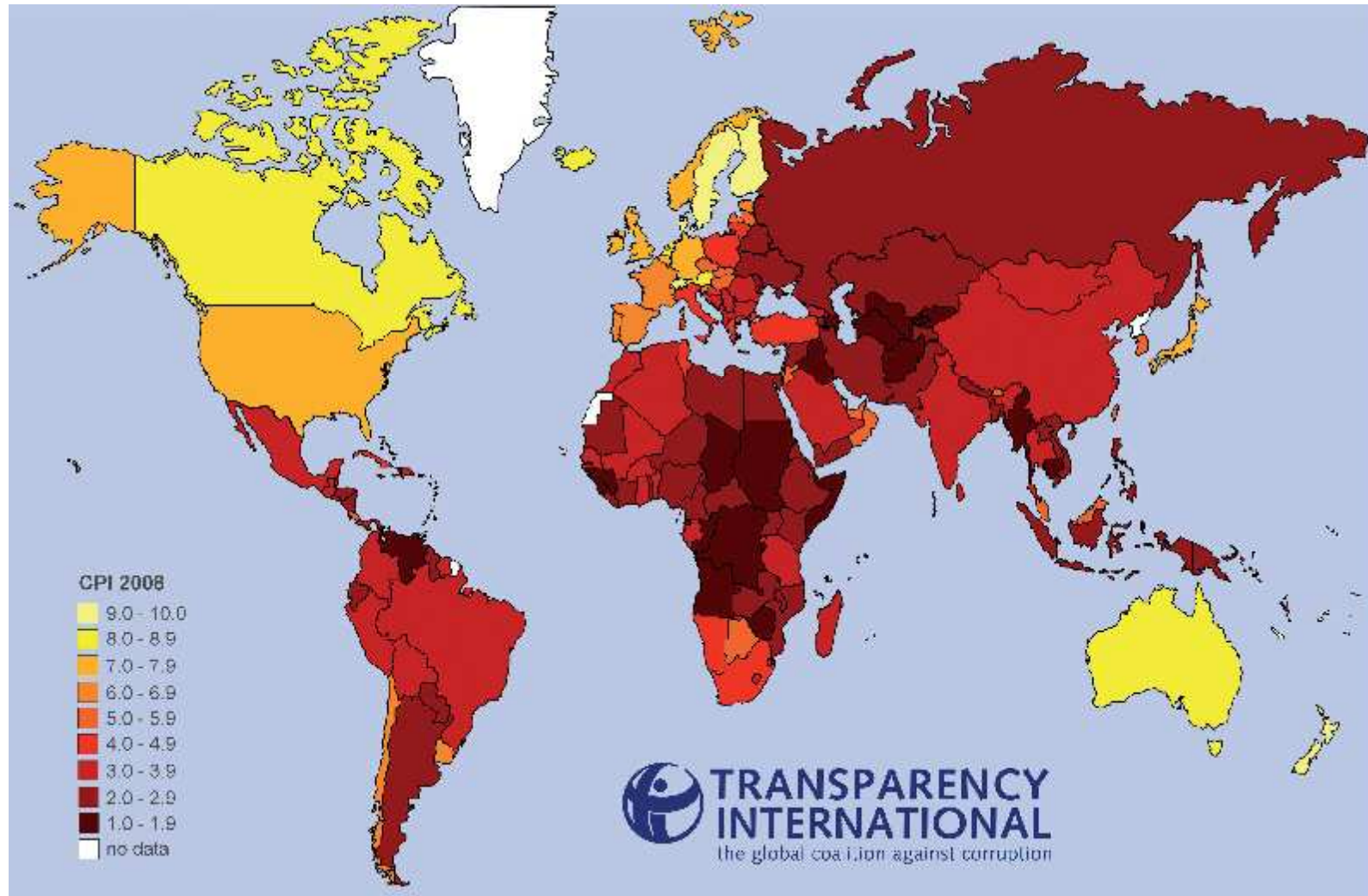
Source: World Bank, 2007.

THE EFFECT RELATIONSHIPS AMONG SMEs IN ARGENTINA (MESQUITA & LAZZARINI, 2008)



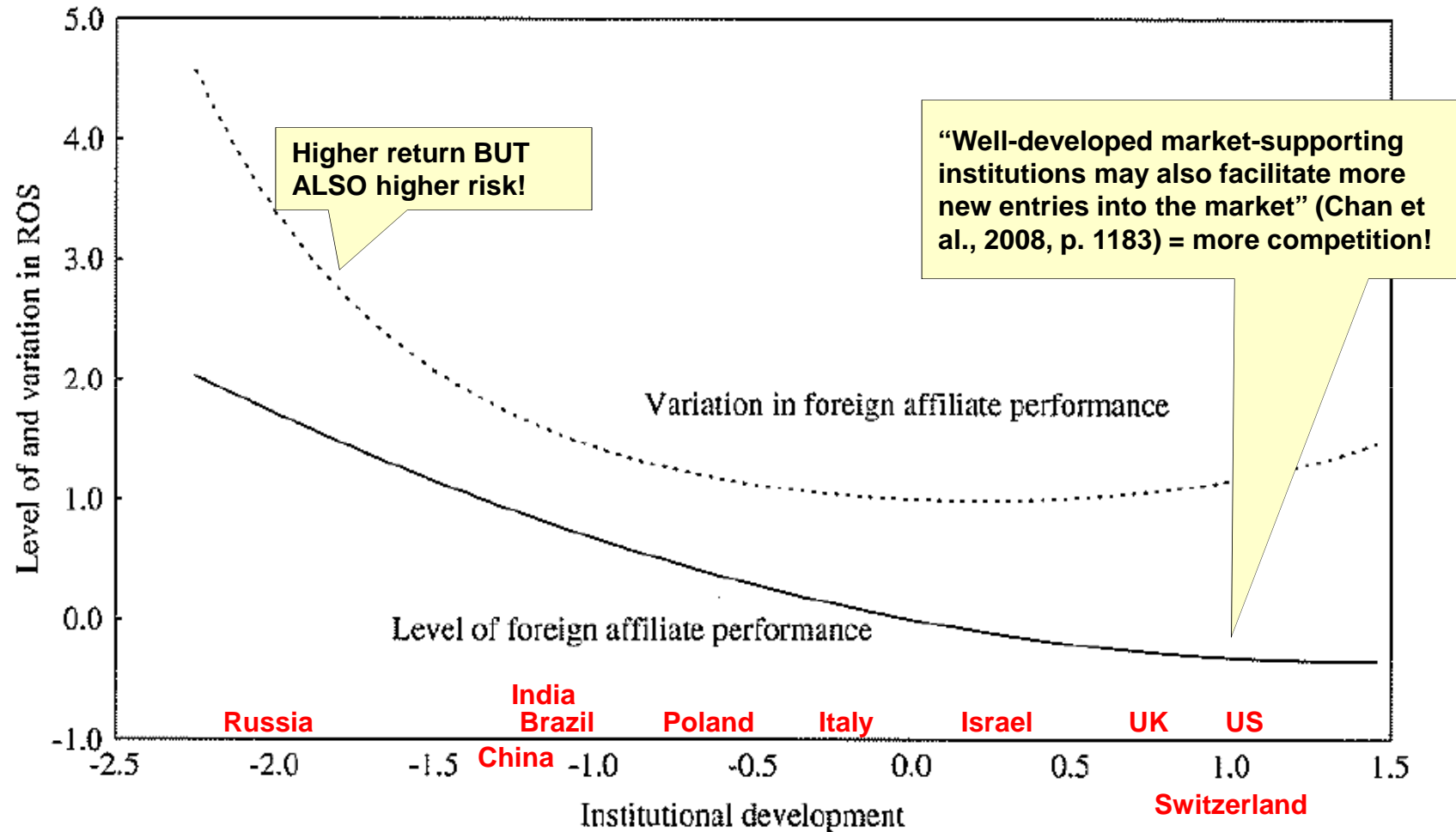
Source: Mesquita & Lazzarini (2008). Data from 232 small and medium enterprises (SMEs) producing furniture (tables, chairs, cabinets, etc.) in the province of Buenos Aires.

