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Understanding the Dynamics of Business Group Advantages and Affiliate Level Advantages

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ABSTRACT ***:*** *This paper explores the theory of the competitive advantages of business groups and their affiliates. The goal is to address the literature on emerging economies which remains short in providing the theoretical background on the nature of different types of emerging economy firms and their competitiveness. This research offers a theoretical framework on the specific competitive advantages of business groups and their affiliates. Some theoretical and practical implications are presented to elucidate the value of the paper towards our understanding on the growth and behavior of business groups.*

KEYWORDS-*affiliate level advantages, business group advantages, competitive advantages, emerging economy firms, recombination capabilities*

I. INTRODUCTION

There are limitations in the literature on emerging economies with regard to understanding the characteristics of emerging economy firms and their competitive advantages. It neglects the issues on the evolutionary tendencies of such firms and their advantages, i.e., their subsequent development and strengthening across borders. There is also a deficiency in differentiating the types of emerging economy firms, particularly their organizational structure, as different organizational structures result to different types of competitive advantages (Contractor, 2013; Ramamurti & Singh, 2009). This paper deals with the above issues in two ways. First, it focuses on a certain type of emerging economy firms with a unique organizational structure which is the business group (BG or BGs).Second, it provides a theoretical framework of their competitive advantages and the subsequent enhancement of such advantages. The goal is to clarify the characteristics of business groups, as a particular type of emerging economy firm, so that a more comprehensive understanding of their competitiveness can be advanced.

II. THEORETICAL FRAMEWORK

The business group literature highlights the influence of environmental conditions in determining the advantages of business groups. However, recent results are showing divergent patterns of explanations. Hence, this research adopts the endogenous explanation, which is more direct, rather than the exogenous explanation of business group advantages, following Penrose (1959). This is because the actual advantages of business groups do not lie from quality of environmental conditions, such as institutions, but on their innovative response to such conditions, i.e. internalization of market imperfections and endogenous capability building among the affiliates (Leff, 1978; Mahmood et al., 2011). The environmental conditions actually hinder the development of competitive advantages by any emerging economy firms, including business groups. Hence, this paper argues that the existence and persistence of business groups, in domestic and international markets, lies in the dynamics of the functioning of their endogenous advantages. It is in the internal dynamics where competitiveness is being developed and strengthened and thus serves as the key explanation of their existence and evolution over time.

Taking the example of the firms from one of the developing countries, the Philippines, a simple manipulation of the financial data will tell that majority of the business group affiliated firms are larger and stronger than non-business counterparts. Assuming that the environmental conditions and institutions are the same for all the firms, the financial performance should not be that different. However, the reality is that the business group firms continue to outperform the non-business groups in different industries. In international markets, the pattern is similar for business groups. In the Fig. 1 below, a comparative data on performance is presented. The data is from OSIRIS, a database onfirms around the world. The figure gives two performance indicators to compare business groups (BG) and non-business groups (NBG). The indicators are assets and revenue, which typically measure the size and operations of the firm. The initial observation here is that business group firms grow larger and faster than non-business group firms.

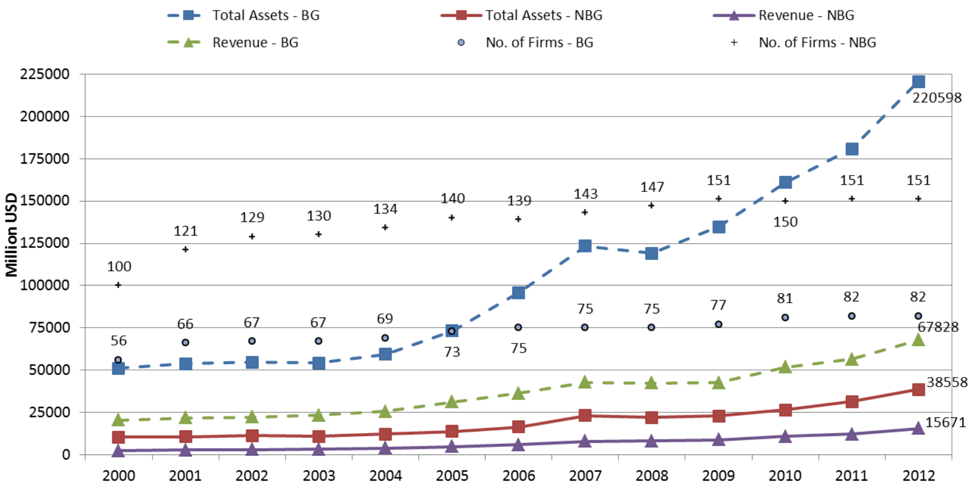

Figure1. Comparative aggregate performance between Philippine BGs and Non-BGs for the year 2000-2012
Note: BG = Business Group; NBG = Non-Business Group
Source: OSIRIS Database

