PART II

DEVELOPMENT POLICIES UNDER GLOBALIZATION:

POLICIES, ACTORS, AND SOCIETY

CHAPTER 5

FIRMS IN DEVELOPING COUNTRIES AND GLOBALIZAION

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This paper is intended to look into development strategies in the 21st century by focusing on firms that are principal actors of the micro economy. As a part of the "Development Strategies in the 21st Century" project, the author of this paper organized a research team that for two years studied the transformation of enterprises in developing countries amid the globalization of economy. This paper outlines some of the findings by the research team.

1. SUBJECT OF THE STUDY

We regard globalization as the key term to understand the 21st century, and attempted to search for a model of firms in developing countries in the 21st century by examining how they are trying to cope with the impact of globalization. We assume "firms in developing countries" to be locally based firms. The decision to select them as the subject of study reflects to a great extent our high expectations on and our academic interest in such local firms. Whether such expectations can be justified by the realities of local firms will be discussed later in relation to the results of our research. Subject of our study are seven countries in two regions: Mexico, Venezuela, Brazil and Chile in Latin America, and South Korea, Taiwan and China in Asia. We made an analysis of the transformation of leading local firms in each country amid globalization. The firms selected for the analysis are mostly those local firms that are coping relatively well with globalization in countries with relatively large economies and favorable economic performances. For that reason, the results of the research tend to underscore the positive aspects of globalization. The author would like to point this out beforehand as the limitations of our research resulting from the limited scope of firms analyzed.

2. ECONOMIC GLOBALIZATION AND FIRMS IN DEVELOPING COUNTRIES

"Economic globalization is a process towards the widening of the extent and form of cross-border transactions, and of the deepening of the economic interdependence between the actions of globalizing entities" (Dunning [1997]). Globalization became a conspicuous trend during the 1970s and advanced rapidly in the 1990s. We consider the following are important factors that promoted globalization.

First, the importance of the role of state in the economy declined. The lost effectiveness of Keynesian economic policies in advanced capitalist nations and the shift to market oriented policies prompted by the deadlock of socialist economies in Eastern Europe and Russia pulled down many institutional barriers that hindered movements of goods and money across borders [Yergin and Stanislaw [1998] Ito [1997]).

The second factor is international competition among firms that actually undertake economic activities. Such competition gained in intensity since the 1970s, during which the postwar catch-up process ended among Europe, the United States and Japan, and encouraged firms to expand their business operations beyond national borders (Dunning [1997]).

The third factor is the innovation of information technology, as represented by computers and the Internet. The substantial reduction in the cost and time required for information processing and communications by the new technologies provided the technological basis for globalization (James [1999]).

What is important for developing countries and firms there is that the above-mentioned three key factors all came from the industrialized world of Europe, the United States and Japan and thus the economic order amid globalization has been shaped by the initiative of these industrial nations. The inclusion of developing countries and their firms into the trend of globalization means their late entry into the economic order being formed by others, whether they chose to embrace it of their own will(as in Asia) or were half compelled to accept it (as in Latin America). Moreover, their power relationship vis-à-vis leading nations were asymmetric both politically and economically (Woods [2000]). This situation needs to be taken into account first of all in examining the responses to globalization by firms in developing countries.

Generally speaking, firms in developing countries are distinctly different from firms in industrial nations in the following aspects.

First, firms in developing countries lag behind in a range of corporate capabilities because of their being latecomers. More specifically, they have comparative disadvantage to firms in industrial nations in such areas as financial resources, technological strength, human resources and management capabilities as they entered the industrialization process late as firms born in

less developed countries.

Second, they have acquired during the course of growth unique characteristics due to the political, social and economic conditions peculiar to developing countries. Such qualities include management control by owners' families, cozy ties with the political authority, oligopolistic control of industry nurtured under the protective system, and excessive diversification of business operations, those qualities especially seen among big firms.

Third, they have advantages and disadvantages of having corporate headquarters in developing countries. The disadvantages are, among others, the narrow and shallow markets due to the low and inequitable distribution of income, the inadequate growth of financial markets, the shortage of human resources and technological accumulation, macroeconomic instability, and political interferences. On the advantage side, firms in developing countries have business chances stemming from the gap in development with industrial nations.