CORRUPTION PERCEPTIONS INDEX (2008)



Source: http://www.transparency.org/policy_research/surveys_indices/cpi/2008

RISK AND RETURN IN EMERGING MARKETS (CHAN et al., 2008)



Source: Chan et al. (2008). Data from foreign affiliates of Japanese corporations operating in 38 countries, 1996-2001. ROS = return on sales; variation in ROS = standard deviation of return on sales for each country.

“Institutional development” is an index considering economic factors (e.g. extent of distribution infrastructure), political institutions (e.g. level of intellectual property rights, law and order, etc.) and social aspects (e.g. corruption, civil freedom, etc.)

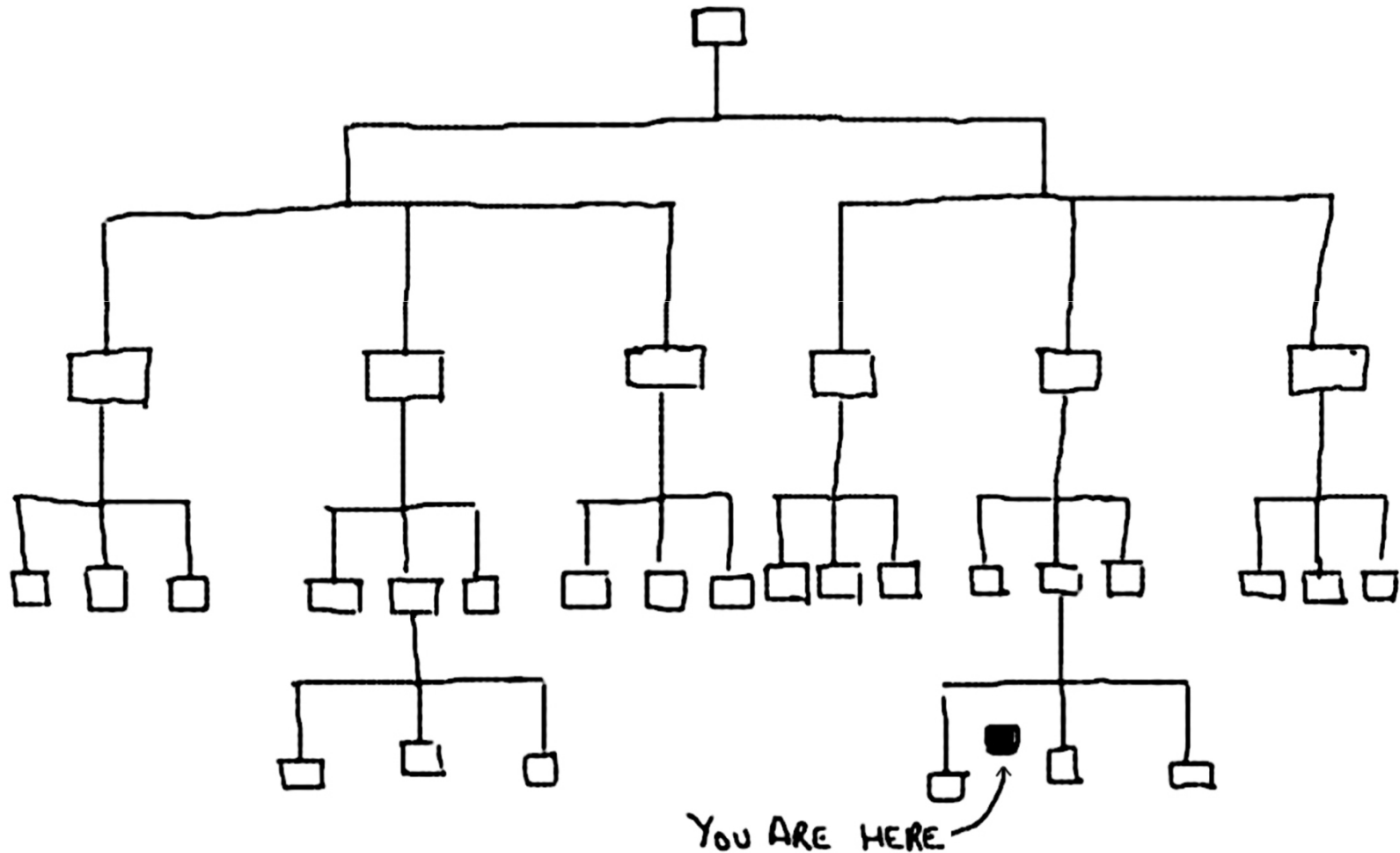
EMERGING MARKETS: IMPLICATIONS FOR RESEARCH IN STRATEGY

- Increased attention to the **institutional environment** – and, especially, institutional “voids” that increase transaction costs (Hoskisson et al., 2000; Khanna & Palepu, 1997, 2000; Leff, 1978). Some even talk about an **institution-based** view of strategy (Peng et al., 2009).

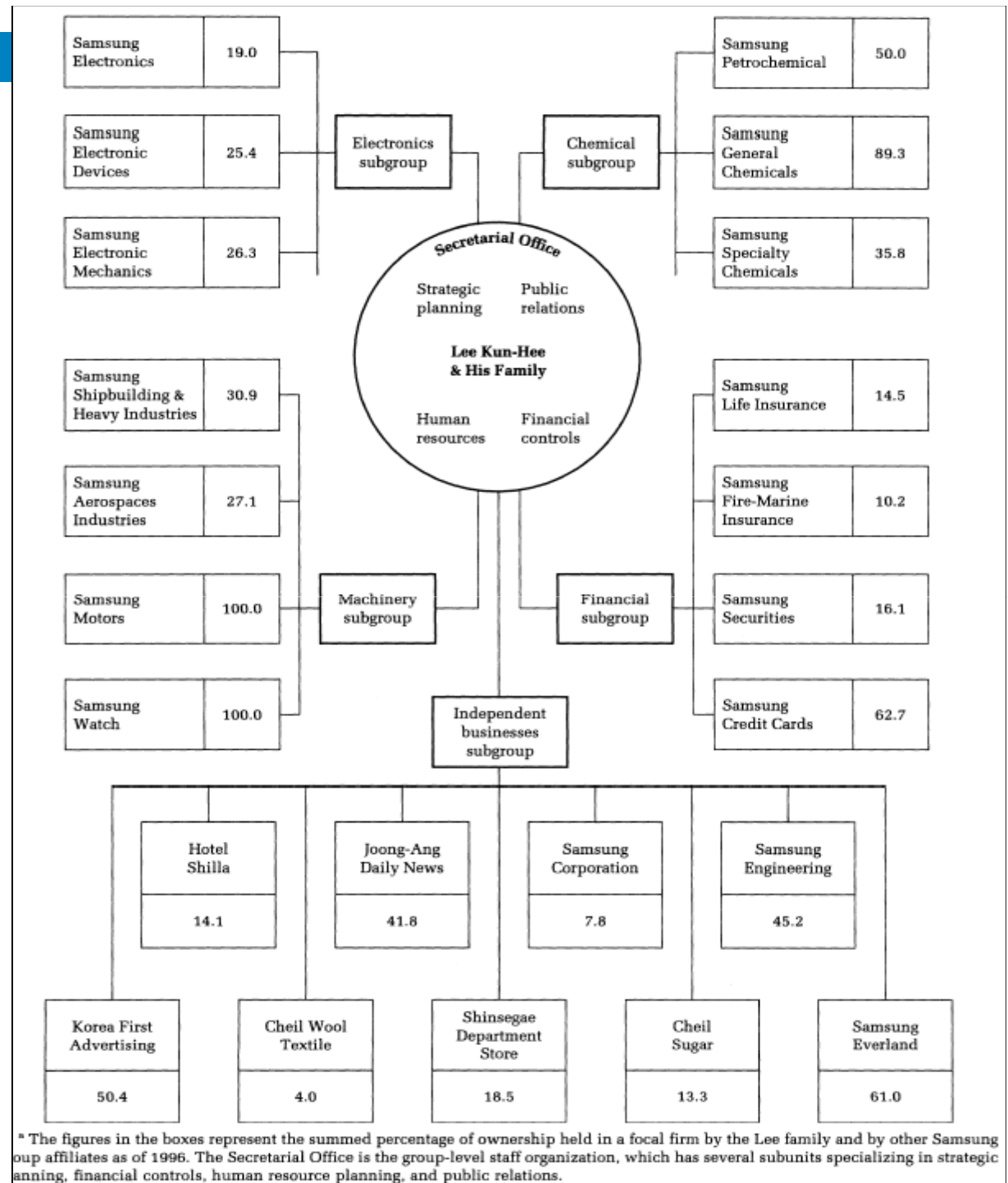
- Important related topics:
 1. Concentrated ownership and presence of **business groups**.
 2. Role of **political connections** as a potential source of competitive advantage.
 3. Direct or indirect **participation by the government**: state-owned enterprises (SOEs); firms with minority stakes by governmental entities; and active industrial policy.

