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Business groups in emerging markets: the Chilean experience

By **Francisco Urzúa Infante**

Business groups are sets of companies managed by the same controlling shareholder, often a family. Both from the finance literature and day-to-day commercial life, we know that business groups can be a force for good. This statement is fundamentally true. The statement that business groups might have a negative impact on their environment, however, is also fundamentally true.

These apparently contradictory truths became clear during the research undertaken for *Do Business Groups Change with Market Development?*, a paper which I co-wrote with Borja Larrain of the Pontificia Universidad Católica de Chile. We set out to test the hypothesis that business groups should be more common in economies with less developed markets and institutions, which we explore using Chilean data.

We limited ourselves to for profit organisations, but business groups are also involved in non-governmental organisations (NGOs) and other not for profit enterprises. For instance, leading Chilean groups support many NGOs. This is hardly something unique to Chile, as Hyundai (Korea) has an applied research institute and Turkey has two universities founded by business groups (Koc and Sabanci).

Also interestingly, even though we study Chilean groups, what we learn sheds light into the development of groups in many other countries. This comes as no surprise given how common business groups are around the world. In Europe one can easily think of the Wallenberg (Sweden) and Agnelli families (Fiat), the Quandts (BMW) in

Germany and Maersk (Denmark) to name just a few. From Asia, maybe the most famous is Samsung.

A dichotomy

There is an obvious dichotomy and a broad range of shades between business groups being good or bad. The stark reality is that business groups are either good or bad depending on the setting. In conducting the research for our paper and to understand them properly as a species, we set out to venture beyond the obvious distinctions and to comprehend such key strands in the corporate DNA as their history, industrial strategy, shareholder make-up as well as their ownership and financial structures.

All have a role to play. The existence of a pyramidal structure of ownership, for instance, can often create divergences of interest between shareholders. This in turn can lead to abuses of power. The behaviour of the late disgraced Robert Maxwell in running his printing and publishing group in the UK in the 1980s and early 1990s might easily be cited as an example of that country's worst corporate behaviour in recent years. It was only after he was

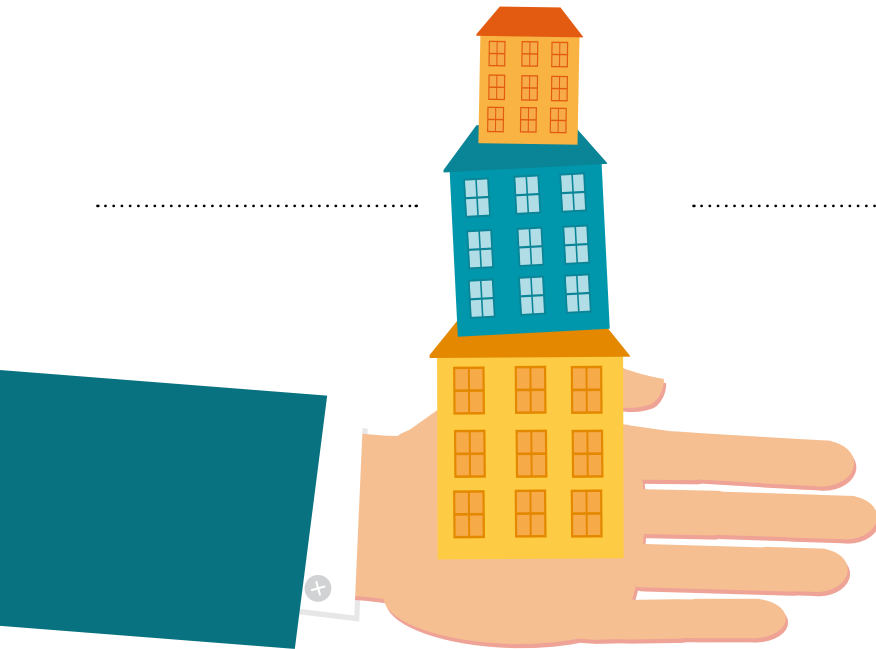
found dead in the sea on 5 November 1991, having disappeared from his yacht off the Canary Islands, that the full extent of his corporate abuse became apparent.

Building a detailed awareness of these key attributes is essential to understand the development of a business group. While it is often said as a cautionary warning in the investment world that past performance is no guarantee of future performance, the structure of Chilean business groups is remarkably stable. Our results show that, despite the changes that Chile experienced in the two decades under examination (1990-2009), business groups are very similar to what they were in 1990. And although there are some changes, most changes in group characteristics do not appear to be systematic (ie, correlated with market dynamics).

The sole exception to the stability of group structure is leverage, which increased significantly from an average of 30 per cent in 1990 to 44 per cent in 2009. This overall increase in leverage is explained by old groups increasing leverage, and not simply by new groups being formed with higher leverage. In common with the prevailing trend elsewhere, business groups took advantage of the expansion of domestic credit by funding more of their operations with debt. This is perhaps broadly analogous to the involvement of the private equity industry in commerce in more highly developed countries.

Relevant lessons

Are there lessons to be learnt that are



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of relevance to international business activity beyond the confines of South America? I believe the answer is yes. Some conclusions are in fact virtually irresistible. Whatever the geographical location or the perceived inherent goodness or badness of a business group, there are clearly a number of key issues that differentiate the successful from the unsuccessful.

Keeping costs down and running the business efficiently are two that spring unbidden to mind. Focusing on the quality of the product is another. Initiating and cultivating good, lasting and productive relationships with politicians and other people of influence is a third. Unfortunately, this last aspect can easily and quickly degenerate into out and out bribery of politicians and people of influence involved, which, of

course, will not be tolerated in some countries. The words legal, decent, honest and truthful are immediately linked to a company's name, even if in most cases it is doing no more than playing the local rules to maximise its position.

Our research shows, inter alia, that a number of business groups in Chile have been extremely successful in this context over the past 20 years, growing export-oriented commodity businesses and establishing subsidiaries elsewhere in South America, Europe and the US. In the traditional business models, the cheapness and quality of their product have typically mattered more than almost any other aspect of commerce.

Such an approach to business will, however, take Chilean business groups only so far, and at some point a decision will have to be taken that will

set the path to the next stage of development. When that point arrives, the challenge becomes how to replicate their success with commodity and price with cutting-edge innovation and value-added products. In this context, stability and persistence can only grow in importance for the success of any business group. ■

This article draws its inspiration from the paper *Do Business Groups Change with Market Development?*, written by Borja Larrain and Francisco Urzúa Infante, and published in the *Journal of Economics and Management Strategy*, 25 (3), 750-784. DOI: <http://dx.doi.org/10.1111/jems.12165>

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