Academy of International Business

INSIGHTS

Vol. 19, No. 2, 2019

Special Issue on Latin America

Multilatinas and International Business Studies
Alvaro Cuervo-Cazurra
p3

Innovation in Emerging Markets: The Case of Latin America
Emerging Multinationals Research Network (EMRN)
Lourdes Casanova, Fernanda Cahen, Anne Miroux, Diego Finchelstein, Anabella Davila, Juana García, Veneta Andonova, Moacir Miranda de Oliveira Jr.
p8

Corporate Governance in Latin America: Towards Shareholder Democracy
Ruth V. Aguilera, Rafel Crespí-Cladera, Luiz Ricardo Kabbach de Castro
p13

The Dominance of Pyramidal Business Groups in Latin America Persists
Susan Perkins
p18

The Importance of Institutional Knowledge for Expats Working in Latin America
Daniel Friel
p22

An official publication of the Academy of International Business

LETTER FROM THE EDITORS

John Mezias, Editor

William Newburry, Associate Editor

Welcome to *AIB Insights* 19(2), which focuses on Latin America. Bill served as Chair of the AIB Latin America Chapter (AIB-LAT) from 2012 to 2018, and his experience has guided this issue. We present five interesting articles that overview topics important to managers and academics in the region, but that also have broad applicability across emerging markets.

Before highlighting the individual articles, we provide some background on AIB-LAT. This chapter's first full meeting was a one-day pre-conference event before the 2010 AIB Meeting in Rio de Janeiro. Its first stand-alone meeting was in Miami in 2012, followed by Puebla, Mexico (2013), Medellin, Colombia (2014), Santiago, Chile (2015), São Paulo, Brazil (2016), Lima, Peru (2017), Buenos Aires, Argentina (2018), and Cochabamba, Bolivia (2019). Over 500 unique individuals have attended these meetings, with many attending multiple times. Recognizing the importance of the Caribbean to this chapter, AIB-LAT's 10th meeting will be in Trinidad and Tobago, with an expanded two-day pre-conference (March 11-12) in Tobago and a two-day main conference (March 13-14) in Trinidad. The chapter is also changing its name to the AIB Latin America and the Caribbean Chapter (AIB-LAC).

Our first article, by Alvaro Cuervo-Cazurra, sets the stage for the issue by providing a historical overview of Latin American development, and how it has resulted in common characteristics across the region that make it ripe for comparative study. The article then highlights four areas where *multilatinas* (multinationals headquartered in Latin America) may provide an excellent sample to examine the impact of home-country conditions on firm internationalization. These issues are important for both academics and practitioners alike.

The second article, by Lourdes Casanova and colleagues, examines innovation in emerging markets, with a particular focus on Latin America. This network of authors spans the Latin American countries of Argentina, Brazil, Colombia, and Mexico, and this article developed through conversations at several prior AIB-LAT conferences. They discuss drivers of innovation, types of innovation, and innovation outcomes. While anchored in the Latin American context, insights from this article also have broad applicability to emerging market practitioners and academics.

The next two articles address corporate governance issues prevalent in the Latin American context. The article by Ruth Aguilera, Rafel Crespí-Cladera and Luiz Ricardo Kabbach de Castro examines the phenomenon of dual-class shares within Latin America. They highlight how this practice jeopardizes shareholder democracy, and provide comparisons across five Latin American countries (Brazil, Chile, Colombia, Mexico and Peru), along with the US, Europe, and high income OECD countries. Susan Perkins' article examines ownership concentration in Latin America and its relationship to pyramidal business groups. She observes huge differences between ownership concentration amongst the largest three stakeholders (above 45% for seven countries examined) when compared to the UK (19%) and US (20%). She then highlights the case of the Brazilian BOVESPA (Latin America's largest stock exchange) and how reforming "rules of the game" provides insights into the newly created Mercado Latinoamericano (MILA) across Colombia, Chile, Peru, and Mexico and other regional stock exchanges.

Our fifth article by Daniel Friel, examines how institutional differences can hinder transfer of best practices to subsidiaries. He compares Argentinian and Brazilian operations of Argentinian farm management company Los Grobo and French food products corporation Danone to demonstrate how different institutionalized expectations, even across neighboring countries, affects transfer of best practices.

Once again, we hope you enjoy this issue and look forward to seeing many of you at the 2019 AIB Meeting in Copenhagen!

Multilatinas and International Business Studies

Alvaro Cuervo-Cazurra, Northeastern University, USA

Introduction

Multilatinas, i.e., multinational firms originating in Latin America, are increasingly playing a dominant role in global business. In the last three decades, many evolved from exporters to become regional leaders in the Americas, like Mexican telecommunications firm América Movil or Argentinean candy producer Arcor. Some have even become global leaders, like Brazilian airplane manufacturer Embraer, Argentinean steel tube maker Techint, or the Mexican cement producer Cemex. However, many *multilatinas* are little known outside their region, or even within it. One reason is their strategies. Many serve other companies rather than final consumers, and those operating in consumer goods tend to hide their country of origin and use foreign brands in their international expansion. Another reason is limited attention among researchers.[1] Much of the interest in multinationals from emerging markets has concentrated on firms from the so-called BRIC countries (Brazil, Russia, India, China) even though the vast differences among these nations hamper meaningful comparisons.

This lack of knowledge on *multilatina* strategies is a missed opportunity. It is not just because they are an exciting and increasingly important phenomenon. It is because *multilatinas* can help us understand the influence of the home country on firms' internationalization in ways that cannot be achieved by examining firms elsewhere. Latin American countries share deep cultural, economic, and political historical commonalities, unlike nations in other emerging regions, such as Africa, Asia, or Eastern Europe. These commonalities enable academics to understand better which and how country characteristics affect firms' internationalization.[2] Such knowledge is also important for managers because lessons derived from the study of the internationalization of *multilatinas* in one country might be highly valuable in others given the similarities in home country conditions; insights from firms in other regions may be of little applicability given the large differences among home countries.

Commonalities across Latin America

The historical evolution of Latin American countries has resulted in many commonalities that shaped firm strategies. The colonial period, starting in the 15th century, led to considerable similarities in socio-cultural development. The colonial powers (Spain, Portugal, and France) imposed a hierarchical social structure with an embedded preference for European descendants; a civil law legal tradition; a bureaucratic and centralized state structure; Romance languages that have mostly superseded indigenous ones; Catholicism; and a system of natural resource extraction that exploited natives and imported slaves, among other factors. Firms were unsophisticated, dedicated to exporting commodities to their colonial power and dependent on the import of sophisticated products from it.

The post-independence period, beginning in the early 19th century, reinforced commonalities among countries and resulted in inward-looking firms. Politically, newly independent countries followed a cycle of democratic governments, which mostly represented the wealthy, followed by military dictatorships, and then return to civilian rule. This cycle reinforced weak institutions and exclusion of the poor and non-whites, leading to internal conflicts and violent military rulers in the 20th century. Economically, Latin America developed by exploiting commodities and open markets. However, after the first third of the 20th century, governments generally adopted an import substitution economic model, imposing barriers against foreign goods and firms, taking an active role in industrialization,

creating state-owned firms, and providing protected markets for local producers. This resulted in companies that were not internationally competitive and focused on serving the domestic market. Firms with government connections enjoyed financial and regulatory support that led to industry diversification and the emergence of business groups.

The last third of the 20th century witnessed a deep economic and political opening that led to the internationalization of firms. Import substitution was replaced with pro-market reforms, starting in the 1970s and deepening in the 1990s. The oil shocks of the 1970s and unsustainable government borrowing created a deep economic crisis in the 1980s, known as the "lost decade," that led to hyperinflation and sharp rises in poverty. To address this, in the 1980s and 1990s governments implemented profound economic transformations by following the so-called Washington Consensus program of pro-market reforms. Governments privatized state-owned firms, deregulated industries and international trade and investment, and liberalized prices. In parallel, in the 1980s Latin American countries underwent a democratic transformation. Military rulers were ousted as they proved inept at managing the economic crisis, while the US withdrew support for dictatorships and promoted democracy as the Cold War ended. As a result, the 1990s became a golden decade. Latin American countries experienced substantial and sustained economic growth and reductions in poverty through trickle-down economics and active social redistribution programs. Companies that managed to adapt and survive the economic transformation, and newly created firms, were much more competitive. Their exposure to imports and foreign competitors forced them to upgrade their capabilities, which enabled some of them to reach international levels of competitiveness and expand abroad.

By the 21st century, Latin American economies had reached middle-income status, and their firms were increasingly globalized. In the 2000s, doubts about the success of pro-market reforms and some short-lived crises led some newly-elected leftist governments to increase economic controls. However, by the late 2010s, most Latin American countries had not only entrenched democracies but also demanding citizens that supported the active prosecution of corruption among the political and business elite, stable economies with sensible macroeconomic policies, vanishing armed conflicts, and growing middle classes. Firms improved their capabilities and started processes of indigenous innovation. Many saw international markets as a viable avenue for additional growth and scale, and some ventured not only into neighboring countries but farther, achieving global player status.

Statistics echo these historical commonalities among Latin American countries and sharp differences among other economies. Tables 1 and 2 provide indicators of the social and economic conditions of Latin American countries, the other BRICS emerging countries, and the leading advanced economies.

There are significant socio-cultural resemblances among Latin American countries, such as common language, racial distribution, dominant religion, and urbanization. Countries show economic similitudes such as relatively high average income for emerging economies, openness to international trade, and intra-region main trading partners. Outward foreign direct investment tends to concentrate in the region, but much of the inward foreign direct investment comes from advanced countries with historical ties, USA and Spain, as well as neighboring countries.

In contrast, countries in other regions show vast differences. The traditionally analyzed BRICS countries have little in common, other than their selection by the consulting firm BCG as countries of the future. They differ in socio-cultural structure, as well as political and economic systems, and their international trade and investment partners show remarkable diversity, except for one unusual commonality: probable round-tripping of foreign direct investment, given that offshore financial centers (Hong Kong and the British Virgin Islands for China, Mauritius for India, and Cyprus and the Netherlands for Russia) are both the source and destination of much foreign direct investment. Advanced economies also have limited similarities, other than high development levels and stable democracies; they are different in socio-cultural characteristics, legal and colonial history; and show a remarkable variety in their international trade and investment patterns. A similar conclusion can be arrived at when studying characteristics of firms in other emerging regions, like Africa, Asia, or Eastern Europe.

Multilatinas and International Business Models

This comparison highlights how historical commonalities among Latin American countries can help understand better the influence of home country conditions on firm internationalization. The similarities act as an implicit control of country characteristics that cannot be achieved in other regions. I now outline four suggestions on how to do this.

First, geographically, *multilatinas* are a natural laboratory for studying how the geographic distance to a sizeable advanced market affects country selection in internationalization. The traditional incremental internationalization process model proposes that firms will expand to nearby countries first and then to more distant countries later. However, *multilatinas* can select between expanding into nearby countries that are very similar to their home country but offer fewer market opportunities, or expanding into the US that is different from their home market but a much larger potential market. Distance to the US, ranging from bordering Mexico to far away Chile and Argentina, can help discern better the role of geographic distance in international trade and investment decisions.

