“A striking feature of most emerging economies, is the prominent role played by business groups” (Khanna and Rivkin, 2001,) Assess the importance of business groups in the economic development of emerging markets.

The term ‘emerging markets’ was defined in 1981 by Antoine W. Van Agtamael of the International Finance Corporation (IFC) of the world bank as an ‘economy with low-to-middle per capita income.’1 Such countries constitute approximately 80% of the global population, representing about 20% of the worlds economies.

In order to answer, I have decided to use examples from the following emerging markets. Firstly, Japan whose Corporate groups of networks and alliances is more commonly known as the Zaibatsu. Secondly, South Korea, the Chaebol and finally Argentina where there are a variety of large interrelated family connections.

At the beginning of the 20th century, the US, UK and Germany were the worlds leading Industrial economies. Developing new technologies and improving methods of communication meant that the ‘gap’ between these three countries and the rest of the world grew larger. In addition to this, barriers to entry, particularly in terms of price and quality of their products, they soon became the source for continuous learning to enhance the productivity of the existing technologies and to commercialise closely related ones. After WWII, catch up began for predominantly Argentina, Japan and South Korea, often described as the ‘latecomers of the North Atlantic Region.’ Against odds such as low population density and resource endowment, Argentina’s growth became stunted due to inadequate commitment to modern manufacturing and inconsistent economic policies adopted by populist governments. However, Japans and South Koreas extensive investment in physical capital and the protection of their domestic markets, unlike Argentina’s policy, and the encouragement of international competitiveness meant the growth of family and corporate alliances are more commonly called Business Groups.

The Zaibatsu was a major presence in the business history of pre-war Japan. The Zaibatsu has been broadly defined as ‘a diversified enterprise group exclusively owned and controlled by a single wealthy family.’2 The Zaibatsu groups were abolished after 1945, to give lead to the new groups called, the Keiretsu. Gerlach (1992) defines the Japenese Keiretsu as, ‘ Intercorporate alliances in the contemporary Japanese economy are marked by an elaborate structure of institutional marrangements that enmesh its primary decision-making units in complex networks of cooperation and competition… There is a strong predilection for firms in Japan to cluster themselves into coherent groupings of affiliated companies extending across a broad spectrum of markets. The basic structure of the Keiretsu takes two forms, firstly, Horizontal Keiretsu which are highly diversified industrial groups organised around two key institutions: a core bank, and a general trading company (Sogo Shosha). For example, Mitsubishi, Mitsui and Sumitomo. Secondly, vertical Keiretsu are organised around a large parent company in a specific industry, for example, Toshiba, Toyota and Sony.

According to work undertaken by Helou, 1991, it has been understood that in the early 1990’s the 163 leading companies of the major 6 Keiretsu effectively controlled more than 40% of all Japanese non-financial enterprises and some 32% of total assets.

The Chaebol are ‘highly centralised, most being owned and controlled by the founding patriarch and his heirs through central holding company. A single person in a single-position at the top exercises authority through all the firms in the group. Different groups tend to specialise in a vertically integrated set of economic activities.’ (Wade, 1990) Therefore, the Korean economy has become highly centralised and oligopolistic, while the small- and medium sized firm sector is relatively underdeveloped. In addition to this, many of these smaller firms are tightly tied into the production networks of the Chaebol.

The two groups, The Keiretsu from Japan, and the Chaebol in South Korea share similarities in the historical and developmental experiences of their past. Their business firms also share common features of Confucian-based familism. Hamilton and Feenstra (1998:128-9) concur that 'In all these background variables, economic, social and cultural, Taiwan and South Korea are as nearly the same as could be imagined between any two countries in the world today. Yet the economics of these two countries are organised in radically different ways.'

Business groups such as this one are prevalent especially in emerging markets, as there are few entrepreneurs with the ability and will to industrialise, where there as there are may types of Industries that could be developed. It is therefore, almost inevitable, that a single big entrepreneur will come to manage a variety of businesses, in the pocess of forming the Zaibatsu or Chaebol. Khanna and Palepu (1999) wrote that, " It is important to recognise that emerging economies unlike those of developed nations, lack many of the essential supporting institutions we tend to take for granted. Court systems, contract law, stock markets, accounting standards, and others that facilitate entrepreneurs and growth are often weak, archaic or entirely missing." Khanna later suggests that by providing substitutes for these kinds of gaps in infrastructure, business groups can help foster entrepreneurship in a variety of different ways. For example, business groups can initially fund capital to bussing entrepreneurs, where they otherwise would not have such an opportunity. The expansion of a capable entrepreneurial class may be a crucial element for the sustained growth of an economy. In a less developed ecoomy, the supply of entrepreneurs who organise and manage production activities, bearing the associated risk is often sub-optimally small. It may be because the markets (for risk sharing) and infrastructure necessary for the efficient and widespread allocation of risk across the population groups are often imperfect or completely absent (Grossman, 1984).

CRISTIC AGAINST BUSINESS GROUPS

The Transaction Cost Theory proposed by Coase (1937)3 suggests that the optimal structure of a firm depends ultimately upon its institutional context.

MORE TRANSACTION COST THEORY

Groups able to provide a variety of support activities and assist in the distribution and marketing goods and services. Perez Companc S.A, for example, is an Argentinian based group, which was founded in 1946, and whose operations span over several South American nations. Its activities in various energy-related Industries have done much to improve the economic infrastructure of this area.

On the other hand, close connections, such as those described above, may serve as barriers to entry, preventing the flourish of entrepreneurship and therefore ultimately stifling growth.

The Chaebols growth was predominantly between 1960 to the mid 1980's. Advantages include the centralised control of management and the lack of monitoring or sanctions by shareholders, mobilisation of resources for new businesses, economies of scale through sharing resources and the fact that such a large groups of companies stemming from one family run operation means that there is a safety net for member companies in crisis.

PARKS ECONOMIC THEORY????

It is therefore possible to see that such a large and rapid growth in these emerging markets would not have been possible without such business groups. However. The question in need of

addressing, is that are they sustainable in the ever changing economic environment? Factors such as globalisation, improved transport and communication, an increasing foreign direct Investment have changed and will continue to change the global economic environment.

Another advantage of business groups within an emerging market is the apparent presence of buyer-supplier relationships. QUOTE BY WHO???? Groups can use their track record and reputation in their established lines of business to gain credibility for new ventures among suppliers and customers. More generally, the scale and scope of groups could allow business groups to internally replicate the functions provided by stand alone intermediary institutions in advanced economies. Firms affiliated with business groups, therefore, can benefit from access to these internal institutions to mitigate external markets failures.

Group structures also have the capacity to reduce the costs of diversification. While groups themselves are often highly diversified individual firms in each group are typically focused. Therefore the most important role of the groups internal capital market is to launch new ventures, in which both the family and the other group affiliates might acquire ownership stakes.

Even though group affiliation can be potentially beneficial, there are also several reasons why the costs of group affiliation may exceed the potential benefits. Khanna and Palepu, in their journal entitled, ‘is group affiliation profitable in emerging markets,’ explore this view concluding that membership in diversified groups can also be subject to conflicts of interest between controlling family shareholders and minority shareholders. Their research based around India’s emerging market shows that family ownership may result in the misallocation of capital by investing cash flow generated by profitable group firms in unprofitable investments, even though this may be in the interest of public shareholders.

1 Global Economic Prospects and the Developing Countries, World Bank, 2002

2 A. Chandler, F. Amatai & T. Hikino (1997) ‘Big business and the Wealth of Nations.’

3 Coase R.H (1998) The Firm, the Market , and the Law