When being absorbed by the trend of globalization and faced with tough international competition, how do these characteristics affect the survival of firms in developing countries? How are they coping with international competition?

3. IMPACT OF GLOBALIZATION

First of all, let us give you a panoramic view of the changes that have been observed in the subject firms amid globalization. In Mexico, China and Taiwan, there have emerged local firms that seized the chance of globalization to expand into international operations. Cemex, a Mexican cement producer, has turned itself into a multinational corporation by acquiring local firms in Spain, the United States, Latin America and Asia, and is now the third biggest cement multinational in the world. In China, some local home electric appliance makers are growing into major international players. At the head of the pack is Haier, which is expanding exports to the low-end markets of industrial nations as well as markets of developing countries and on the path to a multinational corporation by making foreign direct investment in various parts of the world. In Taiwan's personal computer industry, local firms that were able to carve out their positions in the international chain of production met success. Amid the rapidly changing production chain, however, Acer that went into both the upstream and downstream segments of the production chain in the 1990s are now being held in check in growth, and firms with the enhanced degree of specialization are coming to the fore instead.

While there are firms that are still expanding international business operations, others are in difficulty after reaching the stage of international operations. In Chile, the privatization of public enterprises gave birth to local

firms that advanced into neighboring countries through mergers and acquisitions in the first half of the 1990s. Since the Asian currency crisis in 1997, however, an increasing number of such firms are being bought by European and U.S. firms, including electric power firms Endesa and Gener. In South Korea, meanwhile, chaebol conglomerates that had led the country's economic growth were plunged into difficulties following the Asian currency crisis. Of the five major chaebol groups, Daewoo collapsed and Hyundai was divided up, while Samsung, LG and SK groups stay in business. Those remaining groups are trying to revive chaebols by strengthening cross-shareholdings. But the stock ownership of founding families is declining, creating conditions to undermine their control of business.

The conditions are even tougher in Brazil and Venezuela. In Brazil, many local firms were bought up by multinational corporations amid fierce domestic competition brought about by the economic liberalization of the latter half of the 1990s. In Venezuela, since the economic liberalization and banking crisis in the early 1990s, most of large corporate groups, like Empresas Mendoza and Corimon that emerged in the process of import-substitution industrialization, have been bought up by multinationals. In both countries, there still exist a small number of local firms that survived tough competition to keep growing in food processing and other traditional industry sectors.

If the above-described developments are to be summed up in a sentence, the selection of viable local firms is under way amid intensifying global competition. Competition produces both winners and losers. But what should be noted is that a loss in competition does not necessarily mean the total disappearance of losing firms. If a firm is understood to be an autonomous organization made up of owners, managers and employees with distinct principle (specifically, management policy and strategy) and corporate resources, what have been lost are owners, managers and principle of the organization, and when restructuring was carried out, part of employees and corporate resources. Most of employees and corporate resources were inherited and incorporated as part of another organization. In the following section, we are going to examine what has differentiated winners and losers, by defining the winners as firms that have achieved growth while retaining their original corporate organizations and the losers as firms that disappeared as independent corporate entities.

4. DIFFERENCES BETWEEN LATIN AMERICA AND ASIA

Both Latin America and Asia have their own shares of winners and losers. But they are of a somewhat different nature.

By industry, winners in Latin America are concentrated in traditional in-

dustry sectors such as cement and food processing, while Asia, in addition to these traditional industries, has winners in the machine and equipment production of assembly type. What is behind this difference? We can cite the economic crises that hit both regions in the past 15 years until 1997 as an important differentiating factor. Latin America experienced the three economic crises: the external debt crisis in 1982, the Mexican currency crisis in 1994 and the aftermath of Asian currency crisis in 1997. On the other hand, Asia recovered from the debt crisis of 1982 with the arrival of the economic boom in the latter half of the 1980s and enjoyed that boom until 1997. Latin America went through economic structural reform amid the economic stagnation through the early 1990s, while Asia managed to achieve the upgrading of the industrial structure in prosperity, with the machinery and equipment assembly industry as the leading sector. We consider the difference in winning industries between the two regions reflect the difference in experiences in the past 15 years until 1997.

