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# Business Groups Reconsidered: Beyond Paragons and Parasites[1]

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# Business Groups Reconsidered: Beyond Paragons and Parasites

**Abstract**

In this paper, we consider the potential paths of Business Group's (BGs) evolution. We organize our analysis around the two dominant perspectives on BGs: institutional voids (IV) and entrenchment/exploitation (EE). We suggest that the empirical evidence does not entirely support either perspective, and neither fully predicts what we sometimes observe; namely that BGs not only persist and thrive, but also sometimes do so as internationally competitive firms. This indicates that a more contextualized approach is required, and we propose a conceptual framework that can guide future thinking. In so doing, we take explicit account of two key factors relevant to the dynamics of BG evolution: the state's capacity to create market-supporting institutions and the ability of business groups to adapt to evolving institutions. Our framework accommodates the possibility of multiple outcomes, including ones consistent with the IV and EE perspectives, but also ones consistent with the internationalization of BGs, including those from emerging markets.

**Keywords:** business groups, institutional voids, role of the state, group adaptation

## Introduction

Business groups (BGs) are multi-business entities defined as "a collection of firms bound together in some formal and informal ways" (Granovetter, 1994: 454); and though the entities are legally independent, they are "accustomed to taking coordinated action" (Khanna & Rivkin, 2001: 47). Although BGs have existed for over 100 years (Jones & Wale, 1998), they have most recently been associated with emerging markets, where they sometimes account for more than a half of their national output[2]. According to Khanna and Yafeh (2007), the fraction of group-affiliated firms in these countries is substantial, with their prevalence varying from 25% of publicly listed firms in the Philippines to 65% in Indonesia (Carney & Gedajlovic, 2002). It is the loose ties between BG affiliated firms that distinguish them from the typical Western corporation. In advanced European and North American economies, diversified businesses have been tightly organized into multidivisional structures described as the M-form (Williamson, 1975; Chandler, 1990). Coordination in the M-form occurs through the unified internal control of multiple business units,but in BGs it relies on an intricate network of formal and informal control mechanisms, such as kinship relationships among senior managers (Granovetter, 2005) or a dense web of commercial and financial linkages (Khanna & Yafeh, 2007).

The BG phenomenon began to attract the interest of scholars from a variety of disciplines in the mid-1970s, and has been characterized from the outset by considerable disagreement over BG efficiency and performance. Table 1 provides a succinct overview of BG research streams to

[2] They are known as *Grupos Económicos* in Latin America (Strachan, 1976), *Chaebols* in South Korea (Chang & Choi, 1998), *Qiye Jituan* in mainland China (Keister, 1998), *Hongs i*n Hong Kong (Wong, 1996), *Guanxiqiye* in Taiwan (Numazaki, 1996), and *General Corporations* in Vietnam (Abegaz, 2005). In South Asia, they are closely identified with their founding families and known as *Business Houses* in India (Encarnation, 1989) or *Big Houses* in Pakistan (Papenek, 1972). In Russia and Ukraine, they are identified through the group founders (oligarchs) and are popularly described as *Oligarchic Firms* (Perotti & Gelfer, 2001).

date from the fields of business history, development studies, strategy, finance, economics, organization theory, and management. It reports the principal findings from each of the main phases of research about BGs; phases that are identified based on the different forms, locations and time periods studied. In the early literature, business historians viewed 19th-century Japanese and Western business groups as *prototype* multinational enterprises that would disappear in competition with the more robustly integrated multinationals organized on the M-form principal (Jones, 2000; Morikawa, 1992). While scholars have long recognized BGs capacity to solve problems associated with scarce credit and the lack of managerial and entrepreneurial talent in developing economies (Leff, 1978; Khanna, 2000), they have also been concerned that BGs create other, potentially more serious, problems of entrenched monopoly power, which has recently come to be known as "cronyism" (Leff, 1979)[3].

Similarly, in the 1980s and early 1990s, many sociologists and management theorists viewed Asian BGs as a flexible and dynamic structure and a vital element of the Asian economic miracle, while others grew increasingly critical of BGs because of their perceived self-serving behavior following the 1990s Asian financial crisis. As reported in Table 1, comparable debates concerning the efficiency and economic impact of BGs have taken place in other emerging economies, including Turkey, Russia, China, and India. Strategy, finance, and organization research on BGs has accelerated in the past 20 years, but these conflicting claims about their economic and social value have not disappeared and indeed have perhaps become even more acute, leaving "long-standing debates" regarding BG efficiency and impact (Holmes, Hoskisson, Kim, Wan and Holcomb, 2016: 1).

[3] Indeed, one of the earliest works on developing country BGs (Strachan, 1976) proposed a life-cycle model of group development noting that Nicaragua's groups were dynamic at their founding, but lapsed into rent-seeking as they aged.

**------Table 1 about Here-----**

We summarize the contemporary rendering of this long-standing debate about the impact of BGs by organizing our discussion around two prominent theoretical perspectives: the institutional voids (IV) perspective (e.g. Khanna, 2000; Khanna and Palepu, 2000a; Khanna & Yafeh, 2007) and the entrenchment/exploitation (EE) perspective (e.g. Fogel, 2006; Morck, Wolfenzon & Yeung, 2005; Young et al., 2008) respectively. In the literature, they are often positioned as polar opposites, memorably described by Khanna and Yafeh (2007) as "paragons or parasites". IV views BGs as an efficient organizational response to institutional underdevelopment while EE sees BGs as opaque structures designed to extract surplus from shareholders, government and workers to the benefit of their owners. However, as we document in Table 1 and discuss further below, while the literature provides empirical evidence supporting both perspectives, there is also evidence that does not support either of them. Based on this evidence, we argue that the underlying issues are too complex to be well captured by any simple dichotomization and any framing of them as dichotomous is too coarse. We therefore propose a new and richer conceptual framework to guide future thinking, designed to provide a more contextualized understanding of the various ways that BGs evolve through time under alternative host country conditions. Importantly, our framework encompasses, amongst others, both the IV and EE perspectives.

We begin by presenting a summary of the IV and EE perspectives focusing on their potentially contradictory implications with respect to the *effects of BG affiliation* on firm behaviour, profitability and internationalization; and the degree of *BG prevalence* notably its impact on national economic performance. We find considerable heterogeneity across countries in terms of prevalence, persistence and performance of BGs, and argue that one cannot fully explain, using these perspectives, the evidence that in some countries BGs persist and thrive over time, and do so as internationally competitive firms. We conclude that the evolution of BGs in a particular country will depend primarily on two key factors: the way that the institutions of the home country, particularly those associated with the state, evolve, and on the adaptability of firms in response to these changes.

We first distinguish between strong and weak states based on the state's capacity to create market supporting institutions. We propose that this distinction will in large part depend upon the nature of the government's relationship with business elites and how this evolves over time. In contrast, BGs' ability to adapt in different institutional contexts depends on their internal organisational and technological capacities to evolve as markets mature. We conceive BG adaptability to be reflected in their development of proprietary organizational and technological capabilities that are reflected in their product-market and international positioning. We identify three prominent forms of adaptation: refocusing, internationalization, and institutional escape. Contrarily, because some BGs clearly do fail and are dismantled we also identify three syndromes of non-adaptability which we label: collapse/absorption, contingent value, and capture.

Consistent with the evidence of heterogeneity in BG impact and evolution, our conceptualization encompasses several potential equilibrium outcomes, including ones that are consistent with the IV or EE views, but also ones that allow for the possibility that BGs can progress from their initial role of substituting for missing institutions to become internationally competitive firms. This latter equilibrium includes the development of emerging market multinationals (Cuervo-Cazurra & Ramamurti, 2014). Our framework provides a road map for understanding how state policy can influence the evolution of BGs by shaping their institutional and regulatory environment as well as possibilities for future research and the strategic implications for BGs managers.