#1 BUSINESS GROUPS

CORPORATE HIERARCHY

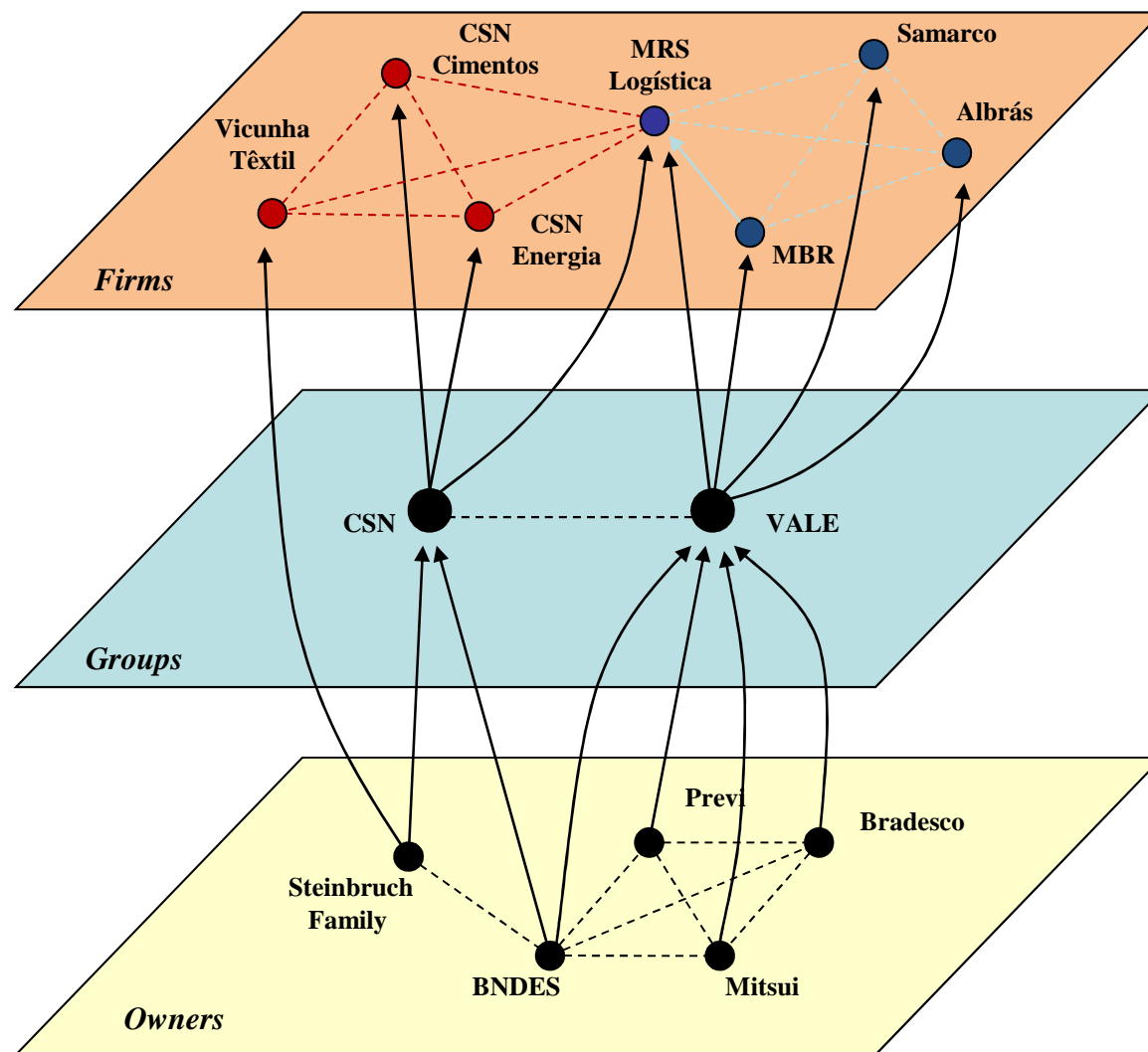


SAMSUNG CHAEBOL (S. KOREA)



Source: Chang (2000)

