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## Corporate Governance for a New Environment: Adjusting Ownership and Organization in an Integrated Market

AREA: 4  
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*Gobierno corporativo para un nuevo entorno: Ajuste de propiedad y organización en un mercado integrado*

*Governança corporativa para um novo ambiente: Ajustamento de propriedade e organização num mercado integrado*

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*Multinational operations in Latin America – whether foreign or locally owned – experienced a dramatic change in their environment during the decade of the 1990s. Starting from a world in which each country was virtually isolated from their neighbors, a series of dramatic political changes brought about significant economic liberalization in its wake, including an explicit policy of market integration both regionally and globally. Firms that operated historically in a federal governance structure, with each subsidiary essentially operating exclusively in its own market and protected by high trade and investment barriers, were driven to change their operational, ownership and managerial structures in order to survive and prosper. The difficulties associated with these changes were significant and many firms and owners failed to adopt the necessary governance structures that would facilitate this change. A comparison of Multinational with Multilatinas firms show significant differences in their approaches and suggests the need for the latter to accelerate their managerial investments.*

*Las operaciones multinacionales en Latinoamérica –ya sean de propiedad extranjera o local– experimentaron un cambio espectacular en su entorno durante la década de 1990. Partiendo de un mundo en el que cada país estaba virtualmente aislado de sus vecinos, una serie de profundos cambios políticos favorecieron una significativa liberalización económica, incluyendo políticas de integración de mercados tanto a escala regional como a escala global. Las empresas que históricamente habían estado operando en el marco de una estructura gubernamental (con cada sucursal dedicada exclusivamente a su propio mercado y protegida por sólidas barreras comerciales y de inversión) se vieron obligadas a modificar sus estructuras operativas, de propiedad y de gestión para poder sobrevivir y prosperar. Las dificultades asociadas a estos cambios fueron evidentes y muchas empresas y propietarios no lograron adoptar las estructuras de gobierno necesarias para facilitar el cambio. Si se comparan las empresas multinacionales con las empresas multilatinas, las diferencias son significativas en su enfoque y en la sugerencia de la necesidad de que estas últimas aceleren sus inversiones en gestión.*

*As operações multinacionais na América Latina – quer estrangeiras quer locais – experimentaram uma alteração profunda no seu ambiente durante a década de 1990. Partindo de um mundo em que cada país estava praticamente isolado dos seus vizinhos, uma série de profundas mudanças políticas trouxe consigo uma significativa liberalização económica, incluindo uma política explícita de integração do mercado, quer regional quer globalmente. As firmas que operavam historicamente numa estrutura de governação federal, com cada subsidiária essencialmente a operar exclusivamente no seu próprio mercado e protegida por elevadas barreiras comerciais e de investimento, foram levadas a alterar as suas estruturas operativas, de propriedade e de gestão a fim de sobreviverem e prosperarem. As dificuldades associadas a estas mudanças foram significativas e muitas firmas e proprietários não conseguiram adoptar as necessárias estruturas de governação que teriam facilitado esta mudança. Uma comparação entre firmas Multinacionais e Multilatinas mostra diferenças significativas nas suas abordagens e sugere a necessidade de estas últimas acelerarem os seus investimentos de gestão.*

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## 1. Introduction

Under historical conditions of import-substituting industrialization, most investors approached different countries in Latin America with the expectation that each national operation would serve primarily its domestic market in a tightly controlled oligopoly. Since market size, sophistication and competitive conditions varied greatly in the region, this led to differentiated investment strategies by country in terms of scale, technology and cost structure. Furthermore, the mandated or implicit preference of local authorities for domestic ownership, encouraged multinational companies (MNCs) to establish joint ventures or licensing agreements with local partners. The end result was the creation of corporate networks in Latin America which consisted of largely independent operations, each characterized by different economic structures and ownership arrangements, and each operating primarily in their respective domestic markets under protected conditions.

By 1990, the prevailing political winds in Latin America had shifted in favor of liberal market systems, particularly in the areas of price controls, investment, trade and competition policy. The resulting decrease in barriers to cross-border trade made competition between units belonging to a common network possible for the first time. Operations which had subsisted side by side in spite of differences in cost performance, quality of output and product range, and which were under the control of different owners and boards of directors, found themselves in competition with one another, often with detrimental results. Furthermore, new foreign and domestic competitors, unburdened by historical restrictions, were able to compete in these markets under efficient structures and force the older competitors to rationalize their efforts.

