Emerging Giants:
Building World Class Companies From Emerging Markets

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Abstract

We theorize about, and provide data and analyses on, the challenges faced by Emerging Giants. We mean this term to encompass companies that have their origins in developing countries but have developed business models that allow them to compete with world-class companies originating worldwide. The paper draws on our existing formal academic work and on our interactions with executives worldwide over the past several years, performs some new empirical analyses on the journey taken by emerging giants, and illustrates general principles through case studies from countries in Asia, Africa, Latin America and Eastern Europe. Finally, the paper is written primarily for a practitioner audience, though it refers to our background scholarly work.

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1. Introduction

As large emerging markets such as China, India and Brazil are playing an increasingly important role in the world economy, entrepreneurs and corporate CEOs in these countries are aspiring to build world class companies. The goal of these “Emerging Giants” is to be globally competitive and to exploit new globalization opportunities. The critical managerial challenge for these firms is to successfully compete with multinational companies which have two fundamental advantages over emerging market companies. Multinationals are well established, and therefore have the benefits of incumbency: brand name, organizational capabilities, and advanced technologies. They can also leverage their access to vast resources – finances, talent, and supplier and distribution networks – in their home markets as they defend their home turf and compete in world markets.

Unfortunately, emerging market companies do not have these advantages in their quest for being globally competitive. Even worse, they come from economies that suffer from severe market failures. They often lack the institutions and infrastructure that make markets work well. When their economies open up, emerging market companies are forced to compete with their advanced market counterparts, even while their own economies are struggling to develop market infrastructure. For example, emerging market companies often cannot access risk capital with the same ease and at the same cost in their home markets as established multinationals can. As a result, it is difficult for them to invest large sums in research and development and brand building which are critically needed to compete effectively with global giants. They are also hampered by creaky domestic infrastructure and unreliable quality of their supply network in competing effectively with multinationals in world markets. Even when emerging market firms are able to circumvent some of these hurdles and settle on a trajectory of rapid growth, they are stymied by the shallow domestic management talent pool in their attempts to build a globally effective organization. In theory, emerging market companies can overcome some of these limitations by accessing global markets for
finance, technology, and talent. In practice, however, various regulatory and reputational hurdles often make this option hard to exercise.

This is why many executives in emerging markets are clearly concerned about being wiped out in their domestic market by multinationals when their domestic markets open up to global competition. They also despair that it is virtually impossible for them to compete on a level playing field with multinationals in global markets. Since the last two decades have seen a wave of countries opening up to the world economy, the challenge for prospective emerging giants is more pressing than ever before.

However, there are a growing set of companies that appear to buck these odds, and score spectacular successes in their battles against multinationals. These companies, whom we shall label Emerging Giants, offer some important lessons in how emerging market businesses can craft winning strategies. We have studied a number of these companies during the last few years through our research visits and case writing efforts. Our quest here is to posit a general framework for building world-class companies from emerging markets.

2. Achieving Competitive Advantage against Multinationals

On the face of it, multinational companies from advanced economies have an important advantage over emerging market companies—access to the institutional infrastructure in their home markets. For example, U.S. multinationals have access to the American financial markets, making it easier for them to raise low-cost finances in abundance. They have access to world-class talent available through a well-developed managerial labor market. They are able to develop high quality brands using sophisticated market research and advertising techniques. They have access to technology developed by leading-edge companies. With all these advantages, wouldn’t American multinationals exploit business opportunities in emerging markets better than the emerging market companies themselves?
There are important reasons why emerging market companies can potentially turn the
disadvantage of operating in an emerging market into an advantage, and/or neutralize the
incumbency advantage of multinationals in terms of their brand name, access to capital
and technology.

First, advanced market multinationals seeking to exploit business opportunities in
emerging markets are faced with some of the same institutional voids that emerging
market companies have to contend with.¹ For example, an American software services
firm seeking to exploit professional talent in India might consider setting an operating in
that country. However, the company has to deal with the quality uncertainty in the labor
market, and learn ways to find talent that is truly capable of serving global market needs.
In addition, the American multinational has to manage within the Indian regulatory
apparatus that is notoriously difficult to deal with. It also has to learn to operate with
poorly developed physical infrastructure. Emerging market entrepreneurs have a distinct
advantage over foreign multinationals in dealing with local institutional voids for a
simple reason—they have considerable experience and cultural familiarity in dealing with
these voids. In fact, multinational managers, spoiled by their years of experience in
environments with a well-developed institutional infrastructure, are often ill equipped to
deal with institutional voids that make it difficult to access reliable market information,
and/or structure business partnerships based on reliable contracts. Emerging market
businesses, in contrast, have considerable familiarity with these institutional voids, and
have learnt ways to manage around them through informal social mechanisms and a deep
familiarity with their environment.

Second, multinationals are often reluctant, sometimes appropriately so, to tailor their
products and processes to each country that they operate in. This is particularly true for
western multinationals with a very successful business in large advanced markets in
North America and Western Europe. For these companies, it is too costly and

¹ We introduced the term ‘institutional voids’ to refer to the absence, or poor functioning, of the specialist
intermediaries needed to bring buyers and sellers together in markets. Thus, the absence of private equity
providers and venture capital firms would be an institutional void, in this parlance, in the market for capital.
See Tarun Khanna and Krishna Palepu, “Why Focused Strategies May be Wrong for Emerging Markets,”
cumbersome to modify their products and services to suit idiosyncratic local tastes just to exploit what they perceive as small and risky business opportunities in emerging markets. Their internal organizational processes and cost structures also often make it difficult for them to produce products and services at price points that are optimal for emerging markets. Domestic companies in emerging markets, in contrast, do not suffer from these constraints.

Third, thanks to globalization, emerging market companies are increasingly able to access advanced markets’ institutions to offset some of the advantages multinationals have. For example, there are hundreds of companies from all over the world listed on the New York Stock Exchange, thereby allowing them to access capital the same way American multinationals can. Further, advanced market intermediaries are attempting to fill emerging market institutional voids by extending their services to these markets. For example, McKinsey and other management consulting firms have opened offices in many emerging markets such as South Korea, Hong Kong, and India. Similarly, many U.S. business schools have launched educational programs in Singapore, Thailand, and China. World-class emerging market companies with sound business propositions can therefore access capital and talent that is somewhat similar to that available to multinationals in advanced markets.²

Fourth, several emerging market companies have attempted to cope with local institutional voids by developing their own internal organizational mechanisms. This is a point we have discussed in detail elsewhere in our work on business groups. In our view, successful emerging market business groups, such as the Samsung Group in Korea, the Ayala Group in Philippines, the Koc group in Turkey, and the Tata group in India, have developed internal capabilities to deal with institutional voids in their respective countries. Such capabilities allow these organizations to attract risk capital, develop

² Overseas Diasporas are another important source through which gaps in knowledge, finances, talent, and credibility, can be mitigated. Examples of such Diasporas include the overseas Chinese communities that are playing an important role in the growth of Chinese enterprises, and the non-resident Indians in the Silicon Valley and the venture capital community who are playing an important role in developing technology-based companies in India.
talent, and acquire technology to compete effectively against multinationals. Further, as a result of their distinguished track record, they have been able to develop a corporate brand name that signifies quality, trust, and transparency. As a result, these business groups are in a position to effectively get around the institutional voids of the local markets, and effectively compete with multinationals. In fact, because of their ability to get around local institutional voids, established local business groups often are partners of choice for multinationals when they enter emerging markets.

Generic business opportunities where building competitive advantage is likely

The above arguments suggest that it is important for emerging market companies to pick areas to compete in carefully if they wish to win against incumbent multinationals. As in any other business context, competitive success critically depends on exploiting comparative advantages. That means, at least, initially, exploiting their unique ability to understand and navigate their home turf. There are three generic ways in which they can do this.

- Capitalize on institutional voids in the product markets
- Capitalize on institutional voids in the factor markets
- Alleviate institutional voids

We will see that most successful business models in emerging markets can be seen as one, or a combination of more than one, of these generic strategies. In an absolute sense, institutional voids are an encumbrance. However, successful emerging market companies can use the fact that they are comparatively better placed to circumvent these voids (relative to incumbent multinationals) as the thin end of the wedge that gets them started.

Generic Opportunity 1: Exploiting unique knowledge of domestic product markets

The first generic opportunity has to do with capitalizing on the experience of being deeply knowledgeable about a unique local product market situation. Uniqueness in local
product markets can arise for two reasons: (1) unique local tastes and customer needs, and/or (2) unique way the local needs have to be fulfilled given the (immature) local market infrastructure such as distribution channels and logistics networks. Unique needs, in turn, can arise for needs over and above those attributable to intrinsic differences in customer preferences – e.g. differences in the extent of insurance coverage for healthcare, and in the procedure by which costs are reimbursed by insurers, implies that the demand for medical equipment will be different across the world, over and above differences attributable to income levels and disease incidence. Large businesses can be built by judicious local adaptation, especially when the local market size is significant. It is also possible to exploit similarities among different (often geographically proximate) emerging markets to expand the business beyond local boundaries. We will discuss below several companies that built world class businesses by focusing on these types of opportunities.