In sum, our approach recognises the evident diversity in the way BGs evolve and relate to their institutional context. We take as our starting point an older review of the BG literature by Granovetter (2005: 445), who calls for scholars "to look closely at how BGs have responded to changes in the economies they inhabit and how we understand their capacities and the way they change over time". In so doing, we differentiate our paper from two other recent BG review papers. Colli & Colpan (2016) address the 'diverse and fragmented' literature on BG corporate governance; Holmes, Hoskisson, Kim, Wan & Holcombe (2016) survey the international business, strategic management and entrepreneurship literatures for insights on BG international strategy. However, our focus is somewhat broader: by addressing Granovetter's call we consider the evident persistence of the BG form and the implied capacity of BGs to adapt over time in divergent institutional settings. We therefore focus on both how BGs have evolved over time, but also on how the multidisciplinary literature on BGs has evolved in its treatment of the BG phenomenon.

## Comparing Institutional Voids and Entrenchment/Exploitation Perspectives

In this section, we compare the IV and EE perspectives with a particular emphasis on the different empirical implications of each. We consider their evaluations of the benefits and costs of BG affiliation as well as their predictions about the likely path of BG evolution over time and the impact of BG prevalence on key measures of national economic performance.

The literature concerning the performance effects of BG affiliation is extensive (e.g., Bhaumik, Estrin & Mickiewicz, 2016; Carney et al., 2011; Claessens, Fan & Lang, 2006; Colli & Colpan, 2016; Estrin, Poukliakova & Shapiro, 2009; Khanna & Rivkin, 2001; Morck, Wolfeson & Yeung, 2005), and includes tests of specific predictions of the IV and EE perspectives. Although these studies are of considerable significance in understanding the two perspectives, the questions of whether BGs remain prevalent or fade away as economies become more developed, and whether high levels of BG prevalence negatively affect national economic growth and other indicators of business performance, are less well understood.

**--------------------Table 2 about here-----------------**

Commencing with the impact of BGs, the main arguments of each perspective are presented in Table 2. In the IV perspective, BGs are viewed as a functional response to an underdeveloped institutional context, and one that enhances economic performance of affiliated firms. Thus, BGs are created to fill voids in the market-supporting infrastructure and to enable the acquisition of resources that would be otherwise unavailable *via* arms-length contracting (Khanna & Yafeh, 2007). However, BG affiliation is also seen to have attendant costs, comparable to those facing diversified M-form firms where bureaucratic coordination costs rise as the number of affiliated firms increases (Hoskisson et al., 2005). In addition, with the development of market-supporting institutions, arms-length contracting becomes more feasible and the benefits of group affiliation erode (Hoskisson, et al., 2005). As a result, it is expected that BGs will gradually focus, restructure, and loosen their ties; ultimately, they should unravel and disappear. This occurs because in a more developed economy, market-based transactions become increasingly efficient and cheaper providers of the necessary resources and capabilities, relative to quasi-hierarchical provision under the BG umbrella. With this scenario, group affiliation should progressively decrease because it will be more profitable for firms to be unaffiliated than affiliated as institutional and economic development proceeds (Hoskisson et al., 2005; Kim et al., 2010; Lee et al., 2008). Khanna and Palepu summarize the view that BGs are a transitional phenomenon by offering the following policy advice: "Governments in developing countries must focus on building up those market institutions in the long term. The dismantling of business groups will, we believe, follow naturally once these institutions are in place" (1999: 126).

In contrast, the EE perspective is less positive. The pyramidal structures and opaque governance of BGs (Bertrand, Mehta & Mullainathan, 2002) are depicted as being designed for self-dealing among related parties (Jia, Shi & Wang, 2013). This leads to the transfer of profits among units to the benefit of ultimate owners, so called 'tunneling' (Bae, Kang & Lee, 2002; Masulis, Phan & Zein, 2011; Siegel & Choudhury, 2012), and to minority investor expropriation as profits are redirected within the group (Bertrand, Mehta & Mullainathan, 2002; Young et al., 2008). The EE literature at times characterizes BGs as being formed or facilitated by states in order to orchestrate a 'big push' toward industrial modernization (Morck, Wolfeson & Yeung, 2005). However, dominant BGs are argued to exploit their monopoly power and government contacts to entrench themselves and enrich their owners. Subsequently, these elite incumbents seek to defend their sources of rents by supporting the conditions that initially favored their economic and social prominence. Moreover, the concentration of economic power in the hands of rent-seeking business owners will have a variety of negative consequences for the national economy (Morck, Wolfeson & Yeung, 2005). Thus, while BGs may first appear where institutions are weak, they rarely disappear, but rather gain 'eternal life'[4] (Morck, 2010). For example, given their important role in the economy and the resulting political powers and relationships, BGs can sustain themselves into the long term, i.e., achieve a stable equilibrium

[4] The singular exception is the total disappearance of BGs as an organisational form which occurred in the US following the enactment of the Public Utility Holding Company Act (1935), and targeted BGs through intercorporate dividend taxation (Morck, 2010). The dismantling of Japanese family owned business groups (Zaibatsu) by the post-1945 US occupation administration did not lead to the ultimate disappearance of Japan's BGs which quickly reappeared in the early 1950s in the guise of Keiretsu.

(Schneider, 2009). Indeed, prominent groups may 'capture' the state (Fogel, 2006), and in some cases tycoons become politicians (Bunkanwanicha & Wiwattanakantang, 2009). As such, they can persist over very long periods of time, successfully resisting entry from foreign firms or domestic entrepreneurs (Byun, Lee, & Park, 2012) and continuing to extract surpluses from minority shareholders and other potential stakeholders, with negative consequences for national economic development and growth.

There are some similarities between the EE view on prevalence and performance and certain literature in the varieties of capitalism (VoC) tradition (Hall & Soskice, 2001). The VoC views BG prevalence as an outcome of complementarities between the state, labour, and corporate elites (Schneider, 2009). BGs are constructed at the early stages of country development to address national economic coordination problems, but these relationships become locked in and foreclose the emergence of new complementarities, such as arms-length contracting and flexible labour markets as the economy becomes more developed (Schneider, 2009). BG prevalence will therefore be associated with negative national economic performance effects through a 'crowding out' mechanism, in which the dominance of a single organizational form limits the evolution of diversity and economic specialization in the economy, an argument articulated by Almeida and Wolfenzon (2006). In this view, the mere existence of BGs may hamper the emergence of alternative corporate forms by depriving them of niches in which to specialize, and these negative effects will be amplified when BGs are highly prevalent[5].

[5] Thus, if too many firms are group affiliated, competitive selection processes will be muted, and BGs will crowd out more specialized forms of organization and so dampen the incentives to develop the firm-specific capabilities required for international competitiveness. Hence economies with a high prevalence of BGs can become caught in the middle-income trap, where a country's economic growth stagnates or slows after reaching middle-income levels (Gomez, 2006; Schneider, 2010).

## Assessing the Evidence on BGs

We focus on two main areas of evidence that arise from the differences between the IV and EE perspectives, which are summarized in Table 2. First, we discuss the evidence on affiliated firm behaviour and performance, including the recent literature on the impact of affiliation on the ability of BGs or their affiliates to compete internationally. Second, we examine the literature on the BG prevalence, its persistence over time and the impact of BGs on the national economy.

