COMPETITIVE ADVANTAGES

A THEORY ON THE COMPETITIVE ADVANTAGES OF BUSINESS GROUPS AND THEIR AFFILIATES

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ABSTRACT: This paper provides a theoretical framework to explain the competitive advantages of business groups and their affiliates. The theory is applicable to the developing economy business groups including those found in the developing economies. The goal is to address the literature on emerging economies which remains short in providing the theoretical background on the nature of different types of emerging economy firms and their competitive advantages. Some theoretical and practical implications are presented to explicate the value of the framework toward our understanding on the growth, behavior and competitiveness of business groups in different economies.

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Introduction

The emerging economy¹ literature appears to have some limitations in understanding the characteristics of emerging economy firms² and their competitive advantages. First, there is no clear explanation on the specific competitive advantages of different types of emerging economy firms, as the conditions of the developing or emerging economies generate different firm structures (Ramamurti & Singh, 2009). Second, the literature neglects the issues on the evolutionary tendencies of such firms and their advantages, i.e., their subsequent development and strengthening across borders (Contractor, 2013; Cuervo-Cazurra, 2012). This research addresses these by focusing on a certain type of emerging economy firm with a unique organisational structure; that is the business group (BG or BGs). A business group is define here as a hierarchy of independent firms with common administrative control and are linked by various

¹ Emerging economies are economies or countries which are considered to be neither under-developed nor advanced (Ramamurti & Singh, 2009; UNCTAD, 2010). These are the countries which recently demonstrated faster growth in response to the globalising world economy; some examples are the BRICS countries or Brazil, Russia, India, China and South Africa.

² Emerging economy firms are firms coming from, or which home countries are, the emerging countries.

social and economic exchanges of resources, interpersonal trust, and mutual adjustment (Granovetter, 1995; Leff, 1978).

Aside from focusing on business groups, this paper also provides a theoretical explanation of their competitive advantages and the subsequent enhancement and evolution of such advantages through their recombination and operationalisation mechanisms. As a type of emerging economy firm, business group is the persistent and most common form of enterprise in emerging economies. Some empirical evidence suggests that business groups in developing economies perform better than their non-business group or stand-alone counterparts (Carney et al., 2011; Khanna & Rivkin, 2001). This is also supported by data which identified the emerging economy business groups as leaders in internationalisation expansion in their economies (UNCTAD, 2010). On the other hand, the assumed competitive advantages of business groups and their affiliates do not have a clear theoretical explanation in the current literature. Thus, the literature has not caught up with tracking the recent development of business groups particularly on their accelerated expansion across borders, as well as mentioning how they utilise their competitiveness vis-à-vis incumbent multinationals and their evolution in the host countries. In addressing this gap, this paper synthesized the previous theories and builds a conceptual model in the hope that a comprehensive explanation on the nature and competitive advantages of business groups will be advanced.

In the succeeding sections, the paper presents the theoretical framework through the following. It starts by presenting its critical analysis and definition of the competitive advantage that is specific to business group organisations using ontological perspectives. Then it explains the two levels of advantages followed by their recombination dynamics. This is followed by the operationalisation, and finally, discussions and conclusion.

Theoretical framework

The competitive advantages of firms remain to be a very fascinating topic for management scholars. This is because firms and their environment continue to evolve which require constant adjustments. This has been the theme of many researchers that focus on the study of firm's resources and growth, competition, and dynamic adaptation (Penrose, 1959; Teece et. al, 1997; Wernerfelt, 1984). Although such theme is recurring in the advanced economies, few are found in the developing economies. This is unfortunate because the spread of globalization has becoming more intense in these economies. Hence, there is less that we know about the adjustments of firms there, and most especially on their competitive advantages which they employ to overcome the challenges.

There are two fundamental levels in explaining the competitive advantages of firms, these are at the country level and at the firm level (Porter, 1990). Although the general understanding is that both perspectives should explain the overall competitive advantage of the firm, clarifying the role of each level is equally valuable. The country level tends to be very general as it is based on the theory of comparative advantage, i.e. the Ricardian model. Therefore, the emergence of the competitive advantage of the firm is the function of the firm's environment, particularly the natural resources, industry and the economic institutions of its home country. As a result, firms are differentiated by how much of the environmental factors are endowed in their organisation. On the other hand, the firm level perspective looks inside the organisation of the firm, following the Penrosian model (Penrose, 1959). The approach is endogenous, which focuses its explanation in the internal working of

the firm's organisation including the capabilities of the employees especially the top managers. The main tenet of this approach is that the competitive advantages of the firm are the result of the combination of environmental resources and the dynamics of the innovative capabilities of the firm's actors. To a greater extent, the environmental factors are just secondary to the overall organisational capabilities of the organisational members. By this, the firms are differentiated by mechanisms, mostly intangible ones, in building capabilities rather than their endowments from the environment.

