

Taking Stock of Research on Business Groups While Looking Into The Future

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Abstract— This essay identifies key issues pertaining to research on Business Groups coupled with our own perspectives. Our aim in this essay is to highlight emerging trends in the area of research on Business Groups and identify opportunities for research. We summarize the various schools of thought seeking to explain the emergence of Business Groups. We emphasize that with changes in social, cultural and business environment due to the globalization era, new explanations need to be sought. We attempt to offer our own ideas on areas where future research should be targeted. We highlight a number of research themes where future research may add to the extant literature on Business Groups. The research themes represent a more broad-based inside-to-the-business view of theories relating to the external environment (contextual factors). Our analysis suggests that future research on Business Groups should take into account inter-disciplinary perspectives on the subject by building on the agency theory and considering complementary theories on the subject

Index terms - Business Groups, Business Group Theories, Future directions.

I. INTRODUCTION

A. Business Groups Research

The last decade has witnessed an explosion in both policy and academic research devoted to business groups. Business group research studies are having an increasing impact on a wide variety of disciplines including management, organization, economics, finance and corporate governance and strategy. Business Groups are the most noticeable organization form for managing large businesses. However despite their existence since an extended period of time the research in this field tends to be highly fragmented. There has been a growing interest in the study of Business Groups among strategic management and organisational scholars (i.e., Chang and Hong2002; Feenstra et al., 1999; Granovetter,1994;Guillen,200;Guthrie,1997;Keister 1998,1999;Khanna and Palepu,2000a;Khanna and Rivkin 2001;Maman2002) but a systematic and integrative framework for understanding Business Groups seems elusive. The reason for the absence of a clear framework can be attributed to two reasons. The first is the fact that the labels for Business Groups are wide and varies across different countries and regions. For instance the reference to *business houses* in India would imply *keiretsus* in Japan, *qiye jituan* in China, *grupos economicos* in Latin America, *grupos* in Spain,

chaebols in South Korea, *guanxi qiye* in Taiwan and *family holdings* in Turkey(Granovetter, 1994). The second is the fact that in addition to label differences, there are differences in organisational arrangements too.

For instance business groups in certain countries take the form of a family dominating ownership of a corporate parent while member firms are inter-linked through vertical integration (*Korean chaebols*). In certain other countries Business Groups represent partnership interactions among individual or family investors that jointly control business operations and are managed more as strategic networks (Taiwanese '*guanxis*'). As a result research in the area of Business Groups tends to be highly contingent on the context in which business groups operate.

B. Definition of Business Groups:

Business Groups can be defined as legally independent firms joined together by some mechanism, mainly equity ownership and coordinate the use of one or several resources such as financial resources and managerial labour (Collin, 1998). The firms involved are legally independent and have several shareholders.

II. THEORETICAL PERSPECTIVES ON BUSINESS GROUP RESEARCH

Business Groups while fragmented by definition are equally fragmented by the theoretical perspectives used to examine them. **Table-I** exhibits a summary of the different theoretical perspectives used by the scholars.

Table-I: Theoretical perspectives on Business Research

Basic Assumption	
<i>Institutional</i>	BGs emerge to fill institutional voids and market failure.
<i>Dependence</i>	State uses BGs to achieve its political-economic objectives.
<i>Transaction Cost</i>	Markets and organizational hierarchy controls exchange of goods/services.Managers should choose organizational arrangements that can reduce transaction costs.
<i>Relational</i>	Organisations are embedded in social context and hence

	survival is aligned to social ties.
Agency	When principal (owner) delegates decision making to an agent (manager) because of conflict of interest agent may not act in principal's interest.
Key factors	
Institutional	Market development and BGs
Dependence	Role and function of State/Govt
Transaction Cost	External market condition
Relational	Role of social beliefs(social norms)
Agency	Dominant shareholders and Monitoring Managers and their interests.
Key variables	
Institutional	Channeling capital, rotating managerial talent.
Dependence	Relation between govt. policy and BGs structure and control mechanisms
Transaction Cost	Internal transactions
Relational	Inter-firm relations for transactions
Agency	Ownership structure and Corporate governance
Contribution by the theory	
Institutional	Ownership structure and Corporate governance explains how BGs emerged as functional substitutes for markets imperfections
Dependence	Direct relationship between government and BGs.
Transaction Cost	How external market environments influence evolution of BGs.
Relational	Explains heterogeneity of BG pattern in society.
Agency	Identifies unique agency relationship between dominant (small) shareholders and managers.
Limitations of the theory	
Institutional	Fails to explain why BGs exist in markets that are advanced or where there are lesser imperfections
Dependence	Fails to explain why BGs exist in countries where govt. intervention is minimal
Transaction Cost	Fails to explain why BGs exist in an environment with developed market institutions

Relational	Fails to measure the impact of globalization on the persistence of culture, value and norms
Agency	Fails to explain all motives such as stewardship and pro-organisational behavior.

Source: Compiled by the authors.

III. CONTEXTUAL FACTORS AND NEED FOR NEW PERSPECTIVES:

The five theoretical perspectives highlight the external contextual factors that impact business groups. The external factors thus represent external market conditions (Transaction Cost theory) social settings (relational perspective), political-economic factors (political-economic perspective) and external monitoring and control systems (agency theory).