Whereas subsidiary management in any network may (and often do) pursue individual goals that diverge from corporate interests, we generally assume that corporate bosses can establish administrative procedures and manipulate the incentive system (or ultimately change the local managers themselves) in order to align all units into compliance with overall corporate objectives. This is obviously not possible when the network is composed of independent entities not subject to unifying corporate governance. Thus, MNCs operating in Latin America could find themselves facing an unruly group of affiliated companies that exhibit different cost and quality profiles, follow divergent financial interests, and are not responsive to traditional administrative controls. The increased level of competition, both intra-group as well as from external parties, will result in lower profits and threaten the stability and survival of the networks.

In this paper, I set out to analyze the problem of how to coordinate a network of subsidiaries after the environment in which they were established has changed. I will rely on three previous studies: the first one analyzed just such a situation for a large European chemical firm active in the region; whereas the second and third consist of a large survey or European, North American and Latin American firms who struggled with these issues for the past 15 years.

### KEY WORDS

**Corporate governance, MultiLatin companies, Efficiency, Effectiveness, Competitive-ness**

### PALABRAS CLAVE

Gobierno corporativo, Multilatinas, Eficiencia, Eficacia, Competitividad

### PALAVRAS-CHAVE

Governança corporativa, Multilatinas, Eficiência, Eficácia, Competitividade

### JEL CODES

**G300; F230; M160**

## 2. Market Integration in Latin America in the 1990s

After a half-century of import-substituting industrialization (ISI)<sup>1</sup>, “a quiet revolution began to shake the traditional foundations of Latin American economic thought. Slowly but steadily, the once undisputed popularity of state interventionism, inward-looking development, and protectionism began to erode while the values associated with free markets, liberalization, and privatization started to influence the policy dialogue” (Costin & Vanolli, 1998, p. v). This quiet revolution spread from Chile in the 1970s to Mexico a decade later, where the government of president de la Madrid began negotiations for Mexico to join the OECD, then to Bolivia and Argentina (under President Menem in 1989), and eventually reaching Brazil with the introduction of the Real plan by Fernando Cardoso in 1994.

The elements of this economic reform movement are many<sup>2</sup>. Average tariff and non-tariff protection dropped dramatically, intra-regional trade doubled in relative terms, privatization of state-owned enterprises was adopted widely, and fiscal reforms brought public deficits to less than 2-3% in most countries. Foreign investment restrictions were lifted in most instances with inward FDI growing from an annual average level of \$6.2 billion in 1985-90 to \$59.3 billion in 1997-99<sup>3</sup>.

Other reforms such as the liberalization of price controls were achieved in most sec-

tors, tax evasion was pursued vigorously and collections accelerated, while greater transparency was introduced into many hitherto-closed governmental processes (e.g., procurement). Inflation abated dramatically in most countries and measures of economic freedom such as those published by the Frazier Institute in Canada or the Heritage Foundation in the United States showed evidence of rapid advance as compared with similar scores of a decade earlier.<sup>4</sup>

This openness to FDI and drop in external protection drove efficiency considerations to the forefronts. As the reform movement took hold, two different factors impacted the strategies of regional firms. One was that the prospects for growth must have seemed better than at any time in the recent past. Second, the members of these networks now found themselves in potential competition with one another and in need to rationalize their efforts (Dasu & de la Torre, 1997; Robles, 2000, Robles, Simon & Haar, 2003).

4. Many critical reform processes, however, proved to be resistant to change. Labor market rigidities, for instance, persisted in many countries and involved high political costs that nascent democracies were unwilling to pay. Civil service and judicial system reform were significantly behind schedule, as were attempts to deal with official corruption and personal insecurity, two large and nearly intractable problems of Latin American society. Poverty remained difficult to conquer as economic transformation often resulted in higher unemployment, and bureaucracies continued to permeate life and render entrepreneurship a test fit only for the hardiest (Djankov et al., 2000). And as the Mexican (1994), Brazilian (1998), Argentinean (2001) and Venezuelan (2002) crises have proven, much remained to be done to achieve stable growth in the region. Edwards et al. (2007) paint a pessimistic picture for the future.

5. For a history of foreign investment in the region see, for example, Bernstein (1966), Inter-American Development Bank (1968), and Grosse (1989). A more recent discussion of the role of FDI in development can be seen in Meier and Stiglitz (2001). Chudnovsky et al. (1999), Martínez et al. (2005) and Santiso (2007) provide a rare glimpse at the activities of Latin American-based multinational companies in the region. MNCs participation in the region increased across all sectors and countries during our study period; they accounted for 220 of the region's largest 500 companies in 2000, versus 135 in 1995. Robles, Simon and Haar (2003) provide a comprehensive look at the recent trends in the region and their implications for corporate strategies among both MNCs and local companies.

