Business groups in emerging economies and the public good

- Business groups are widespread in both Western and non-Western countries, where they often account for large segments of the market and gross domestic product (GDP).
- Dirk Matten (Professor at the Schulich School of Business, Canada), together with Professor Melsa Ararat and Professor Aslı M Colpan, explored the role of these groups in economies worldwide, along with their corporate social responsibility.
- Their work highlights the social contributions and shortcomings of business groups, delineating issues that could be addressed by regulators.

Business groups are groups of independent companies that are formally or informally bound together, coordinating their efforts to boost their collective wealth. These influential entities have a dominant role in both developed and emerging economies, collectively accounting for a large percentage of products and services on their internal markets.

Business groups are shaping the socio-economic landscape of many developing countries, including the so-called BRICS nations (ie, Brazil, Russia, India, China, and South Africa), along with South Korea, Mexico, Indonesia, and Malaysia. Groups in these countries include, for instance, the Tata group in India and the Koç group in Turkey.

Yet they also dominate many developed economies, such as those of Japan, Scandinavia, Canada, Australia, and Singapore. Examples include the Parmalat or Agnelli groups in Italy, the Wallenberg group in Sweden, the Mondragon group in Spain, Koch industries in the Unites States, and the Weston group in Canada.

While business groups play a pivotal role in shaping economies, their contribution is often overlooked and rarely examined in business management research. Dirk Matten, Professor at the Schulich School of Business, York University, together with Professor Melsa Ararat and Professor Aslı M Colpan, recently set out to fill this gap in the literature by exploring the central role of these groups and their corporate social responsibility (ie, actions to help society and the environment).

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Key characteristics of business groups

There are many reasons for the lack of management studies exploring the influence of business groups on emerging and developed economies. The first is that these groups are typically owned by families, states, or institutions; thus, their ownership structure greatly differs from the market-driven shareholder model that powers Western capitalist economies.

Rather than pursuing short-term economic goals, business groups often prioritise long-term goals, an economic process referred to as 'patient capital'. Moreover, their economic and social goals are generally aimed at benefitting their respective communities.

A further difference between business groups and companies driven by Western capitalist models is that they defy the idea that a corporate alliance should have a limited set of core competencies. Instead, they often link companies operating in distinct sectors, combining their skills and competencies under the roof of a single parent company.

Business groups also have complex internal structures that diverge from Anglo-Saxon models of diversified organisations. In their research, Matten, Ararat, and Colpan outline three structures that most commonly characterise these groups, namely network, pyramidal, and diversified structures.

Business groups arranged in networks act as decentralised groups of loosely connected companies. Those with a pyramidal structure, on the other hand, consist of many independent companies, often listed on the stock market, with a holding group at the top controlling the majority of their stakes. Finally, diversified business groups consist of independent companies owned and controlled by the same holding company.

Business groups are shaping the socio-economic landscape of many developing countries.

Corporate social responsibility

In contrast with multi-national companies driven by the capitalist model, business groups are often weaved into a nation's political and economic fabric. They may therefore feel a greater obligation towards the public. As they often operate in contexts marked by poor governance, institutional voids, and sometimes even under authoritarian regimes, they have a very different corporate social responsibility.

While the corporate social responsibility of companies following the capitalist model entails things like protecting the environment and promoting human health, business groups often also focus on so-called welfare state provision, engaging citizens and contributing to improving their quality of life. In some countries, for instance, they help to reduce poverty, unemployment, and the marginalisation of communities.

In developing countries, business groups can fuel significant economic growth, with notable benefits for citizens and their welfare. They may also invest in healthcare, public infrastructure, education, and internship/training programmes, contributing to their country's economic empowerment and the provision of essential services.

Notably, the business model employed by these entities addresses many problems associated with contemporary capitalism, for instance tackling income inequalities, promoting the inclusion of marginalised communities, and directly contributing to the flourishing of local communities.

Matten and colleagues explore the role of business groups in economies worldwide, along with their corporate social responsibility.

Challenges and shortcomings of business groups

Despite their positive contributions to global economies, the central role of business groups also raises various concerns. Firstly, as they often control most the market, these groups can stifle competition and limit the development of emergent and smaller companies.

Due to their large size, business groups can also create so-called 'internal capital markets', which entail the use of internal profits and resources to fund their affiliated companies, without requesting loans from banks and financial institutions. This ultimately hinders the development of independent financial and banking systems.

A further concern surrounding the prominent role of business groups is their ability to influence government policies and regulations, which can fuel corruption and reduce their public accountability. In countries governed by authoritarian regimes, state-owned or state-affiliated business groups can also boost the power and stability of regimes, making them harder to subvert.

A complex non-Western economic organisation

Matten, Ararat and Colpan's studies highlight the advantages of business groups over business structures driven by contemporary capitalism, including their contribution to economic empowerment and citizen welfare. Yet these powerful entities can also inhibit equitable and sustainable economic development, fuelling corruption and reducing competition on the market. The researchers emphasise the need to address these issues. In the future, their work could inspire new studies focusing on business groups or regulations aimed at mitigating their adverse socio-economic effects, for instance by increasing transparency and promoting fair competition.

Personal response

What sparked your research interest in business groups?