Based on simple comparison by financial performance aggregation of both business group and non-business group firms, the business group shows a significant advantage in all aspects over the latter as seen in Fig. 1. In the 12-year sample, the average number of business group affiliate firms, excluding those with consolidated data such as the global ultimate owners (GUOs), is fifty-three percent (53%) less than non-business groups yet their growth performance is far greater than the latter. For example in the year 2000, the sample shows the number of BG firms to be 56 while the NBG is 100, similarly for the succeeding years such as in 2012 where BG firms' number is 82 while NBG is 151. As regards total assets, the 12-year average reveals that the business group firms are five hundred thirty-seven (537%) greater than non-business groups. This can be interpreted as the speed of growth of BG firms through consistent accumulation and investment of capital. Most of these business groups are conglomerates which enter and operate in different industries. This multi-industry growth is made possible because of the idle resources which are easily exploitable in immature markets in developing economies(Leff, 1978; Penrose, 1959). The advantage in assets is quite similar to the revenue indicator which shows that business groups have an advantage of four hundred percent (400%) for the last 12 years. This means that although the number of business groups in the Philippines are few, their operations and productionare significantly larger and faster than non-business groups. These initial results provide a significant foundation in pursuing the explanation on the nature of the competitive advantagesof business groups per se, even without comparing them to non-business groups. The next sections of this paper attempt to do this.

II.1 The competitive advantages of business groups and their affiliates

The competitive advantages of business group affiliated firms in emerging markets arise from the response to, specific country characteristics, imperfections in capital, labor and product markets, and the recombination capabilities of the affiliate firms (Bugador, 2015; Colpan et al., 2010; Leff, 1978; Mahmood et al., 2011). These advantages are supported by the accumulated knowledge that has been captured, owned and controlled by the business group over time (Penrose, 1959). These competitive advantages are internalized and found within the business group structure and stored at the group level. Hence, they are shared by the group through its affiliates. Theadvantages express themselves owing to the interaction of a given external condition, such as market imperfections, and the coordinated and collaborative response among individual affiliate firms and their advantages. In the perspective of network theory, this research contends that the overall advantage is not necessarily the sum of the advantages of all the affiliates within the business group. Because some type of advantages that emerged at the group level are not directly reducible to any characteristics of an affiliate. Therefore, there are two kinds of advantages within the business groups; these are the shared and non-shared ones. The shared advantages are those available and common to all the business group affiliates. These are easily endowed by the business group to the affiliates. The non-shared ones are those which are held by one or few other affiliates, thus they have a characteristic of being exclusive. Although most of the advantages come from the group, their evolution depends on the actions of the affiliates. Hence, the resulting structure of competitive advantages of the business group can be found and distributed among the affiliates in the business group. This is illustrated in Fig. 2 below which shows that the competitive advantage of business groups and their affiliates is derived from the group level advantages, affiliate level advantages and their interaction.

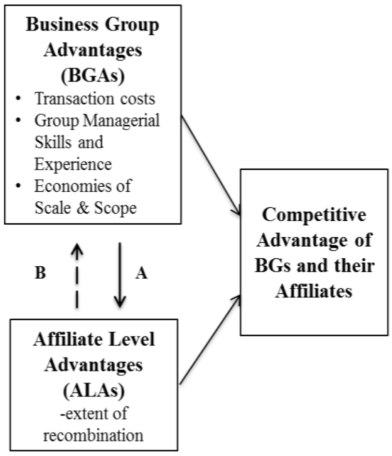

Figure 2. The structure of the competitive advantage of business groupsand their affiliates

II.2 The Business Group Advantages

At the group-level or the business group advantage (BGA), three elements of advantages are common. These are the reduced transaction cost advantages, transferable group managerial skills and experience,and the economies of scale and scope.The business group structure provides an array of internal resources which an affiliate can exploit. These internal resources are the source of savings from transactions costs from dealing with external parties in procuring such resources.The internal group capital is a very good source of capitalization for affiliates in times of investments, including foreign investments, and expansion. Typically, business groups have affiliated holding companies which are entrusted to secure the administrative allocation of the group's financial resources. Since the external market is not the best option, business groups are swayed to withhold earnings and exploit such to its best economic use. This explains their capability to seize multiple portfolios, and their affiliates to expand businesses not only in domestic but also in international markets. This can be illustrated in the growth of assets as can be seen in Fig. 1 above. The business group firms significantly grew larger than non-business groups in the 12-year sample comparison.