### *BG Affiliation: Are There Benefits of Being a Part of a BG?*

The IV perspective suggests the following: *BG affiliation positively affects firm performance when institutions are weak*. However, as institutional voids are filled and host economy institutions strengthen, the advantages of BGs are reduced and they may wither away: *BGs will become less prevalent as institutions develop*. In contrast, the EE perspective sees BGs as rent-seeking exploiters of market failures, used to expropriate profits for their owners, so *BG affiliation will likely not be associated with superior performance.* Moreover, BGs become entrenched so that *BGs will not become less prevalent as institutions develop*; indeed, BGs may impede development, perpetuating 'second best institutions' (Rodrik, 2008) and limiting the competitive evolution of the economy.

The first question to answer is therefore the following: In what ways does BG membership influence the behavior and performance of affiliated companies? There is a considerable body of research on this topic at the firm level, primarily by considering financial and economic performance of affiliated compared with unaffiliated firms (e.g. Khanna & Palepu, 2000a, 2000b; see Table 1). We draw in particular on a recent meta-analysis of 141 primary studies of BGs affiliates' financial performance in 28 jurisdictions to summarize this evidence (Carney et al., 2011). The study concludes that BG affiliation has no significant effect on market-based measures of performance, but is negatively related to accounting measures of performance. Taken together, this evidence does not support the IV perspective. However, Carney and his colleagues also discover substantial heterogeneity in outcomes, suggesting the presence of institutional moderating effects. Thus, the IV hypothesis is found to hold in jurisdictions at an intermediate state of institutional development (e.g., India, Israel, South Africa, and Turkey). The IV hypothesis does not hold in jurisdictions with very low levels of institutional development (e.g., Nigeria, Pakistan, and Peru), where the performance effect of BG affiliation is substantially negative and contrarily, the value of affiliation is sometimes substantially positive in jurisdictions with very high levels of institutional development (e.g., Hong Kong, Sweden, and Singapore). At the same time, much recent evidence suggests that internal markets for capital (Almeida, Kim & Kim, 2015; Buchuk, Larrain, Muñoz, & Urzúa, 2014; Boutina et al., 2013; Masulis, Phan & Zein, 2011) and labor (Cestone et al, 2016) may be efficient. Nevertheless, despite its large volume, the empirical evidence provides only qualified support for the IV view and is in fact far from conclusive with respect to the financial benefits of BG affiliation.

Similarly, in a recent survey of BGs and corporate governance, Colli and Colpin (2016) review the finance literature with respect to pyramidal ownership structures, an important element of the EE perspective. They suggest that although there is evidence supporting the view that pyramidal ownership structures in BGs can negatively impact minority shareholders, for example, through tunneling (Masulis et al., 2011; Siegel & Choudhury, 2012), they conclude that "the research question is not entirely resolved" (Colli & Colpin, 2016: 294). Thus, evidence supporting the EE view is also mixed. This lack of resolution has led Carney and his colleagues to recommend that future research should "eschew monotheoretical accounts characterizing a business group in singular terms… (either) an extraction device for wealthy families or a generalized response to chronic institutional failure... since these characterizations likely divert attention away from their evident structural and strategic complexity" (Carney et al., 2011: 454).

Research originating since 2005 has focused on another important dimension of firm adaptability and performance: *BG internationalization*. Neither the IV nor the EE perspective can easily explain the pheonomenon of BG success in international markets. The EE perspective is stronger in its implication that entrenched BGs have neither the capability nor the incentive to invest internationally in a substantial way. The IV perspective, allowing for the possibility that BGs are functionally efficient, is perhaps slightly more open to the possibility that BGs might develop some international capabilities. First, the IV perspective explicitly allows for the reality of competitive advantages derived from BGs internal executive labour markets (Khanna & Palepu, 1997) and intragroup technology sharing and diffusion (Chang & Hong, 2000). Second, others suggested that BGs might adopt more formal M-form structures to adapt to increasingly competitive domestic environments (Kock & Guillen, 2000). However, the primary prediction of BG evolution suggested that to maintain their profitability in an improving institutional environment BGs would re-focus their product market scope on a narrower range of activities (Khanna & Palepu, 2000a, 2000b; Hoskisson, 2005). Few BG scholars predicted that BGs would develop the proprietary organizational and technological capabilities to become internationally competitive MNEs and the evidence regarding the internationalization of BGs is indeed mixed (Holmes et al, 2016).

There is growing evidence that group affiliation does help firms to share information about foreign opportunities and to acquire advanced technology to become internationally competitive (Lamin, 2013; Mahmood, Zhu & Zajac, 2011). Over the past decade, scholars have documented the pioneering internationalization of firms from emerging markets, the emerging-market multinationals (Matthews, 2006). There is some evidence that BG affiliation may contribute to the international success of these firms through a variety of mechanisms. BG affiliation may provide a springboard to foreign markets (Luo & Tung, 2007; Ramamurti & Singh, 2009; Yiu, Bruton & Lu, 2005) and allow firms to leverage the market knowledge and international connections of their sister affiliates (Lamin, 2013). The consensus arising from this stream of research is that in some situations BG affiliates are in the vanguard of economic development and can represent the country's most internationally competitive firms. For example, Siegel and Choudhury (2012) suggest that India's longest established business groups have become a repository for marketing and technological competences that have fuelled their international rise, and Chari (2013) finds that Indian affiliates of BGs were more likely to engage in foreign direct investment (FDI).

On the other hand, a variety of specific mechanisms has also been identified in the EE literature suggesting how BG affiliation might suppress firm capacities to internationalize. First, controlling shareholders may undermine the competitive potential of their affiliates by extracting or tunneling their resources (Bertrand, Mehta & Mullainathan, 2002). In addition, oligarchic family BGs can use their economic power to extract resources from government (Faccio, 2006) through corporate bailouts (Faccio, Masulis & McConnell, 2006), rent seeking (Fisman, 2001), and inhibiting competition from domestic and international rivals (Fogel, 2006). Receiving an assured stream of rents, these business owners have limited incentive to seek investment opportunities beyond their borders, where the possibilities for rent extraction are less auspicious and the likely returns are much lower (Estrin, Meyer, Nielsen & Nielsen, 2016). Rather, they may prefer to diversify within their own national boundaries (Erdener & Shapiro, 2005; Gaur & Kumar, 2009; Kumar, Gaur & Pattnaik, 2012; Pederson & Stucchi, 2014). Indeed, extensive political and business ties with local actors drive domestic growth, but may inhibit international expansion (Tan & Meyer, 2010; Chari,2013). Thus, there is some evidence supporting the mechanisms proposed by EE that entrenched BGs might have neither the incentive nor the capabilities to expand abroad.

In summary, based on firm-level studies of BG affiliation, there is no unambiguous or overwhelming support for either the IV or the EE view about the impact of BG affiliation on firm performance; neither view can explain convincingly all the observed phenomena, and the findings seem to be context-specific.

***BG Prevalence: Do BGs Become Less Prevalent as Institutions Become More Developed?***

In the IV tradition, it is argued that BGs are created and effectively fill institutional voids, but diminish in importance as institutions become stronger. In contrast, EE theory suggests that BGs become entrenched and powerful and use that power to protect their position; far from disappearing they persist and may become even more prevalent. The question to answer is therefore the following: Do we observe across countries and over time that BG prevalence tends to decline as institutional voids and market failures are reduced? Khanna and Yafeh (2007: 364) pose the question in a similar way: "Do groups evolve in a fashion that is consistent with missing institutions?" The literature has relatively few direct tests of this issue.