Table 1. Comparison of demographic characteristics of Latin American and selected countries

Country	Population, mn	Ethnic groups (% total), top 3	Main language (% spoken at home)	Religion (% total), top 3 above 5%	Urbanization, %	Life expectancy, years	Literacy, % over 15 yrs. old
Latin America							
Argentina	45	White/Mestizo (97), Amerindian (2), Black (0.4)	Spanish	Catholic (92)	91	78	99
Bolivia	11	Mestizo (68), Amerindian (20), White (5)	Spanish (61)	Catholic (77), Evangelical (8), Protestant (8)	69	70	93
Brazil	209	White (48), Mulatto (43), Black (8)	Portuguese	Catholic (70), Protestant (22)	87	74	92
Chile	18	White/Mestizo (89), Amerindian (11)	Spanish (100)	Catholic (67), Protestant (16)	88	79	97
Colombia	48	Mestizo/White (84), African/Mulatto (10), Amerindian (3)	Spanish	Catholic (79), Protestant (14)	81	76	94
Costa Rica	5	White/Mestizo (84), Mulatto (7), Amerindian (2)	Spanish	Catholic (72), Evangelical/ Pentecostal (12)	79	79	98
Cuba	11	White (64), Mulatto/Mixed (27), Black (9)	Spanish	Christian (59), Folk (17)	77	79	100
Dominican Republic	10	Mixed (70), Black (16), White (14)	Spanish	Catholic (95)	81	71	94
Ecuador	16	Mestizo (79), Amerindian (7), White (6)	Spanish (93)	Catholic (74), Evangelical (10)	64	77	94
El Salvador	6	Mestizo (86), White (13), Amerindian (0.2)	Spanish	Catholic (50), Protestant (36)	72	75	88
Guatemala	17	Mestizo/White (60), Amerindian (39)	Spanish (69)	Catholic, Protestant, Indigenous	51	72	82
Haiti	11	Black (95), Mixed/White (5)	French & Creole	Catholic (55), Protestant (29)	95	78	99
Honduras	9	Mestizo (90), Amerindian (7), Black (2)	Spanish & Amerindian	Catholic (46), Protestant (41)	57	71	89
Mexico	126	Mestizo (62), Amerindian (28), White (10)	Spanish (93)	Catholic (83), Evangelical (5)	80	76	95
Nicaragua	6	Mestizo (69), White (17), Black (9)	Spanish (95)	Catholic (50), Evangelical (33)	59	74	83
Panama	4	Mestizo (65), Amerindian (12.3), Black (9)	Spanish	Catholic (85), Protestant (15)	68	79	95
Paraguay	7	Mestizo (95)	Spanish & Guarani (46)	Catholic (90), Protestant (6)	62	78	95
Peru	31	Mestizo (60) Amerindian (26), White (6)	Spanish (83)	Catholic (60), Evangelical (11)	78	74	94
Uruguay	3	White (88), Black (5), Amerindian (2)	Spanish	Catholic (47), Non-denominational (23), Non-Catholic Christian (11)	95	78	99
Venezuela	32	n.a.	Spanish	Catholic (96)	88	76	97
Emerging economies							
China	1385	Han Chinese (92), Zhuang (1)	Chinese	Folk (22), Buddhist (18), Christian (5)	59	76	96
India	1297	Indo-Aryan (72), Dravidian (25), Mongoloid (3)	Hindi (44)	Hindu (80), Muslim (14)	34	69	71
Russia	142	Russian (78), Tatar (4), Ukrainian (1)	Russian (86)	Russian Orthodox (17), Muslim (13)	74	66	99
South Africa	55	Black (81), Colored (9), White (8)	IsiZulu (25)	Christian (86), Traditional (5)	66	64	94
Advanced economies							
France	67	n.a.	French (100)	Christian (65), Muslim (8)	80	82	100
Germany	81	German (87), Turkish (2), Polish (1)	German	Catholic (28), Protestant (26), Muslim (5)	77	81	100
Japan	126	Japanese (98), Chinese (0.5), Korean (0.4)	Japanese	Shinto (70), Buddhist (70)	92	86	100
United Kingdom	65	White (87), Black (3), Asian (2)	English	Christian (60)	83	81	100
United States	329	White (72), Black (13), Asian (5)	English	Protestant (47), Catholic (21)	82	80	100

Source: Created using information from CIA (2019). Figures rounded from the original.
Note: n.a. not applicable/available. Latin American countries are independent countries that were former Spanish, Portuguese, and French colonies.

Table 2. Comparison of economic characteristics of Latin American and selected countries

Country	GDP, PPP US$ bn	GDP, US$ bn	GDP per capita PPP, US$ th	Imports, US$ bn	Imports (% total), top 3	Exports, US$ bn	Exports (% total), , top 3	Inward FDI stock, US$bn	Inward FDI stock (% total), top 3	Outward FDI stock, US$ bn	Outward FDI stock (% total), top 3
Latin America											
Argentina	922	674	21	64	Brazil (27), China (19), USA (11)	58	Brazil (16), USA (8), China (8)	77	Spain (20), USA (19) , Netherlands (9)	41	Uruguay (55), Chile (39), Mexico (13)
Bolivia	84	38	8	9	China (22), Brazil (17), Argentina (13)	8	Brazil (18), Argentina (16), USA (8)	12	Spain (30), Brazil (12), UK (11)	1	Argentina (79), Peru (13), Bangladesh (5)
Brazil	3248	2055	16	153	China (18), USA (17), Argentina (6)	217	China (22), USA (13), Argentina (8)	778	Netherlands (29), USA (15), Spain (11)	359	Austria (21), Cayman Is. (16), Netherlands (11)
Chile	452	277	25	61	China (24), USA (18), Brazil (9)	69	China (28), USA (15), Japan (9)	206	Spain (18), USA (16), Canada (9)	124	Argentina (18). Brazil (17), Peru (13)
Colombia	712	315	14	44	USA (26), China (19), Mexico (8)	9	USA (29), Panama (9), China (5)	180	Spain (31), USA (24), Mexico (14)	56	Chile (35), Panama (33), Peru (13)
Costa Rica	84	58	17	15	USA (38), China (13), Mexico (7)	11	USA (41), Belgium (6), Panama (6)	34	USA (61), Spain (7), Mexico (5)	4	USA (61), Spain (7), Mexico (5)
Cuba	137	94	12	11	China (22), Spain (14), Russia (5)	3	Venezuela (18), Spain (12), Russia (8)	n.a.	n.a.	4	n.a.
Dominican Republic	173	76	17	18	USA (41), China (14), Mexico (5)	10	USA (51), Haiti (9), Canada (8)	37	Mexico (40), Spain (23), USA (22)	1	Panama (55), USA (20), Argentina (20)
Ecuador	193	104	12	19	USA (23), China (15), Colombia (9)	19	USA (32), Vietnam (8), Peru (7)	17	Spain (42), Mexico (23), USA (19)	6	Panama (40), Peru (34), USA (11)
El Salvador	51	25	8	10	USA (37), Guatemala (11), China (9)	5	USA (46), Honduras (14), Guatemala (14)	10	USA (32), Panama (29), Mexico (10)	1	Nicaragua (88)
Guate-mala	138	76	8	17	USA (40), China (11), Mexico (11)	11	USA (34), El Salvador (11), Honduras (9)	16	USA (29), Mexico (17), Colombia (9)	n.a.	Panama (31), Bahamas (31), Barbados (30)
Haiti	78	59	2	9	China (20), Brazil (20), Argentina (13)	11	China (19), Brazil (16), USA (6)	45	USA (80), Italy (13), Korea (7)	20	n.a.
Honduras	46	23	6	11	USA (40), Guatemala (11), China (9)	9	USA (35), Germany (9), Belgium (8)	8	USA (23), Mexico (16), UK (14)	0	Costa Rica (43), El Salva-dor (42), Colombia (11)
Mexico	2463	1151	20	421	USA (46), China (18), Japan (4)	410	USA (80)	554	USA (55), Spain (12), Netherlands (10)	244	USA (33), Brazil (17), Spain (13)
Nicaragua	36	14	6	7	USA (21), China (14), Mexico (11)	4	USA (44), El Salvador (6), Venezuela (6)	1	Mexico (58), USA (36)	1	Panama (90), Mexico (7), Poland (4)
Panama	104	62	25	22	USA (24), China (10), Mexico (5)	16	USA (19), Netherlands (17), China (7)	57	USA (18), UK (13), Colombia (10)	11	Chile (27), El Salvador (18), Turkey (17)
Paraguay	89	39	13	11	China (31), Brazil (23), Argentina (13)	12	Brazil (32), Argentina (16), Chile (7)	6	USA (50), Brazil (14), Argentina (8)	1	Uruguay (86), Argentina (17), South Africa (8)
Peru	430	214	14	39	China (22), USA (20), Brazil (6)	45	China (27), USA (15), Switzerland (6)	98	Spain (19), USA (14), UK (20)	5	Chile (30), USA (22), Panama (17)
Uruguay	78	59	22	9	China (20), Brazil (20), Argentina (12)	11	China (19), Brazil (16), USA (6)	45	Argentina (27), Brazil (8), Spain (7)	20	Argentina (40), Spain (37), Italy (7)
Venezuela	382	210	13	11	USA (25), China (14), Mexico (10)	32	USA (35), India (18), China (16)	33	Netherlands (17), USA (16), France (7)	35	USA (70), Spain (19), Panama (8)
Emerging economies											
China	23210	12010	17	1740	South Korea (10), Japan (9), USA (9)	2216	USA (19), Hong Kong (12), Japan (6)	1523	Hong Kong (44), British Virgin Is. (10), USA (7)	1383	Hong Kong (58), British Virgin Is. (6), Cayman Is. (6)
India	9474	2604	7	452	China (16), USA (6), UAE (5)	304	USA (16), UAE (10), Hong Kong (5)	378	Mauritius (27), UK (16), USA (15)	155	Singapore (27), Mauritius (16), Netherlands (14),
Russia	4016	1578	28	238	China (21), Germany (11), USA (6)	353	China (11), Netherlands (10), Germany (7)	535	Cyprus (30), Neth-erlands (12), British Virgin Is. (10)	471	Cyprus (37), Netherlands (16), British Virgin Is. (12)
South Africa	767	349	14	89	China (18), Germany (12), USA (7)	95	China (10), USA (8), Germany (7)	157	UK (46), Netherlands (19), USA (7)	270	China (18), UK (16), Mauritius (10)

Advanced economies										
France	2856	2588	44	602	Germany (19), Belgium (109), Netherlands (8)	550	Germany (15), Spain (8), Italy (8)	858	Netherlands (17), Luxembourg (13), Belgium (13)	1429	USA (15), Belgium (14), Netherlands (12),
Germany	4199	3701	51	1135	Netherlands (14), China (7), France (7)	1434	USA (9), France (8), China (7)	1653	Netherlands (24), Luxembourg (14), USA (9)	2298	USA (22), UK (10), Netherland (7)
Japan	5443	4873	43	645	China (25), USA (11), Australia (6)	689	USA (20), China (19), South Korea (8)	253	USA (30), Netherlands (15), France (9)	1547	USA (28), Netherlands (9), China (9)
United Kingdom	2925	2628	44	616	Germany (14), USA 910), China (9)	441	USA (13), Germany (11), France (7)	2078	USA (29), Netherlands (15), France (9)	2110	USA (19), Luxembourg (13), Netherlands (12)
United States	19490	19490	60	2361	China (22), Mexico (13), Canada (13)	1553	Canada (18), Mexico (16), China (8)	4080	UK (18), Japan (12), Netherlands (10)	5711	Netherlands (15), UK (13), Luxembourg (9)

Source: Created using information from CIA (2019) and UNCTAD (2019). Figures rounded from the original.
Note: n.a. not applicable/available. Latin American countries are independent countries that were former Spanish, Portuguese, and French colonies.

Second, politically, studies of Latin American multinationals can enable new insights on the internationalization of state-owned firms and the role of government in their globalization.[3] Latin American governments have a wide range of influence on the economy, from the hands-off approach in Chile to interventionism in Brazil to full control in Cuba. There are important state-owned firms in all these countries, and some of them have become significant international players, such as Chilean miner Codelco or Brazilian oil producer Petrobras. Given that much literature on the topic still examines firms from one home country, studying state-owned *multilatinas* can help better understand the influence of diversity in government attitudes toward state-owned firms and their global strategies.

Third, economically, the diversity in development and size of Latin American economics can yield novel comprehension of the impact of the economy on firm competitiveness. Firms that emerge in sizable countries gain an international advantage from achieving minimum efficient scale in their home market. Analyzing *multilatinas* can help refine such argument. For example, among the largest 500 firms in Latin America listed by the magazine *AméricaEconomía*,[4] 192 are from Brazil and 122 from Mexico as expected since these are the largest Latin American countries. However, there are 69 firms from Chile, 41 from Argentina, 31 from Colombia, and 28 from Peru. A similar surprise emerges when analyzing the *multilatinas* among the 500 largest firms. There are 40 from Mexico and 32 from Brazil, followed by 14 from Chile, 9 from Colombia, 6 from Argentina, and 5 from Peru. This ordering is unusual given that Chile is a much smaller country, prompting a rethinking of the effect of home country size on competitiveness and internationalization.