The internal pool of labor also saves transaction costs for the group as it assures quality and fit of people within the whole organization. Business groups in emerging markets operate training schools for grooming pools of employees within the group who will then be dispatched among the affiliates. Through this, affiliate firms align their administrative structure and strategy with that of the group. Last but not the least, a steady supply of inputs and intermediate products is a crucial advantage of business group affiliates. In times of scarce supply and low demand, affiliate firms can tap an intragroup buying and selling linkages (Chang & Hong, 2000). The business groups rely on vertically integrated value chain for their production input, skilled labor, and R&D. Having a diversified structure permits business groups to increase the amount of their monopoly power over those who control or allocate resources, in particular industries or markets.

On the other hand, the BGA on group managerial skills and experience provides a combination of context specific and transferable skills among BG affiliates (Tan & Meyer, 2010). In addition, business group experience in management of product and geographic diversification directly aid other affiliates in other potential product areas and locational expansions (Chang & Hong, 2000). This includes internationalization and alignment in the relevant global value chains. The mode of international entry of business group affiliates can vary a lot and may have a different pattern compared to non-business groups. In some instances, the expansion of affiliates in related and unrelated product lines or geographical locations is a response to the circumstances or positions of other affiliates. Thus, we can see a kind of group internationalization as opposed to the usual single firm internationalization. Lastly, generic advantages of multi-unit organizations or conglomerates, such as business group, are the economies of scale and scope (Colpan et al., 2010). The co-development of resources by group affiliates in the area such as in R&D and technology, marketing and distribution provide leverage to all the affiliates in the group.

II.3 The Affiliate Level Advantages

The affiliate level advantages (ALAs) are the potential advantages which are found at the individual affiliate level. This is because both the sharable and non-sharable resources and capabilities reside in specific affiliates. Therefore, BGA and advantages at the affiliate level are not necessarily the same because both their distributions are different. The ALAs are the unique resources, capabilities and strengths that are specific to an affiliate firm. Through interacting and incorporating with BGAs, affiliate firms can develop specific advantages independently. These BGAs and ALAs combination is a function of the recombination capabilities by the individual affiliates. ALA is different from the simple concept of business group affiliation effect, as assumed in the literature, since affiliation to business groups does not always guarantee advantages to individual affiliate firms. So, the BGA-ALA combination defines the overall competitive advantage of each individual affiliate as well as the heterogeneity of the affiliates within a business group. The variance among ALAs occurs due to the extent of BGA recombination by each affiliate, that is, some affiliates operationalize or depend on BGAs greater than others. This is because each affiliate has specific objectives, roles, operational scope and eventually competitiveness. Hence, the affiliates can use the group structure to complement for the missing and potential advantages (Mahmood et al., 2011).

II.4 The levels and sequence of BGAs and ALAs

One of the dynamics in the interaction of the advantages of the business groups is the sequential pattern between two levels. In the literature, the traditional analysis of the potential advantages of the business groups assumes a single direction (A in Fig. 2). This is the flow of group advantages from the group to the affiliate, while neglects the flow of potential advantages from the affiliate to the group (B in Fig. 2). Following that pattern makes the dynamics simplistic. In fact, there are two problems in this unidirectional conceptualization. First, BGAs are assumed to be transferred easily to any affiliate as long as they are affiliated to the business group, hence the traditional concept of 'BG affiliation' as employed in the previous studies. Second, the affiliate firms are assumed to exclusively embody the same BGAs or the sharable BGAs. This view overlooks the individual development of advantages by BG affiliates which would arise from their specific operational circumstances and recombination capabilities. In short, the affiliates bring new advantages to the group and in turn make the BGAs dynamic. Therefore, BGAs do not only arise out of the group's interaction with the external environment but also a function of the symbiotic relationships between the group and its affiliates. The extent to which the advantages are shared and harnessed by the affiliates becomes the basis of the quality of the overall competitive advantages of the business group. The next paragraphs illustrate the dynamics of the bidirectional flow of BGAs through the introduction of the concept of recombination capabilities (Verbeke, 2009).For the purposes of this paper, the concept of recombination capabilities is used here as the capability of the top executives (of the business groups and their affiliates) to recombine the advantages at the group and affiliate levels. This concept is similar to dynamic capabilities which look at the dynamic response of executives in turbulent industry environments (Teece et al., 1997).