Given the peculiarities of its geography, and its lack of population density, it is easy to see why wireless telephony would find a natural constituency in the icy wilderness of Finland. But there was another historical reason why Nokia emerged as the world-leader from Finland, rather than an equivalent firm arising out of other equally inhospitable and depopulated terrains (e.g. deserts of the Middle East). This has to do with political risk. Finland, always wary of incursions by Tsarist Russia, eschewed a state-run telecommunications monopoly to avoid a situation where a hostile neighbor might bring it to its knees by seizing the entire infrastructure in one fell swoop. It thus relied on numerous telecom companies and seeded a commitment to competition in telecoms, unlike most, if not all, other countries which had a monopoly structure. The happy, if inadvertent, marriage of intrinsic demand and pressure-cooker competition created the local conditions within which Nokia was born.3

Consider several seemingly different, but conceptually similar, examples from the fast-food restaurant industry, originating in different parts of the world. Jollibees in the

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3 For more information, see “Finland and Nokia”, HBS Case No. 702-427 (Boston: Harvard Business School Publishing, 2002)
Philippines emerged from the recognition that Filipinos liked their burgers to have a particular taste. Nandos started in South Africa by providing convenient cooked chicken that suited the local palate. Pollo Campero, originating in El Salvador, also provided locally palatable roast chicken to that country’s populace. These companies have done battle with larger multinationals and, to varying extents, emerged victorious. Further, they have all used their mastery of the unique tastes of their domestic market customers to expand globally. Jollibees caters to the tastes of Filipinos communities worldwide, Nandos can be seen in the United Kingdom and Malaysia among other locations, and Pollo Campero is found in numerous Central American locations with plans to enter the United States.

Another successful example of a company exploiting this type of business opportunity is the Haier Group in China. Haier is the world's No. 2 refrigerator maker, after Whirlpool, and has expanded into a wide range of household electrical appliances including washing machines, air conditioners, microwave ovens, small appliances, televisions, even computers and cell phones. Haier exports to over 160 countries and has global revenue just over $7 billion.

Because China is so diverse, both geographically and culturally, a company must be able to cater to the wide range of consumers’ tastes by adapting its product line for a multitude of possibilities. Haier dominates its home market (29% market share for refrigerators, 26% for washing machines) by developing a superior understanding of the wide variety of the Chinese consumers’ needs and meeting those needs with quality products. Haier tries to use its design and manufacturing capabilities to meet special requirements with minimum waiting time, and is willing to go the extra mile to do so. In 1989, for instance, sales of one model of refrigerators were high in Beijing but under-performing in Shanghai. Through market research, Haier discovered that Shanghai residents had crowded living conditions, and that there was little space for a large refrigerator. As a result, Haier designed a smaller refrigerator only for the Shanghai market, and sales subsequently surged. This sensitivity to local conditions helped in Haier’s worldwide expansion as well. In early 2001, based on information feedback from its Middle East
branch, Haier developed an air conditioner exclusively for desert conditions. The technology contained in the air conditioner combined strong heat-resistance capability with unique exterior materials and allowed the unit to increase its anti-erosion ability. This product proved to be extremely popular with customers from Middle East and African countries.

In addition, Haier has improved efficiency and cost effectiveness by developing logistics capabilities. With its own logistics, Haier can fill the void of China’s fragmented distribution system and ensure that its products can be delivered to customers throughout China, especially to those living outside the major cities such as Beijing and Shanghai. The group has also set up its own logistics company to cater to internal needs. China's transportation and logistics infrastructure remains under-developed and plagued by bureaucracy. There's no single nationwide trucking firm. The average Chinese trucking company owns less than two vehicles. In addition, four separate government bodies regulate air, rail, road and river transport. This structural void in the Chinese market adds costs and inefficiencies to Haier’s business. By adding logistics capabilities in house, Haier can keep the inventory levels as low as possible and ensure better distribution of its goods throughout China.

After establishing itself in its home market, Haier began to expand overseas. Its first overseas joint venture was launched in Indonesia, on December 6, 1996. This was followed by a few more investment projects in developing countries such as the Philippines, Malaysia and Yugoslavia before it moved to the USA in 1999. It established a design center in Boston, a marketing center in New York, and a manufacturing center in South Carolina, with a total investment of US$30 million.

Haier’s initial foray into the US market involved focusing on price conscious niche segments in the white goods market. Currently, Haier has captured about half the U.S. market for compact refrigerators, the kind found in college dorms or hotel rooms. It also pioneered electric wine cellars-- the inexpensive stand-alone cabinets for storing bottles

Generic Opportunity 2: Exploiting unique knowledge of domestic factor markets.

A second way to build an emerging giant has to do with superior ability to identify and manage local talent or the local supply chain to serve either local or global customers. The Indian software industry provides a case in point. Companies like TCS, Infosys, Wipro, and Satyam cater to the tremendous global demand for information technology services, as companies in well-developed markets are seeking to integrate IT into their operations. India is blessed with an abundance of software talent, which is significantly cheaper than similar talent in developed markets. However, given the institutional voids that pervade the Indian economy, it is very difficult and costly for companies in developed markets to access this talent. These difficulties include: sorting talent in a market where quality varies widely, and reputation of educational institutions is highly variable, and operating remote delivery services in an economy with very poor communications and travel infrastructure. Indian software companies have developed business models and organizational capabilities that allow them to match the talent in India with demand in developed markets. Multinational software service providers, such as Andersen Consulting or EDS, took years to acknowledge this potential business opportunity, given the Indian firms more than a decade’s head-start in refining their business models and execution strategies. While these multinational companies are now attempting to replicate Indian firms’ strategies, the institutional voids pose a serious barrier to entry to the former. At the same time, Indian software companies, in an attempt to compete with these multinationals, are able to access global managerial talent markets and global capital market, thus effectively nullifying some of the inherent advantages that multinational may have.

Another prominent example of this type of business model is Li & Fung, a Hong Kong based trading company that helps retailers in the US and Europe source merchandise from low cost emerging countries in Asia. Li & Fung has developed deep knowledge and
sophisticated internal systems to identify and sort the quality of suppliers in many different emerging markets of Asia, help them design and manufacture products for Western customers, and to meet stringent delivery requirements despite the poor quality of local infrastructure. Multinational retail companies which are interested in sourcing low cost and high quality products from emerging markets find it very difficult to replicate Li & Fung’s capabilities. As a result, trading houses such as Li & Fung have been able to create a very successful business with a sustainable competitive advantage. As the Li & Fung example suggests, exploiting this type of business opportunity may allow an emerging market company to collaborate, rather than compete, with multinationals to create a win-win situation. This is in fact the case with many contract manufacturing companies operating out of China. Take the case of Inventec, a Taiwanese company with significant operations in China. Inventec is the world’s second largest manufacturer of note book computers, PCs, and servers. The company supplies its products primarily to HP and Toshiba who sell them under their own brands. Inventec allows HP and Toshiba to access the low cost and high quality manufacturing possibilities of China, without having to incur the cost of mastering all the complexities of setting up factories in China and operating them. Inventec also allows these companies to access very talented software and hardware professionals in China to design products in an industry fraught with extremely short product life cycles and rapid technological changes. Beyond serving the needs of HP and Toshiba, Inventec has recently began selling computers in Taiwan and China under its own brand name. These computers have Chinese language operating system and software, and hence do not directly compete with the products of its multinational clients.

Generic Opportunity 3: Exploiting Local Institutional Voids as Business Opportunities

A third opportunity for building a world-class emerging market company is to create private sector businesses to fill local institutional voids in the market infrastructure. This approach is motivated by a simple observation that, since institutional voids impose costs on market participants, entrepreneurial ventures that seek to fill these voids can create significant value. While some of the market institutions are under the purview of the
government, there are many that can be owned and operated by private sector. In general, these institutions can be classified into two categories.

The first category of market institutions involves those that facilitate credible information flows in the market. One (sub)set of these enhances the credibility of claims made by producers of goods and services. Examples of such institutions in the U.S. markets include the public accounting firms in the financial markets, ISO and other quality certification agencies in the product markets, and AACSB and GMAC in the talent market. Another (sub)set analyzes information and provides recommendations to market participants. U.S. examples here include stock analysts and rating agencies in financial markets, the Consumers Union and JD Powers in product markets, and publications ranking universities and professional schools in the talent market.