1. This strategy was first articulated by UNCTAD in the early 1950s. It was subsequently adopted and promoted by the Economic Commission for Latin America, an agency of the United Nations (Prebisch, 1964).

2. For an excellent discussion of these developments see Edwards (1995), Costin and Vanolli (1998) and Edwards, Esquivel and Márquez (2007).

3. It is worth noting that cross-border FDI (firms based in one Latin American country investing in one of their neighboring countries) also increased dramatically from less than \$5 billion in 1991 to over \$30 billion in 1997.

### 3. One Firm's Struggle with Adaptation

Let us consider the case of a diversified chemical firm with sales of more than \$20 billion, operating in fields ranging from petrochemicals to pharmaceuticals. Its fibers division, which in 1991 had worldwide sales of approximately \$3 billion and operating income of \$280 million, ran all international operations through Fibers International (FI), a separately organized company that accounted for just over 20% of division sales and for nearly one-third of its total profitability. FI entered Latin America in the late 1950s and had five affiliates in five countries by 1973. Because of prevailing practice or regulatory constraints, the parent company held a majority interest in only two of these. These subsidiaries were very different among themselves, both in terms of size and product sophistication. All enjoyed near monopolies in their respective markets (controlling 35-75% of the market) and were quite profitable.

Beginning in 1989, FI's financial performance took a turn for the worse with return on sales dropping by one half by 1995. Part of the problem was due to the increase in competitive pressures from Asian producers and a rise in capacity investments by other competitors in FI's main markets. But an important factor was the changing competitive environment in Latin America which for the first time encouraged inter-affiliate competition for the same customers.

The relative performance of each affiliate was a function of various factors that included size, technological level and quality of management, as well as of exogenous factors linked to national economic performance. Since nominal exchange rates and inflation rates varied quite dramatically from period to period, relative cost performance between FI affiliates also varied with time independently from their own merits.

FI's European management was convinced that the Latin American group would benefit from coordinating their activities by shifting production among them in response to macroeconomic conditions, and by partially specializing plants along product lines. However significant questions had to be answered regarding the form of coordination, the magnitude of any resulting gains, and the basis for allocating such gains among subsidiaries. The fact that three of these operating units were under different governance structures rendered these problems more complex.

#### 3.1. Modeling Complexity

In order to answer these questions, we built a model of the company's Latin American operations based on extensive research into each of the five companies and local market conditions. Some critical characteristics included the following:

- Customers would not switch producers indiscriminately.
- Foreign FI subsidiaries could match the technology of their local counterparts, but could not easily match the quality of service and support provided by the local company.
- Non-FI domestic producers could match the quality of service and support of domestic FI producers, but not the technology.
- Foreign, non-FI producers had to overcome technical and service disadvantages to gain market share.
- Since technical qualities represent higher barriers to entry than service, the entry barriers for non-FI domestic suppliers were slightly higher than those for foreign FI affiliates.



- About 85% of the markets was made up of commodity products sold basically on price, service and technological performance.

- An additional 15% of the market was made up by specialty products commanding higher prices and protected by proprietary technology and design.

- Set up costs at the plants were rather high each time a new batch was to be produced, therefore encouraging long production runs.

- The total market was relatively inelastic over a certain price range, and highly elastic on either side of it. The upper bounds on synthetic fiber prices were determined by the prices of direct substitutes such as cellulosic and natural fibers. The lower bound was a function of both production costs and substitute prices.

### 3.2 Three Scenarios

Three principal scenarios were constructed that combined two political environments (a continuation of old protective markets versus economic liberalization) and two extreme governance forms (total independence versus unified governance). We named the first scenario "Old World" (OW), and it represents the status quo prior to liberalization. Each company satisfies its domestic demand first, and then exports to non-competing markets to the extent it has excess capacity. Parallel imports are difficult due to protectionist regulations in all countries. In the second scenario, "Wild West" (WW), all firms are free to compete in all markets subject only to market forces, transportation and tariff costs, and profit maximization. The last scenario was labeled "Deus ex Machina" (DEM), and it assumes the existence of a central coordinating agency that allocates markets to producers in a way that maximizes total returns. In-

dividual companies under these rules have no capacity for independent decision. They supply the markets which are assigned to them and they serve all domestic customers as if they were their own, irrespective of the source of supply<sup>6</sup>. A fourth possible scenario combining protected markets and central corporate planning is irrelevant for our purposes<sup>7</sup>.