Thus we see that a number of theories have been applied to explain the emergence of Business Groups. Institutional theories assert that Business Groups create value by compensating for a nation's inefficient capital, labour and product market (Clague 1997; Coase 1937,1998; Harriss et al 1995;Leff 1978;North,1990). Social theory proposes that Business Groups represent interactions between state/government objectives and business firms. Transaction cost theory argues that internal business transactions reduce transaction costs(Chang and Hong,2000; Choi et al,1999; Hill 1995; Khanna and Palepu 1997,2000). Agency theory argues that because Business Groups are owned and managed by founder families agency problems are minimized between managers and shareholders.

A. OBBGs and CBBGs and the changing dimensions:

The early stages of economic development with institutional voids' lack of well-developed capital, labour and product markets served as a fertile ground for the emergence of business groups that were typically owner-based. An Owner-based-business group (OBBG) is a family owned and managed company. Such OBBGs had to overcome external market inefficiencies by developing internal market mechanisms. Additionally OBBGs minimized agency problems because they were owned and managed by founder families. However as the economy developed so did the capital, labour and product markets minimizing the need for OBBGs to rely on their internal market. As Business Groups expanded it no longer made sense to finance operations through internally generated capital hence necessitating the dependence on external financing. As time progressed professional managers took over managerial responsibility. In order to prevent dilution of ownership and managerial control the controlling shareholder (founding family) created a control based business group (CBBG) structure to give them managerial control over affiliated firms with limited equity investment of their own. Thus CBBGs emerged as a collection of legally independent companies (which were formerly OBBGs) bound together under the control of the founding family by means of interlocking-ownership (cross-shareholding), (Chang, 2002:

Claessens et al 2000). This led the authors to take a two-dimensional view of Business Groups.

Our first dimension focuses on the horizontal connectedness of member firms in the group. The second dimension represents the ownership control of resources (vertical linkages). **Table-II** exhibits a summary of the various forms of horizontal and vertical linkages among Business Groups as prevalent today.

Table-II: Forms of Horizontal and Vertical Linkages:

Types of Connectedness	
A.Horizontal	
(i)Internal business transactions	
Mechanism	Trading/Allocation of goods/resources among individual firms in same BG.
Reason	Presence of institutional voids so firms make use of internal market for critical resources.
Benefits	Better resource allocation decision among units and superior capacity of asset deployment.
(ii)Cross-shareholding	
Mechanism	Individual firms in BG hold ownership shares between each other.
Reason	Creates inter-dependence among member firms, facilitates resource sharing
Benefits	Protection from market uncertainty, takeover threats and competition
(iii)Interlocking directorates	
Mechanism	Person affiliated to one organization sits on the board of another.
Reason	Impacts corporate behavior (social cohesion, monitoring, career advancement)
Benefits	Coordination mechanism, uncertainty reduction
(iv)Social ties	
Mechanism	Social ties provide BGs with an alternative system to trade goods and resources.
Reason	Social ties act as non-ownership governance devices through which managerial executives coordinate their activities.
Benefits	Creates a community like or club like system that enables resource sharing.
B.Vertical Linkages	
(i)Pyramidal ownership	
Mechanism	Each unit at upper level of BG holds stock in other units at next

	lower level. Eg., 'A' holding company owns 51% share in firm B, which owns 51% share in firm C, which owns 30% in firm D.
Reason	Founding owner/family wants to obtain administrative authority over individual firms
Benefits	Majority control through relatively small investment. Incentive for expropriation.
(ii)Control	
Mechanism	Ownership-management integration by keeping strategic positions within family/friendly personnel
Reason	Retain control
Benefits	BG functions like a network through which individual firms are coordinated as partners to achieve complementary resources.

Source: Compiled by the authors.

B. Future Research Agenda:

While the four theoretical perspectives serve to explain the emergence of Business Groups they need to be examined in the light of internal functioning of business groups. Each of the four perspectives provides a complementary and comprehensive understanding of the contextual factors that influence internal functioning of business groups. **Table-III** presents our contributions on the probable directions of research on business groups.

Table III: Research Questions/ Issues for the future

Horizontal Connectedness	
Institutional	How to BGs change in response to external environment? How BG and context co-evolve over time? How does context shape choice of BG structure?
Social	How do BG structure vary across socialties How does power matter in inter-firm relations.
Transaction	Does resource sharing and transfer of capabilities reflect on BG performance?
Agency	What are the key determinants of ownership structure among BGs?
Dependence	How do BG translate govt. support to firm specific advantages
Vertical Linkages	

<i>Institutional</i>	How does corporate governance shape group strategy formulation
<i>Social</i>	What explains BG firm behavior better formal governance mechanisms or informal governance mechanisms (social ties)
<i>Transaction</i>	What is the impact of interlocking directorates on BGs performance?
<i>Agency</i>	Do BGs expropriate cash flows and cross-subsidize investments against wealth maximization of shareholders.
<i>Dependence</i>	How do agency problems between state owned groups differ from that of family owned groups

CONCLUSION:

In this essay we propose that the various theoretical perspectives of business groups have led to researchers focusing on contextual factors in which business groups operate. Although there are clear differences between the diverse theories, we posit that they can be used to develop a more holistic approach to the research on business groups. By providing a concise view of theories, the key variables, contributions of the theory and limitations we use this discussion to highlight the fact that these theories are in fact complementary to each other. Through this examination and by proposing research ideas we offer guidance to future researchers to choose the theoretical lens they intend to adopt in future.

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