GROUPS IN BRAZIL



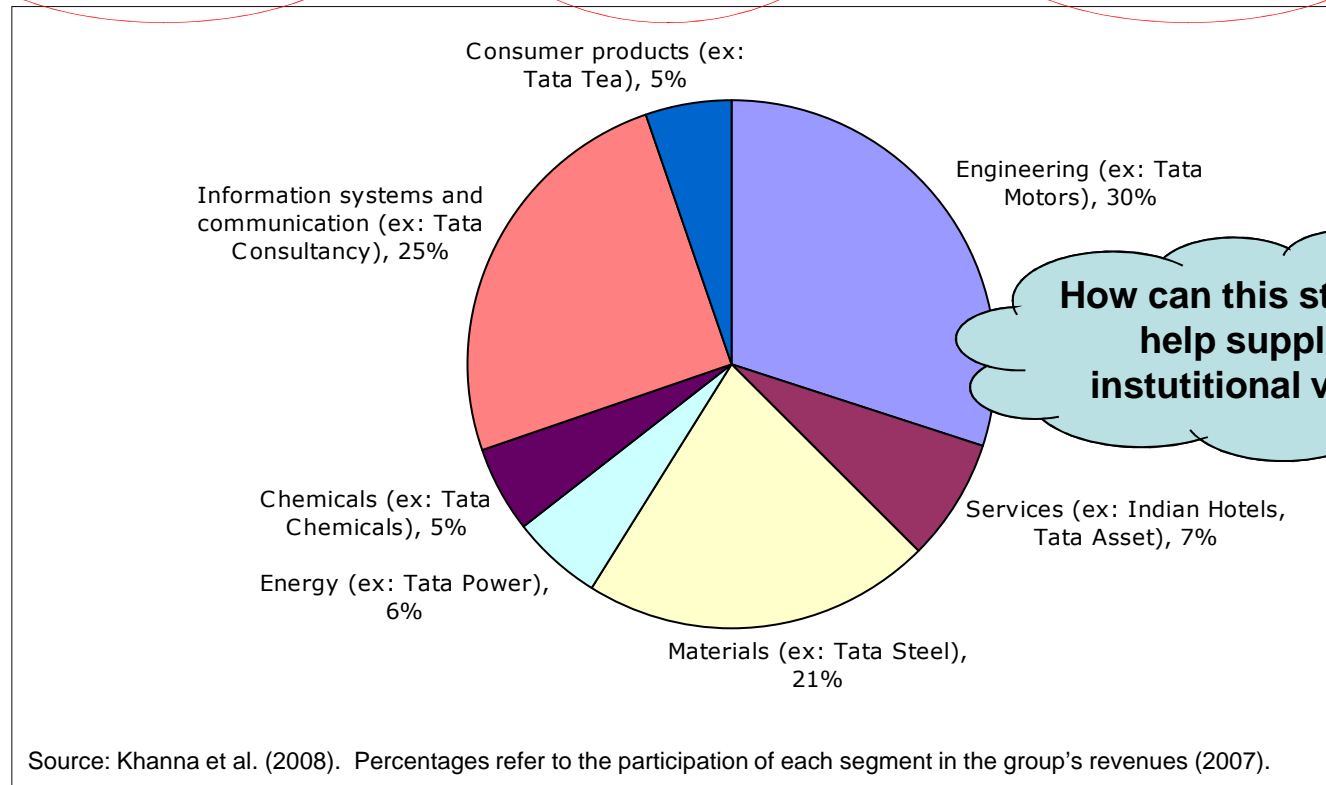
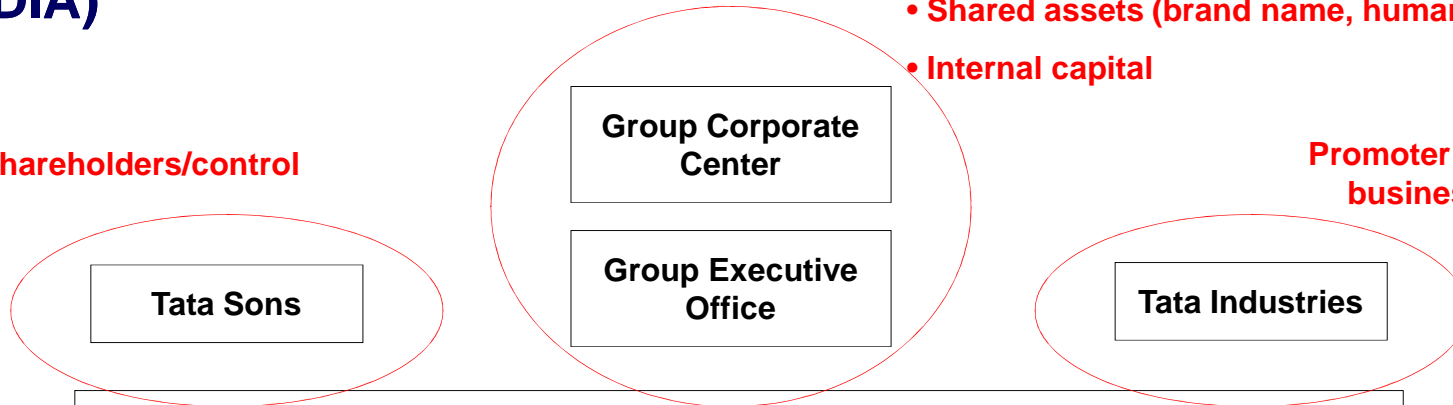
Source: Lazzarini (2010)

TATA HOUSE (INDIA)

- Strategic formulation
- Corporate control
- Shared assets (brand name, human capital,...)
- Internal capital

Shareholders/control

Promoter of new
businesses








How can this structure help supplant institutional voids?

Source: Khanna et al. (2008). Percentages refer to the participation of each segment in the group's revenues (2007).

INSTITUTIONAL VOID

HOW GROUPS CAN HELP (KHANNA & PALEPU, 1997; ORIGINAL ARGUMENT BY LEFF, 1978)

- | | | | |
|----|---|---|---|
| 1. | Inefficient capital markets; illiquid and with high risks of expropriation. |  | Close monitoring of businesses; provision of capital; launch of new enterprises |
| 2. | Rigid and incipient labor markets: scarcity of skilled people. |  | Creating and developing internal talent; internally managing layoffs. |
| 3. | Lack of information and mechanisms of customer protection in product markets. |  | Group reputation: private regulation of quality ("umbrella" brand name and internal quality procedures) |
| 4. | Weak contractual enforcement. |  | Group reputation: self-regulation of contracts and track record of fair deals. |
| 5. | "Biased" and unstable governmental regulation. |  | Managing political and governmental connections. (However: may be associated with "cronyism" and corruption!) |

BUSINESS GROUPS: “PARAGONS OR PARASITES?” (SEE REVIEW BY KHANNA & YAFEH, 2007)

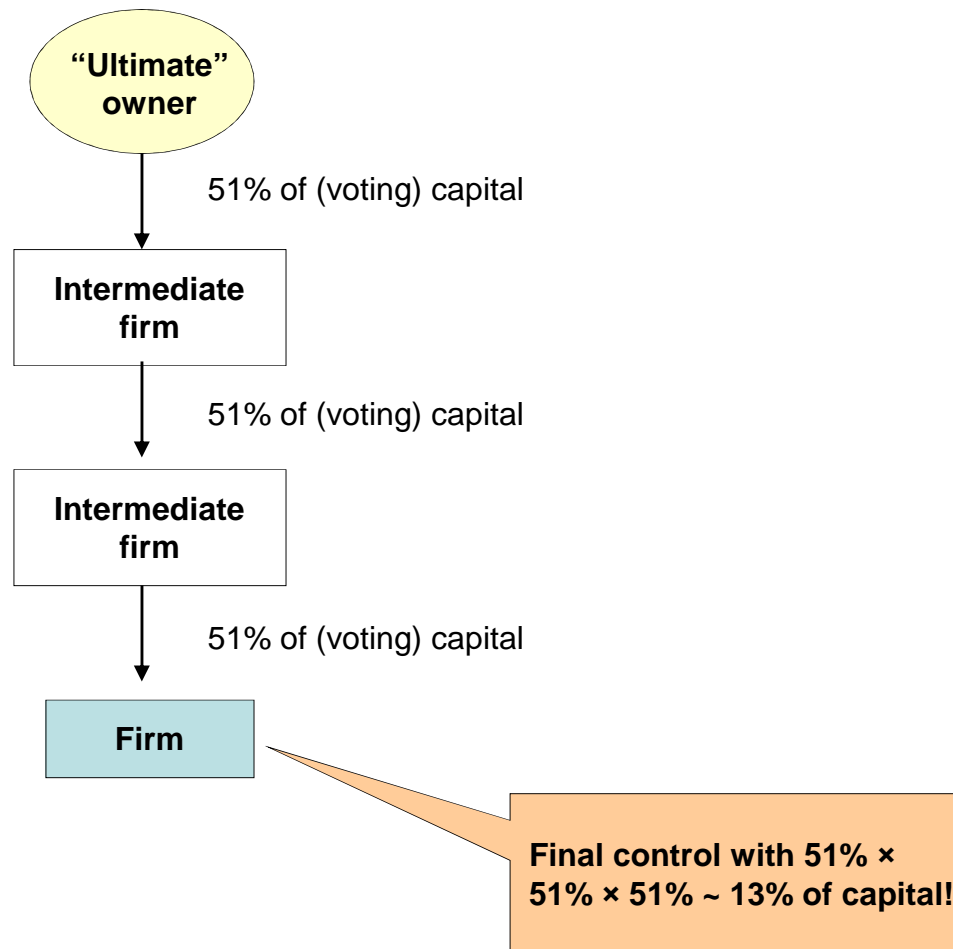
POSITIVE VIEW

- Groups as mechanisms to supplement institutional voids.