### 3.3. Simulation Results

It comes as no surprise that 'group' profits were higher in every case had the OW environment of high tariffs, low competitive pressures and no intra-regional trade been preserved. This base case outcome represented profits of \$538 million before tax for the whole group over a five-year period. The WW scenario produces a reduction in the pre-tax profit of 22%, mostly transferred to consumers in the form of lower prices. The share of this loss borne by each FI affiliate is assigned by market forces, and determined by the relative efficiencies of each affiliate and the macroeconomic policies of their respective governments. The DEM scenario (forced collaboration) improves matters and reduces the loss from the OW scenario to less than 9.3%. DEM protects the affiliates from market incursions by their most formidable competitors, their own sister companies, and allows full capacity utilization in the most cost-effective way.

Over 100 simulations runs were carried out, each using different economic policy assumptions. Not once did WW outperform DEM for the group as a whole. Collaboration increased group profits relative

6. Under this arrangement there are no penalties associated with imported FI products since the provenance of the goods is opaque to the final customer. The buyer is serviced by the local FI affiliate with the same quality products and service that would be expected if the local company were actually manufacturing the product.

7. For a full description of the model and its components see Dasu and de la Torre (1997).

to WW by as little as \$40 million (9.6% of the WW figure) to a high of \$202 million (89.8%). But when measured individually, not all subsidiaries did better under DEM than under WW, even when the group did. This illustrates the issue that a mechanism is needed for rebalancing the gains of collaboration among all participants in order to provide the proper incentives when ownership structures do not allow forced coordination.

Similar problems arise when the group begins to contemplate a capacity increase in response to market growth. In one simulation, it emerged that the best country in which to build additional capacity was that of the second most efficient affiliate, because that would do most for the overall competitiveness of the group. Again, absent forced coordination, capacity expansion decisions may require lengthy and difficult negotiations about how benefits are to be distributed.

And what of public welfare? A detailed analysis of the sources of profitability in the base case reveals that only 6.1% of the profits recovered by DEM are due to efficiency gains (the sum of savings in tariffs, transportation and manufacturing costs). The bulk come from higher prices and some minor volume gains. Collaboration, while in the interest of the group, does not appear to be in the interest of society. In order to test this proposition, we ran a second simulation with a much more aggressive external competitor (lower costs and comparative technology) facing duty-free access to some markets in the region. Under these conditions, over 76% of the recovery brought by DEM over WW is due to efficiency gains. These results confirm the intuition that the more severe the competitive conditions, the highest the premium in (and more urgent) the search for cost-reducing solutions.

### 3.4. Conclusions from the Case Analysis

Several general conclusions emerge from the simulation results on how best to integrate the operations of a multi-affiliate organization operating in such a changing environment:

- Whereas an “Old World” scenario is nearly always more profitable for the group, the welfare gains and long-term benefits of open market policies are so evident that governments throughout the region seem unlikely to revert to the old bankrupt system. Therefore, choosing the right adjustment policy is critical.

- Some degree of domestic advantage will always remain, and the natural barriers of transportation and service costs will continue to favor domestic producers to some extent. Yet the gains obtainable by coordinated activities will overcome these remaining barriers in the near term and drive survival and profitability.

- Macroeconomic policies have significant and often destabilizing effect on the competitiveness of individual companies. If governments follow erratic monetary, fiscal and exchange policies, domestic subsidiaries will be subject to large fluctuations in their ability to serve local or export markets competitively.

- A policy of collaboration will in nearly all circumstances increase group performance over the free-for-all competitive (WW) scenario. The increased profitability comes partly from a reduction in consumer surplus, but it is largely caused by a more efficient allocation of production and a reduction in manufacturing and transport costs.

- In a forced collaboration scheme

not all firms will benefit equally, nor will those who benefit do so in all time periods. Therefore, a structure whereby the benefits of collaboration are shared equitably is an essential element to any collaborative agreement.

Some significant issues remain. The model, for instance, does not include the costs of generating DEM levels of collaboration. Adding in administrative costs, information-sharing friction, delays, misunderstandings, etc, would lead to smaller net coordination benefits than those suggested. But nor does the model take into account other possible gains from co-ordination. For instance, we estimated that a central stocking policy for capital equipment and spares would yield inventory savings equivalent to nearly 5% of the group's invested capital. Other benefits in areas such as new product development, borrowing costs, management selection and development, risk sharing, etc., would also contribute to higher returns.