We begin by noting that there is certainly some understanding that "BGs have typically defied predictions of their imminent demise surviving the conscious attempts by reform-minded politicians to break them up and the impact of financial crises" (Granovetter, 2005: 445), and recognition of this fact has prompted researchers to address the question of why some BGs persist (Gao et al., 2017). In fact, BG prevalence varies widely across markets, and recent research shows that group affiliation remains common even in some highly-developed economies with strong market supporting institutions, such as Belgium, Germany, and Sweden (Belenzon et al., 2013).

Turning to dynamics, studies estimating the effects of improving market supporting institutions on affiliate profitability in countries such as Chile (Khanna & Palepu, 2000), China (Carney, Shapiro & Tang, 2009), India (Zattoni, Pedersen & Kumar, 2009), and Korea (Lee, Peng & Lee, 2008), conclude that, consistent with the IV perspective, BG performance tends to deteriorate over time, albeit slowly. In contrast, studies of India and South Korea (Chittoor, Kale & Puranam, 2015; Kim et al., 2010; Manikandan & Ramachandran, 2015; Siegel & Choudhury, 2012) show that affiliate performance may improve with institutional strengthening, though once again, this evidence refers to single countries and is similarly inferential. However, none of these studies provide a direct test of whether BG prevalence, defined as the extent to which the corporate sector is controlled by business groups (Almeida & Wolfenzon, 2006), actually declined. Zhang, Sjogren, and Kishida (2016) directly examine the emergence and persistence of BGs in three countries: China, Japan, and Sweden. They conclude that BGs emerge in times of institutional instability and tend to persist partly because of their capacity to diversify and share risks, though the manner in which this occurred was context-dependent.

Carney et al (2017) provide direct estimates of trends in BG prevalence by drawing on data from a large number of BG studies. In Figure 1, we show BG prevalence trends for eight countries, calculated using linear least squares estimates. While BG prevalence may have *declined* in some countries, as illustrated by Chile, Korea, Russia, and Turkey, there are *upward* trends in prevalence in countries such as China, India, Japan, and Taiwan. Indeed, Carney et al. (2017) show that BG prevalence is also increasing in Belgium, Brazil, Indonesia, Israel, Malaysia, Peru, Singapore, and Thailand. Generally, they do not identify any common trend in BG prevalence across countries or over time. Their results are not consistent with either of the two perspectives.

A longstanding research strand has focused on another important dimension: the effect of BG prevalence on national economic performance. These effects have previously been assessed in terms of growth in industrial capacity and productivity growth (Amsden, 1989; Evans, 1995; Lazzarini, 2015; Wade, 1990), often with ambiguous results (see Table 1). The IV argument is simply that BGs should diminish in importance as economic development proceeds but EE scholars identify several mechanisms through which the relationship between the level of economic development and BG prevalence might be negative. One is that entrenched BGs use their political power to limit competition, particularly foreign competition, with its attendant spillover benefits (Morck, Wolfeson & Yeung, 2005); another is that they have limited incentives to engage in and support innovation because they seek to protect existing sources of rents (Chang, Chung & Mahmood, 2006; Mahmood & Mitchell, 2004). The general argument is that high BG prevalence creates a weak competitive environment, and this undermines firm capabilities and incentives to engage in innovation, which in turn limits GDP growth and international competitiveness (Fogel, 2006; Kock & Guillen, 2001). However, Carney et al. (2017) find no evidence of negative relationship between BG prevalence and GDP per capita (the standard measure of level of development), country level innovation, as well as inward FDI or outward FDI.

Thus, BGs can remain prevalent at relatively high income countries and show no definite downward trend over time, as predicted by IV theory. However, the prevalence of BGs in the national economy does not appear to be systematically associated with poor national performance, as suggested by the EE perspective. The overall picture suggests that the persistence of BGs is widespread, albeit not in every country, and not necessarily for reasons associated with entrenchment. Schneider (2010: 666), on the other hand, concludes that BGs "often fail, which suggests important limits to theories of entrenchment and rent seeking". Thus, contrary to the 'eternal life' (Morck, 2010) hypothesis, BGs can sometimes fail to adapt, collapse, and disappear.

**Figure 1: BG Prevalence Trends in 8 Countries**

**Moving Forward: Reflections on BG Theory**

We have used the IV and EE perspectives as a way of organizing our analysis of the BG phenomenon. Contrary to the EE view, BG affiliation often enhances financial performance though this result is context specific. In contrast to the IV view, BGs do not automatically disappear as institutions strengthen; rather, BG affiliation becomes less prevalent in some countries, but more prevalent in others. Once again, the precise pattern is context specific. Moreover, there is no consistent evidence supporting a negative impact of BG prevalence on country variables related to growth and competitiveness. BG persistence is not necessarily caused by the phenomena at the heart of entrenchment theory, namely elite capture (Morck, Wolfeson & Yeung, 2005). Hence the observed persistence of BGs appears to be accompanied by context-specific adaptive BG behaviour, a phenomenon not discussed by either perspective. We therefore conclude that the simple stylization in the literature into a dichotomy of "paragons or parasites" is too coarse, and that we need to develop frameworks capable of characterizing the more complex dynamics leading to hetergoneous outcomes over time and across countries.

Specifically, we require a finer grained conceptual framework that explicitly brings into the analysis two key elements: the national institutional context and BG adaptive strategies. It must also be able to accommodate a variety of potential equilibrium outcomes, including BGs becoming competitive internationally. We propose that the two critical determining factors for BG performance and persistence are the state's capacity to create market-supporting institutions and the adaptability of BGs to evolving institutions. Thus, we envisage four potential equilibria, subsuming the two characterized by the existing theoretical approaches.

***The strength of the state***

Strong and effective political institutions underpin the functioning of market-supporting institutions, such as creation and enforcement of property rights (Acemoglu & Robinson, 2012; Haggard & Tiede, 2011). However, despite Khanna and Palepu's (1997) exhortation that the state should focus on construction of market-supporting institutions, the potential role of the state in the evolution of BGs is not much evident in the recent literature. The IV perspective is silent on the question of constructing effective political institutions that support a strong state, namely political accountability, bureaucratic transparency, and the rule of law. Moreover, one of the assumptions of the EE perspective is that, to protect their interests, elites and BG oligarchs will capture state institutions. Yet the growth and development of democratic political institutions can result in legitimate regime change (i.e. via elections) that can check the power of elites, with the consequence that BGs' political connections may possess a 'contingent value' following regime change (Siegel, 2007; Sun, Mellahi & Wright, 2012).

To sharpen the characterization, we categorize contexts between *strong* and *weak* states.

By *state strength*, we refer to the ability and commitment of governments to stimulate economic transformation, either through the development of market-supporting institutions or through state guidance and intervention, producing a form of state capitalism (Wade, 1990; Musacchio, Lazzarini, & Aguilera, 2015). Acemoglu and Robinson (2012) and Hallward-Driemeier and Pritchett (2015) also point to strong states as ones that can both create and enforce effective laws and regulations.

The defining feature of the strong state is 'embedded autonomy', a state capacity to engage constructively with business elites while simultaneously maintaining freedom from dependence upon any particular group of elites (Evans, 1995). Autonomy implies the ability to formulate and realize collective goals instead of permitting individual officeholders to pursue their private interests, often with business elites. Strong states therefore establish meritocratic, bureaucracies with public officials selected through public exams (Fukuyama, 2014). The coherence of public bureaucracy enables the suppression of rent seeking while maintaining close relationships with the business elite. At the same time, the latter has the autonomy to formulate business group strategies that are appropriate to their evolving capabilities.