The second category of market institutions facilitate transactions either through aggregation and distribution of goods and services, or by creating forums where buyers and sellers can transact with each other directly. Distributors and aggregators provide low cost matching and other value added services for suppliers and customers through expertise and economies of scale. Examples include venture capital/private equity firms, and banks in financial markets, retailers of various types in product markets, labor unions and (at least to some extent) universities in talent market. Stock exchanges, Ebay, and online job announcement sites are examples of transaction forums in financial, product, and labor markets respectively.

Since many of these institutions are either missing or under developed in many emerging markets, they offer tremendous new business opportunities. Clearly, multinationals can exploit these opportunities as well. Multinationals can bring expertise and global credibility, two very critical assets for building many of the market institutions. Therefore, in exploiting the opportunities in building market institutions, domestic businesses need to focus on areas where they are likely to have advantages. Once again, there are several sources of potential advantage that emerging market businesses can exploit. First, many market institutions are human capital intensive, so running them
requires familiarity with local talent, culture, and language. Second, many of these institutions are information intensive, so ability to access widely dispersed information of variable quality - and to analyze it reach reliable conclusions - requires local expertise. Third, governments often consider a number of these market institutions – for example, media, banking and financial services - to be of particular importance to national interests. As a result, multinationals are either prohibited from exploiting these opportunities, or they are required to collaborate with a local organization.

There are two other observations that are important to consider here. First, while many of these opportunities are potentially available for a domestic company in an emerging market, by their very nature, ability to use domestic success as a launching pad for going global may be limited. Therefore, these opportunities may have limited potential in countries where the domestic market size is limited. However, in large emerging markets such as India, China, Russia, and Brazil, one can aspire to build sizable businesses even if the activity is limited to a domestic context.

Second, in many areas of intermediation, the market often can be segmented into a “global piece” and a “local piece.” The global segment may be best served by multinationals, where as the local segment is best served by a domestic company. Take the case of banking, for example. Multinational banks such as Citicorp are able to serve large blue chip companies in emerging markets because evaluating their credit worthiness is relatively straight forward – many of them produce high quality financial statements audited by globally reputed public accountants, and are listed abroad. However, evaluating the credit quality of small and medium enterprises is very hard for the

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4 We conducted fieldwork on entrepreneurial ventures in Argentina, Brazil, Hong Kong, India and Mexico in 2002. Half our sample was comprised of ventures launched by incumbent business groups, the other half was comprised of de novo entrepreneurs. We expected that the greater prevalence of specialized intermediaries in some of these economies relative to others would make de novo entrepreneurship easier. No such correlation appeared. This is because most of the well-run intermediaries in these economies turned out to be branches of multinationals (e.g. banks and consulting firms and executive search firms); these did not have the cost structures to justify working with any indigenous enterprise other than the ‘cream of the crop.’ As such the mere existence of specialized intermediaries did not end up promoting de novo entry; it just cemented the status quo as represented by the incumbent business groups. See Tarun Khanna and Krishna Palepu, “Entrepreneurship in Emerging Markets: Field Evidence from Five Countries,” mimeograph prepared for the Russell Sage Foundation, New York, 2002.
multinational banks because of paucity of reliable information on them. Domestic banks, with local knowledge and informal connections, are in a much better position to cater to this segment. In Turkey, for example, the likes of Citibank skim the top end of the corporate market, whereas sizeable local businesses just below this tier (in size) are catered to by profitable and well-run local banks, like Finansbank.

There are a number of successful examples of emerging market companies that play the role of market institutions. Consider Old Mutual, an insurance company in South Africa. South Africa traditionally lacked mutual funds and other long-term investment vehicles, as a result of poorly developed domestic financial markets. Old Mutual recognized that this presented a significant business opportunity. It responded by creating insurance policies that had significant savings account features, and marketed them to millions of South Africans. Through this process the company grew rapidly and became a large financial services firm that offered a variety of insurance and savings products to consumers. When the South African economy was integrated into the world markets, Old Mutual took advantage of its capabilities and began expanding into world markets – first in the African regional markets, and later in Europe and North America. Today, the company is listed on the Johannesburg and the London Stock Exchanges, and has operations all over the world.5

Agora of Poland is another interesting example. Agora is one of the most successful companies set up in Poland since the introduction of the free-market economy. It is the publisher of the biggest newspaper in Poland, Gazeta Wyborcza (GW). GW commands 42% of the national readership in Poland and has 62% market share in national newspaper advertising revenues. The strong position of GW is the result of its excellent content, wide geographic coverage and its unique national/regional structure, as well as a consistent marketing strategy.

5 For more information, see “Old Mutual,” HBS Case No. 701-026 (Boston: Harvard Business School Publishing, 2000)
The paper was first started in 1989 as a mouthpiece for Solidarity. After the elections, the founders of Agora decided to make the newspaper an independent media institution. By the end of 1993, the company had 17 regional offices, laying the foundations for today’s most important competitive advantages of Agora, namely its unique countrywide/regional coverage and its extremely broad and high quality content. Agora filled the information void in Poland not only by providing strong news coverage but also by providing a format for advertising. Today's Gazeta readers come largely from Poland's emerging middle class, an educated, urban lot with plenty of disposable income. Gazeta advertisers -- the travel agencies, carmakers, cellular-phone companies and pension funds that fill its pages with ads. These advertisements, in a highly regarded newspaper, provided new consumers with much needed information.

Agora’s story also illustrates how emerging market companies can exploit globalization to their advantage. The company’s founder and president is Wanda Rapaczynski, a graduate of the Yale School of Management, and an ex-employee of Citibank. The company is listed not only on the Warsaw stock exchange, but also on the London Stock Exchange, enabling it to raise the necessary finances to fund its rapid growth. In addition, in 1993, the company sold 20.7% of its shares to Cox Enterprises, Inc., a US media company. This alliance enabled Angora to quickly gain a further competitive advantage based on the know-how and capital obtained from Cox. Agora, therefore, has been able to build a world-class media company by identifying an important institutional void in Poland, and by accessing the global markets for talent, know-how, and capital.

Emerge Logistics of China provides a third example of a company seeking to exploit an institutional void in an emerging market. While China’s economy has been growing by leaps and bounds, there is a significant institutional void in China’s growing international trade: logistics and fulfillment--getting goods to the right places at the right time and outsourced bookkeeping and order management. Because China’s distribution system is so fragmented, the nation spends about 15-20% of its GDP (which was $1.2 trillion last year) on logistics, well above the U.S. rate. Getting goods across the country to potential buyers is not easy.
To address this need, Emerge Logistics was founded in 2000 to provide third party logistics (3PL) to importers trying to navigate the Chinese system. Operating from a warehouse an hour from central Shanghai, Emerge Logistics takes foreign companies from the filing of import applications before their goods enter the country all the way to collecting payments from customers after the wares are delivered. In between, the company helps coordinate and track movement of goods between different modes of transportation, such as trucks and airplanes, as well as taking orders from Chinese customers for companies' products and doing the billing. Emerge helps multinationals sell products into the Chinese market by capitalizing on its understanding of the disjointed transportation system and baffling bureaucracy. In addition, by providing effective third-party trade accounting to complement physical distribution, Emerge facilitates direct sales channels to Chinese manufacturing customers.

In summary, we have articulated three conceptually distinct generic strategies arising out of the institutional voids that pervade emerging markets. Many successful business models can be seen as combinations of these business models. Consider the Haier case, for example. The roots of its success lie in circumventing local institutional voids more efficiently than a multinational might be able to (in this case, leveraging its nuanced understanding – unavailable to the outsider in any neatly-packaged market research reports – of consumer tastes, and investing to overcome a fragmented and sometimes nonexistent country-wide distribution network). That is, it exploited unique understanding of product and factor markets. Other companies – e.g. Koc group in Turkey or Samsung in Korea – might be seen as combinations of all three generic strategies. Not only do these companies understand local product and factor markets, but they also create specialist teaching institutions (company specific business schools, say) to fill a void in their respective markets for talent.
3. The Journey

So far, we have discussed establishing a dominant position in an emerging market context. What happens next? How do you move from a dominant position in a particular country to a global presence? Should you? What are the possible sequences of steps that can work? Proponents of the new era of globalization suggest that companies are ‘going global’ earlier in their life-cycles. How easy is it to be global at the outset? These are questions we set out to begin to answer in this section in two ways. From numerous case studies we have written over the years in China, India, South Africa, Brazil, South Korea, Turkey, and Chile, we draw on examples of multiple approaches to the globalization journey. And we report on patterns we uncovered from a novel statistical approach using recently compiled data regarding the histories of ‘emerged’ giants from several emerging economies.