Second, while the advantages of collaboration are obvious for the group as a whole, how to institute the right system of incentives, and when and how to subordinate individual decisions to the group's interest, is not evident. Any structure (short of a buy-out by one of the partners<sup>8</sup>) must take into account that trust must be a critical component of success. Therefore, it may be necessary to scale back short-term expectations and create intermediate forms of collaboration that attain some, but not all, of the benefits while building trust among the parties.

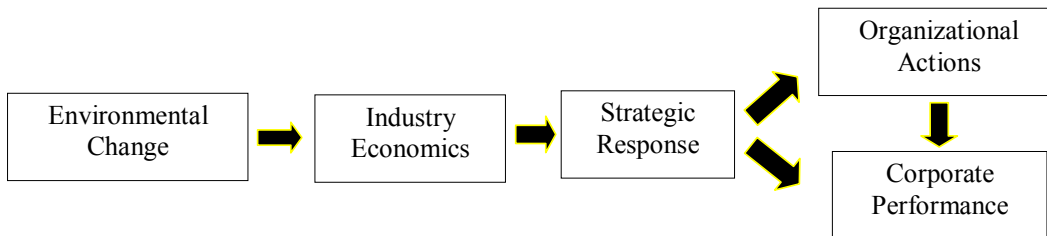
In the end, the optimal solution is probably the hardest to achieve: consolidate the network into one regional holding company owned jointly by all former owners in accordance to their relative values and contributions, in a shared governance structure. This may allow the holding company to be floated in a regional stock exchange gaining liquidity for its previous owners and solving the issue of how best to distribute the gains. Such a solution, although attempted, was out of reach for our case company because some of the local owners refused to trade their majority shares in their domestic subsidiaries for a minority share in a regional holding company, regardless of the gains in value such a move would signify.

#### 4. A Broader Sample of Multinational Companies

In order to test whether these results were unique to our case company or broadly shared in the market, we set out to survey MNCs in the region. We have argued that environmental change (increased requirements for regional integration in this case) will alter industry economics, which in turn will cause companies to modify their strategies accordingly, and thus adapt their organizations in order to implement the modified strategies. Companies that make these strategic and organizational adjustments in a manner consistent with the environmental changes are expected to perform better than others which do not follow suit, are late in their adjustments, or exaggerate their responses (Rumelt, 1974; Ginsberg and Venkatraman, 1985). The sequence is as follows:

8. In fact, the model might provide an estimate of the increase in the value of the assets in the network associated with a coordinated policy and, therefore, lead to an outright acquisition.





However prevalent, global forces have impacted industries in differentiated ways depending on the nature of products or services they offer and the markets they serve (Bryan et al., 1999). For many companies in certain industries this has meant seeking higher integration of their value-chain activities across geographic areas in search for efficiencies that come from scale, scope and learning economies, and linking their network of subsidiaries tightly (Jarillo and Martinez, 1990; Roth and Morrison, 1992; Birkinshaw et al., 1995; Taggart, 1998; O'Donnell, 2000). Other industries and firms, however, have not experienced the same level of integration pressures. As we stated earlier, the process of subsidiary integration requires considerable coordination efforts (and costs) in order to obtain the desired efficiencies and synergies, and these efforts have not always been painless nor have they brought about improved performance (Mitchell et al., 1992; Ushijima, 2002). Therefore, given natural organizational inertia, we expect that the intensity of a firm's perception of these integrating forces will determine the degree to which coordination efforts will be undertaken (Figure 1).

We can interpret this relationship in a dynamic context. That is, growing pressures from regional integration during this period call for a suitable competitive reaction and a concomitant organizational response from these firms. But again, this response needs to be consistent with the underlying causes.

Inappropriate or exaggerated changes—assuming, of course, equilibrium conditions at the start—are bound to lead to inferior performance.

#### 4.1. The Sample and Method

In order to test these notions, we conducted a mail survey of 449 MNCs in Europe (172) and North America (277). Ninety of the companies had no relevant operations in the region, and an additional 86 firms refused to participate for a variety of reasons, mainly related to corporate policy. We received 75 completed questionnaires, of which 17 were discarded for various reasons, mainly related to incomplete data. The questionnaires were mailed or emailed beginning in 2001 to the most senior executive responsible for Latin American operations or, in cases where these were not known, to the company's CEO. A letter announcing the project was sent to all companies ahead of time. All respondents were followed up with telephone calls during which the proper respondent was confirmed or identified. Questionnaires were sent in English, Spanish and Portuguese, properly translated by the authors and back translated independently for control purposes.