Early accounts of BG functioning were alert to the importance of the strong state and its capacity for supporting economic development through the development of legal reforms, efficient bureaucracies and the cultivation of financial and organizational capacities in a country's leading enterprises. Role models for the strong state include Japan (Johnson, 1982), Korea (Amsden, 1989), and Taiwan (Wade, 1990). Weak states are defined by the absence of embedded autonomy.

In contrast, weak states have not evolved in this way; rather they are entrenched in rent-seeking behavior, with control exercised by elites who exploit their political and economic power for their own benefit and for the maintenance of their political stranglehold. Weak states are thus characterized by what Acemoglu and Robinson (2012) refer to as "extractive institutions", that is, institutions designed to benefit elites. Weak states may appear strong, in the sense that a 'strongman' or despot is able to exercise a monopoly of power and expropriate resources, yet possess little capacity to establish a coherent public bureaucracy since the despot and other public functionaries may engage in rent-seeking. In addition, corporate elites lack the autonomy to realize an economic transformation.

Although we limit our analysis to the cases of strong and weak states, we acknowledge the possibility of intermediate cases such as Brazil, India, or Turkey. At the same time, a state can transition from weak into strong by promoting market-supporting institutions and legal reforms that limit elite-government collusion as in China since Deng Xiao Peng, or vice versa as observed in Turkey under President Erdogan.

***The adaptability of the BG***

Turning to the adaptability factor, our reflections on the BG debate suggests the need for a framework that recognizes the possibility that some BGs can sometimes be capable of thriving as a group, including the ability to adjust to global opportunities and threats, as economic circumstances evolve. In contrast to the IV perspective, which views BGs adaptation as a tendency to refocus their business scope, we see a wider range of possibilities. Thus, reconsiderations based on recent research findings suggest that group adaptability refers to the aptitude of BGs for responding to changing institutional circumstances, by developing group wide competitive capabilities that enable them to exploit effectively the evolving opportunities. Based on historical and longitudinal studies in the literature, we describe three possible syndromes of BG adaptability: reflecting strategies of *refocusing*, *internationalization*, and *institutional escape* respectively, each being contingent upon the shape of state institutions. However, some BGs may display inertia in the face of institutional change. This leads us to depict three further syndromes, which we describe as *collapse/absorption*, *contingent-value*, and *capture.* These possibilities are discussed in detail below in our presentation of the four quadrants in Figure 2.

***-Figure 2 about here-***

***The matrix of outcomes of BG evolution***

These factors are summarized in Figure 2, where we have created a 2x2 matrix that shows *group adaptability* and s*tate strength* on its axes. The traditional IV and EE views are captured in the lower quadrants where it is **assumed** that BGs are non- or weakly adaptable. Thus, in strong states, institutional voids will be filled and when this is combined with BGs that cannot adapt by developing the necessary business capabilities, the result will be the demise of BGs, as discussed above. On the other hand, in weak states, BGs can persist and become entrenched without altering their non-transparent structures, as envisaged in the EE perspective. The strength of the business elite, in contrast to the feeble state, can lead to state capture and as we have seen may be an important element hindering the evolution to further institutional change. We discuss these cases further below.

***The cases of BG adaptability: the upper quadrants***

As we have suggested, our approach permits two additional outcomes indicated in the two upper quadrants of Figure 2. The upper left hand quadrant depicts the combination of a strong state and highly adaptable BGs which we refer to as *"Competitive BGs"*. Here, a strong state and adaptable BGs combine to produce an outcome that includes nationally and possibly internationally competitive business groups co-existing with populations of other types of firms via strategies of refocusing and internationalization. We identify three different mechanisms for the evolution of business groups within each pair of quadrants; each being associated with different trajectories of growth and persistence.

We commence with refocusing, in which the horizontal or vertical scope of the BG is reduced by dissolving ties with peripheral affiliates so the firm increasingly focuses core activities (Hoskisson et al., 2005). It is most evident following an exogenous shock such as a financial crisis, as occurred in the wake of the Asian financial crisis when highly leveraged business groups shed assets to reduce their debt load (Chang, 2006). Refocusing also tends to follow after states adopt liberal international trade policies. Thus, the third-generation Mexican family business group, Cemex, had leveraged its monopoly of the domestic cement market to build a diversified construction, petrochemicals, mining, and tourism empire. Following the creation of NAFTA which threatened its business model, Cemex refocused on its original cement business disposing of its unrelated assets to fuel an international acquisition strategy (Lessard & Lucea, 2009). On the other hand, restrictions on capital outflows and international sanctions against South Africa's apartheid government encouraged domestic firms to adopt a diversified BG structure. For example, South African Breweries (SAB) diversified into non-brewing businesses such as clothing retail, supermarkets, hotels, and gaming. With the end of apartheid and capital controls, SAB refocused its activities on brewing and became an MNE through acquisitions (Goldstein & Prichard, 2009), but also developed an escape strategy (see below).

Adaptation by refocusing is at first glance suggestive of the IV prediction that BGs will disappear through internal restructuring. However, we note that as BGs refocus and internationalize, they typically retain a group structure. For example, by shifting their public listing to foreign stock exchanges they often maintain the complex and nebulous corporate structures consisting of both public and privately held entities in the manner described by Belenzon et al (2013). These corporate structures depart in significant ways from the standard model of the M-form structure comprising a single unified legal corporate entity.

Some BGs may internationalize without refocusing. Government linked BGs, such as Singapore's Temasek Holdings (Tsui-Auch & Yoshikawa, 2010) and China's state owned BGs such as Sinopec (Yiu, Ng & Ma, 2013; Guest & Sutherland, 2010) have made extensive FDI for strategic asset seeking purposes (Yiu, Bruton & Lu, 2005). Others have internationalized in a more organic manner, pursuing international opportunities based upon their evolving capabilities, for example, with respect to innovation (Castellacci, 2015) and organizational learning (Lamin, 2013). Perhaps, the archetype of this strategy is Korea's Samsung, a family owned business group, which has created a global brand that facilitates innovation through a system of corporate governance that combines both western management practices as well as a Japanese-style business group structure (Khanna, Song & Lee, 2011). Thus, contrary to both the IV and the EE perspective, such adaptation may result in improved national and international competitiveness, growth in the number of affiliates, and increasing group scale and scope (Siegel & Chowdhury, 2012; Chari & Dixit, 2015).

Both of these evolutionary paths for BGs are contingent on the strength of the state. A strong state enables BG adaptation by improving market supporting institutions, but also exerts discipline over BGs by steadily increasing competitive pressures that incentivize productive adaptations; for example, by liberalizing investment and trade agreements and allowing the growth of both foreign and domestic freestanding firms. In the examples above, the strong states of Singapore and China combined with adaptable BGs to produce more focused and international firms. The category of Competitive BGs also includes successful BG affiliates in countries such as Japan, Korea and Taiwan, as referenced in Table 1, as well as BG affiliates such as the Koc Group in Turkey, that compete successfully in their home markets against strong foreign competitors, perhaps also as a result of their reputational capital (Gao et al., 2017). In addition, such BGs may create spillover benefits to other firms in the home economy, an outcome not predicted by either the IV or the EE perspective, but, as we have noted in Table 1, sometimes observed in practice.

Finally, the upper right hand quadrant depicts the combination of a weak state and highly adaptable BGs which we refer to as *"Escape Strategy"*. In this quadrant, we observe an equilibrium in which adaptable BGs are operating in the context of a weak state. This situation may arise when there is a lack of congruence between state and industrial actors so that state policy may conflict with BGs interests notably in the areas of rule of law, corruption and protection of property rights. Thus, the political system may succeed in limiting institutional development, possibly to the advantage of political elites, but to the detriment of some business leaders, notably BGs. In this situation, the institutionally weak context of the home economy may not change, and state weakness will persist.