Fourth, socially, diversity in human development across countries can help better understand the role of the home country on the development of innovations among *multilatinas*. Interest in understanding strategies for the base of the (economic) pyramid emerged from the experience of firms in India, which served extremely poor customers. Instead of a large base of the pyramid, Latin American countries have a significant and growing middle of the pyramid. These new middle classes enjoy disposable income and seek aspirational products with better quality and features but still at low prices. *Multilatinas* have responded by innovating their offerings to meet such needs, such as providing medical services and generic drugs together like Mexican pharmacy chain Farmacias Similares. Such experiences help conceptualize the drivers of innovations for poor customers.

Conclusions

Multilatinas are a newish set of global competitors that have received relatively little attention in comparison to multinationals from other emerging countries. This is unfortunate not only because these firms are increasingly becoming global challengers to established firms and deserve better attention, but also because their study can help reveal new insights into the impact of the home country on global strategy in ways that are unavailable from studying firms from other regions. The commonalities among countries in Latin America help compare the experiences of firms from multiple countries, while the variation in particular home country dimensions facilitates identifying the influence of such dimensions on firms' internationalization. Managers of *multilatinas* can derive insights that are more useful by learning from the experiences of similar countries and avoid imitating strategies of firms in very different emerging markets, no matter how successful those firms have become and how much the press and consultants promote them. Academics can play a leading role in providing relevant insights by developing educational materials that reflect the realities of the region, rather than assuming that lessons from firms in advanced economies or the largest emerging economies have universal applicability.

continued on page 17

Innovation in Emerging Markets: The Case of Latin America

Emerging Multinationals Research Network (EMRN)
Lourdes Casanova, Cornell University, USA
Fernanda Cahen, University of Southern California, USA, and Centro Universitario FEI, Brazil
Anne Miroux, Cornell University, USA
Diego Finchelstein, Universidad de San Andrés/Conicet, Argentina
Anabella Davila, Tecnológico de Monterrey, Mexico
Juana García, Universidad de los Andes, Colombia
Veneta Andonova, Universidad de los Andes, Colombia
Moacir Miranda de Oliveira Jr., Universidade de São Paulo, Brazil

Introduction

In the past 15 years, emerging markets have come to represent about half of global Gross Domestic Product (GDP). Led by China, they have made gains in economic development as well as political influence; in turn, their companies have taken on a new level of importance in driving innovation, local development, and global competition (Casanova & Miroux, 2018). Thus, we discuss the drivers, types and outcomes of innovation in emerging markets, with a focus on Latin America. The Emerging Multinationals Research Network (EMRN) has undertaken a number of case studies, collaborations with the Emerging Markets Institute (EMI), and a survey-based research study on this issue, building on discussions at AIB-LAT conferences in Santiago de Chile (2015), São Paulo (2016), Lima (2017) and Buenos Aires (2018). This work on innovation is being compiled in a forthcoming book by Cambridge University Press entitled *From Copycat to Leaders: Innovation from Emerging Markets*. This article sets out some of the issues to be dealt with in the forthcoming book (Cahen, Casanova, & Miroux, 2019).

From the turn of the century to 2015, Latin America has witnessed a profound economic and social transformation, which has significantly impacted the creation and flow of technology as well as innovation in the region. Pro-market reforms and a decade of economic growth has fostered the expansion of consumer markets and elevated most economies to middle and upper-middle-income status. This scenario ushered in a business environment increasingly attractive for multinational companies. It also contributed to the rise of Latin American multinationals – *multilatinas* (Andonova & Losada-Otalora, 2017).

Following a decline in commodity prices and corruption scandals, market turbulence in Argentina, recession in Brazil, and a continued political deterioration in Venezuela, economic growth in the region slowed down between 2016-2018. The region grew by 0.6% in 2018 and is expected to grow 1.6% in 2019. Despite these challenges, certain areas in Latin America have developed a business-friendly environment with resilient ecosystems that seem to resist the political and economic instability (Oliveira Jr., Cahen & Borini, 2019). Examples include the São Paulo state in Brazil in banking, information technology (IT) and aeronautics; Guadalajara in Mexico in IT; Santiago in Chile in knowledge intensive services; or Bogotá and Medellín in Colombia in banking and services. Some *multilatinas* have become global innovative leaders, such as the

bus manufacturer Marcopolo, and cosmetics company Natura from Brazil, building materials firm Cemex, bakery manufacturer Grupo Bimbo and IT company Softtek from Mexico (Casanova, 2009), steel manufacturer Techint and ecommerce firm MercadoLibre from Argentina, and LATAM airlines from Chile.

Typically, many of these companies have played a modest role in global innovation, but some have been successfully developing their own capabilities on this front (Amann & Cantwell, 2012). These include large *multilatinas* that have been thriving amidst global competition, but also an increasing number of innovative entrepreneurial companies and digital unicorns (as of 2019 there are around ten in the region, nine of them in technology). Increasing connectivity, brought about by internet dissemination and mobile telephony, has fostered unprecedented business opportunities for innovative small companies in e-commerce, digital services, and digital platforms (Cahen & Oliveira Jr., 2018).

Drawing on examples from Latin America, this article explores how innovation contributes to the region's economic growth. It features new types, mechanisms and conditions for innovation: the relevance of the institutional environment, the impact of innovation on social development, and the "catch-up" dynamics in the region.

From Copycat to Leaders: Innovation from Emerging Markets

Prominent studies on innovation have typically focused on technology-driven and R&D-based innovation, analyzing mostly patent applications and intellectual property. Such studies essentially have been based on the experiences of multinationals from developed countries (DMNEs). Traditionally, DMNEs first developed and commercialized innovations at home and in a second stage set up subsidiaries to introduce them in emerging countries. Over the last two decades, however, the origin and direction of innovation flows has significantly changed, with many examples of products first introduced in emerging countries.

The literature on innovation does not discuss much the particular drivers and agents of innovation in emerging markets. For example, R&D-based innovation in developed countries tends to rely heavily on the private sector; however, the private sector in emerging markets faces significant financial and institutional constraints. Hence, the public sector, and sometimes the military, play a key role in this type of innovation despite small public budgets. In some cases, state-owned firms and agencies are a key driver in R&D and innovation. In addition, the success of innovative companies often also depends on the efforts of other innovators and on relationships with other actors (such as research institutions, governments, etc.) within their innovation ecosystems.

In emerging markets, fast economic growth and integration into the global economy often coexist with institutional voids, limited public spending, poor governance, corruption, poverty, and inequality. This context leads to alternative drivers of innovation. For instance, the Argentine software developer Globant took advantage of the high-quality of human capital available in the country and the conditions prevailing in the country in the wake of a large economic crisis to build one of the most dynamic unicorns in the region. Likewise, driven by the need to answer the basic needs of the population in resource-scarce societies, companies, mainly from Asia as well as Latin America and Africa, have been developing new products and services that are considerably less expensive than in developed countries. A variety of terms have been coined to date to refer to such innovations like low-cost, frugal, social, and bottom-of-the-pyramid innovation, etc.

Most studies exploring innovation in emerging markets describe a very incipient process based on imitation (copycats) with only a few more sophisticated organizational capabilities pointing at organic innovation. In our analysis, we follow the broad (and relatively widely accepted) definition of innovation that includes not only technology and R&D-based innovation but also new organizational and production processes and business models. We pay particular attention to knowledge transfers from emerging economies (reverse innovation), and new types of innovation such as frugal innovation.

Based on the literature, our framework of analysis (see Figure 1) establishes a taxonomy of different drivers, types, and outcomes of innovation in emerging markets.

Innovation in Latin America

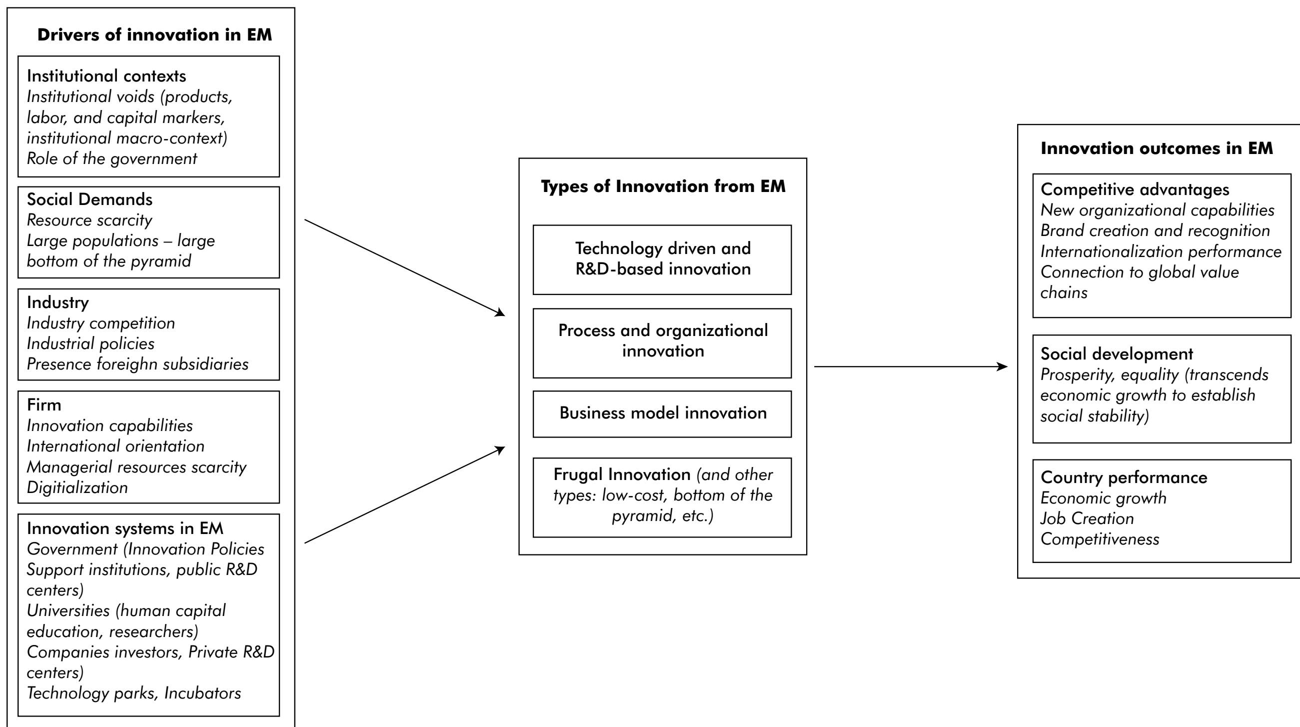
The following sections focus on the drivers, types, and outcomes of innovation in Latin America.

Drivers of Innovation

- Institutional challenges: These challenges increase transaction costs and operational constraints for local companies. As a result, innovation and internationalization in key sectors are typically shaped by strong government involvement (Finchelstein, 2017), or undertaken by state-owned companies. Governments in Latin America also act as strategic investors in public labs and private companies to foster innovation. Still, public and private spending as a percentage of GDP remain small.

- Social demands: Latin American countries suffer from social inequality and poverty. While these are major operational challenges for local companies, they can also serve as busi-

Figure 1. Drivers, types, and outcomes of innovation in emerging markets



ness opportunities for companies that develop low cost original products and services, as well as new business models to face such social issues (Cuervo Cazurra et al. 2019).

- Industry: Competition is a traditional driver of innovation. Growing and more sophisticated consumer markets are increasing the production standards and innovation processes of local companies. Subsidiaries of multinationals from developed countries are also an important source of innovation.

- Firm: A number of factors, such as size, ownership, or degree of internationalisation can influence a firm's innovation capabilities. Studies on *multilatinas* have confirmed that companies with higher commitment to innovation (R&D expenses, as a percentage of total expenses) tend to be present in more international markets.

- Innovation systems: Many elements of innovation ecosystems (research institutions, technology parks, universities, investors and risk capital) are far more constrained in Latin America than in developed countries. Brazil has the most mature innovation ecosystem in the region and as such has one of the most successful high-tech entrepreneurial movements in Latin America. Recently, Mexico has made significant progress in promoting innovation and startups through a number of regulations and reforms. Colombia and Argentina lack large-scale innovation initiatives but have a vibrant entrepreneurial community finding opportunities through new business model creation.