## 4.2. Conclusions from the MNC Survey Data

The data confirm that managers responsible for Latin American operations in major North American and European multinational companies perceived a rapid and significant increase in globalization and integration pressures within their region during the 1990s. The process of market integration and economic liberalization that followed the fall of the Berlin Wall and which spread across the region in this decade placed a considerable premium on a coordinated response. Lower tariffs, large increases in FDI and a remarkable drop in regulatory barriers to cross-border transactions all conspired to render purely nationally responsive or multi-domestic structures inefficient relative to those resulting from more integrated approaches. The growth of multinational distribution alone, for example, made it imperative for consumer product companies in the region to coordinate their national offerings to companies such as Wal-Mart, Carrefour and Royal Ahold<sup>9</sup>. Multinational companies that responded to these changes by increasing centralization of decision-making and by greater coordination of their activities in the region stood a better chance of exploiting the opportunities for market expansion or scale economies that these events created. Those which did not react accordingly or that over-structured their operations relative to the demands of the new environment stood to lose ground in the competitive shakeout which followed.

The organizational response most often associated with these changes in economic and market conditions was a significant increase in the formalization of relationships

between local subsidiaries and regional (or global, in some cases) headquarters. Yet, other measures of intra-firm coordination, such as increased use of planning and control mechanisms or an increase in the use of expatriate personnel, showed similar results. The relative complexity of the integrative process and the small size of the sample combined to render clear conclusions difficult to obtain. But most results point to a direct relationship between the degree to which management felt the pressures of the new environment and the actions they took to bring a far flung empire of hitherto independent units under central control.

Perhaps most importantly, the evidence confirms a link between a firm's performance and the appropriateness of its response to these pressures. Whenever management chose not to act, either out of inertia or owing to a lack of recognition of the importance of these factors, their firms underperformed their competitors in terms of both market (sales and market share) and financial measures. On the other hand, an exaggerated reaction that brought about excessive centralization relative to the demands of industry conditions also seems to have led to lower performance results in most cases. In the first instance, this may be the result of the organization's inability or unwillingness to take advantage of multi-country synergies. Years of operation under autonomous conditions may have hardened positions against cross-border collaboration, or fostered duplicate structures difficult to rationalize. In the latter case, lower performance may come about as stringent centralization snuffs out entrepreneurship or local responsiveness to an extent not justified by competitive conditions.

As integration continues unabated throughout the region in spite of current economic difficulties, and in anticipation of the

9. The number of individual stores these three multinational chains operated in the region rose from just 5 in 1990, to 110 in 1995, and then leapt to 1,920 by 2001. The impact of this change alone on the product demand and supply chains of local companies must have been dramatic.

broader integration of continental markets in the context of regional or subregional negotiations, firms operating in Latin America will have to heed these results as they plan for the future<sup>10</sup>. It seems that the contingency view of strategy-structure-performance, as Wolf and Egelhoff (2002) recently reported, is still alive and well in regional if not in global markets.

## 5. The Experience of Multilatinas

Multinational companies domiciled in emerging countries have expanded significantly in recent years (United Nations, 2000). Latin America produced a number of such budding MNCs during the 1990s. Companies like Arcor and Techint (Argentina), Gerdau, Embraer, CVRD and AmBev (Brazil), LAN Airlines and Andina (Chile), Bavaria and Corona (Colombia), or Cemex and Bimbo (Mexico), among many others, have gained major market share in neighboring or global markets in recent years. The economic and institutional transformation in the region described earlier created favorable conditions that not only attracted established MNCs from abroad but fostered the emergence of locally based multinationals<sup>11</sup>.

By comparing a sample of emerging multinationals in Latin America (“multilatinas” or MLs hereinafter) during the 1990s with the local operations of their more experienced foreign rivals, we can examine the organizational and management processes that accompany the early expansion from national to multinational operations.

### 5.1. Emerging Latin American Multinationals

Although some of the firms that pioneered the foreign expansion from Latin America are quite large—such as Mexico’s Cemex (\$5 billion in sales) or Brazil’s Companhia Vale do Rio Doce (over \$2 billion)—most are relatively small, suggesting a decreasing minimum size for internationalizing firms (Manolova et al., 2002). A growing body of literature is attempting to measure the critical attributes of these new emerging MNCs, including studies on international entrepreneurship (McDougall et al., 1994; Westhead et al., 2001), new “born global” companies (Oviatt & McDougall, 1995; Sharma & Blomstermo, 2003; Knight & Cavusgil, 2004), and high technology companies (Bloodgood et al., 1996). Many of these recent studies are exploratory in nature and predominantly based on case studies. Two important exceptions are Buckley (1990) and Oviatt and McDougall (1994) who develop a theoretical perspective on this theme. More recently, Grosse (2003) provided a useful taxonomy of the challenges emerging market firms encounter in a globalizing economy.