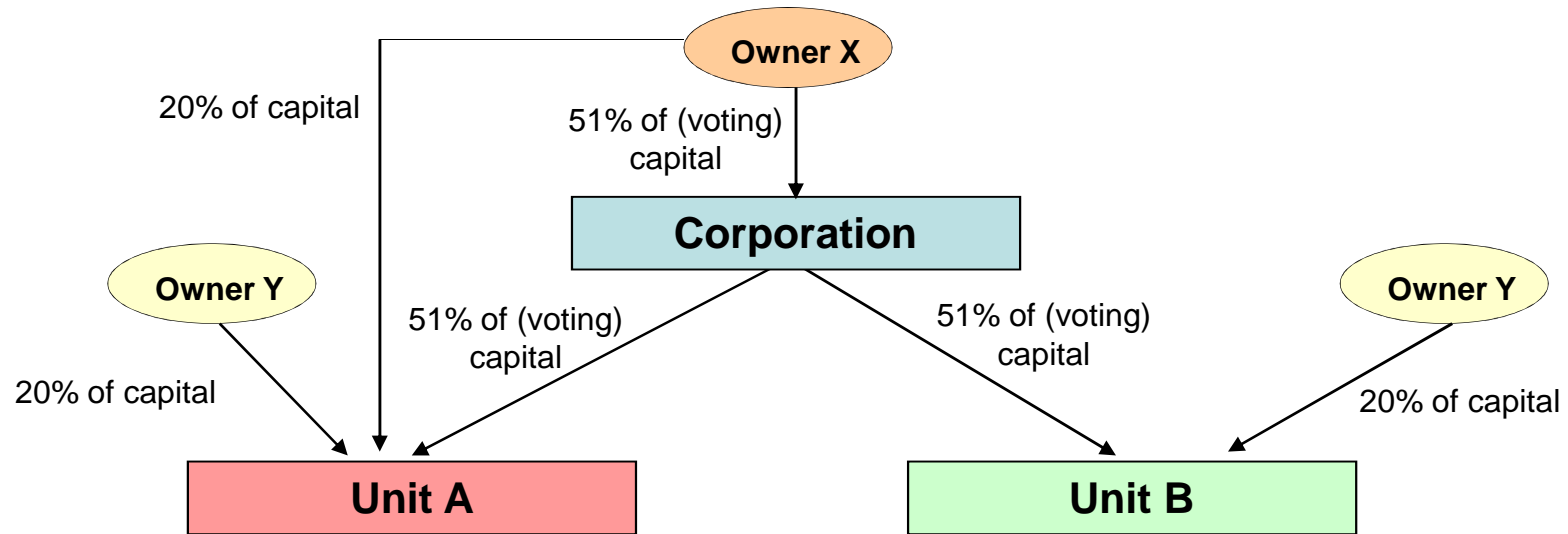
NEGATIVE VIEW

- Groups as mechanisms to exploit political connections.
- Groups expropriating minority shareholders.
- Groups as conduits of intra- or inter-industry collusion.

PYRAMIDS: CONTROL WITH LESS CAPITAL



“TUNNELING”



If Unit A is losing money but Unit B has positive profits, Owner X (controlling owner) may pursue “transfers” to Unit A (e.g. favorable “transfer prices”, financial subsidies, etc.)

(See e.g. Bertrand, Metha, Mullainathan, 2002 for evidence in India)

COLLUSION: THROUGH *MULTI-MARKET CONTACT* (1/2)...

		F2	
		High price	Low price
F1	High price	(20, 60)	(0, 40)
	Low price	(40, 0)	(10, 30)

Nash equilibrium

Suppose **one market only**, infinitely repeated game.

Let the discount factor be $0 < \delta < 1$.

Assuming trigger strategy, Firm 1 will keep high price if

$$20 + \delta 20 + \delta^2 20 + \delta^3 20 + \dots \geq 40 + \delta 10 + \delta^2 10 + \delta^3 10 + \dots$$

or

$$20/(1 - \delta) \geq 40 + 10\delta/(1 - \delta)$$

or $\delta \geq 2/3$.

COLLUSION: THROUGH *MULTI-MARKET CONTACT* (2/2)...

		MARKET A	
		High price	Low price
F1	High price	(20, 60)	(0, 40)
	Low price	(40, 0)	(10, 30)

Nash equilibrium

		MARKET B	
		High price	Low price
F1	High price	(60, 20)	(0, 40)
	Low price	(40, 0)	(30, 10)

Nash equilibrium

Suppose now **two markets, asymmetric positions**, infinitely repeated game.

Assuming trigger strategy, Firm 1 will keep high price if

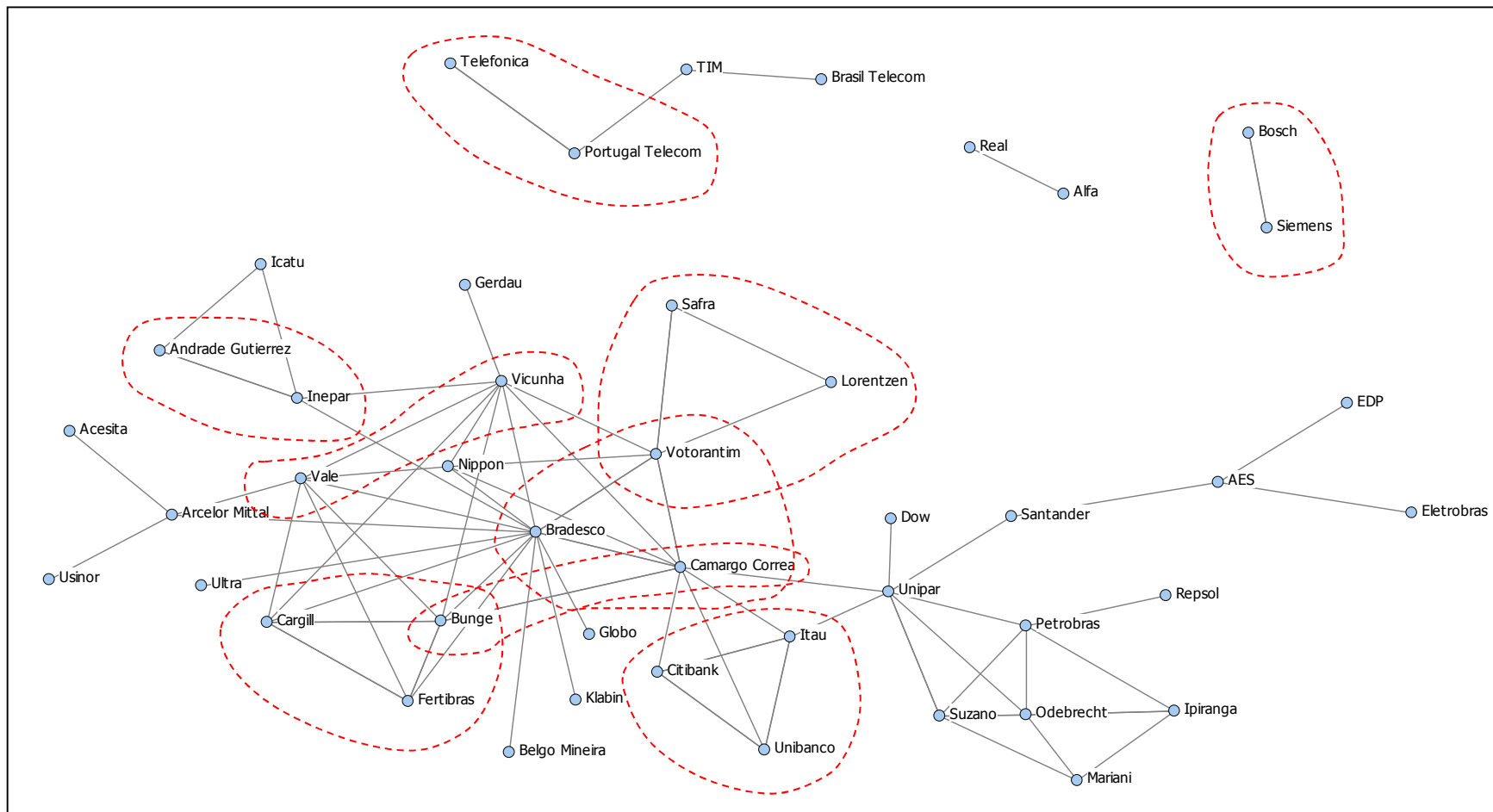
$$(20 + 60)/(1 - \delta) \geq (40 + 60) + (30 + 10)\delta/(1 - \delta)$$