Relating to winning industries, another important difference between two regions is a difference in degree of integration into the international division of labor. Firms in Asia have achieved growth by being firmly integrated in the international chain of machinery and equipment production of assembly type, promoted by the U.S. and Japanese firms. On the other hand, in Latin America, formation of the similar type of international chain of production must be waited up until the structural economic reform, and in the process of its formation local firms were not encouraged to enter into the chain. Actually the degree of integration of Latin American firms is far below of Asian firms.

However above-mentioned differences would not be considered of permanent nature. For example, the difference in experiences of crisis affects the conditions of firms after the Asian currency crisis. Firms in Latin America met with the 1997 crisis after undergoing the two crises and going through the process of selection in those periods. Firms in Asia, meanwhile, faced the life-or-death crisis for the first time after experiencing the long period of the booming economies, with a good example found in South Korea. In that sense, it can be said that Asian firms are belatedly emulating the experiences of Latin American peers in a condensed manner. On the other hand, there also exist a possibility that Latin American firms that have survived frequent economic crisis enter into the newly formed production chain. Some more time seems to be required to have prospect in future because the situation still continued to be fluid.

5. REQUIREMENTS FOR SURVIVAL OF FIRMS IN DEVELOPING COUNTRIES

What types of firms are achieving growth amid intense international competition? The winners among our study subjects have the following features in common.

First, they are in industries with the high degree of maturity, standardization or public disclosure of product or processing technologies. This aspect of traditional industries such as cement and food processing is easy to understand given the long corporate history of successful firms and the accumulation of technologies during those years. As for relatively new industries such as personal computers and home electric appliances (like refrigerators and washing machines), being assembly industries seem to be of great significance. In these industries, technological innovation takes place at a rapid pace and technologies also become obsolete and are opened quite rapidly. Therefore, even firms in developing countries can improve technological capacity by learning and outsource core parts and components they are not capable of making with their own technologies. This allows them to enter markets and grow there if they adequately choose product segments or positions in the international chain of production.

The second common feature of the winning firms is that they are eager in creating new markets through the cultivation of niche markets in industrial nations and of markets of developing countries, construction of distribution systems and information and communications networks, establishment of new brands, etc. Essential for the creation of new markets are corporate resources based on experiences and networks. In this area, firms in developing countries can have capabilities equal to or larger than those of firms in industrial nations. Capabilities of creating new markets are their important strength for making up for the disadvantages in competition with firms in industrial nations.

In connection with this feature, the third feature shared by the winners is that their home base provides them with conditions that foster their competitive advantages against rival firms in industrial nations. It offers, for example, abundant cheap and highly qualified labor, large and rapidly growing market, a motivation for corporate innovation because of existing fierce competition among firms, and an opportunity to accumulate corporate resources that could be utilized for a creation of new market in other developing countries. These strengths derived from home base overlap with the "Diamond of the Competitive Advantages of Nations" as described by Michael Porter. As home base conditions essential for corporate innovation, Porter cited the diamond consisting of four elements: factor condition, demand condition, related and supporting industries, and firms strategy, structure and rivaly [Porter 1990]. In the case we cited, cheap and highly qualified labor relates to factor condi-

tion, large and rapidly growing market and the accumulation of corporate resources for a creation of new market relates to demand condition, and competition among firms can be regarded as the firms strategy, structure and rivaly.

The fourth common characteristic of winners in developing countries is that they are not saddled with financial difficulties. This may not be the common strength of winners. Rather, there were so many losers who failed directly because of the mismanagement of financial risks. With the progress of globalization, international financial markets became increasingly volatile (Strange [1986]). In addition to volatility risks, firms in developing countries face risk premiums associated with home countries. The reasons why winning firms in developing countries are not faced with financial problems include their excellent capabilities to manage financial risks, macroeconomic stability of home countries, and relatively small risk premiums on home countries. Financial risk management capabilities have become extremely important for corporate survival.