Types of Innovation in and from Latin America

- Technology-driven and R&D-based innovation: Such innovation is developed by the private sector in Latin America. Examples of innovative firms include Brazil's Marcopolo (5th largest bus maker in the world) and Mexico's Cemex (operations in more than 50 countries). Internationalization is a key driver of innovation for *multilatinas*. Accessing knowledge from R&D subsidiaries in developed countries has been an integral part of their competitive strategy (Oliveira & Borini, 2012). Some successful examples include: Brazil's Sabo, an auto parts producer that acquired the German company Kaco to increase its R&D competence; Petrobras, which has developed sophisticated technology for deep water oil drilling; and the Chilean Sigdokopper, which acquired the Belgian Maggoteux, obtaining expertise in solutions for high abrasion industries. Governments also play a significant role. Local governments manage innovation labs and research institutions, such as the Brazilian Agricultural Research Corporation (EMBRAPA), as well as state-owned companies (e.g., Brazil's Petrobras and Argentina's Invap). Foreign subsidiaries of DMNEs have also done R&D in Latin America. Examples include General Electric, Roche, L'Oréal, Eaton, Siemens, Microsoft, IBM, and Ford in Brazil; Sony, Samsung, LG Electronics, HP, IBM, Siemens, and Motorola in Mexico, and even P&G in Venezuela.

- Process and organizational innovation: Economic growth, combined with unstable local environments in Latin America have led many companies to develop new organizational processes to deliver products and services. For example,

weak institutional environments have prompted companies to servitize (adding innovative services to the product offer), thereby creating development opportunities in the service sector. This particular environment has also enabled human resource management to link policies and practices between strategic human resources and the innovation capacity of companies.

- Business model innovation: There has been a dramatic increase of companies in Latin America using digital technology to implement business model innovations in a diversity of businesses, such as internet platforms, digital games, digital solutions, and digital content. Some Latin American examples include Brazil's Nubank (fintech), Argentina's Etermax (digital games), Satellogic (satellites), and Globant (digital solutions) (Cahen & Oliveira Jr., 2018).

- Frugal innovation: Innovation based on cost-effectiveness involves redesigning and new products development using fewer resources and new production processes. For instance, the Brazilian unicorn PagSeguro created a payment machine called Moderninha, which has no paper reel, rendering the whole process cheaper than the usual payment machines.

Innovation Outcomes in Latin America

Measuring the outcomes of innovation can be very challenging. Still, some relevant indicators are available. For instance, the Global Innovation Index 2018 includes in its innovation output sub-index[1] variables related to knowledge, technology and creative outputs. Latin America does not rank high, especially if one considers the size of some of its economies. Brazil and Mexico (ninth and fifteenth largest economies in the world) were ranked respectively 64th and 56th in 2018. Chile led the region in the GII rankings at 47th, while Costa Rica and Colombia were identified as innovation achievers.

Still, traditional and alternative types of innovation are bringing prosperity that transcends economic growth as it reduces inequality and contributes to peace and social stability. Such outcomes are much more difficult to measure, however. Social innovation, including peacebuilding, has ranked high on the agenda of the largest Latin American multinationals. For example Postobon, the largest soft drinks company in Colombia, incorporated into its supply chain farmers and ex-combatants who grow fruits in conflict-affected areas with the goal of maximizing the shared value for the firm and the community (Andonova & García, 2018).

The Need to Study and Recognize Latin America Innovation Initiatives

The discussion on innovation in emerging markets is still incipient. Most studies on innovation and R&D internationalization focus on a small number of emerging markets, especially in Asia and in particular China (Wan et al., 2015), while only a few studies highlight the innovation and R&D internationalization of Latin American companies.

Most Latin American companies besides the largest *multilatinas* face technological and capability gaps, and struggle to achieve international standards. Innovation in Latin American companies is often of a type that does not fit the traditional high-tech, R&D-based models and is too often overlooked by scholars. This traditional approach does not account for harder-to-measure, more dispersed and even informal types of innovative activities (e.g., business model, organizational or social innovation, among others) common among Latin American companies and many other emerging markets. More research needs to be done to unveil and promote these innovation activities as a way forward for the region.

References

Amann, E., & Cantwell, J. (Eds). 2012. *Innovative firms in emerging market countries.* Oxford: Oxford University Press.

Andonova, V., & Losada, M. 2017. *Multilatinas: Strategies for internationalization.* Cambridge: Cambridge University Press.

Andonova, V., & García, J. 2018. How can EMNCs enhance their global competitive advantage by engaging in domestic peacebuilding? The case of Colombia. *Transnational Corporations Review*, 10(4): 370-385.

Cahen, F., Casanova, L., & Miroux, A. 2019. *From copycat to leaders: Innovation from emerging markets.* Cambridge: Cambridge University Press.

Cahen, F., & Oliveira Jr, M. M. 2018. Digital transformation in emerging markets: strategies and internationalization of digital companies from Latin America. In: L. Casanova & A. Miroux (Eds.), *Emerging market multinationals report (EMR)*, Emerging Markets Institute, S.C. Johnson School of Management, Cornell University. Available at: https://www.johnson.cornell.edu/Portals/32/EMI%20Docu/EMR/EMR2018_V3.pdf.

Casanova, L. 2009. *Global Latinas: Latin America's emerging multinationals.* New York: Palgrave Macmillan.

Casanova, L. & Miroux, A. 2018. Emerging Market Multinationals Report: *Emerging Markets Reshaping Globalization*. Emerging Markets Institute. S.C. Johnson School of Management, Cornell University. ISBN: 978-1-7328042-1-0. Available at: https://www.johnson.cornell.edu/Portals/32/EMI%20Docu/EMR/EMR2018_V3.pdf.

Cuervo-Cazurra, A., Carneiro, J., Finchelstein, D., Durán, P., Gonzalez-Perez, M. A., Montoya, M. A., Borda, A., Fleury, M. T. & Newburry, W. 2019. Uncommoditizing strategies by emerging market firms. *Multinational Business Review*, forthcoming.

Finchelstein, D. 2017. The role of the State in the internationalization of Latin American firms. *Journal of World Business*, 52(4): 578-590.

Oliveira Jr., M., & Borini, F. 2012. The role of subsidiaries from emerging economies—A survey involving the largest Brazilian multinationals. *Thunderbird International Business Review*, 54(3), 361-371.

Oliveira Jr., M; Cahen, F & Borini, F. 2019 (Forthcoming). *Startups and innovation ecosystems in emerging markets. A Brazilian perspective.* New York: Palgrave Macmillan.

Wan, F., Williamson, P. J., & Yin, E. 2015. Antecedents and implications of disruptive innovation: Evidence from China. *Technovation*, 39: 94-104

Endnote

1 The Global Innovation Index (GII) is composed of an "innovation input" sub-index and "innovation output" sub-index. See Cornell, INSEAD, and WIPO (2018) Global Innovation Index 2018 Report.

Emerging Multinationals Research Network (EMRN)

Lourdes Casanova (lc683@cornell.edu) is Senior Lecturer and Director of the Emerging Markets Institute at Cornell University. In 2014 and 2015, she was one of the 50 Most Influential Iberoamerican Intellectuals, and in 2017, one of the 30 Most Influential Iberoamerican Women Intellectuals by Esglobal. Co-author: *Entrepreneurship and the Finance of Innovation in Emerging Markets* 2017. Co-Author with A. Miroux: *Emerging Market Multinationals Report 2018, 2017, 2016.* Co-author: *The Political Economy of an Emerging Global Power 2014, author 'Global Latinas: Latin America's emerging multinationals'* 2009.

Fernanda Cahen (fribeiro@fei.edu.br) is Visiting Researcher at University of Southern California - Marshall School of Business and Assistant Professor of management at Centro Universitario FEI, Brazil. She received her PhD from University of Sao Paulo in Business Administration and was a Post-doctoral fellow at Kelley School of Business - Indiana University. She specializes in international entrepreneurship with focus on strategy and innovation of high tech and digital new ventures.

Anne Miroux (am2449@cornell.edu) is Faculty Fellow at the Emerging Markets Institute, Cornell University and former Director of the Technology Division in the United Nations Conference on Trade and Development (UNCTAD). She graduated from HEC-Paris and holds a PHd from University of Paris1-Sorbonne. Her areas of work included developing country debt, FDI and TNCs, and technology and innovation policies. For several years she led the World Investment Report (WIR). Her current research area is emerging market multinationals.

Diego Finchelstein (dfinchelstein@udesa.edu.ar) is Assistant Professor at Universidad de San Andrés (Argentina) and a researcher at the Argentine national research agency (CONICET). He holds a PhD from Northwestern University. His main area of research is connected the relation between institutions, state actions and internationalization. Finchelstein is an active member of the Emerging Markets Research Network and is also part of the executive board of the Latin America and Caribbean chapter of the Academy of International Business.

Anabella Davila (anabella.davila@tec.mx) is Professor of Management and Strategic Human Resource Management and the leader of the research group: Strategy and Management in Emerging Economies at EGADE Business School, Tecnologico de Monterrey. She holds a Ph. D. from The Pennsylvania State University. Her current research interest is the social dimension of human resource management with a focus on human development, sustainability and competitiveness. She is a member of the Mexican Researchers System of CONACYT Tier II.

Juana García Duque (juanagarcia@uniandes.edu.co) is Professor at the Business School at Universidad de los Andes, Colombia. Her research includes international cooperation and private sector in peacebuilding process in Colombia and emerging countries. She is leading the work with the Colombian Agency for the Reintegration of Ex-combatants, documenting the process and the engagement of multiple society stakeholders, including business organizations. She has been working in new blended courses and MOOCs for education in Emerging Markets.

Veneta Andonova (veneta.andonova@gmail.com) is Associate Professor of Business Strategy at Universidad de los Andes School of Management, Colombia. She obtained her PhD degree from Universitat Pompeu Fabra, Spain. Her research stands at the intersection of business strategy, entrepreneurship and economic development in the context of emerging and transition economies. Her most recent books are on the internationalization of Latin American corporations, the multilatinas, and on the birth of entrepreneurial ecosystems in unexpected places.

Moacir de Miranda Oliveira Jr. (mirandaoliveira@usp.br) is Full Professor and Head of the Business Administration Department at USP - University of São Paulo. He is the director for Latin America of GLORAD (Center for Global R&D and Innovation), Chief Editor of Innovation & Management Review, and part of the Global Steering Committee of Emerging Markets Institute - Cornell University. His research interests include startups and innovation ecosystems in emerging markets.

Corporate Governance in Latin America: Towards Shareholder Democracy

Ruth V. Aguilera, Northeastern University, USA
Rafel Crespí-Cladera, Universitat de les Illes Balears, Spain
Luiz Ricardo Kabbach de Castro, University of São Paulo, Brazil, and Universidad de Navarra, Spain

How can Latin American majority shareholders keep their corporate control? Shareholder democracy, the idea that "one-share equals one-vote" and that firms are controlled by shareholders who exercise their power with equal economic rights, has recently gained great attention in corporate governance debates. This is particularly because technology companies such as Ebay or Facebook have founders who control a lot more than they own via dual class shares, some companies such as social media Snap listed with shares with no voting rights, and stock exchanges such as Hong Kong Stock Exchange changed listing regulations to prevent losing future technology companies such as Alibaba.

The advocates of shareholder democracy sustain that aligning the economic rights and voting power of controlling shareholders may increase their incentives to maximize the value of the firm (i.e., value for all shareholders) while simultaneously reduce the potential incentives for private benefits of control (i.e., value only for controlling shareholders at the expense of minority shareholders). Hence, shareholder democracy is a key element of corporate governance systems to protect outside investors, and consequently, to facilitate the development of the supply-side of capital, through equity.

Dual-class shares where one share does not equate to one vote jeopardize shareholder democracy and might exacerbate an agency problem between large (controlling) shareholders and minority investors. In part, this is because the dual-class shares do not generate any direct competitive advantage to the company, but clearly intensify potential moral hazard concerns by increasing the difference between largest shareholder economic (cash flow) and control rights. In this article, we discuss the role of the dual-class share mechanism as vehicle to enhance control, and its implications for economic outcomes in emerging economies.