There have been prior attempts to address what are variously referred to as ‘third world multinationals’ by Lou Wells or companies that rise from ‘the Rest’ (where the ‘Rest’ is Alice Amsden’s term for late globalizing countries). What is the added value of our exercise over these earlier efforts (respectively in the early 1980s and in 2000)? There are several differences between our approach and these earlier efforts, though two stand out in particular. First, following a wave of liberalizations worldwide – that Daniel Yergin referred to as a move away from the ‘commanding heights’ of state intervention toward embracing the market – many more countries are (partly) open to global product and factor input flows today. This recasts the challenge faced by emerging giants. Not only is the threat to them greater from developed world companies, but the opportunities are more enticing as well. Second, there is a difference in emphasis. Our focus, unlike that of Alice Amsden’s work for example, is not on policy, but on conceptualizing the challenges faced by the individual entrepreneur. We do this through the lens of market failures and the resultant institutional voids, which we argue delineate not just the barriers to successful economic activity, but also contain the seeds of why such activity is often best accomplished by indigenous entrepreneurs rather than by mature-market multinationals. While our abstraction (inevitably) does some violence to the details of a
few cases, we find it useful enough to shed light on a variety of seemingly disparate attempts to globalize from developing countries.6

For our statistical analysis, we first identified countries of interest. Jeffrey Garten of the Yale School of Management identified the ‘Big 10’ Emerging Markets which we used as a starting point. The large size of these markets suggests that an interesting range of intra-country economic activity is feasible. By the same token, problems that might be unique to the problems of companies in smaller countries receive less attention in the statistical analysis (though are not ignored by our framework, we believe).7 We then supplemented this list by focusing on countries that had attracted the attention of the global investor community. As a(n admittedly limited) proxy, we looked to see which countries were most of interest to institutional investors in the United States. In particular, we focused on the countries features in the investments of prominent mutual fund families like Dreyfus, Fidelity, Oppenheimer, T. Rowe Price and Vanguard. We include all countries from these two criteria except those, like Russia (and its predecessor state, the U.S.S.R.), where we had trouble finding good data. This gave us Brazil, China, India, Mexico, South Africa, and South Korea. Finally, we combed the international (English) media to identify countries that were frequently discussed. This added Argentina, Indonesia, Poland and Turkey. Each of these, we felt, added interesting dimensions to the problem of interest (e.g. Poland and Turkey brought in emerging markets in or close to Europe, Indonesia brought in the world’s largest Islamic society and Argentina, a once-flourishing state that the ravages of time had reduced to chronic distress).

6 Lou Wells’ earlier effort emphasized the interaction between country (and therefore, market) size and viable technologies. This was particularly important in a time when many economies were relatively closed. Amsden has emphasized the role of governments in jump-starting successful companies. We return to this theme below.

7 For example, Grace Kennedy is a Jamaican conglomerate that pays a lot of attention to stability of earnings. Given the size of the Jamaican economy, it is likely to be heavily buffeted by macroeconomic and political vagaries, and, one might imagine, that diversification through multi-business activity might have some value creation purpose over and above what it might if the same company existed in a large emerging market like Brazil or India.
We wanted to include all prominent companies within each of these countries. Why? Because this meant that information on the histories of these companies, needed to analyze the ‘journey,’ were available. We used the Forbes Global 500 and the Fortune International 500 lists of companies within these countries as our measure of this. We supplemented these lists with companies in these countries in which the institutional investors mentioned above had invested. It is important to note that prominence, using the measures here, does not always equal economic success, though is correlated with it. That is, there are chronic underperformers, using any of a variety of reasonable measures, in the 61 companies we identified using these criteria in our 10 emerging markets.

Of course, this data-driven approach causes some inevitable biases. For example, we miss for the purposes of this analysis small and medium sized enterprises that have been competitive in some countries – eg. Taiwan. We also miss companies that once might have been emerging (or emerged) giants and thereafter faltered and vanished from sight. To partially guard against this problem, we supplemented our sample with companies in the International History of Company Directories which profiles firms that have at least $25 million in revenues and which are “leading influences in the industry or geographic region.” This adds 73 firms across the 10 emerging markets, for a total of 134 firms on which we base our statistical exercise. (Several of the 61 firms also are profiled in this directory.)

We amass a lot of data on each of these 134 firms. This includes data on various current attributes of each firm, drawn from Hoover’s, Moody’s and miscellaneous web-based and print sources, time-series data on key ‘events’ going back to the origin of the firm, drawn

8 Indeed, it is not hard to imagine companies that have retraced their attempts at globalization. Think of Nomura, once striding the world as the preeminent banking colossus, now confined to a primarily Japan-centered footprint, following Japan’s decade-plus recession and a series of management and corporate governance missteps.

9 Revenues (domestic; int’l); Profits; Market cap; No. of exchanges (incl. US/European?); ADRs; Analyst coverage (int’l; domestic); Foreign investment (equity; debt); Government own?; Business Group member; Auditor; GAAP; Employees; Management (board) foreign exposure (education; experience); Fortune 500 partnerships.
from the company history directory and from Hoovers, Moody’s and company websites,\textsuperscript{10} and performance data from Global Vantage for the publicly traded firms (market/book ratios currently, and equity price appreciation relative to a country index).

Based on the attributes of the firms in our sample as they exist today, we group them into three categories.\textsuperscript{11} A quarter of our prominent companies have primarily domestic footprints. A quarter have heavy international exposure and orientation. And half appear, at least based on very aggregate data, to have some measure of government involvement and, perhaps, protectionism. Examples of the first category include Banco Itau in Brazil and Akbank Turk AS in Turkey, examples of the second include Anglo American from South Africa and Cemex from Mexico, and examples of the third include Petrobras from Brazil and Sasol from South Africa.

We turn next to determine factors in the histories of the companies that can be used to separate out those that have chosen to orient themselves internationally from those that have chosen to remain domestic entities. This is based on six countries – Brazil, China, India, Korea, Mexico and South Africa – primarily where we have long enough data strings for sufficient numbers of companies.

\textit{Precedence}

A simple way to get into the data is to examine which ‘events’ in the life-cycle of an emerging giant precede other events. In particular, we were interested in the extent to which domestic activity was a precursor to international activity, if at all. To this end, we

\textsuperscript{10} Key events that we code are: diversification, divestiture, domestic acquisition, domestic capital raising, executive change, geographic expansion, international capital raising, joint venture (domestic), organizational structure change, origin, ownership change, regulatory closing, regulatory opening, joint venture (international), vertical integration.

\textsuperscript{11} We use factor analytic techniques to do so. Three factors emerge prominently. The first captures old, relatively low market capitalization firms (though these are not firms whose stock price performance is lower than that of an industry index). The second captures firms with heavy foreign involvement – that is, foreign investors own significant proportions of these companies and the management and the board have extensive international experience or education. The third captures firms that have heavy government involvement.
first coded the ‘histories’ of the companies into ‘event time’ strings. A typical example featuring Banco Itau in Brazil is showed in Figure 1. We also simplified this by recoding events into 3 categories: domestic, international, and other. Domestic events were domestic acquisitions, domestic capital, and domestic joint ventures; International events were geographic expansion (assumed to be international), international capital, and international joint ventures; "Other" events were internal changes and events that couldn't be coded for international versus domestic: changes in ownership, executive, or internal structure, and diversification and divestiture.

We can then ask whether the first domestic event preceded the first international event. The statistical significance of the proportion of times that domestic events precede international events in our data was computed by simulating 2000 ‘event strings’ with the same proportion of event types as in the actual data, and observing where the realized value of the statistic of interest occurred in the derived distribution.

We also computed the relative proportion of international events for each company thus (# international events)/(# international events + # domestic events), ignoring events coded "other". This is a measure of how much of the company's focus was international. Relative timing of international events was computed by assigning a sequence number to each domestic or international event and computing (average sequence number of international events) / (average sequence number of domestic and international events). This number ranges between 0 and 1, and is higher if the company's international events occurred relatively later in the company's history.

Both these methods showed clearly that the bulk of the early years of a company’s history were dominated by domestic activity with international activity occurring relatively late. That is, the idea of being ‘born global,’ or even going global relatively early on, does not appear to have much traction in our data.

How does this precedence analysis square with real-world cases? Very well, as it turns out. Consider South African Breweries, one of the dominant brewing companies in the
world. It was founded in 1895 in South Africa. During several decades of incremental growth, it developed a unique ability to distribute chilled beer outside the formal distribution channels in South Africa. This was an important, and large, market segment to reach since, under the restrictive apartheid regime of pre-1990 South Africa, the black South African population accessed beer through informal and fragmented ‘shebeens.’ Think of roadside shacks where liquor was distributed in the informal sector. Thus, the first stage in the emergence of SAB as a world-beater was the development of a unique capability rooted in the domestic institutional context. In particular, SAB learned to offset a particular institutional void, that of a missing distribution system rooted in the socio-political inequities of the country.