Few studies of emerging MNCs have focused on Latin America. Robles (2000) observed the process undertaken by several large domestic companies to expand into neighboring countries as they developed a regional strategy. Chudnovsky et al. (1999) traced a large set of Latin American companies who undertook international strategies in the early 1990s. Many of these emerging multilatinas were part of local conglomerates or groups, as documented by Peres (1998). Machado da Silva et al. (2001) and Sacramento et al. (2002)

10. For an analysis of the impact of trading agreements (NAFTA and MERCOSUR) on FDI patterns in the region see Frischtak (2004).

11. Treviño and Mixon (2004) found that such institutional proximity was paramount in attracting FDI into Latin America, playing an even larger role than macroeconomic environment.

focused on case studies of Brazilian firms, and a recent special issue of the *Journal of Business Research* (October 2000) included several case studies on emerging multinationals originating in Latin America. Finally, Robles, Simon and Haar (2003) provide a comprehensive look at recent trends in the region and their implications for corporate strategies among both MNCs and local companies. However, the evolution of organizational structures and coordination and control mechanisms within these new smaller international firms, particularly as their networks of operations become more complex and geographically diverse, remains to be studied and understood.

We will now focus on the firm specific assets, management processes and organizational strategies displayed by a group of firms based in Latin America. We analyze the operational and organizational strategies of 40 local firms with rapidly expanding international operations within the region and contrast them with those of the 58 U.S. and European multinational corporations described in section 3 above. By comparing these two sets of firms—emerging and experienced—in the same context and over the same time period we can test for the universality of models of organizational change and adaptation.

## 5.2. Sample and Method

We employed the same questionnaire and followed the same procedures described above in the case of the MNC survey. We mailed the questionnaire to 154 companies in ten countries (Argentina, Brazil, Chile, Colombia, El Salvador, Mexico, Panama, Peru, USA and Venezuela). We eliminated 27 companies for not having sufficient operations in the region, and 8 declined to participate. Following multiple contacts we obtained 55 responses of which 40 were complete.

## 5.3. Conclusions from the Comparison of MNCs and MLs

Our data show that MLs are different from experienced MNCs in both firm specific capabilities and in their organizational processes. It also appears that MLs are evolving in terms of their capabilities to imitate their more experienced rivals, and are adopting more appropriate organizational mechanisms in this process. Not surprisingly, we find that MLs are significantly smaller than MNCs and that they are far more dependent on their home region, suggesting a clear preference for geographic and cultural proximity in their foreign investments. This contrasts with recent “born global” MNCs, particularly in high technology sectors, where firms originating in North America, Europe or Asia have been shown to venture into distant regions as they exploit their competitive advantages. This behavior is related to the fact that research and development, as a percent of sales, and product innovation are far less important for MLs than for MNCs, providing them with a weaker source of competitive advantage at the early stage of internationalization. Instead, region specific knowledge embedded in language, culture, and business practices provides a partial shield against competition from MNCs and allows niches for the MLs’ success. Consistent with these results, there was significant evidence that MLs tend to compete in industries where they face more differentiated (i.e., localized) demand and compete primarily with other local firms, whereas MNCs compete mostly in industries where demand is more homogeneous and other MNCs are active. To the extent that successful MLs begin to expand into more distant and more competitive markets, they will need to close this technology gap with their more experienced rivals.

The data also showed differences in terms

of the management processes used to coordinate and control Latin American operations by these two groups of firms. We anticipated that MLs, being relatively new at the multinational game and facing more heterogeneous markets, would be more concerned with expansion than with efficiency, exhibiting lower needs for integration, coordination and control. Under similar circumstances and facing a similar change in social and economic conditions, MNCs concentrated decision making more, made use of stronger formalization of corporate relations, and used more intensive strategic planning and budgeting processes than MLs. Moreover, they made far more use of corporate control and reporting mechanisms than MLs currently do. From a dynamic perspective, MNCs have also surpassed MLs in expanding the level of regional coordination in the latter part of the 1990s, showing a stronger response to the integration pressures that typified the decade in Latin America.

As MLs acquire experience over time and are exposed to more contested markets further away from their neighborhood (or as more experienced MNCs from other regions move into their markets), these emerging multinationals copy and adopt the managerial practices of the successful, experienced MNCs. The analysis of the data from a reduced sample that excluded the largest MLs and the smallest MNCs gave some partial confirmation of this, in particular in terms of the MLs use of more sophisticated coordinating mechanisms. Indeed, the smaller MNCs in our sample (all originated from Portugal and Spain and managed a network of more recent investments in Latin America) exhibited many of the same characteristics that were predominant among the MLs.