Under these circumstances, BG adaptability may manifest itself in what we term an "escape strategy", similar to that identified by Witt and Lewin (2007) and Cuervo-Cazurra and Ramamurti (2017). In this case, firms adapt to weak domestic institutions by moving operations to another country. There are numerous instances: During the second half of the 20th Century newly independent postcolonial states across Africa and Asia adopted nationalist political and economic agendas, but often lacked the bureaucratic capacity to enact them (Tipton, 2009). As a result, previously friendly colonial regimes were replaced by states hostile toward foreign-owned BGs (Carney & Gedajlovic, 2002). Many well-established groups elected to repatriate their capital but continued to operate though often with different product-market strategies (Jones, 2000). For example, during the post-independence conflict in Zimbabwe, the London and Rhodesia Mining Group expatriated its assets to Lonrho, an international property and trading company. Similarly, in postcolonial Malaysia, the timber and palm oil Borneo Group managed the transition to become Inchcape, a London based multinational automobile distributor (Jones, 2000). Many of these groups survived for almost two centuries meeting their eventual demise in the late 1980s with the emergence of 'anti-conglomerate sentiment' in capital markets (Colpan & Jones, 2010).

Nevertheless, these adaptable persistent groups closely resemble Morck's (2010) 'eternal life' hypotheses. In the modern era, unanticipated regime change in countries with weak and unstable political institutions may precipitate a BG escape response via capital flight (e.g., Dieleman & Sachs, 2008). One example is SAB, referred to above, which ultimately moved its headquarters from South Africa to the UK.  Another example is First Pacific of Hong Kong, a subsidiary of Indonesia's Salim Group, which fled Indonesia to Hong Kong after the fall of Suharto in 1998. UNCTAD data (2008) shows that with some $7 billion in international assets, First Pacific generates no revenues in Hong Kong and of its 66,000 employees, just 36 are located there. Similarly, the Turkish Yilditz Holdings, a BG created during the secular nationalist era in Turkey, became less well connected under the new Islamic political elite around Recep Erdogan. Turkish Yilditz Holdings has purchased Godiva in the USA and United Biscuit in the UK, and launched a new holding company Pladis to be quoted on the New York exchange.

***The cases of BG inertia: the lower quadrants***

We have previously suggested that both the IV and the EE perspective implicitly assume that BGs are non-adaptable; in the former this is combined with a strong state and in the latter with a weak one. These outcomes are represented in the bottom left and right hand quadrants of Figure 2 respectively.

However, we can extend the analysis and identify more finely grained categories within each lower quadrant, paralleling our analysis for the upper quadrants. Hence, for the case of non-adaptability (inertia), we depict three syndromes: collapse/absorption, contingent-value and capture. As in the upper quadrants, these represent different mechanisms for the evolution of business groups within and between each quadrant; each syndrome being associated with different possible trajectories over time and within countries.

The lower left hand quadrant depicts the combination of a strong state and low BG adaptability. Collapse/absorption refers to the failure and subsequent dissolution of a BG when its own inertia is combined with the emergence of a strong state, which exposes the firm to stronger market based competition. As market-supporting institutions are strengthened, entire BGs can be overwhelmed when exposed to market-based exogenous shocks. For example, the 1997 Asian financial crisis precipitated the collapse of BGs in the worst affected countries. One of Thailand's largest groups, the Bangkok Metropolitan Bank (BMB) group failed (Wailerdsak & Suehiro, 2010). Similarly, 13 of South Korea's top 30 business groups were technically bankrupt. However, in the case of South Korea, an external crisis was used by the strong state to force BGs to reorganize and become more adaptive. The government stepped in to reorganize some of these groups, for example, Kia Group's automobile business was absorbed by Hyundai, but many other BGs were dissolved and their assets spun off, including the fourth-largest group Daewoo, as well as five other top 30 BGs (Chang, 2006). Thus, the strong state helped BGs transition to become more adaptable.

A less catastrophic outcome also encompasses absorption into another group via merger or acquisition. During the 1980s, many of Hong Kong's colonial era British owned Hongs were absorbed into BGs owned and controlled by local entrepreneurs; for example, Hutcheson-Whampoa was absorbed by Li Kashing's Chueng Kong Holdings. In Chile, there was a slow churning of BGs and some groups were absorbed by others – in particular older family owned groups, such as Endesa, were acquired by foreign owners (Larrain & Urzúa, 2016). In these cases, BG prevalence persists, but ownership changes facilitate a transition to more adaptable businesses.

The lower right hand quadrant depicts the combination of BG inertia with a weak state in a trajectory of rapid ascent and decline, denoted contingent value. This syndrome is characterized by a patron-client relationship between political elites and business leaders, such that the BGs value is contingent upon the patron's continued grip on power. The contingent value of these relationships is documented by Fisman (2001) who observed that the market value of BGs connected with the Indonesian president Suharto declined in response to reports of his ill-health. Evidence of the contingent value of BGs political connections has been noted in a variety of jurisdictions (Lu & Ma, 2008; Siegel, 2007), but they are especially prominent in weak states that combine political instability with the prevalence of clientelism. Hawes (1992) describes the rise and fall of several groups associated with the Marcos regime in the Philippines and Gomez (2009) recounts the rapid rise and fall of Malaysia's Renong group which, under the sponsorship of Malaysia's finance minister Daim, became Malaysia's largest BG in just five years. However, President Mahathir became intolerant of Daim's wasteful patronage and he fell from favor. The assets of Daim's 'allies and proxies' were taken over by the state to be reallocated to newly favored clients. Schneider (2010) refers to BGs on this trajectory as 'Icarus Groups' noting the spectacular rise and fall of the Cruzat–Larraın and BHC groups in Chile which had especially close relations with the Pinochet government. The point is that, even in circumstances where BGs are entrenched, their positions are contingent on government patronage.

Similarly, we identify BG capture as another non-adaptive response to, most commonly, regime change in a weak state. It is also the counterpart to escape when BGs are adaptable, and refers to cases where a BG is captured by a hostile state and the group's assets are put to new uses. For example, in the 1970s, Malaysia's largest BG, British owned Sime-Derby, elected to remain in Malaysia but was eventually acquired by the state who used Sime-Derby as a proving-ground designed to create an ethnic-Malaysian entrepreneurial class (Drabble & Drake, 1981). As part of an infrastructure-based industrial strategy, Singapore's developmental state acquired foreign owned BGs, such as Guthries in the 1970s (Jones, 2000).

**Discussion**

We have argued that the empirical evidence to date does not provide unambiguous support for either the IV or EE approaches to BGs, with heterogeneous outcomes being observed contingent on time and context. Thus, despite their ubiquity, there is much variation between BGs across countries, on dimensions such as forms of ownership and control, the extent of vertical integration and horizontal diversification, their relationships with the state, their broader economic welfare effects (Yiu, Lu, Bruton & Hoskisson, 2007), and their evolution over time. We have therefore proposed a more fine-grained and nuanced framework that permits a broader range of BG-related outcomes. Our framework also allows for different outcomes within a single country and over time, and thus permits an understanding of the dynamic evolution of BGs. In this discussion, we outline some of the implications of our framework for future research, government policy and managerial practice. The evidence suggests that BGs sometimes have the ability to adapt as groups to their changing institutional context, but without necessarily disappearing as envisaged by the IV perspective. We suggest that future research should distinguish between refocused and diversified internationalizing groups, and between adaptability that occurs within strong and weak states. Refocusing is represented by exemplars such as CEMEX and SAB which have leveraged a domestically developed competitive advantage in a core product (cement, brewing) to enter other emerging markets, before developing the capabilities necessary to compete in advanced economies. Research might also examine the extent to which a focused internationalization strategy is accompanied by a structural shift toward stronger vertical and horizontal ties, such that they increasingly resemble the integrated M-form corporate structure, as originally suggested by Kock and Guillen (2001). However, as the SAB example illustrates, outward FDI can also be viewed as an adaptation to overcome weak home country institutions (Stoian & Mohr, 2016), and it is important for future research to fully articulate the dynamic interaction between firm adaptability and institutions that result in firms choosing to invest abroad.