SAB then realized that the capability of mastering a fragmented distribution network, and of tailoring beer to the local tastes, would stand it in good stead in neighboring Southern African countries. This is the expansion it then envisaged and executed successfully. From there, the next step was to enter and pioneer other emerging markets in Eastern Europe, China and India. This was followed by an overseas listing to raise capital and, equally importantly, to get visibility for itself. And the final stage was an expansion to the developed world in the form of an acquisition of Miller Breweries in the U.S. That is, the expansion path is characterized, following the development of a local capability, by the gradual expansion in ‘concentric’ circles in Africa and emerging markets.

The beer industry provides other such examples. San Miguel Beer is a world-beater from the Philippines. It is prominent through much of Southeast Asia and farther afield including parts of Australia. Its origins lie in a Filipino brewing and distilling company over a century ago. Its presence, through production facilities and joint ventures in Hong Kong, mainland China, Vietnam, Indonesia, Australia, Japan and elsewhere, is built on the 90% market share in the Filipino market. We see the same domestic strength transformed into a gradually expanding regional presence.

Consider also examples from other industries and other parts of the world. The Argentine candy producer, ARCOR, was founded in 1951. Today it is the world’s
leading producer of caramels, and the leading chocolate producer in Latin America, with a vast export business in foods, candies, chocolates, cookies and crackers, ranging far beyond the Mercosur countries in Latin America to the rest of the world. In becoming a leading ‘multilatina,’ Arcor too has displayed the familiar “inside-out” pattern of growth. The first step was the overcoming of institutional voids in Argentina several decades ago. This involved, in Arcor’s case, having to vertically integrate to obtain acceptable quality raw materials and packaging in the closed economy in which it operated, and even generating its own electricity to guarantee reliability of its operations. In 1976, Arcor opened operations in Paraguay, in 1979 in Uruguay, in 1981 in Brazil, all countries immediately adjacent to Argentina. It then branched out further in Latin America, selling in 1989 to Chile, 1996 to Peru. Acquisitions came later in its history and included another significant food and candies brand in Argentina, Noel, and, even later on, the Chilean market leader Dos en Uno.

Similar patterns emerge in the Middle East. The Koc group is one of Turkey’s most prominent family-run conglomerates. One of its successful arms is a food-retailing business, Migros, which has expanded through the Balkans and the parts of the CIS. Migros is a market leader not just in Turkey but also in Russia, Bulgaria and the Ukraine. Similarly, Abdel Latif Jameel, the world’s largest independent distributor of Toyota cars, headquartered in Jeddah, Saudi Arabia, has parleyed the dominant position and expertise in its home country into successful businesses in Algeria, Lebanon, Morocco, Sudan and Turkey.

These results should not be surprising. There are lots of links between neighboring countries. Singaporeans are bound to know much more about the ‘gossip,’ including business-relevant gossip, in Malaysia than do Russians or Belgians. Indeed, there are cartoons lampooning each others’ countries in this region. There are ethnic links, and student exchanges; cultural and university exchanges; folks travel across borders for medical treatment, etcetera.
This means that institutional voids in a particular market, the result of informational and contracting problems in that market, are often best alleviated by folks most familiar with the environment. That is, the Chinese entrepreneur in Malaysia is far likelier to pick up clues regarding the subtle, unstated aspects of doing business in Thailand, China or Vietnam than is a European or a Latin American. Further, if she runs into trouble, she can draw on myriad social, ethnic or kinship networks to try to resolve the business dispute.12

We see strong fingerprints of this assertion in some of our other formal work regarding corporate governance. In a series of papers, we show that the de facto similarity in corporate governance practices around the world is far smaller than the de jure similarity. That is, unstated clues about how contracts are governed are far more important than the letter of the law. There is evidence that deep immersion of a society in its neighbor brings their contractual and (business) informational practices into close proximity. Lastly, there is no sense in which the American system of governing contracts is emerging as a blueprint for the world. The intent of good corporate governance is the same everywhere, to protect investors and resource providers sufficiently to induce them to contribute to the productive commerce, but the rubber meets the proverbial road very differently in Bogota, Bangalore and Budapest.13

What about exceptions to the inside-out pattern we document? Consider India’s leading high-technology company, software offshoring giant, Infosys Technologies. Its first contracts were in the United States. Our first observation is that this type of ‘big leap’ is relatively unusual in our data. But, more importantly, consider the underlying logic of what made such a big leap feasible. Much as SAB had to build its international expansion on a domestic capability, so also did Infosys. In the latter case, it was its ability to exploit

12 As Lou Wells tells us, in the 1980s, Indian investors were the best at filling out the cumbersome forms of the Indonesian bureaucracy. Perhaps they had retained some of their special skills from the British Raj!

India’s human capital in sufficient numbers and with sufficient rapidity, exceeding that of potential rivals like EDS, IBM, Accenture, etcetera, that made the difference. Ultimately it had to overcome the institutional void in the market for management talent to make its global expansion feasible.

*Different Strokes for Different Folks*

The second major pattern that comes out of our ‘strings’ analysis of the histories of prominent companies is the idea that there are multiple possible paths to prominence. Different strokes for different folks.

We get to this result thus. First, we coded the event sequence so that each event was represented by a single letter, and then "distances" between the event sequences were computed by computing a "string edit" distance for each pair of strings (Sankoff & Kruskal, 1983). The first distance measure used was the Levenshtein distance, which counts the total number of letter insertions, deletions, or replacements required to transform one string into the other, minimized over all possible sets of transformations using a dynamic programming algorithm. Using this distance measure, event sequences that had similar types of events didn't necessarily have a close distance, so an alternative distance measure, "generalized edit distance" (SAS Institute Inc., 2003) was used. In this measure, transpositions (e.g. replacing "ab" by "ba") and replications (e.g. replacing "a" by "aaa") were allowed. The pairwise distances were computed for each pair of companies, and then cluster analyzed using Ward's method (Aldenderfer & Blashfield, 1984; SAS Institute Inc., 1999a), and 5 recognizable clusters of companies were obtained.14

We found the following clusters from our analysis.

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Cluster 1: companies that focused on product diversification, often with joint ventures
Cluster 2: international expansion primarily in a single product line, without much product diversification
Cluster 3: frequent divestitures and access to capital markets, possibly indicating a cash shortage
Cluster 4: tendency to build a strong domestic base by domestic acquisitions before international expansion
Cluster 5: a small group characterized by many organizational structure changes or ownership/management changes

To our mind, clusters 1 and 4 are qualitatively similar and primarily focused on domestic activity, often yielding very impressively run companies that would withstand global competition and successfully defend the domestic turf from multinationals from the developed world. These businesses are often diversified across multiple industries and often controlled by a single family. Cluster 2 is qualitatively different in that it emphasizes a single line of business across multiple geographies. That is, the first pattern is diversified across industries but not across countries, the latter is diversified across countries but not across industries.\footnote{Clusters 3 and 5 are more emblematic of turmoil and harder to associate with companies that are exceedingly well run.}

Real world analogs of this statistical exercise are again easy to find, bolstering our confidence in the former approach. Consider Grupo Carso and Cemex for example. Both originated in Mexico: both are quite successful. It is hard to get around Mexico without running into one of Carlos Slim’s (the controlling shareholder of Grupo Carso) products or services. On the other hand, the Zambrano family has eschewed non-cement businesses and concentrated on becoming one of the world’s five remaining big players in cement, the most profitable one to boot, and the only one originating from an emerging market (all others are of European origin). That is, one entrepreneur chose to diversify across industries and the other across countries.
A similar pattern can be observed in India. Consider India’s Tata Group, in existence since the 1870s, and Infosys in existence since 1981. Like the Carso/Cemex duo, the Tata group is diversified across industries in India while Infosys concentrates on software services worldwide. Note that it is not the case that Grupo Carso and the House of Tata do not spawn businesses with global footprints. Quite the contrary. They do, and they do so in consonance with the patterns we observed above regarding precedence. Carlos Slim has expanded in telecommunications all over Latin America, for example, and now further afield. The Tata’s have spawned some of India’s most global businesses in tea, software, and automobiles, among others. It is just that the global aspect of their businesses have followed, rather than preceded, the domestic base. And it is hard to argue that either of these groups are worse off as a result.¹⁶

But what if one of these approaches is demonstrably superior to the others? That is, companies in one of the clusters outperform those in others. This turns out not to be the case. We computed two different performance measures, one based on market/book ratios at a point in time (2001), and another based on a simple measure of how much stock market returns outperformed a benchmark (industry-adjusted) index.¹⁷ There is little correlation between ‘cluster’ and these performance measures. One reason might be that companies optimally select the kind of evolution for which they are best suited. Further, we also looked for the most commonly occurring sequences of events in our data. There appears to be no penalty, in either of our performance measures, for firms that do not have a high incidence of these commonly occurring sequences of events. Again, “different strokes for different folks” seems to us to be a sensible interpretation.