or $\delta \geq 1/3$.

(For a general demonstration, see Motta, *Competition Policy*, 2004)

... ENHANCED BY *CROSS-SHAREHOLDINGS*

Cross-equity stakes between business groups in Brazil in 2003. Ties between nodes indicate whether a group has a stake (majority or minority) in another group's affiliate. The dotted circles indicate cases where groups have joint majority stakes in common affiliates.



Cross-shareholdings can have an important **collusive** effect – see Gilo, Mosh & Spiegel (2006).

#2 POLITICAL CONNECTIONS

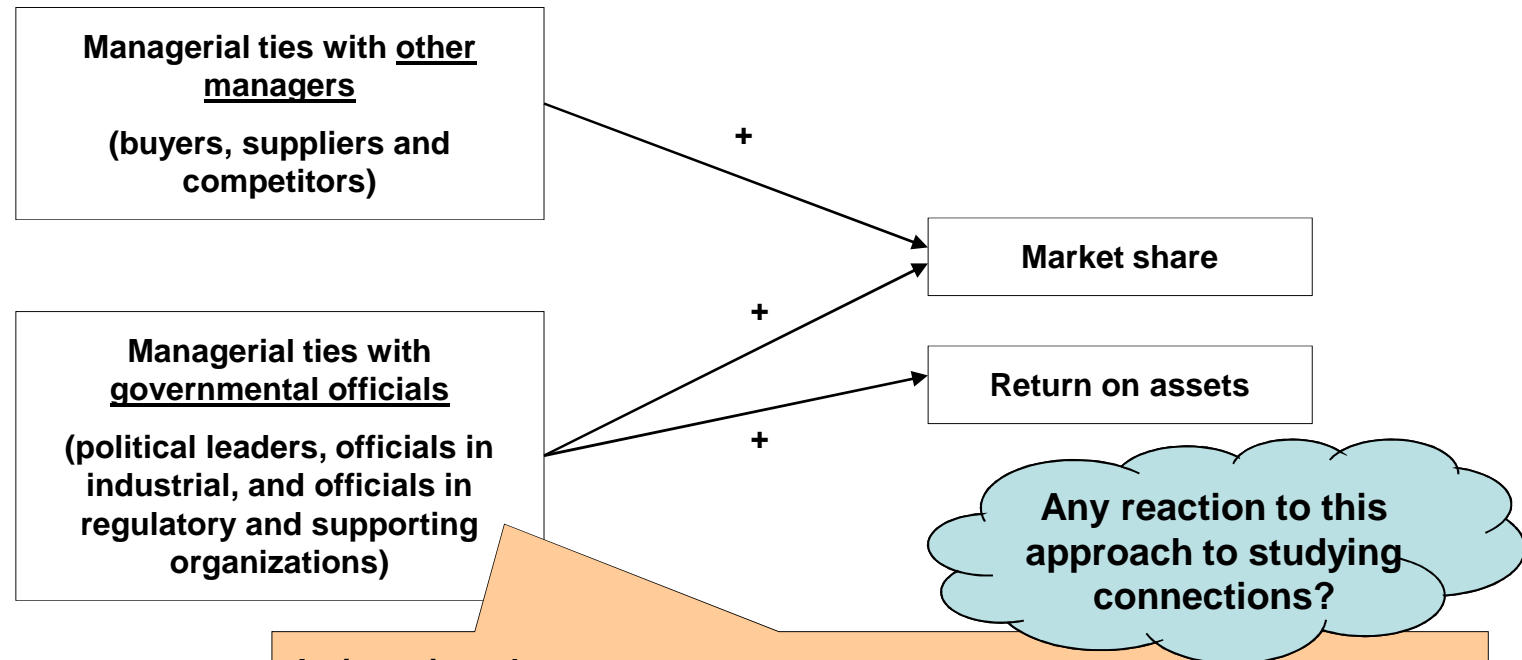


“The lobby of the House of Commons” (1886), lithograph by Liberio Prospero

POLITICS AND FIRM-LEVEL COMPETITIVE ADVANTAGE

- **Non-market strategies:** how firms deal with the political environment (e.g. de Figueiredo and Tiller, 2001 on lobbying; Henisz and Zelner, 2001 on expropriation hazards; McDermott et al, 2009 on local private-public networks...).
- Political connections as source of competitive advantage? Access to scarce resources, more “protection,” improved information... (Hillman et al, 1999; Fisman, 2001; Johnson & Mitton, 2003).
- Connections can be valuable, rare, difficult to imitate (e.g. the resource-based view – Barney, 1991; Frynas, Mellah & Pigman, 2006).

THE EFFECT OF RELATIONSHIPS (*GUANXI*) IN CHINA (PENG & LUO, 2000)



An interviewed manager:

“All of these officials, who can be regarded as your ‘mothers-in-law,’ absolutely have to be pleased. If you fail to do that, you may be forced to close your factory without knowing what’s wrong at all... On the other hand, if these ‘in-laws’ are happy, they can make life a lot easier for you. Sometimes they make you think they have the magic touch to make anything happen. For example, they can procure cheaper materials for you, provide priority access to infrastructure, and promote your products in statecontrolled distribution channels.”

Source: Peng & Luo (2000). Data from 127 Chinese firms (49 from Jiangsu, 12 from Guangdong, 16 from Shandong, 19 from Zhejiang, 21 from Shanghai, and 10 from Anhui). OLS regressions; variables measured through questionnaires.

THE FISMAN (2001) STUDY

How the share price of firms in Indonesia responded to rumors about the health of dictator Suharto (effect on stock returns). *POL* is a variable measuring the extent of political connection based on assessments by a local consulting firm (“Suharto Dependence Index”).

“All of the companies affiliated with President Suharto’s children (Bimantara and Citra Lamtoro Groups) received a score of five, as did those owned by longtime Suharto allies Bob Hasan (Nusamba Group), Liem Sioe Liong (Salim Group), and Prajogo Pangestu (Barito Pacific Group)” (Fisman, 2001, p. 1097).