Institutional Voids and Corporate Governance

Emerging markets are best defined by structural deficiencies due to institutional voids (Gao et al., 2017). When these institutional structures are absent or weak, governance deteriorates, corruption escalates, uncertainty increases, and instability emerges; all of which exacerbate institutional constraints to mutually productive exchanges. Although Latin America countries clearly present significant institutional differences, there also exist a set of common factors including development of the economy, capital markets, and other institutions. Table 1 shows some of the structural dimensions of selected Latin American economies compared to the U.S. and OECD countries. It is worth noting that there is a pattern toward institutional voids, which harms the economic exchange within a country and across its borders. Inefficient judicial systems, the lack of creditors and shareholders protection, high levels of corruption, and high costs of cross-border transactions are examples of institutional factors affecting firms' decisions and outcomes. It is easy to conclude from this snapshot that there are structural challenges, a common denominator in emerging economies.

Corporate governance is concerned with distributing rights and responsibilities among different stakeholders (Aguilera & Jack-

son, 2003) in order to minimize conflicts of interest, allocate resources efficiently, and enhance transparency and accountability. Again, corporate governance in the Latin America is by no means uniform, but there are common institutional characteristics across countries. Mierta Capaul (2003), Chief Economist of the Word Bank for Latin America and the Caribbean Region, described three main corporate governance features: French civil law origin, the ubiquitous presence of large concentrated shareholders, and family business groups ("grupos de negocios"). Between her findings and the Table 1 current data, there is a gap of 15 years with little real structural change in corporate governance institutions supporting economic growth.

Latin American countries, therefore, do not seem to be converging toward the Anglo-American corporate governance model characterized by strong shareholder rights, high transparency, relatively open CEO labor markets, and external markets for corporate control. Latin American countries are more akin to traits of the internal corporate governance mechanisms that characterize emerging markets. That is, ownership concentration, business groups, insider boards of directors, and information asymmetries (Aguilera et al., 2012; Aguilera & Haxhi, 2019). In part, these firms' governance and strategic decisions are influenced by a country's institutional voids, weak minority shareholder rights, and underdeveloped stock markets (Khanna & Palepu, 2010). As such, a chicken and egg scenario exists.

Is There Shareholder Democracy in Latin America?

It is worth noting that the dual-class share governance mechanism is spread around the world (Kim, Matos, & Xu, 2018). In Latin America, following the period of liberalization in the late 1980s, despite the shift from state to private hands through the privatization process of state-owned firms and market-oriented reforms, many governance practices persisted including high ownership concentration in the hands of domestic business groups and the practice of dual-class shares. Chong and Lopez-de-Silanes (2007) describe the ownership structure of the largest companies in six Latin American countries to show that not only is the ownership highly concentrated in the largest shareholder, but also that there exists a significant separation of ownership and control in Latin American corporations. This is accomplished through two control-enhancing mechanisms: dual-class shares and pyramidal business groups (see Perkins [2019] in this special issue).

Table 1. Institutional variables in selected Latin American countries, the United States, and OECD countries

Economy	Brazil	Chile	Colombia	Mexico	Peru	United States	OECD High Income
Starting a Business - Procedures (number)	11	8	8	7.8	8	6	5
Starting a Business - Time (days)	82.5	7.5	11	8.4	41.5	5.6	9.4
Starting a Business - Cost (% of income per capita)	5.2	5.9	14.1	17.8	9.9	1.1	3.7
Getting Credit - Strength of legal rights index (0-12)[1]	2	4	12	10	7	11	6
Protecting Minority Investors - Strength of minority investor protection index (0-10)[1]	6.5	6	8	5.8	6	6.5	6.4
Score-Trading across borders[2]	58.79	80.56	61.83	82.09	68.22	92.01	93.8
Trading across Borders - Cost to export: Documentary compliance (USD) 2	226.4	50	90	60	50	60	36.3
Trading across Borders - Cost to import: Documentary compliance (USD) 2	106.9	50	50	100	80	100	29.5
Trading across Borders - Cost to export: Border compliance (USD) 2	862	290	630	400	630	175	146.2
Trading across Borders - Cost to import: Border compliance (USD) 2	821.7	290	545	450	700	175	111.5
Enforcing Contracts - Time (days)	731	480	1288	340.7	426	420	570
Enforcing Contracts - Cost (% of claim)	22	25.6	45.8	33	35.7	30.5	21.7
Enforcing Contracts - Quality of the judicial processes index (0-18)	13.1	9	9	10.1	8.5	13.8	11.0
Corruption Perception Index (Rank 1 to 180)	37 (96)	67 (26)	37 (96)	29 (135)	37 (96)	75(16)	–

Source: http://www.doingbusiness.org, Doing Business Report, 2017; Corruption Perception Index from https://www.transparency.org/news/feature/corruption_perceptions_index_2017
1: DB15-19 methodology, 2: DB16-19 methodology, 3: DB16 methodology.

Table 2. Voting rights and dual-class shares of the largest shareholder across countries.

Country	Number of Firms	Mean Voting Rights (%)	Standard Deviation (%)	Dual-Class Shares (%)
Brazil	269	48.5 (53.7)	26.0 (25.0)	50.9
Chile	130	42.9 (42.7)	25.5 (26.8)	7.6
Colombia	25	39.1 (60.0)	26.2 (16.9)	5.7
Mexico	93	38.6 (35.3)	25.1 (26.5)	28.6
Peru	104	54.8 (54.4)	28.6 (28.2)	52.3
Total	621	46.7 (51.5)	26.8 (26.7)	37.9
United States[1]	6,707[2]	61.8[3]	–	6
European firms[4]	493	46.0 (46.0)	24.0 (24.0)	29

Notes: In parentheses, we report the average voting rights for dual-class firms to compare with the U.S. sample from Gompers et al (2010).
1. Gompers, Ishii, and Metrick (2010: 1057).
2. This data refers to the year 2002 (see Table 1, Gompers et al., 2010).
3. This data refers to dual-class firms.
4. Maury and Pajuste (2011: 362), this data refers to 2005.

Using a sample of 621 (6,253 firm-year observations) non-financial firms (i.e., excluding banks and insurance companies) publicly listed in five Latin American countries from 2003 to 2017, we show in Table 2 that there is low shareholder democracy in Latin America[1] and that the presence of dual class shares is widely spread, relative to other countries in the world. The largest shareholder holds, on average, 46.7% of voting rights, and more than one third of the firms use dual-class shares to enhance their controlling positions. In Brazil, for example, the controlling shareholder of Suzano Holding S.A., who controls Suzano Pulp Mills, holds 87.54% of the voting rights and only 35.69% of economic rights. This separation is mainly due to the existence of dual-class shares.

Advocates for dual-class shares argue that founders and entrepreneurs can retain control of a company to implement their long-term plans or value creating idiosyncratic vision. From a market perspective, dual-class shares allow investors to select the shares that better suit their preferences. Even assuming higher cost of capital, these companies can finance their expansion taking advantage of public markets with the benefits of private companies.

This enhanced shareholder control deters the myopic focus on short-term yield which imposes short-term earnings reports, allowing discretionary power for long-term investments. Yet the effect varies depending on the type of large shareholders across different countries. For example, when a firm's largest shareholder is an *individual or a family*, it is likely that, in order to keep family control or to guarantee the firm succession in the hands of future generations, they may seriously consider leveraging its control position through dual-class shares. *Governments* as largest shareholders may strengthen their voting power for strategic interests such as monopolies (i.e., oil and gas, or utilities) or use the dual class shares control-enhancing mechanism to resist takeover bids, while *industrial firms* may retain control to develop internal capital markets through business groups. This tradeoff is particularly salient in emerging markets, where the underdeveloped institutional environment makes controlling structures an efficient response to reduce the cost of transacting in the market (Khanna & Palepu, 2010).

Considering that different controlling shareholders may diverge in their interests towards firms' decisions and outcomes, in Table 3, we report differences of the largest shareholder voting rights between firms with and without dual-class shares across different largest shareholders types. It is worth noting that the only type of shareholder that does not use the dual-class mechanism is "institutional investors" (i.e., mutual and pension funds). This is because they are not typically directly related to the management of the firm; instead, they work as a strategic partner with patient capital, where long-term performance is desirable.

What Are the Consequences of Shareholder Autocracy?

We still do not have a final answer whether shareholder autocracy – the presence of a large shareholder with strong power

under firms' decisions – is, *per se*, good or bad for firms' value. However, we do know that some governance mechanisms are more likely to entrench majority shareholders, such as dual-class shares, and consequently significantly reduce the ability of minority shareholders to have a say on firms, particularly, in times where managerial decisions are not sound and the institutional setting precludes outside investors to enforce their rights. See, for example, the recent Brazilian corporate scandal that affected Petrobras, the largest oil company in Brazil, where the largest shareholder is the Brazilian government. The American investors who invested in Petrobras' ADRs (American Depositary Receipts) in the NYSE were able to sue the company to claim their rights, while the Brazilian investors, most of them with preferred shares (i.e., with no voting power and preference in cash outs), were left behind.

At the same time, Gao et al. (2017) argue that family business groups in emerging economies, such as the Tata Group in India, Koç Holdings in Turkey, and Grupo Bimbo in Mexico, all under a shareholder autocracy lead by control-enhancing mechanisms, have been able to survive and expand, delivering value for the family controlling shareholder and their other stakeholders. They propose that the main driver for the "incentive effect" in those firms is reputation. Reputation is strongly related to the long-term perspective of business groups and their controlling shareholders. Therefore, in the presence of shareholder autocracy in emerging economies, investors may look at the level of commitment of the largest shareholder towards a firm's reputation and long-term results.

For policymakers, fostering and encouraging firms to develop a long-term perspective where shareholders and stakeholders can base their relationship on mutual trust, transparency, dialog, and respect is worth taking. This implies developing better safeguard mechanisms for minority (non-controlling) shareholders other than ownership mechanisms. Examples include: third-party arbitration for conflicts of interests, greater dialog between entrenched boards and investors that reduce the cost of minority investors to access information and increase their incentives to commit for the long-term, more transparency in the decision-making process through a sound and procedural decision-making policy, responsible remuneration policy for entrenched managers (government officials or family members) that is aligned to company's mission and values, and clearly linked to the successful delivery of the long-term strategy.

Table 3. Voting rights of the Largest Shareholder for Dual-class and non-dual-class shares firms.

Panel A. Largest Shareholder Typology	Stats	Non-Dual-Class Shares	Dual-Class Shares	Total	Difference	p-value
Corporate	N	1,944	1,360	3,304		
	Mean	49.99	55.35	52.2	5.36	0.000
	SD	25.22	24.54	25.08		
Banks, Insurance, and Other Financial Firms	N	1,037	415	1,452		
	Mean	37.76	47.38	40.51	9.62	0.000
	SD	24.02	27.04	25.29		
Families	N	344	286	630		
	Mean	30.82	35.87	33.11	5.05	0.013
	SD	22.32	26.87	24.6		
Mutual and Pension Funds	N	321	109	430		
	Mean	41.88	44.97	42.67	3.09	0.273
	SD	29.92	30.55	30.08		
Government	N	105	122	227		
	Mean	54.06	69.86	62.55	15.8	0.000
	SD	30.3	21.07	26.88		
Others	N	134	76	210		
	Mean	36.34	44.41	39.26	8.07	0.027
	SD	26.26	28.58	27.33		
Total	N	3,885	2,368	6,253		
	Mean	44	51.52	46.84	7.52	0.027
	SD	26.21	26.71	26.65		
Panel B. Free Float		Non-Dual-Class Shares	Dual-Class Shares	Total		
Free-Float	N	3,885	2,368	6,253		
	Mean	33.05	29.63	31.76	-3.42	0.000
	SD	33.05	29.63	31.76		

References

Aguilera, R. V., & Haxhi, I. 2019. Comparative corporate governance in emerging markets. In R. Grosse & K. Meyer (Eds), *Oxford handbook on management in emerging markets*. Oxford: Oxford University Press.

Aguilera, R. V., & Jackson, G. 2003. The cross-national diversity of corporate governance: dimensions and determinants. *Academy of Management Review*, 28(3): 447-465.