More generally, we need to understand how and when BGs adapt to changes in the institutional and selection environment and whether there are policy frameworks that support such developments (Castellacci, 2015; Gao et al., 2017; Kock & Guillen, 2001). We observe considerable variation in BG adaptability. For example, some BGs in India are more likely to adapt to pro-market reforms and are thus a “stable and effective alternative form of organizing diverse businesses” (Manikandan & Ramachandran (2015), 613). Other BGs retain diversified portfolios and venture abroad to seek strategic assets that they can assimilate and use as a springboard to further expansion (Cuervo-Cazurra & Ramamurti, 2014). Notable amongst these are a number of Indian BGs, such as Tata, which have overcome the traditional weakness of the

Indian state to leverage strong competitive capabilities that they have acquired abroad across a diversified range of product markets. The Tata Group contains some 29 publicly listed and more than 100 operating companies and firms. These businesses are organized around four clusters that resemble the General Electric model of strategic business units designed to tap synergies and share common capabilities. A major new research effort is needed to understand the factors driving the adaptability of BGs and their choice of business strategies by documenting the divergent trajectories of business groups in the same institutional context. At the same time, we have considered a variety of contexts in which BGs are dissolved or where troubled BGs are absorbed and reorganized, and this also highlights the need for further research into the causes and dynamics of BG evolution.

Our framework therefore reinforces Granovetter's (2005) call for researchers to examine the way BGs change and adapt over time. We need to understand better how adaptation allows BGs to persist in layers of co-existing corporate systems (Meuer, Rupietta & Backes-Gellner, 2015). Thus, rather than 'crowding out' alternative configurations of institution and corporate structures, BGs may simply occupy a nodal point, albeit at times a rather prominent one, in a shifting and developing corporate landscape. For instance, in the manner suggested by Belenzon et al (2013), German corporate groups continue to coordinate industrial activities in technology and capital-intensive sectors of the economy alongside a large and diverse population of autonomous midsized Mittlelstand firms (Herrigel, 2000). Research in the VoC literature suggests that BG prevalence and high levels of inward FDI can produce a self-reinforcing dynamic resulting in strong complementarity between foreign MNEs and BGs, which together form a dominant stable coalition in many emerging markets (Nolte & Vliegenthart, 2009; Schneider, 2009). Schneider (2009) predicts that linkages and inward investments by MNEs push

BGs into new sectors and expand the scope of their diversification. Nolte and Vliegenthart (2009) depict similar dynamics in the central Europe's transitional economies, where local diversified BGs coalesced with MNEs to create global assembly platforms for medium-range consumer durables, such as auto parts and electronics. In both cases, BGs affiliated firms are highly prevalent alongside substantial inward FDI.

The coexistence of foreign MNEs and domestic BGs is also consistent with the international business view that inbound FDI can be particularly effective in encouraging industrial restructuring (Dunning & Narula, 1996), which is an important antecedent of outward FDI by BGs (Meyer, 2006). That is, inward FDI can encourage domestic firms to be competitive. At the same time, it must be recognized that several East Asian economies, such as Japan and Korea, actively *discouraged* inward FDI in the early stages of development as a means of developing domestic capabilities (Amsden, 1989; Gerlach, 1992). Therefore, in this view, the relationship between levels of BG prevalence and inward FDI is ambiguous, with considerable heterogeneity across countries. We believe that our framework provides a potentially useful way to integrate the VoC and BG literatures in a more complete manner.

Our framework also addresses recent calls to incorporate nonmarket actors, including the state, more effectively into global strategy research (Doh & Lucea, 2013). We argue that the strength of the state is the second pivotal contingency characterizing the likely path of BG evolution. This is consistent with the recent literature on cross-national differences in entrepreneurship, social, and commercial that highlights the importance of national institutions and state activism (recent examples include Ault & Spicer, 2014; Estrin et al., 2013a, b; Stephan et al., 2015).

Importantly, these studies raise serious questions regarding how state strength and activity is defined which go beyond the scope of this paper, but are significant issues to address in future. Explicit recognition of the state in the analysis of BG evolution also raises questions of causality and dynamics. One example is the recent study of industrial policy in Brazil by Mingo and Khanna (2014), where they clearly distinguish between a policy period and a post-policy period. In terms of causality, Cantwell et al (2010) and Cuervo-Cazzura (2015) point to the possibility that MNEs and institutions will co-evolve. Applying a co-evolutionary approach to BGs, Carney & Gedajlovic (2002) describe how Southeast Asian family owned BG's adapted their corporate structures and financial strategies to major shifts in the political environment. In their view, Southeast Asian BGs capacities for internal financing inhibited the growth of external capital markets across the region. Alternatively, in other contexts as capital markets become more liquid, BGs have shifted from substituting for missing capital market to performing a complementary role (Chittoor, Kale & Puranam, 2015) by becoming attractive investment targets for arm's length investors.

Co-evolution is certainly an avenue of exploration for future research on BGs because it links firm adaptability and institutional development. A co-evolutionary perspective also suggests that institutional development does not necessarily lock-in into a given path dependent course determined by initial conditions. Since both states and BG leaders are capable of forming new coalitions they may shift from one path to another (Evans, 1995).

Our approach is also consistent with studies that recognize the interaction between the international competitiveness of a country's prevailing organizational forms and country-level policies and institutions (Porter, 1990; Rugman & Verbeke, 1992). Our proposed framework places emphasis on the interaction between business organizations and institutions, seeking to understand why and when BGs can develop the organizational resilience to adapt to external change, and under what circumstances they will support and embrace such change.

Finally, in building our new framework, we have drawn on the observation that the evidence is not consistent with the notion of global convergence towards a 'standard model' (Hansmann & Kraakman, 2004): a population of focused, freestanding firms embedded in an architecture of market supporting institutions of the type found in mature liberal market economies. Rather, we see the persistence of the BG form as a departure from any standard model that perhaps is related to a world of co-existing institutional forms for firms. This notion of multiple equilibria resonates with the idea that a variety of institutional systems exist (Fainshmidt, Judge, Aguilera & Smith, 2016) and is consistent with the notion of more than one efficient variety of capitalism (Hall & Soskice, 2001), though our framework also includes inefficient outcomes. The idea that different forms of market economy and of firms can co-exist and successfully compete with each other significantly increases the degrees of freedom available to policy makers in designing development strategies. Moreover, firms operating on global markets need to be aware that they may find themselves competing with organisations with a very different internal architecture and system of resource allocation to their own, and therefore willing and able to follow strategies outside their own choice set.

Thus, our framework also has important implications for policy makers and practitioners. For example, it may not be appropriate to judge all potential corporate forms according to a single yardstick; in certain circumstances, the BG form may provide a basis for strong national economic performance and value for shareholders comparable to the focused companies characterizing most mature market economies. For policy makers, this implies that BGs may not necessarily be a constraint on economic development, as envisaged in the EE perspective; rather when BG adaptability is combined with a state actively building market supporting institutions, BGs may provide an efficient mechanism for economic development at home and for internationalization. For managers of Western multinationals, it provides a warning that, while BGs may not have an organizational structure and governance arrangements with which they are familiar, there remain circumstances in which they may still be highly effective competitors on the global stage.