¹⁶ There are also country-specific regularities to the clustering. Across the six countries with the largest number of companies, there was a significant association between countries and cluster membership. China is associated with clusters 3 and 5, possibly indicating organizational instability or distress. Korea and South Africa were associated with clusters 1 and 2, the two clusters most strongly related to international expansion. Mexico was associated with clusters 1 and 4, suggesting an emphasis on diversification and domestic expansion first. India and Brazil had mixed pictures, with companies generally spread across all clusters except cluster 5.

¹⁷ RELPERF = log(price/price_t) – log(markett/markett_t). In spite of taking logarithms, the performance numbers had very high kurtosis (long tails), so they were transformed by computing RELPERF2 = SIGN(RELPERF) * SQRT(ABS(RELPERF)). The transformed variable was approximately normal.
Leveraging Global Institutions

What is wrong with an approach, seemingly separate from the ones above, of listing overseas to raise capital when local markets are under-developed, or using international executive search firms to find a CEO when local talent proves inadequate? In other words, why should the local context constrain firm strategy when global specialists are often accessible? Certainly the volume of listings on exchanges in New York, London and Hong Kong, on the one hand, and the burgeoning cross-border business of blue-chip executive search firms like Egon Zehnder in Europe and Russell Reynolds in New York, suggest that numerous emerging market companies avail themselves of such shortcuts.  

But it is insufficient to only consider whether a firm in Prague should be able to raise capital in London. Investors in London should also be willing to part with their money at a reasonably attractive rate of interest. Executives from London should be willing to relocate to Prague for compensation packages that do not cause the Czech company to be priced out of the market. This, in turn, will only happen if one of the generic strategies we discussed in the earlier section is adopted. That is, factor inputs in the global markets—accustomed as they are to moving to the part of the world where they are most efficiently utilized—are only likely to be available to the candidate emerging giant if it operates a successful business in the emerging market. This, in turn, means that it must have circumvented local institutional voids in one or more of the generic ways delineated above.

So accessing global institutions is certainly a way around local institutional voids. But it is only accessible to those firms who have already derived some compelling value proposition. This reasoning is vindicated by our sequence analysis, which clearly shows

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that the one measure of accessing global institutions on which we have data – accessing global capital – occurs after a domestic market position is acquired.

Examples of this are easy to find. Cementos Mexicanos raised debt in Spanish capital markets to evade a Mexican discount but only after it had demonstrated a superior business model in the cement business in Mexico and other Spanish speaking Latin American countries. The cream of Israeli high-tech companies list on NASDAQ. Infosys Technologies borrowed the reputation of US capital markets and listed on NASDAQ even though it was fairly flush with capital at the time; its novel idea was to signal to potential U.S. customers that it could be trusted despite its origins in India, a country not known for superior corporate governance.

IV. Confronting Strategic ‘Truths’

Would-be stewards of emerging giants worldwide are thirsty for knowledge. Naturally, they seek to emulate their brethren in the developed world. While endorsing the quest for knowhow, our experience leads us to issue some caveats. Throughout this section, we will make the point that simple-minded reproduction of an observed phenomenon from a mature western economy to an emerging market setting is unwarranted. We are not arguing that the underlying logic does not apply. Quite the contrary. But it is the case that non-contextual reproduction of the result of the logic (from more familiar mature market settings) can lead one astray.

We start this section by considering ideas central to two of the dominant schools of thought in Strategy today and ask how these ideas would apply in an emerging market. We then do the same with research on corporate governance. The ‘truths’ that emerge from immersion in mature economic contexts (like the US, or Western Europe) do not transfer over unmodified to emerging markets. Finally, we confront various shibboleths in the cacophony of writings on globalization.
(A) The Paramount Importance of Industry?

Michael Porter’s celebrated five-forces model provides a now-ubiquitous tool to analyze exactly how the relative bargaining power of various participants in an industry cause them to share rents among each other. An attractive industry is one where the firms in question capture a disproportionate share of the rents relative to their customers on the one hand, and to suppliers of capital, talent, ideas, etcetera on the other. And the scholarship that followed Porter’s original writings has convincingly demonstrated that industry membership is a primary determinant of long-run success of a company.

So we asked, in partnership with Jan Rivkin, how important industry was explaining the profitability of emerging market companies.19 It turns out that it matters as much that a particular company is (or is not) a part of Grupo Carso or the House of Tata as it does that it is a telecommunications company or a steel mill. Membership in a business group explains as much, and sometimes more, of the variation in profitability as does the industry in which a firm operates.

The underlying logic of industry analysis is not in question. That is, to understand the attractiveness of a particular opportunity, one still has to revert to the fundamentals of relative bargaining power of the various industry participants. But the way relative bargaining power is allocated across constituents is itself dependent on the context. For example, employees in a particular industry may have very different bargaining power (vis-à-vis firms in that industry) from one country to another depending on their ability to ‘walk away’ from unfavorable outcomes in which they might find themselves. Their ability to do so might, in turn, depend upon how well labor markets function in their surroundings, since this will affect their ‘outside option,’ so to speak, or the best alternative use for their talents that they can find.

Consider similarly the bargaining power of buyers in a particular industry. Depending on the ease with which buyers can track down credible information regarding alternative

products, their ability to comparison-shop and force down prices – and thereby capture more of the rents themselves – might well vary with the ambient product market institutions. Institutions that transcend the product market may also matter; e.g. the credibility of information depends on consumers’ beliefs that the judiciary will police and sanction misrepresentations expeditiously. Thus, non-technological fundamentals, arising out of different institutional endowments, will affect buyer power.

Product differentiation possibilities vary as a function of broad institutional variables even within an industry. Consider the decision by Mercedes-Benz to have its cars include an automatic problem-detection alarm that triggers an alarm in a central location, which then initiates a process that may result in a rescue team being dispatched. It would be considerably more costly to offer such a differentiated product in India than in the U.S., as the former would not have the specialized intermediaries to deliver on this safety & security commitment. Speedy response to a distress call requires good roads as well as a measure of reliable telecommunications infrastructure that is likely unavailable. The demand side for such differentiation would, in turn, depend on the wealth distribution in the economy. Smaller demand would plausibly translate into higher per-unit costs, in a production process that is likely scale-sensitive, further making supply uneconomic.

Entry into a particular industry may depend on the availability of risk capital in the economy more generally. Thus, technological characteristics of an industry – minimum efficient scale, for example – might remain constant, but the number of firms in the industry – hence, industry structure – might nonetheless vary across countries. The nascent nature of bankruptcy procedures might result in exit being infeasible in one country, yet being (relatively) pedestrian elsewhere for a similar industry, resulting in first-order dynamic implications for industry structure. In Thailand, for example, bankruptcy and associated exit is not only difficult to pull off, even the laws have proven resistant to reform.20

Further, the common assumption we make in well-functioning market economies – that competition will expose inefficiencies and drive out unprofitable firms – may not be true in many parts of the world, where government intervention might serve to keep firms afloat. Indeed, exit might be hampered by the belief that there might be intervention of this sort.

Data from a broader range of countries are now available, and highlight the first-order effect of institutional differences. Elsewhere, also with Jan Rivkin, we have shown that, when industries are ranked by profitability within each country, the correlation of these ranks across pairs of countries is statistically indistinguishable from zero.\(^{21}\) This suggests that knowing the kinds of industries that are uniquely profitable in one environment tells you, on average, nothing about what kinds of industries will be profitable elsewhere. Stated differently, a manager who has honed his skills in the retail sector in one country should not, on average, expect that these skills would predispose him to success in the retail sector in another industry. Industry structure responds to local institutional voids.

\(\text{\textbf{(B) The importance of core competence?}}\)

Consider another homily in strategy, the admonition to ‘stick to your knitting.’ This is well intended advice, but, in our view, often misinterpreted. The problem arises because the knitting in question is not always the same from one place to another. In other words, in a mature market setting, populated with well functioning intermediaries, it makes sense to tell a bicycle manufacturer that they should stick to making bicycles and not go into financial services. But what if the bicycle manufacturer has the best semi-urban and rural distribution system in an emerging market, there is a reasonable case, in our view, to be made that its core competence lies in accessing rural distribution when the general distribution intermediation structure is under-developed, and it might well branch into selling consumer products or rudimentary advise regarding financial services. Western observers often deride this by saying that it is tantamount to unrelated diversification, but

this presumes that our cognitive constructs of industries are the predominant determinants of variation in profitability. It is hardly so. Consistent with this, in our work we have found over and over that there is little evidence that such moves as exemplified by the example above are *per se* ill-conceived.

As an example, consider Yamaha’s transition from music to motorcycles. Here the underlying core competence is plausibly not the company’s ability to make musical instruments, at which it is undoubtedly excellent, but its reputation for quality in environments where information about and guarantee of quality is harder to come by than in environments where *Consumer Reports*, say, works superbly. Yamaha Motor was spun off from Yamaha Corporation in 1955. It leveraged the renown of its music company affiliate to enter, first, Thailand, and then countries like Malyasia, China and Brazil, and eventually Europe.