Capaul, M. 2003. *Corporate governance in Latin America*. World Bank, Working Paper.

Gao, C., Zuzul, T., Jones, G., & Khanna, T. 2017. Overcoming institutional voids: A reputational-based view of long-term survival. *Strategic Management Journal*, 38: 2147-2167.

Gompers, P.A., Ishii, J., & Metrick, A. 2010. Extreme governance: An analysis of dual-class firms in the United States. *Review of Financial Studies*, 23(3): 1051-1088.

Kim, J., Matos, P., & Xu, T. 2018. *Multi-class shares around the world: The role of institutional investors*. Working Paper.

Khanna, T., & Palepu, K. 2010. *Winning in emerging markets: A road map for strategy and execution*. Boston: Harvard Business School Publishing.

Maury, B., & Pajuste, A. 2011. Private benefits of control and dual-class share unifications. *Managerial and Decision Economics*, 32(6): 355-369.

Perkins, S. 2019. The dominance of pyramidal business groups in Latin America persists. *AIB Insights*, 19(2): 18-21.

Endnote

1 To be included in the sample, a firm should have, at least, five consecutive years of data. The table presents the average and standard deviation of control rights of the largest shareholders. It also reports the percentage of firms in each country that issue dual-class shares.

Ruth V. Aguilera (r.aguilera@northeastern.edu) is a Distinguished Professor at Northeastern University, a Visiting Professor at ESADE in her native Barcelona, and an AIB Fellow. She received her PhD from Harvard University and her research interests are in corporate governance and corporate social responsibility. She is a Senior Editor at Organization Science, an Associate Editor at CGIR, and a Consulting Editor at JIBS. She serves on the Board of Directors of the Strategic Management Society and the International Corporate Governance Society.

Luiz Ricardo Kabbach de Castro (lrkcastro@gmail.com) is an Assistant Professor and Director of the Group of Excellence in Family Firms at the University of São Paulo, and Associate Professor at the Universidad de Navarra, Spain where he teaches Strategy and Family Business Management. His research interests include corporate governance and strategy in emerging economies, in particular, in family firms.

Rafel Crespi-Cladera (rafel.crespi@uib.es) is a Full Professor in the Department of Business Administration at the Universitat de les Illes Balears (Spain). He holds the Banca March Family Business Chair. His research on corporate governance focuses on how ownership structures influence firms' governance practices. His research has been published, among others, in *Strategic Management Journal, Family Business Review, Journal of Corporate Finance, and Journal of Banking and Finance.*

continued from page 7

References

AméricaEconomía. 2018. Las mayores 500 empresas de Lationamerica. AmericaEconomia, June 15. https://www.americaeconomia.com/negocios-industrias/conozca-las-500-empresas-mas-grandes-de-america-latina. Accessed February 13, 2018.

CIA. 2019. The world factbook. CIA. https://www.cia.gov/library/publications/the-world-factbook/. Accessed February 13, 2019.

Cuervo-Cazurra, A. 2016. Multilatinas as a source of new theoretical insights: The learning and escape drivers of international expansion. *Journal of Business Research*, 69(6): 1963-1972.

Cuervo-Cazurra, A. Inkpen, A., Musacchio, A., & Ramaswamy, K. 2014. Governments as owners: State-owned multinational companies. *Journal of International Business Studies*, 45: 919-942.

Cuervo-Cazurra, A., Luo, Y., Ramamurti, R., & Ang, S. H. 2018. The impact of the home country on internationalization. *Journal of World Business*, 53(5): 593-604.

UNCTAD. 2019. UNCTADStat. https://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx?sCS_ChosenLang=en. Accessed February 1, 2019.

Endnotes

1 See Cuervo-Cazurra (2016) and references there for an overview of *multilatinas*.

2 See a more detailed explanation of the influence of the home country on internationalization in Cuervo-Cazurra et al. (2018).

3 See Cuervo-Cazurra et al. (2014) for an overview of the theoretical explanations.

4 See *AméricaEconomía* (2018) for the list of firms.

Alvaro Cuervo-Cazurra (a.cuervocazurra@neu.edu) is a Professor of Global Strategy at Northeastern University. He received a Ph.D. from the Massachusetts Institute of Technology and an Honorary Doctorate from Copenhagen Business School. Alvaro is a Fellow of the Academy of International Business and co-editor of *Global Strategy Journal*. He studies the internationalization of firms, particularly emerging market multinationals; capability upgrading, focusing on technological capabilities; and governance issues, especially corruption in international business.

The Dominance of Pyramidal Business Groups in Latin America Persists

Susan Perkins, University of Illinois at Chicago, USA

Latin American capital market integration took place in 2011, combining the national stock exchanges of Colombia, Chile, Peru, and most recently, the addition of Mexico in 2014. These four stock exchanges combined, known as the Mercado Integrado Latinoamericano (MILA), represent the largest regional stock exchange in Latin America and it is a close second in size (e.g., market capitalization) to the BOVESPA in Brazil, the single largest national stock exchange in Latin America.[1] Since the integration, what many practitioners and scholars of corporate governance are asking: Is the MILA ready for "good governance" rules?

Business Groups in Latin America

The corporate governance context in Latin America deviates significantly from the one-vote, one-share proportional representation of the concentric overlap between ownership and voting rights found most commonly in the US. Many who understand and practice corporate governance in the context of the US or UK undoubtedly are most familiar with dispersedly owned stand-alone firms that rarely have any other affiliated firms also listed on the same stock exchanges. The key governance concern when considering these dispersedly owned firms found on the New York or London stock exchanges is the "principal-agent dilemma" that can arise within the boundaries of the firm between the separation of ownership (the principals) and managerial control (agents) (Jensen & Meckling, 1976). At the worst when the two are not properly aligned, scandalous managers can obfuscate their fiduciary responsibilities to instead maximize their personal wealth at the expense of appropriations to the shareholders, the rightful owners. However, in contrast, business groups – also known as *grupos* in Latin America -- often have a dominant shareholder who also plays a significant role in firm management, thus creating a different set of corporate governance concerns, such as the likely goal divergence and information asymmetry between the dominant owner-manager(s) (in this scenario, the principal-agent role is combined) and minority shareholders, whom are frequently foreign investors. International business scholars, in both management and finance, have long been intrigued by this highly diversified and socially embedded organizational form. The seminal study by La Porta et al. (1998) on global corporate governance and ownership revealed a ubiquitous pattern of more concentrated ownership around the world which suggests that the ownership forms we observe in Latin America are more common, in fact, than rare. Many Latin American countries are characterized by having extremely high ownership concentrations with yet some of the poorest levels of investor protections. One of the largest corporate governance issues in Latin America[2] called out in this study is the disproportional representation of a small set of controlling owners which often leads to elevated expropriation risks (see Table 1). Since this study was published over two decades ago, two important questions that practitioners face when devising corporate governance and ownership structures in this region are: Do these concentrated ownership forms persist given the institutional reforms designed to curb such governance problems related to managerial entrenchment? and Do these ownership forms pose a threat to potential joint venture partners or minority shareholders given the revelations of more recent Latin American corporate governance research which exposed potential expropriation schemes of local pyramidal group partners (Perkins, Morck & Yeung, 2013) and competing market forces from new varieties of state-controlled capitalism (Musacchio & Lazzarini, 2013)?

Descriptive statistics comparing the patterns of corporate ownership in Latin America over the last decade show no major shifts in ownership patterns of the concentrated dominant owners. Figures 1 and 2 provide some stylized facts that on several Latin American stock exchanges – including the Santiago Stock Exchange, Chile (BCS); Mexican Bolsa, Mexbol (BMV); Colombia Stock Exchange (BVC); Lima Stock Exchange, Peru

(BVL); Bolsa de Valores de São Paulo, Brazil (BOVESPA) -- the level of dominant ownership of the single largest shareholder and the top 5 largest shareholders' average ownership persisted over the last decade when comparing ownership in 2007 to 2017. The top shareholders maintained both voting and decision rights based on their majority/controlling stakes in the firm. These patterns of ownership throughout Latin American contrast from the more dispersedly owner listed firms in the UK and US (Figure 3) where the largest shareholder, on average, owns less than 16% stakes.

Table 1. Corporate Ownership and Expropriation Risks in Latin America

Country	**Risk of Expropriation Index [0-10; 0=High]**	**Ownership % - Largest 3 Shareholders**
Argentina	5.91	53%
Brazil	7.62	57%
Chile	7.5	45%
Colombia	6.95	63%
Ecuador	6.57	
Mexico	7.29	64%
Peru	5.54	56%
Uruguay	6.58	
Venezuela	6.89	51%
Widely-held Stand Alone Country Benchmarks		
UK	9.71	19%
US	9.98	20%

Source: Data extracted from LaPorta, Lopez-de-Silanes, Shleifer, & Vishny (1998).

One key point of contestation of these business groups, relative to other corporate governance forms, is the corporate governance mechanisms that leave minority shareholders prey to the self-dealing behaviors of the dominant owner or most notably referred to as the "private benefits of control." The idea of self-dealing, different than the classic principal-agent dilemma, refers to the act of the controlling owner's misuse of their power over the managerial decision rights to divert the wealth of the firm for personal gains. Djankov, La Porta, Lopez-de-Silanes and Shleifer's (2008) global study on self-dealing, which provided comparative analysis across 72 countries, showed that Latin American countries rank the highest among other regions for expropriation risks of self-dealing by the dominant controlling shareholders. Of these country-level comparisons, Brazil and Mexico had the highest control premiums of all, at 49% and 47% respectively. Venezuela was also among the top 5 ranked highest for control premiums.[3] To confound the

Figure 1

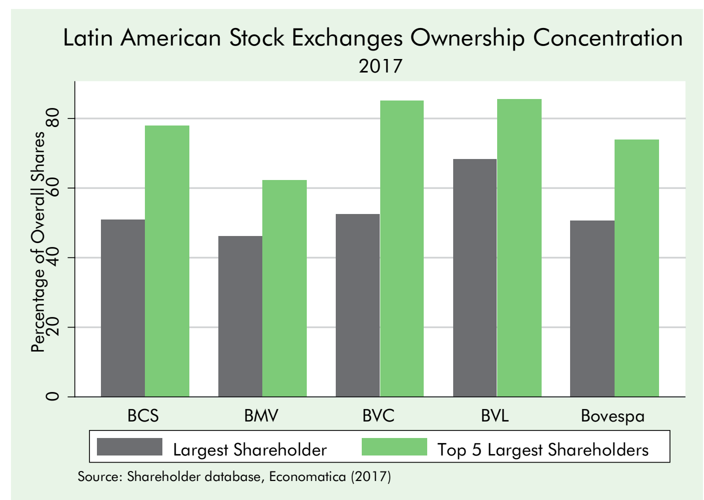


Figure 2

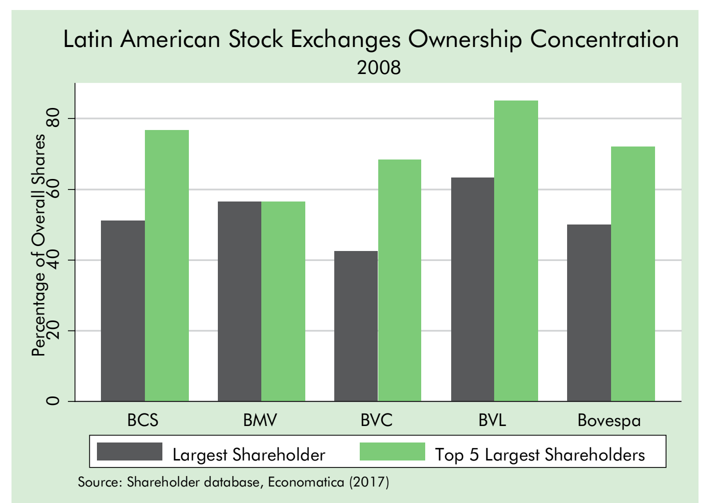
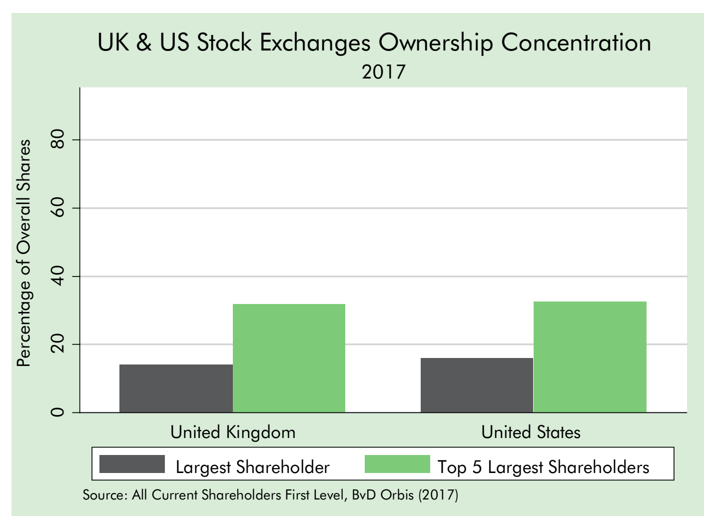


Figure 3



problem even further, Latin American countries also suffer from corporate governance challenges driven by an institutional context that provided very low anti self-dealing protections. In their anti-self-dealing index, Latin American countries represent 6 of the top 10[4] for the lack of shareholder protections in the law to curb such behaviors.