The fifth factor in common, which is related to the first common feature, is a tendency to select domain of business and concentrate corporate resources there. One of the key previously noticeable characteristics of firms in developing countries, as we discussed earlier, was the diversification of business operations. This characteristic apparently has undergone change, as international competition no longer allows them to disperse corporate resources into varied businesses. Incidentally, there is no recognizable trend as to management control by owner families, another of the key previously noticeable characteristics of firms in developing countries. In Asia, the control of firms by owner families was blamed for reckless borrowings, which is said to have invited the currency crisis. Against this background, in South Korea for example, reform of corporate governance was one of the key policy agenda in the wake of the crisis. In Latin America, on the other hand, management reform at private firms did not emerge as a policy issue because the economic crises were caused mainly by the deterioration of government finances. So, owner families still maintain the firm grip on management even at growing firms. As with the case of Cemex, family ownership in some cases proved advantageous in allowing firms to make a drastic shift in business strategies or quick business decisions. Therefore, management control by owner families itself cannot be construed as an important factor that differentiate winners from losers. Based on the above-mentioned definition of corporate entities, we can say that firms can be winners or losers not by the identity of owners and managers but by the quality of managers and the contents of their business principle.

6. MODEL OF FIRMS LEADING DEVELOPMENT IN THE 21ST CENTURY

The common features of growing firms examined in the preceding section give shape to one model of developing country firms that may lead development in the 21st century. The model is the "firm that has technological strength and capabilities to create new markets, utilizes the strengths derived from home base, excels in financial risk management, and select domain of business and concentrate there its corporate resources." Armed with unique competitive advantage, the model firm can compete with rival firms from industrial nations in the international market on an equal footing. This model is applicable to a growing number of multinational corporations that originated in developing countries (Kumar [1981] Wells [1983] Lall [1983] United Nations [1993] Chudnovsky and Lopez [1999]). We call it "one model" because this model has been derived inductively from the limited scope of study subjects that are mostly biggest local firms in developing countries in the relatively advanced stages of industrialization. Separate research needs to be conducted on less industrialized developing countries or smaller local firms.

While there are multinational firms from developing countries that are still growing, they are expected to confront with a variety of difficulties in achieving sustained growth.

First, they may be negatively affected by their being based in developing countries. In particular, the influence of the macroeconomic instability may loom. In that case, they will find it important to strengthen their risk management capabilities.

The second problem is that risk management is not an easy task. Financial risk management is particularly difficult because it involves an assessment totally outside control by firms concerned, namely, confidence by international financial markets. The problem is doubly difficult to deal with because that assessment also takes into account an assessment about home country.

Third, the strengths derived from home base cannot necessarily be sustained for long. For example, cheap labor gradually becomes hard to get with the progress of industrialization and the enhancement of the standards of living (as seen in Taiwan). Also, such strengths do not necessarily provide competitive advantage if there exist domestic rivals (as seen in China). Moreover, corporate resources accumulated with the experiences of business in developing countries do not provide a competitive edge over firms backed by similar corporate resources (as the case of Cemex).

Fourth, technological backwardness is hard to overcome. If technological innovation is go through the three stages of catching up, keeping up and getting ahead (Mytelka [1999]), the innovation strategies of the subject firms in our study are at the stage of keeping up at best. Strategies of getting ahead are

needed to get out of the technological dependence on firms in industrial nations. But at this stage firms have no precedents to learn from, so they face much greater difficulties and uncertainties.

The fifth problem relates to the upgrading of corporate resources in the course of international competition. As long as they stay in international competition, even firms from developing countries are compelled to upgrade their corporate resources at the same pace as rival firms in industrial nations.

Even internationally active firms cannot completely free themselves from the handicaps typical of firms coming from developing countries. Then, what will make up for these handicaps? Akira Suehiro termed the "innovative combination" the entrepreneurship demonstrated by local firms in Asia in the combination of existing corporate resources (Suehiro [2000]). Firms that sustain growth amid fierce international competition are those that demonstrate innovativeness in combining corporate resources. The key is the combination of technological capabilities, capabilities to create new markets, strengths derived from home base, and financial risk management capabilities. Each component of corporate resources owned by these firms can be easily emulated, and competitive advantages based on each component cannot be sustained long. However, when more than once corporate resources are combined, potential competitors would need greater costs and longer time to emulate all the components. In addition, the "excellence of the combination" may give firms the originality that can never be emulated by competitors. Competitive advantages acquired this way may be maintained for a long period of time.