A decade ago, I wrote a book chapter with Ratan Tata, then Chairman of the Tata Group in India. Tata is one of the 100 most valuable brands in the world and a global player, owning Tetley and Jaguar Rover, for example. During my research, I was impressed how different business groups operate, how socially inclusive they see their purpose, and the scope of engagement for the public good assumed by the group. It excited me to learn more about this specific type of non-Western business model and how it impacts societal welfare in the communities it operates in. As an expert in corporate social responsibility (CSR) I felt that the story of non-Western businesses and their contribution to the public good is not sufficiently told. Hence my research interest in business groups.

How does the role of business groups typically differ in emerging and developed economies?

In developed economies, business groups typically focus on the long-term interests of its owners, predominantly families. In emerging economies, the additional feature is a very strong focus on key arenas of social welfare and community services. Often this comes in company with strong informal influence on political and wider governance processes in these countries – for better or for worse.

What do you feel is the most concerning aspect of business groups and could you provide a real-world example that illustrates this?

The main problems with business groups derive from a lack of transparency in corporate governance and the political influence provided by their sheer size in their respective economies. Scandals at business groups in the developed world such as in Italy, Japan, or South Korea have mostly emanated from accounting frauds and personal embezzlements of powerful insiders. Incidents at Parmalat, Hyundai, Samsung, Olympus, or Toshiba are examples of this. In emerging economies, bribery of governmental officials, vote rigging, and general corruption in obtaining government contracts have occurred. A widely reported case for this has been the Petrobras and 'Car Wash' scandal in Brazil in the last decade. In other cases, such as Turkey or India, business groups historically have been accused of collusion with governments in order to impede markets for investment, hinder market entry of foreign companies, blocking foreign direct investment, and stifling competition in domestic markets through consolidating oligopolistic market structures.

How could the shortcomings and challenges of business groups be addressed?

The shortcomings of business groups can be addressed at three levels. Over time, we have seen that many of these changes have taken place in developed economies. Currently, there is an ongoing process of implementing such changes in emerging and developing economies as well.

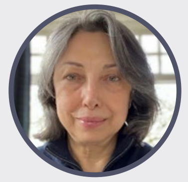
The first level is the political or regulatory level. Creating and regulating financial, labour, and consumer markets are a crucial step to address the power and dominance of business groups. This includes legal duties of transparency, most notably reporting and public accountability process for these companies. It comonly also includes reforms in the taxation system. Often such reforms are accompanied by anti-corruption measures, in particular in the public and political sector of a country. Historically, the development of a strong, independent system of liberal democracy has led to the avoidance of many of those shortcomings in developed countries.

The second level of reform targets the business itself. This includes the appointment of outside directors, management professionals, and a general enhancement of corporate transparency and accountability. Important measures also include a simplification of ownership structures, in particular in the case of pyramidal business groups. Historically, many business groups have consolidated their assets and shrunk the breadth of their involvement to core competencies, which resulted generally in a professionalisation of their approach. More recently, we have seen a rise in corporate social responsibility (or sustainability) programmes in these companies with the goal of professionalising their activities for the public good.

Finally, a third level in addressing many of those shortcomings lies at the individual level of the (often family-based) owners of business groups. This can be considered a specific strength of business groups as the influence of insiders is stronger than in publicly owned businesses. Historically, we have seen this manifest in many forms of paternalistic engagement focusing mostly on employee well-being and flourishing of local communities. Currently, business groups such as Tata in India, or Sabancı and Koç in Turkey, show a strong, owner-driven commitment to CSR and sustainability. Such engagement by individual leaders of business groups can have an influence on competing business groups to follow suit. In some cases, such as India or China, this individual engagement has ultimately encouraged governmental initiatives for CSR, such as the Companies Act of 2013 in India.

Details

Professor Dirk Matten



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Bio

Professor Dirk Matten holds the Hewlett-Packard Chair in Corporate Social Responsibility (CSR) at the Schulich School of Business, York University, Toronto, Canada. He is founding director of Schulich's Centre of Excellence in Responsible Business and was instrumental in making his school one of the world's top-ranked institutions in sustainable business research and education. He has a doctoral degree and the habilitation from Heinrich-Heine-Universität Düsseldorf in Germany.

Melsa Ararat was a Professor of Management and Strategy at Sabancı University, where she served as the founding director of Corporate Governance Forum for 20 years before retiring in 2022. She is currently an advisor to international financial institutions and UN agencies. She served on the board of ICGN for 6 years up until 2019 and coordinated IFC's Emerging Markets Corporate Governance Research Network for 15 years until the same year.

Aslı M Colpan is Professor of Corporate Strategy at the Graduate School of Management and Graduate School of Economics, Kyoto University. She was the Alfred Chandler Visiting Scholar at Harvard Business School in 2016. Previously, she was a visiting scholar at Harvard University and MIT in the 2012–13 academic year, and at Koç University in 2015.

Further reading

- Ararat, M, Colpan, AM, Matten, D, (2018) Business Groups and Corporate Responsibility, *Journal of Business Ethics*, 153, 911–929.
- Cuervo-Cazurra, (2018) The Evolution of Business Groups' Corporate Social Responsibility, *Journal of Business Ethics*, 153, 997–1016.
- Carney, M, et al, (2017) Business group prevalence and impact across countries and over time: what can we learn from the literature. *Multinational Business Review*, 25(1), 52–76. ISSN 1525-383X.