The emergence of business group's competitive advantages

This paper builds on the Penrosian model in explaining the competitive advantages of business groups. The focus is on the internal dynamics within the organisational structure of business groups and their affiliates. It argues that the environmental or institutional conditions in the emerging economies only serve as inputs for business groups in building their competitive advantages and not the source of advantages themselves. This argumentation is veering away from the previous literature which focuses on the external conditions in explaining the competitive advantages of business groups in emerging economies (Ramamurti & Singh, 2009). Specifically, this research believes that the ultimate competitive advantage of business groups emerges from their innovative response to, rather than based on, their economic environment. This has been the original theme in the study of business groups, such as that of Leff (1978), which looked at the competence of business groups in the internalization of market imperfections in developing economies.

One of the recent bundles of studies on business groups and emerging economies evokes the existence of institutional voids in the developing economies. Institutional voids are problems in the conduct of economic transactions, either soft or hard institutional configurations (Khanna & Palepu, 2000). These studies consider the institutional voids as the overarching framework in understanding the nature and competitive advantages of business groups (Kumar, Gaur, & Pattnaik, 2012). According to this framework, the existence of institutional voids result to the emergence of business groups and their advantages. Therefore, the absence of institutional voids, which can also mean the change of the economic environment of business groups, suppresses the existence of business groups and their competitive advantages. Seemingly, this is not what is happening in different developing and emerging economies, which are now experiencing some improvements in their institutions. The business groups in these economies continue to exhibit resilience and persistence, not mentioning the consistent expansion and growth outside their economies (Ramamurti & Singh, 2009; Siegel and Choudry, 2012). This thesis supports these recent results and considers the institutional voids merely as part of the environmental conditions and not of the nature of business groups. Further, the institutional voids actually inhibit rather than contribute to the growth as well as the development of the competitive advantages of business groups and their affiliates. It is in the internal dynamics of the business group organisation where they strengthen their competitive advantages and position over time.

The business group advantage

As an organisation, business groups develop their competitive advantages by harnessing their internal network. Through internal dynamics or their interaction and response to their economic environment, especially in the developing economies, business groups create a specific type of competitive advantage that is different to typical firms outside their network (Chang & Choi, 1988). Hence, the emergent competitive advantage defines their differentiated position from other firms in a market economy. This paper calls this the *Business Group Advantage (BGA or BGAs)*

as the competitive advantage which accrues exclusively to business group firms. The BGA emerges out of the interaction of a given external condition, such as market imperfections in the economic environment (Leff, 1978), and the coordinated and collaborative response among individual affiliate firms through internal network dynamics (Mahmood et al., 2011). Using the theoretical perspectives of networks and emergence, this research contends that the overall BGA is not necessarily the sum of the advantages of all the affiliates within the business group. It is a collective phenomenon which is not always reducible to characteristics and actions of the affiliates (Durkheim, 1933; Sawyer, 2001). BGA assumes some sort of macro-level characteristics which has its own attributes as a product of recombined external environmental factors and organisational level advantages. Although BGA is a collective concept its elements, such as those that are the subjects of the internal dynamics, could be projected. Three of these stand out in the context of developing economies. These are transaction cost advantages, group managerial capabilities and economies of scale. All three are the common features of the competitive advantages of business groups in the emerging economies (Colpan et. al, 2010).

The transaction cost advantages of business groups are realised as a result of their internalization of market imperfections (Leff, 1978; Chang & Hong, 2000). This is more pronounced in the developing economies where institutional and resource infrastructures are lacking. Business groups can save on transaction costs by creating an internal market which affords them to avoid the inefficiencies of the financial market, unstable supply chain and weak market regulations in the developing economies. With lower costs, business groups achieve higher profitability than non-business group firms (Carney et. al, 2011; Khanna & Rivkin, 2001). The group managerial capabilities are almost an exclusive type of competitive advantages for business groups in the developing economies. This is because the business groups could transfer their successful managerial experiences to their affiliates. When the affiliates need to enter or expand in new markets (including international) the top business group executives provide the necessary technical assistance and direction based on their previous experiences. Therefore, the group affiliates can learn and implement faster compared to other non-business group firms (Mahmood et al., 2011; Tan & Mayer, 2010). As regards economies of scale the business groups tend to be large in the developing economies because of their ease in securing contracts and financial capital. Their size does not only provide them with market power but also affords them to monopolies a considerable share of markets in many industries (Chandler, 1990; Ghemawat & Khanna, 1998).