	Jan. 30– Feb. 1, 1995	April 27, 1995	April 29, 1996	July 4-9, 1996	July 26, 1996	April 1-3, 1997
<i>POL</i>	-0.58* (0.34)	-0.31 (0.18)	-0.24* (0.15)	-0.95*** (0.27)	-0.57*** (0.22)	-0.90** (0.35)
Constant	1.29 (0.79)	0.21 (0.32)	0.12 (0.46)	0.83 (0.64)	-0.07 (0.41)	0.77 (0.97)
R^2	0.037	0.043	0.025	0.147	0.078	0.075
<i>N</i>	70	70	78	79	79	79

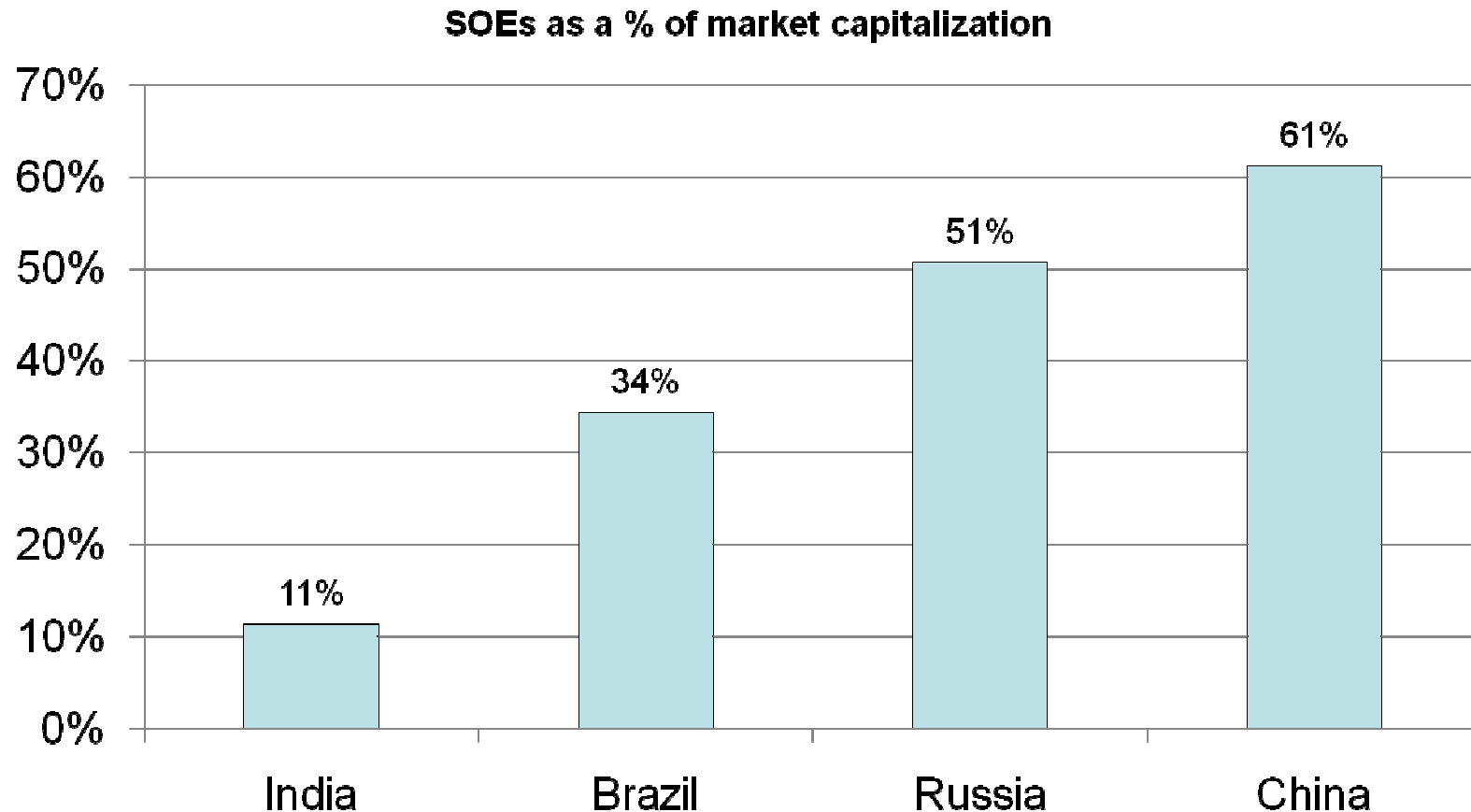
MEASURING POLITICAL CONNECTIONS

- Surveys (however: are they reliable?).
- Politicians as company directors (e.g. Khwaja & Mian, 2004; Faccio, 2006).
- Observed political “investments,” such as campaign donations (e.g. Bandeira-de-Mello & Marcon, 2004; Claessens, Feijen & Laeven, 2008; Boas, Hidalgo & Richardson, 2011).
- Political cycle (elections) and differential lending (e.g. Dinç, 2005).
- Other ways??

STATE PARTICIPATION



STATE OWNERSHIP IN EMERGING MARKETS



*** Estimated from data from Capital IQ. SOE defined as companies with >10% of government ownership. Graph represents the market value of SOEs over the market value of the largest 125 companies (100 for Russia). For Russia other calculations put this figure at 40% of mkt cap.
Source: Musacchio & Lazzarini (forthcoming)

“LEVIATHAN IN BUSINESS”: PROS AND CONS...

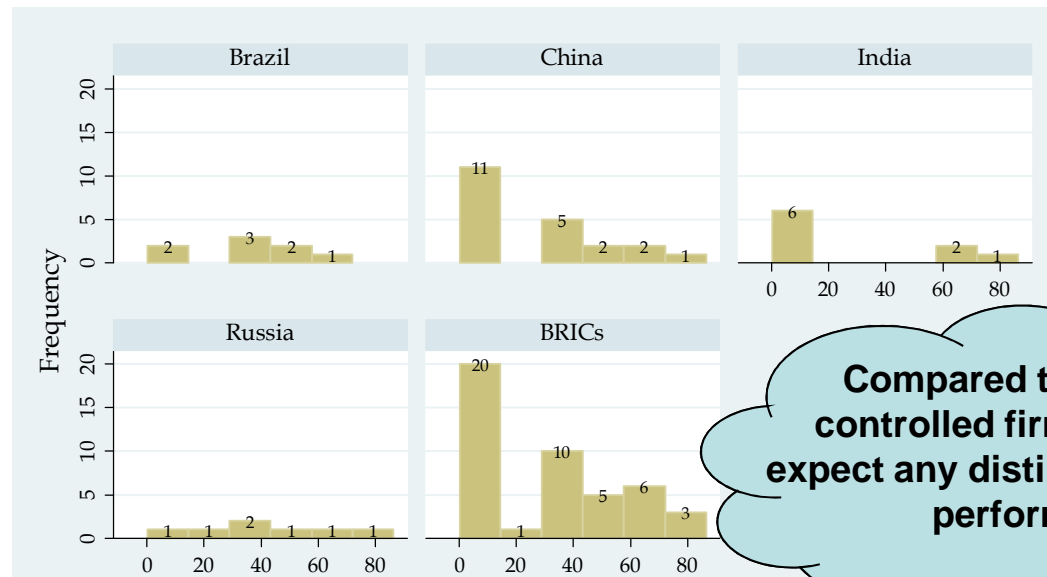
POSITIVE VIEW

- Mitigating *market failure*.
Example: executing industrial policy (Amsden, 1989; Rodrik, 2004).
- Promoting *long-term*, nonredeployable investments given financially-constrained firms (Trobat, 1983; Lazzarini & Musacchio, 2010).

NEGATIVE VIEW

- *Governmental failure* (Krueger, 1990): unjustified protection, failed “targeting” ...
- *Agency problems* and *political meddling* within SOEs (Shleifer & Vishny, 1994).
- Interaction with business groups: “*cronyism*” (Harber, 2006) and *governance* issues (Lazzarini & Musacchio, 2010).

WHAT IF THE GOVERNMENT PARTICIPATES AS A *MINORITY SHAREHOLDER*?