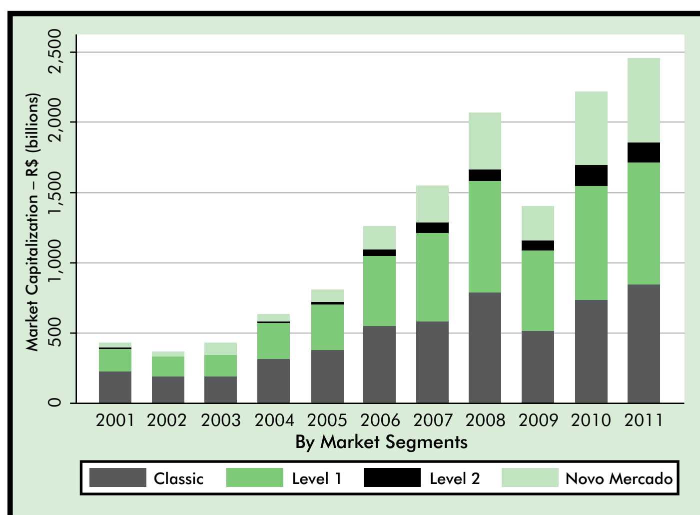
Also vastly different than the US and UK capital markets, some public firms in Latin America have dual-class shares both with and without voting rights. The agency problems are even further exacerbated when the dominant owner exerts distorted levels of control through dual class voting shares and other control mechanisms that create paths to maximize the wealth of the pyramidal group's apex rather than the lower-tiered publicly listed firms. The high agency costs to minority shareholders locked out from control stems from the large gap between control and cash flow rights that then gives the controlling owner(s) the ability to leverage their stakes across tiers of the pyramidal corporate structure of which many are not transparent to the market. A cross-country comparative study (Nenova, 2003) that focuses on dual-class shares and control blocks found that among the 18 countries examined, Brazil had the highest use of dual class shares. In Brazilian listed firms, for example, ordinary shares (ON) are the only class of shares that carry voting rights and are predominately owned by the controlling shareholder(s). Preferred shares (PN), mostly owned by minority shareholders and foreigners, carry no voting rights. This cross-country comparative study further revealed that the control block ownership of publically listed firms in Latin American countries including Brazil, Chile and Mexico represented more than a quarter of the companies' market capitalization. Indeed, others, such as Dyck and Zingales (2004), have pinpointed the premiums associated with these control blocks of the dominant shareholders as being unusually high in Brazil, the highest at 65% relative to control premiums in 38 other capital markets studied around the world; 34% in Mexico; 27% in Argentina and Venezuela; 18 % in Chile; and 14% in Peru, compared to 1% in both the US and UK. The primary motives of such ownership combined with dominance of the decisions rights points back to increased opportunities for self-dealing. The biggest problem identified with corporate structures that have concentrated control is the risk of expropriation from the controlling owner to give preferential treatment to their own. Expropriation risks are higher because the main shareholder, which is often a dominant owner of a powerful business group, could effectively govern and determine the strategic decisions of the firm with limited to no rights given to minority shareholders. For this reason, management scholars of Latin American corporate governance have referred to pyramidal groups as either "paragons" or rent-seeking "parasites" (Khanna & Yafeh, 2007) because of the difficulty in detecting the true wealth maximization motives either directed towards the wealth maximization of the firm or self–dealing motives to maximize the wealth of the dominant/controlling shareholder(s). From this perspective, the presence of a shareholder with large equity holdings is indicative of costs to other shareholders, based on the presumption that ownership control will result in value going disproportionately to the ultimate main shareholder at the expense of others.

The sum of these insights revealed from cross-country comparative views of corporate governance practices in Latin America may bring hesitations regarding market investments to the unassuming manager, particularly those accustomed to more Anglo-American governance norms (e.g., one vote, one share norms). Most importantly, however, these insights underscore the importance of both the corporate governance practices of firms within a given institutional context and the financial markets upon which these firms rely. Therefore, the underlying concerns that are most important to consider are not solely whether there is a dominant controlling owner, but what are the prevailing corporate governance practices being utilized by the firm?

Brazilian Securities Regulators Changed the "Rules of the Game"

This inability of the market to not easily detect the wealth maximization motives of many listed dominantly owned firms became a severe problem for the liquidity of the BOVESPA in Brazil by the end of 1999. As economic theory predicts, markets without these fundamental minority shareholder protections will receive less overall investments and fewer firms will be inclined to go public. The reality of the BOVESPA nearly collapsing made evident to the Brazilian government by 2000 that corporate governance institutional reforms were needed to address this market failure. Why might Brazil be a model for the MILA exchange or others countries that have dominant shareholders and lack strong minority shareholder protections? Because in 2001, the Brazilian securities and exchange commission, Comissão de Valores Mobiliários (CVM), reformed the "rules of the game" on the BOVESPA with the hope of providing more mechanisms of "good governance" practices such as greater transparency, disclosure rules requiring using US Generally Accepted Accounting Principles (GAAP) audited financials, instituting board requirements to adopt independent directors at a ratio of 1 to 5 per board seat, and limiting the disproportions between voting stakes shares versus non-voting shares. These are all considered exemplars of "good governance" practices commonly found in developed economies, but are relatively new to emerging markets (La Porta el al., 1998). The clever solution embedded into the institutional reform recognized that not all listed Brazilian firms had poor governance practices, but those that were better governed had no credible way to signal to the market their wealth maximization motives. The regulatory changes introduced three new voluntary corporate governance listing categories, including the Novo Mercado being the most stringent, followed by Level 2 then Level 1 cor-

Figure 4



Source: Securities Financial Database, Economatica, 2017

porate governance listing segments, of which each has unique regulatory reporting and compliance requirements. This regulatory shift provided both existing (seasoned equity offerings, SEOs) and new equity offerings (initial public offerings, IPOs) listed on the BOVESPA a voluntary path towards increasingly more stringent governance rules to allow each firm to signal to the market their commitment to stronger shareholder rights reinforced by a redistribution of more proportional voting rights. The Brazilian corporate governance reforms also created a market arbitration chamber where shareholder disputes are settled within six months, a needed solution to counter the inefficient judicial systems where firms often experienced slowness in having a case heard and a lack of specialization around these governance issues.

Brazil's regulatory reforms to Latin America's largest stock market created a turnaround in the growth trajectory of a previously failing market which suffered from corporate governance institutional voids. From 2001-2011, the increasing market capitalization of the BOVESPA was primarily driven by the stocks in the more stringent listing categories, mainly the Novo Mercado and Level 1 (Figure 4). Perhaps these results reveal what is most needed in Latin America are regulatory interventions to improve the weak investor protections given that these dominantly owned business groups persist. Considering the effectiveness of regulatory strategies that Brazil has put in place in their capital markets over the last two decades to reform problems of "bad corporate governance practices" that often left minority shareholders getting the short end of the stick, this may be a winning strategy for other Latin American stock exchanges. Market regulators in Brazil already provided the test of the durability of this corporate ownership form.

The long-term strategy for Latin American markets perhaps is not to expect the dominant ownership structures to change, but instead to incentivize better corporate governance practices of these business groups. The policy regime in Brazil can be a useful benchmark for other emerging market economies looking for the next step in developing and/or stabilizing capital market growth.

References

Dyck A., & Zingales, L. 2004. Private benefits of control: An international comparison. *Journal of Finance,* 59(2): 537–600.

La Porta, R., Lopez-de-Silanes, F., Shleifer, A. & Vishny, R. W. 1998. Law and finance. *Journal of Political Economy*, 106(6): 1113–1155.

Jensen M., & Meckling, W. 1976. Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, 3(4): 305–360.

Khanna T., & Yafeh, Y. 2007. Business groups in emerging markets: paragons or parasites? *Journal of Economic Literature,* 45(2): 331–372.

Mussachio, A., & Lazzarini, S.G. 2013. *Reinventing State Capitalism: Leviathan in Business, Brazil and Beyond*. Boston: Harvard University Press.

Nenova, T. 2003. The value of corporate voting rights and control: A cross-country analysis. *Journal of Financial Economics*, 68: 325–351.

Perkins, S., Morck, R., & Yeung, B. 2014. Innocents abroad: The hazards of international joint ventures with pyramidal group firms, *Global Strategy Journal*, 4: 310–330.

Endnotes

1 Market capitalization data comparisons derived from the World Federation of Exchanges, Annual Statistics Guide, 2017.

2 These Iberian colonized countries adopted their legal traditions primarily from the French civil law influences.

3 Venezuela is tied for 5th place with South Korea.

4 These countries include Ecuador, which was ranked the lowest of the 72 countries studied; Venezuela, ranked 3rd; Bolivia, ranked 4th; Panama, ranked 6th; Mexico, ranked 8th; and Uruguay, ranked 9th.

Susan E. Perkins (susanp@uic.edu) is an Associate Professor of Strategic Management at the University of Illinois at Chicago. Her research interests include global strategy, institutional reform, leadership and market regulation. She is an expert on Brazilian corporate governance. Her research appears in journals such as *Administrative Science Quarterly*, *Global Strategy Journal*, and the *Harvard Business Review.* Susan was a former AIB Finalist for the Richard N. Farmer Dissertation Award.

The Importance of Institutional Knowledge for Expats Working in Latin America

Daniel Friel, Universidad de San Andrés, Argentina

Introduction

Firms from the developed world operating in emerging markets confront a variety of challenges in adapting their operations to the institutional contexts in these countries. However, most of the preparation provided to expats from these companies focuses on general cultural differences and not institutional differences such as how to work with suppliers or unions in emerging markets. In order to work effectively in these countries, expats need a framework for identifying critical institutional differences that shape how institutions impact the implementation of best practices. The most common framework is the theory of institutional voids. It argues that institutions in capital, labor and product markets are weak or missing in emerging markets causing firms to have to rely on vertical integration (Khanna & Palepu, 1997). The claim that institutions are weak or missing does not enable expats to gain an in-depth understanding of how institutions actually shape the behavior of firms in these countries. This article suggests that the varieties of capitalism framework is a more appropriate means for understanding this topic because it specifically focuses on how organizational practices are shaped by institutions. It compares five critical institutions, namely governance, industrial relations, training and education, supplier relationships and employee relations, across nations (Hall & Soskice, 2001).

Given the relative similarities in the cultural underpinnings of countries in Latin America, this region represents an excellent case to examine potential institutional differences throughout emerging markets. If they are discovered here, we can also expect to find important differences between countries within other emerging-market regions. This article uses the varieties of capitalism framework to explore major institutional differences between Argentina and Brazil by examining how an Argentine and a French MNC attempted to implement best practices in each of these countries. The former company failed in Brazil because the practices that proved critical to the success of this firm in Argentina could not be adapted to employee relations and relations with suppliers in that country. By contrast, the latter company was successful in both of these countries because the practice it implemented could be adapted to the institutions of industrial and employee relations. If institutions in these areas were weak or missing in these countries, as presumed in the institutional voids framework, no adaptations would not have been necessary.