Since both levels have different dynamics, the affiliate firms should be responsible to capture the potential complementarities. For example, when the group has superior technology and an affiliate has employees who can exploit such technology, then the best recombination can be achieved. There are actual cases of this in the past such as those acquisitions of some business groups of advanced technology in advanced economies which were then transferred in their home economies. Some business groups were successful because they had affiliates that have sufficient or superior capabilities which matched the acquired group technology. In this particular case, the affiliates have already developed essential capabilities to be developed by the entire business group. The success of the affiliate in recombining both superior technologies at different levels results to the advancement of the competitiveness of the whole group.

In some cases, though, the quality of the advantages of the business group and the affiliates is asymmetric. That is, either the business group or an affiliate has a superior advantage than the other. When the business group advantage is overriding than that of the affiliate's, the latter is expected to depend on the group. This is where an affiliate plays some role in the group which is not very significant. Therefore, it is yet to accumulate some relevant resources and capabilities for its use. The affiliate can set its strategic objectives when the business group advantage becomesavailable. The affiliate then matches its initial strategic objectives with the strengths and advantages of the business group. An example of is where an affiliate displays a potential to develop specific routines or products that go well with its distinctive location and customer base. It may access the information and capital of the business group to start it operations. Thereby building on the business group advantages and eventually making them complemented in return.On the other hand, when the case is the opposite or when the affiliate has superior resources and capabilities than the business group, then the matching and contribution will come significantly from the affiliate. This situation illustrates the value of the non-sharable advantages. Even when the affiliate makes its resources and capabilities available to the entire group, very few or none of the other affiliate in the group is able to utilize them. Therefore, this situation displays an aspect regarding the distribution of the roles of the affiliates in the business groups. This is to say that the interaction of the affiliates, which lead to the roles and positioning, depends on their inherent advantages. The differences between the affiliates will also depend on their distinct recombination of advantages over time. If the affiliates are not successful in their recombination then the business group advantages will decline as well. The roles, strategic position and the characters of the affiliate level advantages then influence the quality of the overall competitive advantages of the group.

III. DISCUSSIONS AND PRACTICALIMPLICATIONS

There are a lot of operational challenges in the developing and transitioning economies, especially in the Asian region. Stable supply of capital and labor are the most important assets in the developing economies because of the severe imperfections of the labor and financial markets. These imperfections are what have been known in the literature as "institutional voids". These in fact become hurdles on the growth and building of competitive advantages by emerging economy firms (Colpan et al., 2010; Ramamurti & Singh, 2009). The business groups are not exempted from these. However, the business groups have learned some mechanisms to deal with these challenges. This is what this paper is attempting to demonstrate. The data on the Philippine business groups provide this requirement. The business groups can certainly utilize their competitive advantages to counter these challenges. The business groups maythen encourage the interaction of their affiliates to ensure resilience and flexibility of all their resources and at the same time develop their recombination capabilities. This approach will avoid different types of risks in capital, labor and inputs.Therefore, the internalization mechanism or the group internal market, out of the group advantages, provides the competitive advantage to business groups over other firms. As a result, the existence of strong business groups in developing economies means that the non-business groups would need extraordinary advantages in order to compete in their industries.

On the other hand, for business groups that are operating in advanced economies, the need to enhance their global competitiveness is inevitable. The challenge is to use their BGA in group managerial skills and experience to take advantage of global knowledge and supply chain. Some business groups were successful in utilizing these assets to acquire and recombine knowledge from incumbent multinationals and host countries. This can be done by a group network exploration and exploitation with the special participation of their foreign subsidiaries and stakeholders in the host countries. This is evident in the case of Indian business groups, particularly in their operations in the advanced economies of Europe and the UK. Indian business groups retain the management team of the acquired high technology businesses while making sure that their subsidiary managers learn from their practices including those related local operational practices and institutions. These practices will then be transferred to the whole business group to enhance and add to the group managerial skills and experience. This is the approach to maintain and expand the business group global operations.

IV. CONCLUSION

This paper provides a perspective on understanding the competitive advantage of business groups and their affiliates by looking deeper at the dynamics of the level of advantages with in thebusiness group. The goal is not to offer some general and empirical assumptions but rather to complement and contribute to the refinements of the previous studies. The conceptualization of the competitive advantages of business groups has not been fully explored in the existing literature. Either the concept is subsumed at the organizational and firm levels or assumed to exist due to some external factors such as the institutions in the developing and emerging economies.In this paper, the concept is adequately uncovered. Hence the concept can now provide a richer understanding about business groups and their position from one point to the other. Be it strategic, operational expansion and competitiveness.The paper though has some limitations in providing sufficient cases and applications of the concepts of BGA, ALA and recombination capabilities. Nonetheless, the initial objective of codifying the nature of the competitive advantages of business groups and their affiliates is satisfied.

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