Other examples are not hard to find. Nokia, the celebrated cellphone company started life as a forestry company. Wipro Technologies, one of India’s dominant software offshoring companies, has its roots in oilseed manufacturing (and still retains a substantial presence in this business). The House of Tata in India has similarly invested a lot of senior management time and energy in coming up with a set of procedures to ensure the quality of all the products and services that India’s largest group produces. Clearly the quality guarantee, rather than the particular capability of delivering a product or service, is the underlying core competence here. This quality guarantee, and other group-level competencies (as opposed to industry specific knowhow), have been leveraged to enter several diverse industries and also to launch the industry itself in India. As a board member mentioned to us, “If everyone is told not to go into unrelated businesses, how will the airlines, oil, and telecommunications industries develop? The government has said that they can’t do it. So there’s a social benefit to all this diversification.” Figure 2 shows a over one hundred year timeline of entries into (and exits from) businesses.
Our position, then, is akin to that on the importance of industry. That is, the logic underlying core competence is a sound one, but its application requires care, nuance, and a sophisticated understanding of context.

(C) Governance and the imperative of the US model
Is it important for companies to embrace US governance techniques to become emerging giants. Our answer is, not strictly. That is, again, the logic of good governance is an absolute imperative, but the particular way in which the interests of providers of capital, talent and ideas, are protected varies dramatically from one country to the next.

We demonstrate this in our econometric work. We show, akin to the expansion paths of emerging giants we discussed in The Journey section above, that governance rules are more similar in geographically proximate countries. That is, there is little evidence that even rules-on-the-books regarding corporate governance - which, in our study, was operationalized as rules protecting equity and debt providers – are approaching the US model. Rather several regional models coexist and predominate.22

An interesting illustration of our point of view is playing out as we speak in Japan. The example is particularly interesting in that, even in this OECD country, there is little evidence of the superiority, for that context, of US-style corporate governance. The regulator has offered companies the option of embracing US-style corporate governance rules, or sticking with the Japanese system, as long as there is full disclosure about this. Some companies, like Sony and Nomura, the dominant consumer electronics and investment banking companies, have embraced US style corporate governance rules, whereas other, equally prominent ones, like Toyota and Canon, have not. The overall number of firms that have gone the Sony-Nomura route is relatively small.

Of course, in a world where capital markets are global, and emerging giants might seek to access capital overseas, the advisability of eschewing US style corporate governance has costs as well. For example, disclosure in US GAAP can help attract US institutional investors if the latter are convinced that the incentives to disclose are credible. Indeed, our econometric work shows that trade links with the US do prompt adoption of US disclosure norms. But it is not the case that every good emerging market firm, nor even many of them, should, or do, choose to disclose per US GAAP.

(D) Snake oil and Globaloney: Revisiting Shibboleths

Is more global better?

At one level, the answer to this question might seem to be an affirmative one. The logic would be that well-managed companies will spread their wings over time and encompass broader geographic scope. Therefore, at any point in time, there will be a correlation between global scope and performance. But this should not be confused for a causal relationship—what is important is identifying whether global scope results in competitive advantage (rather than global scope itself being the result of advantage derived in some other fashion).

Indeed, there is more than one way to skin the proverbial cat here. There are world-class companies that are not quite as global as one might expect. Consider the Tata group in India, founded in 1874. It is home to seventy-plus major companies in India spread over a range of sectors. Though some of its businesses have a truly global footprint (Tata Consultancy Services in software; Tata Tea), and others sell to developing countries


(Telco, the truck manufacturer), the bulk of its operations are in India. Yet, the group, with its reputation for probity, is the preferred destination for providers of technology and capital. When Hong Kong’s Jardine Matheson group wanted to invest in India, it chose to get exposure to a broad cross-section of the Indian economy through an equity stake in a Tata investment vehicle. Thus, the Tata group is a player in the global markets for capital and ideas despite having primarily local operations and no global financial listing. A similar phenomenon appears to be at play with Mitsubishi’s investment in the leading business group in the Philippines, the Ayala Group.  

Supporting these examples, the raw correlation between size and degree of globalization in the UNCTAD list of top 50 (by market valuation of assets) emerging market companies is only 0.4. There are several companies that are successful enough, in the sense of achieving a large market capitalization, without having a global footprint.

The admonition to globalize selectively is, of course, not particular to companies in emerging markets. There are plenty of examples of US companies, for instance, that have raised their market value by de-globalizing as it were. Consider Tricon Restaurants, for example, the spinoff fast-food restaurant chain from Pepsico (comprising Taco Bell, Kentucky Fried Chicken, etcetera). The rapid rise in market value was a direct result of their deciding to concentrate their global efforts in a small number of select countries, rather than operate in several dozen.

*Is governmental involvement, per se, bad?*  
World-class companies are never built solely on government support and patronage. That is, companies cannot thrive for long in a head-to-head match with an efficient multinational from a mature market if the only thing they have going for them is government largesse, protectionist barriers etcetera.

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25 These are qualitatively different from companies like the state-run petroleum companies of Brazil and Malaysia, Petrobras and Petronas, which also have primarily domestic operations, but also have a fair degree of protectionism benefiting them. Given their size, they are somewhat natural destinations for foreign capital.
But a weaker statement about government involvement is feasible. That is, that
governments can help launch companies that eventually turn out to be world-class. Alice
Amsden has emphasized this in the case of Korea. The danger of course is that
government support breeds addiction to continued support, and that supported companies
are never weaned away.

But this need not be the case. In fact, many world-class companies today benefited from
some form of government assistance in their infancy and adolescence. India’s
pharmaceutical industry today would not have existed if the government had not imposed
protectionist barriers in the 1970s. We are the first to concede that specifying the
counterfactual against which this policy, for example, should be benchmarked is tricky.
Would a better use of resources have resulted if this sort of protectionism had not been
instituted? While difficult to answer, what can be said is that it is very unlikely that
India’s leading pharmaceutical companies, like Ranbaxy, now operating with more than
half of its profits and sales form the U.S. market, would be in existence today without an
initial protectionist phase. While not world-beaters yet, these companies have put the
world’s pharma majors on notice.

Another example from India is Reliance, India’s first private-sector entry into the Global
Fortune 500. Dhirubhai Ambani, the founder, famously said that he was willing to
‘salaam’ anybody (that is, salute to anyone) if it got his work done, implying that getting
close to government to get favors was not something he would shy away from. But the
key is that this protectionism was not wasted – it was used by the astute entrepreneur to
develop world-class project management capabilities, most on display in the massive
petrochemical complexes run by the company in India, often put up in world-class time
and run to exacting world-class standards. The company also developed financial savvy
unparalleled in emerging markets. Reliance pioneered going to the retail investor in India,
thus spurring the development of equity markets, and also pioneered raising capital from
the global debt markets with one of the first long-term global debt issues in London. That
is, it is hard to argue that the patronage resulted purely, or even mostly, in social waste or
rent-seeking. And Reliance is one of the best run world-class companies form a
developing country today. Other examples are unfolding in India today. Jet Airways has developed what we will argue is one of the more pleasant aviation experiences in the world by flying, efficiently, often, and profitably, in-between major Indian cities, but has done that in an environment where foreign airlines are prevented from operating. It is now spreading its proverbial wings through the rest of Asia.

A key conventional wisdom to confront here is the one regarding openness of the economy. There are two points our research leads us to make. First, openness is not a binary construct. That is, thinking of China as open and India as closed, for example, has a grain of truth but has an equal amount of falsity. For example, China is more open to foreign direct investment than is India, but is and has been much less open to flows of talent and ideas, both into and out of the country. Second, there is a case to be made, as Henry Rosovsky did several decades ago, for selective openness. This is a point of view that macroeconomists and scholars of capital markets have come around to in wake of emerging markets financial crises and the contagion of the late 1990s. That is, a plurality of the profession embraces the idea that opening up financial markets with abandon, while the domestic financial infrastructure remains underdeveloped, is to court instability. But a similar idea can be extended, we think, to markets other than those for capital. That is, some protectionism can be good, if, and only if, it is used in conjunction with incentives to use the protectionism to further socially useful investment. This happened in Korea, arguably because the incentives were there in the form of forcing the selected chaebol to export and thereby to confront global competition.

*The Janus Face of Multinationals*

*The Economist* magazine had a brilliant cartoon in 2000 illustrating the changing attitudes of the world towards multinationals. From the four decades ranging from the 1960s to the 1990s, the world’s attitudes towards behemoths from the developed markets have ranged from horror, unmitigated fear, to complacence and insouciance. Yet, these simple-minded characterizations, varied as they are, do not help understand the core economic problem; rather they illustrate the confusion in the minds of emerging market
entrepreneurs about the Janus face of multinationals. In particular, when should folks compete with versus cooperate with multinationals.