Institutions and Best Practices in Emerging Markets

Best practices transferred from one country to another often prove ineffective because they do not suit the institutions of the receiving one (Ansari, Fiss, & Zajac, 2010). Some best practices are more difficult to transfer than others because they depend extensively on a certain set of institutions (Jensen & Szulanski, 2004). For example, human resource practices that depend on high employee turnover are difficult to implement in countries with strong unions and labor laws that require workers to be financially compensated upon termination. Expats pay particular attention to the transferal of best practices because they are customarily the source of their companies' competitive advantages in foreign countries. Nevertheless, multinational corporations are just in the early stages of understanding how institutions shape their ability to transfer best practices to their subsidiaries in emerging markets.

The ability of expats to understand what type of best practices can be implemented in a particular country depends on their

ability to correctly evaluate its institutions. Kostova, Roth and Dacin (2008) argue that multinational corporations are immune from pressures to make their policies accord with different national institutional contexts. They believe that these companies can choose whether or not to adhere to local institutions. In some countries, some institutions simply cannot be ignored. Friel (2011) points out that although laws and regulations are not enforced for smaller companies in Argentina, larger companies are forced to comply with them. Even if these companies can ignore local institutions without violating the law, it is unclear to what extent such behavior is advisable. In some emerging markets, the local populace, and sometimes even governments, will not tolerate such behavior even if it is legal. For example, companies in Argentina can try to ignore unions or undermine their power. However, if they do so, they can face stiff resistance not only from the populace at large but also potentially from left-leaning national governments.

The Case of Los Grobo[1]

Los Grobo is the largest farm management company in Argentina. At its peak in the 2009-2010 fiscal year, it had 900 employees, worked with 5,000 farm owners and had 4,100 suppliers. During that same period, the company oversaw the production of 2.6 million tons of grain and generated a revenue of US$ 550 million. At that time, the company managed farms in Argentina, Uruguay, Paraguay and Brazil. This company has expertise in every part of its value chain, while simultaneously relying on an extensive network of registered suppliers that work almost exclusively for this company (Bell & Scott, 2010).

Los Grobo CEO Gustavo Grobocopatel believes that paying his suppliers in percentages of the crops harvested and having them compete against each other based on their past performance and availability provides the firm a competitive advantage. Although the company encourages its suppliers to work for others to improve their knowledge, it seeks to retain them in order to build on their experience working with the company. In order to retain them, the firm offers guaranteed trusts for buying their equipment, thereby reducing their financial costs substantively. This type of financial help is particularly useful in emerging markets because interest rates are prohibitively high due to economic and political uncertainty. The company also offers its suppliers training on the latest farming techniques as a way to retain them and improve their productivity. The company CEO believes that this business model works particularly well in Argentina because it is in accord with a cooperative management style typically used in this sector in Argentina. According to Gustavo Grobocopatel, the firm's network-style business model was possible in Argentina because Argentina's work culture is not hierarchical.

Los Grobo began operations in Brazil in 2007. The Los Grobo CEO argues that shortly after beginning its operations there, the company began having problems using its network-based organizational structure. One of the principle problems, according to his assessment, was the hierarchical work culture in the Brazilian agricultural sector. He mentioned, for example, that in Brazil, the company has to book two different hotels, one for workers and one for managers, whereby the hotel for the latter had to be better than the one for the former. In Argentina, he contended that it was not uncommon for managers and workers to even sleep in the same room. At the same time, the type of contracts he had with suppliers in Argentina was simply illegal in Brazil. It was considered a type of slavery. Consequently, Los Grobo ended up using the employees of the land that was rented to it. This form of contracting was in contradiction to this company's business model as it did not allow the firm to create the type of competition between the suppliers that existed in Argentina. At the same time, the company CEO could not motivate workers by paying them in percentages. For all intents and purposes, Los Grobo became a financial company in Brazil because it merely used the existing resources of the farm owners and advanced them money for renting their land. This type of operation did not justify Los Grobo being in Brazil. In 2013, the company sold its Brazilian operations to Mitsubishi.

The Case of Danone[2]

Danone is the world's largest maker of dairy products, representing 52% of the company's sales. It also sells baby nutrition, water and medical nutrition. Sixty percent of its US$21.14 billion in sales in 2012 came from emerging markets. Out of its workforce of almost 100,000 people, 27% of them are employed in the Americas. Executives at Danone are aware of the benefits of adapting best practices and generally empower their local managers to determine which best practices are best for their subsidiaries. Nevertheless, every year it requires all of its subsidiaries to adapt a set of best practices or explain to the company's headquarters why a particular practice will not work in their country. At the same time, the firm allows its subsidiaries extensive leeway in adapting these practices to their local contexts. One of these best practices was DaMaWay, a lean production program. It envisioned creating teams responsible for a variety of activities previously performed by management, thereby enabling the firm to function with fewer managers.

In Argentina, levels of middle management were eliminated but teams were not created. Instead, each individual worker was given responsibility for a machine or part of it and assigned duties previously performed by managers. Workers at this factory would not accept working in teams. They took pride in doing individual work and not that which could be done in a team. To reinforce these feelings of individual pride, management put a picture of the worker responsible for a machine or a particular part of it above his or her work area. The union at this company did not allow the firm to terminate even a

single worker. It also secured significant raises for its members, enabling the highest paid workers to receive more money than the lowest paid managers. So workers did not want to be promoted and managers were unmotivated. Hence, lean production that empowered individual workers made sense because it enabled the firm to fire underpaid, unmotivated managers and give more responsibilities to well-paid workers.

The situation in Brazil was the opposite in many regards. The introduction of DaMaWay changed little in this factory. The only part that did change was the ability of workers to be promoted to managers. Before this never happened. This was a significant source of motivation for workers because an entry-level worker received a salary of approximately US$300 a month, while top floor managers received a salary of US$3,000. Hence, workers were motivated to get promoted and not work together. New positions became available roughly every three months. At the same time, employee turnover ranged between 16% and 18%, making teamwork practically impossible. The weakness of the union at this facility undermined the ability of the firm to reduce this figure. The nature of labor laws in Brazil also limited the ability of this firm to reduce the turnover rate. In this country, firms put 8% of a worker's salary into an escrow account that a worker can access only after being fired. Consequently, firms face no real cost when firing workers. Moreover, workers would often ask to be fired so that they could access this money. It was one of the few avenues open to workers to access additional funds as banks would not lend to them money and black market loans were prohibitively expensive.

Conclusion and Ramifications

The cases of Los Grobo and Danone demonstrate that institutions in Argentina and Brazil are radically different and that these differences have a dramatic impact not only on how a best practice needs to be adapted but also occasionally on whether it can be adapted at all. Expats need to be aware of these differences so that they can avoid making potentially costly mistakes. This article also demonstrates that executives also cannot assume that even two neighboring emerging market countries from a similar cultural background have similar institutions. They cannot rely solely on general overviews of institutional settings in regions such as Latin America because they tend to overlook important differences such as the nature of labor laws. Although both Brazil and Argentina are said to have strong labor laws, this article demonstrates that the laws in each country have a dramatically different impact on the best practices firms can implement.

References

Ansari, S., Fiss, P., & Zajac, E. 2010. Made to fit: How practices vary as they diffuse. *Academy of Management Review,* 35: 67-92.

Bell, D., & Scott, S. 2010. *Los Grobo: Farming's future?* Harvard Business School Case #511088.

Friel, D. 2011. Forging a comparative institutional advantage in Argentina: implications for theory and praxis. *Human Relations,* 64(4): 553-572

Friel, D., & Pinot de Villechenon, F. 2018. Adapting a lean production program to national institutions in Latin America: Danone in Argentina and Brazil. *International Management,* 24(3): 284-299.

Hall, P., & Soskice, D. 2001. Introduction. In P. Hall & D. Soskice (Eds), *Varieties of capitalism: The institutional foundations of comparative advantage*. London: Oxford University Press: 1-68.

Jensen, R., & Szulanski, G. 2004. Stickiness and the adaptation of organizational practices in cross-border knowledge transfers. *Journal of International Business Studies*, 35: 508-523.

Khanna, T., & Palepu, K. 1997. Why focused strategies may be wrong for emerging markets. *Harvard Business Review*, 75: 41-48.

Kostova, T., Roth, K., & Dacin, T. 2008. Institutional theory in the study of multinational corporations: a critique and new directions. *Academy of Management Review*, 33: 994-1006.

Endnotes

1 All information cited in this section except in the first paragraph is based on interviews this author conducted with the company CEO.

2 The information contained in this section is based on an article by Friel and Pinot de Villechenon (2018).

Daniel Friel (dfriel@udesa.edu.ar) is an Associate Professor of Strategic Management at the Universidad de San Andrés in Buenos Aires, Argentina. He obtained a Ph.D. in Political Science from the New School for Social Research in New York. His work focuses on the impact of institutions on the strategies and export policies of firms in Latin America. It includes work on the agricultural industry, foodstuffs, metallurgic firms and the wine industry.

EDITORIAL POLICY

AIB Insights is the Academy of International Business official publication that provides an outlet for short (around 2,500 words), interesting, topical, current and thought-provoking articles.

Articles can discuss theoretical, empirical, practical, or pedagogical issues affecting the international business community. The publication seeks articles that have an international business and cross-disciplinary orientation with IB researchers and faculty as the intended primary audience.

Authors should highlight the insight of their article in the first paragraph. They should prompt the reader to think about international business and international business teaching/learning in new ways. Articles sought should be grounded in research, but presented in a readable and accessible format.

Articles written for *AIB Insights* should be free of professional jargon and technical terms, light on references, but heavy on insight from the authors' experiences and research. Terminology should be defined if it is not in the common domain of the IB literature. Authors should remember the intended audience of the publication and write accordingly. A regression equation, a correlation matrix, a table or a graph needed to support a point may be included.

AIB Insights does not seek the kind of articles that are intended for traditional journals in international business, such as the *Journal of International Business Studies*. The publication is intended to inform, educate, and enlighten readers with state of the art information on a topic with a broad appeal to the profession. Acceptable articles may fall into one of several categories:

1. Research insights from authors' stream of research
2. Current issues affecting international business as a discipline
3. The use of technology in international business
4. The evolving nature and evolution of the International Business department/function/discipline
5. Internationalization of the curriculum
6. Innovative approaches to teaching international business
7. Teaching pedagogy and content articles
8. Other topics of interest

Please include a cover page with all the authors' contact details (email, university affiliation, full address, telephone, fax if used). The second page should include 50-75 word biographies of participating authors. Articles submitted should follow *JIBS* referencing style for consistency. *AIB Insights* is published four times a year and available in print and digital format. Please submit your manuscript via our online manuscript submission system at *aib.msu.edu/publications/insights.* For any questions, please contact the *AIB Insights* editorial team via email at *insights@aib.msu.edu*.

Submit your manuscript at *aib.msu.edu/publications/insights*

AIB Insights (ISSN: print 1938-9590; online: 1938-9604) is an official AIB publication and provides an outlet for short, topical, stimulating, and provocative articles. Past issues of *AIB Insights* can be accessed at *aib.msu.edu/publications/insights*.

AIB Insights is jointly published with the *AIB Newsletter* by the Academy of International Business Secretariat. For more information, contact the AIB Media and Communications Coordinator at:

Academy of International Business
Michigan State University
Eppley Center
645 N Shaw Ln, Rm 7
East Lansing, MI 48824 USA
Tel: +1-517-432-1452
Fax: +1-517-432-1009
Email: media@aib.msu.edu

Past Editors:
Daniel Rottig, Editor (2016-18) &
Associate Editor (2013-15)
Romie Littrell, Editor (2013-15)
Ilan Alon, Editor (2009-12)
Tamir Agmon, Editor (2004-08)
Betty Jane Punnett, Founding Editor (2001-03)

***AIB Insights* Editorial Team**

John Mezias, Ph.D., Editor
University of Miami, USA

William Newburry, Ph.D., Associate Editor
Florida International University, USA

Chei Hwee Chua, Communications Director
University of Miami, USA

Anne Hoekman, Managing Editor
Michigan State University, USA

100% recycled

Copyright © 2019 Academy of International Business