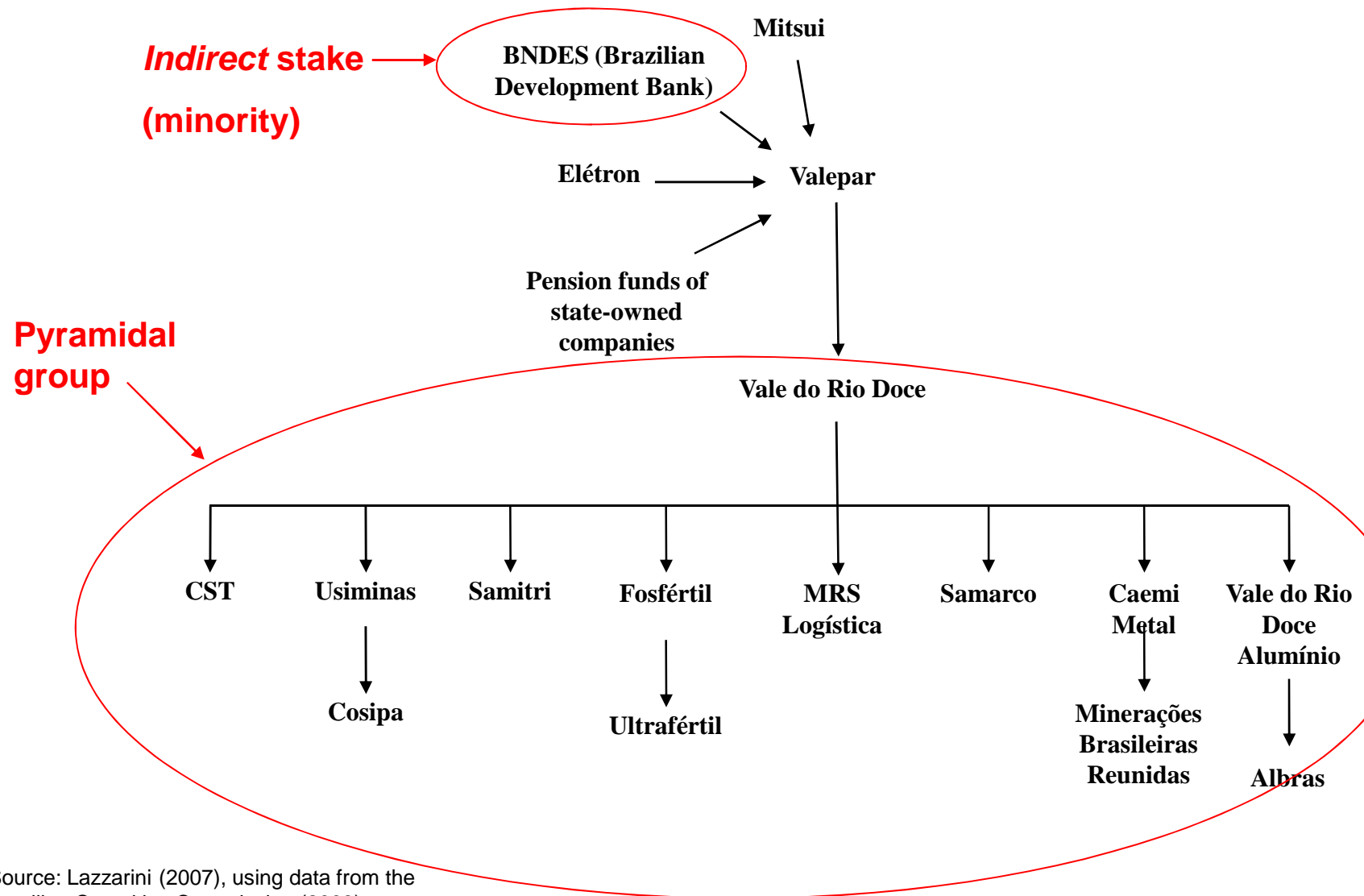


Compared to fully-state-controlled firms, would you expect any distinct effect on firm performance?

Distribution of firms according to their percentage of state ownership (%), based on Capital IQ database (top-125 publicly traded companies in each country; top-100 for Russia).

Source: Musacchio & Lazzarini (forthcoming)

VALE GROUP (BRAZIL) IN 2003



Source: Lazzarini (2007), using data from the Brazilian Securities Commission (2003).

Lazzarini & Musacchio (2010): regression results (296 publicly traded Brazilian firms, 1995-2003)

Variables	ROA (1)	ROA (2)	ROA (3)	ROA (4)	Leverage (5)	Leverage (6)	Leverage (7)	Fixed (8)	Fixed (9)	Fixed (10)	Fixed (11)
BNDES ownership											
BNDES (direct and indirect stakes - dummy)	0.038** [0.017]	0.063** [0.026]	0.063** [0.027]		0.004 [0.069]	-0.005 [0.068]		0.055** [0.027]	0.052* [0.027]		
BNESDir (direct stakes only - percentage)				0.589*** [0.178]			0.117 [0.741]			0.074 [0.122]	0.092 [0.176]
Group dummies											
Foreign group			-0.056 [0.078]	-0.06 [0.082]		-0.076 [0.174]	-0.082 [0.183]		-0.065 [0.052]		-0.078 [0.049]
State-owned group			-0.042 [0.073]	-0.044 [0.075]		-0.268 [0.294]	-0.228 [0.289]		0.014 [0.064]		0.033 [0.067]
Belongs to a group	0.045 [0.039]	0.055 [0.041]	0.081 [0.068]	0.09 [0.073]	0.216 [0.211]	0.278 [0.258]	0.3 [0.275]	0.023 [0.026]	0.052 [0.033]	0.039 [0.026]	0.066** [0.031]
Interactions with group dummies											
BNDES*group		-0.05 [0.036]			-0.038 [0.118]			-0.048* [0.028]			
BNDES*foreign group			-0.045 [0.045]			0.025 [0.086]		-0.043 [0.036]			
BNDES*state-owned group			-0.067* [0.040]			-0.084 [0.116]		-0.153** [0.076]			
BNDES*domestic group			-0.048 [0.049]			-0.033 [0.149]		-0.032 [0.032]			
BNESDir*foreign group				-0.09 [0.226]			0.263 [0.868]				-0.227 [0.211]
BNESDir*state-owned group				-3.831** [1.216]			1.816 [2.876]				-6.139*** [1.648]
BNESDir*domestic group				-0.499* [0.276]			-0.481 [1.088]				0.079 [0.269]
Controls											
ROA	N	N	N	N	Y	Y	Y	Y	Y	Y	Y
Gross revenue	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Leverage	Y	Y	Y	Y	N	N	N	Y	Y	Y	Y
Fixed	Y	Y	Y	Y	Y	Y	Y	N	N	N	N
Ownership dummies (foreign, state, etc.)	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Year, industry, industry-year fixed effects	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Constant	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	1,793	1,793	1,793	1,702	1,793	1,793	1,702	1,793	1,793	1,702	1,702
Number of firms	296	296	296	291	296	296	291	296	296	291	291
p (F test)	< 0.001	< 0.001	< 0.001	< 0.001	< 0.001	< 0.001	< 0.001	< 0.001	< 0.001	< 0.001	< 0.001
Adjusted R-squared (panel)	0.083	0.084	0.081	0.077	0.042	0.039	0.031	0.242	0.245	0.22	0.224

*** p < 0.01 ** p < 0.05 * p < 0.10. Robust standard errors in parenthesis

A blue L-shaped graphic element consisting of a horizontal bar at the top and a vertical bar on the left, meeting at a white square corner in the top-left.

THANK YOU!

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