Our research shows that the basis for cooperation between multinationals and local firms varies by the type of firm. That is, consider the Koc Group in Turkey. It is the preferred local partner in the region for mature market multinationals. But much of what the multinational brings is already accessible to Koc. For example, despite capital market imperfections in Turkey, accessing capital is not a problem for the company founded by Vehbi Koc. It can rely on fairly deep internal capital markets, and it has a track record that endears it to London and New York. So the basis for cooperation is the provision of technical knowhow from the multinational in exchange for knowledge about the local environment. What is clear is that, absent regulatory intervention, over time such arrangements will generally be renegotiated. As the multinational acquires sufficient familiarity with the local environment it will need Koc and its ilk less and less. Thus the problem for Koc becomes, not whether to compete, but how to learn as much as possible over a defined but uncertain time horizon from the multinational. Or to bind itself to the multinational in a way that the latter cannot wean itself away from the former. Mansour Group in Egypt has arguably done the latter with its Caterpillar franchise. It took the franchise in Egypt and expanded it to eight other African countries. The same is true for Sime Darby, the Malaysian conglomerate, and Caterpillar in Southeast Asia. For Cat to abandon Mansour and Sime Darby would be more costly than if it were beholden to each of them in only one country.

In contrast collaboration with a would-be entrepreneur is potentially based on a different rationale. A multinational might plug in an entrepreneur into its global value chain. The stand-alone entrepreneur (as opposed to an incumbent entity) might well rely on the multinational for talent, capital as well as technology transfer. It is not that the threat of renegotiation withers over time, but the time horizon over which this happens is potentially different. Our field research in five emerging markets (Argentina, Brazil, Mexico, Hong Kong and India) shows that collaborative agreements generally last longer
between multinationals and stand-alone entrepreneurs than between multinationals and established, diversified business groups.

V. A Brief Summary

We have tried to synthesize insights from our fieldwork and research in emerging markets in Asia, Latin America, Africa and Eastern Europe over the past several years. We think that it makes sense to identify generic strategies of the sort articulated in section II. These are not industry-specific, rather they are specific to the kinds of institutional voids that exist in the economy in question. Building an emerging giant requires a deep-seated understanding of the contextual environment from which the emerging entrepreneur builds her enterprise.

We have also supplemented this conceptual framework with empirical analyses of the journey to ‘giantdom.’ The quest for success in the developed world, more often than not, first goes through defense of the home front, and then through building successful businesses in the proximity of the home front. Here proximity is usually, though not necessarily, identified with geographic distance. This is because the influences of history, and continued interaction in the social, political and economic spheres often make neighboring countries institutionally more ‘adjacent’ to each other than they would be by chance.

Finally, we endorse the thirst for knowledge on the part of would-be emerging giants. These have a vital role to play in the development of their societies. But strategic homilies from the developed world can be usefully parsed into the underlying logic and the homily per se. The former applies everywhere, the latter scarcely anywhere outside its context at all.
<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
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<tbody>
<tr>
<td>1944</td>
<td>Founded as Banco Central de Credito</td>
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<tr>
<td>1964</td>
<td>Merged with Banco Itau &amp; changed name to Banco Federal Itau</td>
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<tr>
<td>1966</td>
<td>Merged with Banco Sul Americano &amp; change name to Banco Federal Itau Sul Americano</td>
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<tr>
<td>1969</td>
<td>Merged Banco America into its own operations</td>
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<tr>
<td>1970</td>
<td>Merged Banco Alianca into its own operations</td>
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<tr>
<td>1973</td>
<td>Merged with Banco Portugues do Brasil &amp; changed name to Banco Itau</td>
</tr>
<tr>
<td>1974</td>
<td>Merged Banco Uniao Comercial into its own operations</td>
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<tr>
<td>1979</td>
<td>Acquired Banco Itau Winterthur &amp; Itau Tecnologia</td>
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<tr>
<td>1985</td>
<td>Merged Banco Pinto de Magalhaes into its own operations</td>
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<tr>
<td>1992</td>
<td>Closed subsidiary Bancredit Treinamento para Vigilancia</td>
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<tr>
<td>1993</td>
<td>Established Itau Bank (Cayman Islands)</td>
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<td>1993</td>
<td>Established Arapanes Administracao e Participacoes</td>
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<tr>
<td>1994</td>
<td>Established Itau Administradora de Consorcios</td>
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<tr>
<td>1994</td>
<td>Changed branch office in Buenos Aires to subsidiary named Banco Itau Argentina</td>
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<tr>
<td>1995</td>
<td>Established Itau Asset Management</td>
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<tr>
<td>1995</td>
<td>Acquired 13 companies</td>
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<td>1995</td>
<td>JV with Bankers Trust to form Itau Bankers Trust Banco de Investimento for capital market operations</td>
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<tr>
<td>1996</td>
<td>Established subsidiary Itau Participacoes</td>
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<tr>
<td>1996</td>
<td>Closed subsidiary Administradora e Comercial Comaco</td>
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<tr>
<td>1996</td>
<td>Parent Co Itausa transferred controlling interest in Itau Seguros to Co</td>
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<tr>
<td>1996</td>
<td>Subsidiary BFB Leasing absorbed subsidiary Frangest Empreendimentos</td>
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<td>1997</td>
<td>Acquired all shares of Banco Ramercindus do Brasil &amp; renamed Banco Itau Europa Luxembourg</td>
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<tr>
<td>1997</td>
<td>Acquired 95.97% holding in Itau Seguros from parent Co Itausa Investimentos Itau</td>
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<tr>
<td>1997</td>
<td>Acquired 99.97% holding in Banco Banerj at privatization auction</td>
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<tr>
<td>1997</td>
<td>Increased holdings in Itau Providencia e Seguros e Administradora de Bens</td>
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<td>1997</td>
<td>Established AESA Administracao e Participacoes</td>
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<td>1997</td>
<td>Dissolved subsidiary Comanha Bancredit Servicos de Vigilancia</td>
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<td>1998</td>
<td>Established Banerjcard Administradora de Cartoes de Credito</td>
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<td>1998</td>
<td>Sold part of of its participation in Banco Itau Europa Luxembourg to Itausa Portugal</td>
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<td>1998</td>
<td>Acquired at privatization auction 90.74% share of Banco do Estado de Minas Gerais</td>
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<td>1998</td>
<td>Acquired Banco del Buen Ayre</td>
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<td>1999</td>
<td>Acquired Intrag Distribuidora de Titulos e Balcoes Mobiliarios</td>
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<td>1999</td>
<td>Subsidiary Banco Itau Argentina merged Banco del Buen Ayre into its operations</td>
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<tr>
<td>2000</td>
<td>Sold Duraflora</td>
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<td>2000</td>
<td>Acquired 88.04% interest of Banco Banestado</td>
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<tr>
<td>2000</td>
<td>Sold Union Carbide do Brasil</td>
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<tr>
<td>2000</td>
<td>Subsidiary Itau Corretora de Valores acquired 100% interest in Co's outstanding share capital</td>
</tr>
<tr>
<td>2000</td>
<td>Debts of R$4,264,985,000 from international &amp; domestic sources</td>
</tr>
</tbody>
</table>
Figure 2

Evolution of the Tata Group: 1900-2003

Year Entered

1874 Textiles
1902 Hospitality
1907 Steel
1912 Cement
1931 Printing/Magazine Publishing
1932 Aviation
1940 Chemicals
1950 Commercial Vehicles & Locomotives
1954 Air-Conditioning
1952 Consumer Electronics
1982 Cosmetics
1963 Pharmaceuticals
2001 Textiles
2003 Cement
2003 Printing/Magazine Publishing
2009 Insurances
2010 Telecommunications
2010 Watches & Financial Services
2010 Auto Components
2009 IT
2009 Commercial Vehicles & Locomotives
2009 Soaps & Toiletries
2009 Passenger Cars

Year Exit

1870 Textiles
1880 Textiles
1890 Hospitality
1900 Power
1910 Soaps & Toiletries
1930 Printing/Magazine Publishing
1932 Aviation
1950 Chemicals
1950 Commercial Vehicles & Locomotives
1954 Air-Conditioning
1952 Consumer Electronics
1952 Cosmetics
1952 Pharmaceuticals
2001 Textiles
2001 Cement
2003 Printing/Magazine Publishing
2009 Insurances
2010 Telecommunications
2010 Watches & Financial Services
2010 Auto Components
2009 IT
2009 Commercial Vehicles & Locomotives
2009 Soaps & Toiletries
2009 Passenger Cars

Source: Bombay House, Tata Group, Jan 2004