The levels and sequence of BGAs

The advantages of business groups should be conceptualized at two levels in a sequence. Thus far, the traditional analysis of the potential advantages of the business groups assumes a single direction or an open-loop system. This is the flow of business group advantages from the group to the affiliate. Such explanation is incomplete as it neglects the flow of potential advantages from the affiliate back to the group or the feedback system. Hence, there are two problems in the unidirectional conceptualisation. First, BGAs are assumed to be transferred easily to any affiliate as long as they are affiliated to the business group, hence the traditional concept of 'BG affiliation' as employed in the previous studies (see for example: (Gaur & Kumar, 2009; Kumar, Gaur, & Pattnaik, 2012). Second, the affiliate firms are assumed to exclusively embody the same BGAs. This view overlooks the individual development of advantages by BG affiliates which would arise from their specific operational circumstances and recombination capabilities. In short, the affiliates bring new advantages to the group and in turn make the BGAs dynamic. Therefore, BGAs do not only arise out of the group's interaction with the external environment but also a function of the symbiotic relationships between the group and its affiliates. The

next paragraphs illustrate the dynamics of the bidirectional flow of BGAs through the introduction of the concept of affiliate level advantages.

The competitive advantage of business group affiliates

Consistent with the application of the theory of emergence in explaining the business group advantage, a similar treatment can also be made in understanding its components. It can be argued that since the BGA is stored within the organisation of the business group, the business group affiliates, then, serve as the primary repository of the initial advantages. This argumentation gives us a picture that there are two levels in understanding the competitive advantages of business groups. One is at the group level and the other is at the affiliate level. Both are used in competing with other firms in a certain economy. Thus it is also crucial to provide an explanation on the competitive advantages of business group affiliates. The business group affiliate advantage, or coined in this paper as affiliate level advantage (ALA or ALAs), is the unique resources, capabilities and strengths that are specific to a business group affiliate firm. It varies from one affiliate to the other according to the affiliate's operational scope and interaction with the advantages of the whole group - the BGA, and its direct environment. The interactions provide each affiliate an idiosyncratic competitive advantage which is non-reducible and different from the BGA. The ALAs and their interactions are the foundation of the emergence of the BGAs. The next section attempts to clear up this dynamics.

The recombination dynamics of BGAs and ALAs

The interactions of the group and affiliate advantages are complex because of the difficulty in pinpointing where they start and end. This study believes that this can be understood by looking at the relative strength of the two levels and how they influence each other in a strategic manner. The affiliates are responsible for these interactions because of their operational and administrative objectives as per the demand of their respective industries. This paper calls these interactions as the recombination dynamics, which are the mix of competitive and complementary actions that affiliates are subject to (Dyer & Singh, 1998; Lavie, 2006). Subsequently, this shows how much GSAs and ALAs reside in each affiliate and eventually determines the heterogeneity in the business group network.

FIGURE 1. THE DYNAMICS OF THE BGA-ALA RECOMBINATION
BY BUSINESS GROUP AFFILIATE FIRMS

		Business Group Advantages (BGAs)	
		Weak	Strong
Affiliate-Level Advantages (ALAs)	Strong	3	1
	Weak	4	2

The Figure 1 below tries to capture the recombination dynamics by the affiliates which result into four discrete characteristics based on the strength of BGAs and ALAs. These characteristics are general in nature irrespective of the size, operational scope and location (domestic or international) of the business group affiliate firms. However, for affiliates that are already operating outside their home country, or those that are multinational enterprises, the importance of adding the host country's comparative advantages in the recombination dynamics is necessary. This is by combining the three types of advantages which are the BGA, ALA and country-specific advantages (CSAs). This kind of recombination dynamics has already been pointed out in the literature, especially with regard to the global strategy of multinational enterprises (Rugman & Verbeke, 1992).