These results have a number of theoretical and policy implications. As Manolova et al. (2002) observe in the context of small firms,

internationalization may spread the firm's resources too thinly and present severe internal coordination problems. Resource constraints, rather than lack of strategic focus may therefore cause a deficit in coordination mechanisms by MLs as well as the emerging multinationals in general. From a Darwinian perspective one must infer that the more complex, although costly, management processes developed by MNCs are efficient, given the contested environment in which they compete. As they seek to enter new territories and to extract higher profits from their current ventures, MLs and emerging multinationals in general will need to become less culture-bound and evolve by adopting many of the managerial processes that can be found in experienced MNCs. A model of gradual learning as firms venture far from home and test their mettle in new competitive environments seems consistent with our evidence.

## 6. Overall Conclusions

These three experiments seem to confirm a simple but powerful assertion: firms operating in multiple countries in Latin America, regardless of their national origin, must constantly adjust to the pressures for regional integration or risk falling behind or, in the extreme, their survival. This implies a vigilant attitude and a constant questioning of governance and organizational mechanisms in play. In addition to the conclusions already stated in each of the three sections above, it may be worthwhile to highlight three points.

First, international expansion will create stress in the availability of key resources and raise the need for and the required sophistication of managerial and control systems in an exponential manner. Firms must be prepared to invest in people and

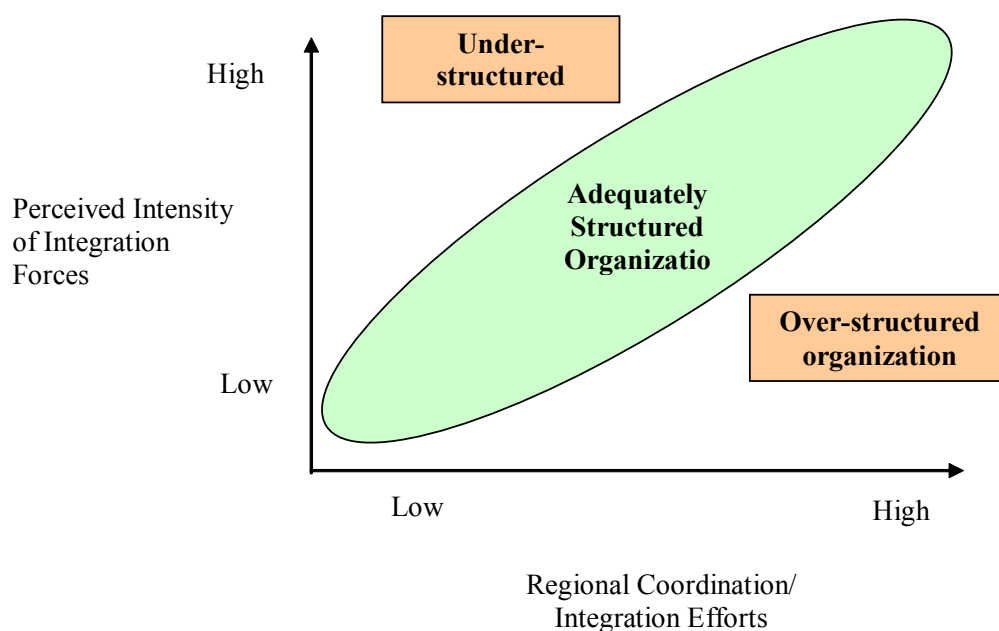


systems that will allow them to deploy such resources as the need for cross-national coordination increases.

Second, a structure consisting of joint ventures with local partners, different in each country, is not conducive to rapid adjustment and may increase friction and resistance to change so as to render adjustment impossible. Therefore, a firm employing such governance structures must anticipate the need to alter them in the future and should establish mechanisms from the beginning that will permit it to buy out local partners, or transfer their interest to a regional organization.

Finally, these are all evolutionary processes. It pays to study the experiences of those who preceded us and observe their mistakes so as to avoid repeating them. By being late arrivals at the multinational game, multinationals have a formidable advantage. They not only know the local markets and consumers better, since the institutional and cultural barriers are lower for them than for distant investors, but they can also learn from the experience of these older and more established firms and, thus, leapfrog their evolutionary steps. In doing so, they can save themselves the pain of breaking up old inadequate structures to create new, more adapted ones.

Figure 1: Integration Forces and Organizational Response



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