At any rate, even firms on the track of growth find a severe path ahead. Similarly successful firms might emerge in the future, but we have to say the hurdles newcomers have to clear are extremely high.

7. DEVELOPMENT OF COUNTRIES AND GROWTH OF FIRMS

In the final section, we would like to cover the important problem that was outside the scope of our study but needs to be dealt with going forward, which is the impact of international expansion of firms in developing countries on the economy of developing countries. In this case, developing countries refers both home base country and host country of firms concerned. The interests of the nation and firms do not come into conflict as long as firms grow by mobilizing corporate resources to create employment and wealth within the national boundaries. At this stage, firms could be regarded as the national agents for development. But when firms expanded beyond national borders to compete with firms from other countries, the interests of firms came to clash with the interests of the nation. This is the longstanding theme in the studies

on multinational corporation (Vernon [1971]). How does the transformation of local firms into multinationals affect the economy of developing countries?

With regard to the interest of host country, let us exemplify by the Venezuelan case. The cement division of Venezuela's Empresas Mendoza was purchased by Cemex of Mexico. Through post-acquisition restructuring of operations, the purchased entity improved efficiency and strengthened its international competitiveness, a development that can be considered as Cemex's contribution to the upgrading of the local economy. However, on the other side of the coin, we saw the dismissal of a large number of employees. Employment problems also have to do with the economic dynamism of host country. If a host country has the dynamism to upgrade its economy and create new jobs, surplus labor would be absorbed eventually, only leaving the problems of the adjustment process and the allocation of costs during that process. But in an economy lacking dynamism, like in Venezuela, the prospect is bleak for the creation of employment through the economic upgrading. One conceivable scenario for the Venezuelan economy is the economic bipolarization into a very few number of very efficient industries (firms) controlled by multinationals and the state's oil monopoly and a majority of inefficient industries (firms) controlled by local capital. The problem has to do with not only multinationals from developing countries but multinationals in general, including those from developed countries. How mergers and acquisitions by multinationals of firms in developing countries affect the economy of developing countries? This subject remains to be studied empirically in future.

On the other hand, how does the international expansion of firms in developing countries affects development of home base countries? This issue is related to our expectations on local firms explained at the outset of this paper. Let us consider this also through the case of Cemex. Loss of jobs by business restructuring can also happen in Cemex in Mexico, its home base country. In that sense, Mexico is not free from problems experienced by Venezuela. What we would like to focus on is whether Mexico is benefiting from Cemex being a local Mexican firm in any way denied to Venezuela. More plainly, the question is how Cemex is contributing to the upgrading of the Mexican economy. Sanjaya Lall and others surveyed the impact of overseas direct investment by developing country firms on home countries' international balance of payments, employment and income, technologies and skills, industrial structure, government revenues, and other areas (United Nations [1993]). They noted the measurement of such impact entails a methodological problem that assumptions would significantly influence results. They also noted any conclusion would be no more than reasoned deductions because of limited research data on developing countries. Yet, relying on the analogical reasoning based on research data on industrial nations and a limited number of developing countries, they reached a conclusion that foreign direct investment by developing country firms seems to have a positive impact on home base countries

in net terms. The net positive impact may differ in scope and quality depending on type of activities and country. If home countries' economies are open and full of technological dynamism, they argued, foreign direct investment has potential to contribute to upgrading the home country economies through feedback effects. Porter argued that the diamond of the competitive advantages of nations can provide firms with conditions for acquiring competitive advantages. If we go along with these lines of thinking, the competitive advantages of nations help firms upgrade their competitive advantages and encourage them to expand into international markets, and firms can help further raise the competitive advantages of nations through the feedback of competitive advantages acquired in the process of internationalization. In this case, the competitive advantages of home countries and firms mutually influence each other. Our latest research did not extend far enough to make a full examination of this relationship between national economies and firms' activities. We have to leave the matter as a subject of our future research.

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