In the first quadrant (number 1) which characterizes both the BGAs and ALAs to be strong, the affiliate here in question has successfully recombined the best features of the business group's entire range of advantages. This is to say that the affiliates that belong to this quadrant are the strongest with regard to the possession of advantages and the most competitive within the business group network. In some studies they are dubbed as the "core elites" which have the characteristics of being the strategic leaders in their group (Yiu et. al, 2007). One of the indicators of this type is the ownership of a superior technology which could integrate the business group's overall portfolio of operations. Examples are the technology in engine and processing machine which becomes the basis of the supporting operations by other affiliates in the group. Having such a technology represents a specific strength as an individual affiliate firm and having integrated support operations from other business group affiliates carries the highest competitive position within the business group. All three BGA elements are present here such as the need of financing the superior technology from the internal capital, development and sharing of group managerial capabilities and saving transaction costs by involving other affiliates in the entire operations. The second kind of combination in quadrant two (number 2) indicates that the strength of the affiliate (s) is mostly derived from the BGA. That is to say that the affiliate is dependent on the BGA in its operations and competitive positioning. Thus this type of combination requires the BGA to be recombined with the ALA continually. The affiliates in this category show some potential for success such as in the development of new technology and products but desperately need some support from the business group in terms of capital and managerial guidance. This is the state where the affiliate must take advantage of the BGA to develop its ALA. For example, some business affiliates could find some opportunities to pursue such in the case of business expansion (domestic or international) but have limited resources; the only way for them to realize this are through obtaining a capital and information from their business group. This has been observed in the past, as documented in the previous literature, which showed that the business group plays a very important role in the development of ALAs and in the internationalization decisions and processes of the affiliate firms (Elango & Pattnaik, 2007).

The third combination (number 3) is the opposite of the quadrant two. Here, the affiliates mainly rely on their own means and advantages rather than that of the business groups'. They are prolific in exploiting the elements of the BGA such as in building internal capital, accumulating managerial experiences and cost efficiency. That is to say that some affiliates could display superiorities in its individual organization that makes the BGA become redundant or even inferior. They could comprehend with the overall mix of advantages of the business group and thus demonstrate a consistent and skillful recombination of BGA and ALA over time. As a result these affiliates develop some specific type of advantages, which are sometimes non-sharable to the business group. Eventually the affiliates in this category could create a competitive position that is different from the business group or those that are espoused by their group headquarters. In some instances, affiliates lessen their integration with the group or to some extent even spin-off from the business group

by engaging in risky and independent projects (Chang, 2006). The last quadrant (number 4) is a combination of BGAs and ALAs that are both weak. Hence there are no unique characteristics in this recombination other than the tangible resources of an affiliate. The objectives of these affiliates in this set are usually dependent on the strategic direction of the business group. So their projects and actions are based on the decision of the group. They serve as support to the overall operations of the group, especially to those affiliates that need to increase their economies of scope and scale.

The above four recombination characteristics can represent the distribution of the BGA and ALAL in a business group. Therefore, they can be the source of the competitive positioning not only by the affiliates but also by the whole business group. Also, as the matching of BGA and ALA is dynamic, it can lead to the evolution of the business group; whether in the transfer and improvement of the range of competitive advantages or geographical locations over time.

The operationalisation of the business group advantages

This part presents the mechanism on how the affiliates operationalise or utilize the business group advantages. The operationalisation mechanism of BGAs is unique to business groups and their affiliates. The subject of this operationalisation are the elements of the BGA such as saving on transaction costs, sharing and transferring the group managerial capabilities and the economies of scope and scale. At the onset, business group affiliates assume roles within their business group. There are two basic roles that a firm must commit being an affiliate of a business group, these are: (1) exploration and (2) exploitation. Exploration means the development and commitment to share advantages, while exploitation means search, usage and enhancement of advantages. However, for the lead firm, there is an added role of 'control', being in-charge of the fit between the group advantages and strategy. Control also means evaluation, allocation and distribution of BGAs.

There are varieties of activities where BGAs are configured in the group based on the roles of the lead firm (or firms) and affiliate firms. Essentially, the situations pertaining to the mechanisms of BGAs involve the affiliate firms that do the sharing and exploitation, and the lead firm that does both as well as the control function. Importantly, the lead firm is tasked to evaluate the existing BGAs which are being shared in the group. It assesses internal and external costs (allocation of activity) as an implication of the affiliate firm's sharing and exploitation activity. It is also expected to endorse the sharing and exploitation based on its merit to the entire group. Lastly, the lead firm tries to allocate and distribute resources and capabilities in a fair and efficient manner. There are six scenarios where BGAs are configured in the group based on the roles. Figure 2 depicts the roles of affiliates and lead firm in the exploration and exploitation.

