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Multinational Corporations: Victims and Villains
Why market and political reforms don't eliminate problems in emerging economies

When emerging economies transition to open-market systems or their governments change from military regimes to democracies, one would expect an open-market system to develop. However, the large diversified conglomerates that dominate emerging economies actually strengthen during these positive transitions.

The result is that multinational corporations seeking to succeed in these economies also function as conglomerates -- clusters of coordinated activities by interlinked but legally independent enterprises.

Those are the conclusions of a paper published online today (August 6, 2018) in the Strategic Management Society's *Global Strategy Journal* authored by Marcelo Bucheli, University of Illinois at Urbana-Champaign, Erica Salvaj, Universidad del Desarrollo, Chile and Minyoung Kim, University of Kansas.

Some scholars postulate that conglomerates or business groups, as they are also called, owe their existence to the market imperfections created by protectionist and economically interventionist governments, imperfections such as insufficient labor markets and financial institutions, closed economies, and weak or corrupt governments and judicial systems.

Citing earlier studies, the authors say, the second global economy (when the home countries of these business groups were opening their doors to foreign investment) that started in the 1970s and the third wave of democratization that started in the 1980s should have substantially lowered or even eliminated market imperfections.

However, the transitions that took place were more complex than originally expected. Instead of having the whole world converging towards a Western-style liberal democracy and market economy, the world that emerged was a multi-polar world comprised of a multiplicity of political and economic systems.

Multi-national corporations investing in these emerging economies have the great disadvantage of being "outsiders." Consequently, their business strategies had to take into consideration the persistence and strength of conglomerates, making them both victims and perpetuators of these market problems.

The paper entitled *Better Together: How Multinationals Come Together with Business Groups in Times of Economic and Political Transition*, studied two interrelated questions:

First, why do conglomerates in emerging markets thrive and prevail after pro-market reforms are implemented in their countries?

And, second, what type of adaptation strategies can multinational corporations develop in order to be competitive in economies dominated by conglomerates?

The authors studied business groups in Chile during the period that country underwent dramatic political and economic changes, from a democratic regime to a military dictatorship and later back to democracy, and from a highly protectionist economy to a globally oriented open market economy.

“We maintain,” wrote the authors, “that business groups were created in periods of protectionism as a way to navigate economies with strong state participation or inefficient markets, as a way to economize on transaction costs created by the limited political and economic system.

“The evidence also shows how the business groups were created to benefit from close relations to policy-makers, and the process of creation of business groups led to a strong concentration of economic power around those groups.”

As the economy transitioned towards more open markets, elites in emerging economies were unwilling to abandon the advantages of having links among their businesses. Therefore, the transitions did not necessarily create more competitive environments, leaving Chile, for example, an oligopolistic economy.

“With this type of economic consolidation,” wrote the authors, “we conducted a network analysis to show how the business groups increased the concentration of their power by building links with each other through interlocked directors. . .this process was carried out not only by the Chilean business groups, but also by the foreign multinational corporations entering Chile, which adopted a business group structure and built links with other business groups (both Chilean and foreign).”

“In sum,” write the authors, “strategies devised as means to reduce market imperfections created new imperfections that incentivized the business groups to retain their structure and forced multinationals to become business groups.”

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