The first scenario is when an affiliate firm explores and the lead firm controls. This is one of the most important mechanisms, wherein the lead firm is tasked to evaluate the existing BGAs which are being shared in the group. Also, the lead firm assesses internal and external costs (allocation of activity) as an implication of the affiliate firm's exploration activity. Lastly, the lead firm is expected to endorse the exploration based on its merit to the entire group. The second scenario is when an affiliate conveys its intention to exploit and the lead firm controls. Here, the lead firm plays its very important tasks, which are to allocate and distribute resources and capabilities in a fair and efficient manner. Also, any exploitation within the group, either affiliate-to-lead firm or affiliate-to-affiliate, is expected to be endorsed by the lead firm.

FIGURE 2. OPERATIONAL MECHANISMS OF BUSINESS GROUP ADVANTAGES

Role of the Lead Firm	Control	1	2
	Exploitation	3	4
	Exploration	5	6
		Exploration	Exploitation
		Role of the Affiliate firm	

The third scenario is when an affiliate explores while the lead firm exploits. This is a situation where the lead firm directs the affiliate to their internal search of BGAs; or, utilizes the affiliate's shared advantages for the exploitation of other affiliates. Hence, the explored BGAs will result to exploitation by other affiliates. The fourth scenario is when both the lead firm and the affiliate firm exploit BGAs. This situation presents the highest form of cooperation between the lead firm and the affiliate though learning by doing. This is when a new kind of BGAs is being utilized by the group and is expected to be enhanced through exploitation or implementation. On the other hand, the fifth scenario is when both the lead firm and the affiliate explore BGAs. This demonstrates the highest form of collaboration within the business group. They utilize this situation to develop, share and feed-in BGAs for the use or exploitation of the entire group. Lastly, the sixth scenario pertains to the advantages of the lead firm which are being exploited by affiliates. This is when the affiliates need complementary resources from the lead firm; and the acquisition of such BGAs is expected to enhance the competitiveness of the recipient affiliate.

Discussions and practical implications

The operations of business groups in the developing and emerging economies are challenging. Stable supply of capital and labor are the most important assets in the developing economies because of the severe imperfections of the labor and financial markets. These conditions are obvious in Asia and other East European economies. Thus, the challenge for the business groups in these economies is to continuously recombine and operationalize their BGAs and ALAs. They may exploit the BGA in transaction costs by maintaining an internal capital and labor markets rather than depending on external sources. This approach will avoid different types of risks in capital, labor and inputs. To some extent, some of the business groups have done this in the past. They have established their own banks, training schools and supplier networks to operate efficiently above industry standards. This is also a key in taking advantage of BGA in scale and scope. Hence, the internalization mechanism or the group internal market provides the competitive advantage to business groups over other firms and multinationals in the region.

On the other hand, for business groups that operate or have expanded in advanced economies, the need to enhance their global competitiveness is a must. The challenge for them is to use their BGA in group managerial skills and experience to take advantage of global knowledge and supply chain. Some business groups were successful in utilizing these assets to acquire and recombine knowledge from incumbent multinationals and host countries. This can be done by a group network exploration and exploitation with the special participation of their foreign subsidiaries and stakeholders in the host countries. This is evident in the case of Indian business

groups, particularly in their operations in the advanced economies of Europe and the UK. Indian business groups retain the management team of the acquired high technology businesses while making sure that their subsidiary managers learn from their practices including those related local operational practices and institutions. These practices will then be transferred to the whole business group to enhance and add to the group managerial skills and experience. This is the approach to maintain and expand the business group global operations.

Conclusion

The foregoing sections provide the theoretical framework and explanation of the competitive advantages of business groups and their affiliates. The objective is not to offer some general and empirical assumptions but rather some refinements and supplementary to the previous literature. This paper expounded the theory that there exist some advantages which are specific to business groups and their affiliates. Although this has been partially mentioned in the literature, its entire conceptualisation remains incomplete (see some related work: Delios & Ma, 2010; Ramamurti, 2012). Hence, this paper resolved this limitation by offering a unique and novel conceptualisation through the concept of BGA and ALA, their dimensions, evolution and potential value in the operations or international expansion of the business group and their affiliates.

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