**Conclusion**

Business groups are a prominent feature of the business landscape not only in developing countries, where they have been accorded more attention, but also in more mature economies. Nevertheless, their performance and persistence, remain unsettled areas of research. We find no consistent evidence to support either side of the competing "paragons or parasites" narrative. Rather, the evidence that we have assembled suggests that this polarized characterization is too coarse; the two apparently competing narratives should be seen as potential outcomes of a broader framework. We have proposed a more fine-grained analysis by introducing two new categories based on the capacity of the state to create market-supporting institutions and the ability of BGs to adapt to changes in their institutional environment. The empirical implications of our model point to the identification of the specific institutional contingencies that contribute to differences in BG prevalence and performance.

The evidence suggests that there is considerable cross-country heterogeneity over time in both BG performance and prevalence. Thus, we present a theoretical approach to BGs in which there are multiple potential outcomes and there is no automatic convergence to a standard global model. As a prevalent economic and social institution, BGs are likely to bear a complex and multifaceted relationship with their host economies, and we suspect the identification of their merits and failings will occupy corporate governance, political economy, organizational dynamics, and international business scholars for some time to come.

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**Table 1: Forty years of business group research**

| **Time period & Context** | **Theory & Findings** |
|---|---|
| **Period:** 1870-1914<br><br>**Context:** First major wave of international trade and investment between Europe and colonial Southeast Asia, India, Africa, and Latin America.<br><br><br><br><br>Modernization and industrialization of Japan. | Business historians describe prototype BGs from this period as 'agency houses' (Drabble & Drake, 1981), 'investment groups' (Chapman, 1985) 'expatriate firms' (Davenport-Hines & Jones, 1989), and 'business groups' (Jones & Wale, 1998). These organizations monitored, traded, and performed financing, logistical, and shipping functions for freestanding companies (Wilkins, 1988) and engaged in international mining, commodity production, trading activities. Mostly founded in the late 19th Century but with post-WWII decline of colonialism these BGs disappeared or evolved into integrated multinational enterprises (Jones, 2000).<br><br>Japan's modernizing state facilitates the emergence of family controlled Zaibatsu BGS in this period. Zaibatsu imitate selected Western management practice and followed the colonial era BGs forming international trading divisions in East and Southeast Asia (Morikawa, 1992). |
| **Period:** 1970s<br><br>**Context:** Concern with economic backwardness (Gershenkron, 1962) in less developed countries (LDC).<br><br>Identification and support for an indigenous capitalist class in LDC and postcolonial societies. | Described as 'Economic groups' or *grupos económicos,* BGs generate developmental externalities based on scarce entrepreneurial insight in Latin American postcolonial countries lacking an indigenous capitalist class (Leff, 1978). Nicaraguan family- and bank-based business groups provide a range of services to their affiliates (Strachan, 1976).<br><br>*Grupos económicos* appear dynamic in the early stages of the life cycle, but as they age, they lapse into a defensive mode seeking political protection and rent seeking (Strachan, 1976). Big family business houses are widespread in postcolonial South Asian societies and instrumental in promoting 'partial' modernization (Papanek, 1972). BGs solve the development problem in LDCs, but generate the new problem of the LDC 'robber baron' (Leff, 1979). |
| **Period:** 1980s-1996 | Economic development scholars and sociologists identify state-led industrialization with active state role in coordinating and channeling capital to diversified BGs in Japan |

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|---|---|
| **Context:** Recognition of 'East Asian Economic Miracle' in Japan, South Korea, Taiwan, and later China.<br><br>The developmental state.<br><br>Global liberalization of trade investment regime.<br>The growing international division of labor, global commodity chains. | (Johnson, 1982; Gerlach, 1992), South Korea (Amsden, 1989), Taiwan (Wade, 1990), and later China (Keister, 1998).<br><br>A few BG studies appear that identify the role of network organizational structure (Lincoln et al., 1996, and resource sharing in Japanese and Korean BGs (Goto, 1982; Chang & Choi, 1988).<br><br>Main findings show that BGs promote firm growth and generate industrial capacity. Very few studies focus on relative financial performance (e.g., Weinstein & Yafeh, 1995; Ferris et al., 1995).<br><br>Dissenting perspectives suggest BGs are rent-seeking capitalists who impede economic development (Evans, 1989; Yoshihara, 1988). |
| **Period:** 1997-2005<br><br>**Context**: Asian financial crisis and recovery.<br><br>Identification of BRIC countries (Brazil, Russia, India, and China) as key emerging markets.<br><br>Information technology boom.<br><br>Acceleration of outsourcing, 'hollowing out' of Western corporations. | Surge in BG literature. Two broad directions identifying diverging positive and negative BG attributes.<br><br>Influential theoretical and empirical studies introduce positive perspective of BG capacities for filling institutional voids in India (Khanna & Palepu, 2000a) and Chile (Khanna & Palepu, 2000b). Performance consequences of BG affiliation in several emerging markets (Khanna & Rivkin, 2001). Growing management literature on BG structure and resource acquisition and sharing (Chang & Hong, 2000; Gedajlovic & Shapiro, 2002; Guillen, 2000; Yiu et al., 2005), BG refocusing as a response to institutional development (Hoskisson et al., 2004; Kim et al., 2004). Literature published primarily in management and strategy journals.<br><br>Influential theoretical and empirical studies introduce a negative perspective reporting agency problems with BGs corporate governance structures (Morck & Yeung, 2003). Costs and benefits of BG affiliation (Claessens et al., 2002; Perotti & Gelfer, 2001; Weinstein & Yafeh 1998) specify several mechanisms used to exploit minority investors including pyramids, tunneling, and related party transactions (Bertrand et al., 2002; Friedman, Johnson and Mitton, 2003). A variety of specific performance effects of BGs are analysed, often negative and usually published in economics and finance |

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|---|---|
| | journals; for example on tunelling (Bae et al., 2002) or risk sharing (Khanna and Yafeh, 2005).<br><br>Literature in the post-1997 period is heavily focused on the relative performance of BG affiliates. Meta-analysis identifies 141 studies from 28 countries containing estimates of affiliate performance (Carney et al., 2011). Results show that BG affiliates slightly underperform unaffiliated firms, but BG affiliates do better in less developed institutional contexts.<br><br>Mid-decade literature surveys identify continuing contradictory evidence about BG performance and attributes (Granovetter, 2005; Khanna & Yafeh, 2007; Morck et al., 2005). |
| **Period:** Post 2005<br><br>**Context**: Economic shocks and financial crises.<br><br>Growing number of emerging markets attain middle-income and advanced economy status (e.g., Israel. Korea, Taiwan).<br><br>Increasing numbers of emerging market firms listed among the world's largest 500 multinational enterprises. | New streams of research emerge in the BG literature:<br><br>Consistent with a positive BG perspective, research focuses on BGs' ability to develop international competitive advantage through networks (Elango et al., 2007; Mahmood et al., 2008), innovation (Belezon & Berkovitz, 2010; Castellacci, 2010; Chang et al., 2006), and increasing international scope (Lamin, 2012; Ayyagari et al., 2015).<br><br>The literature also tests specific components of the IV and EE perspectives for example, concerning whether controlling shareholders "tunnel" resources from minority shareholders (Masulis, Phan & Zein, 2011; Siegel & Choudhury, 2012) or whether BGs maintain efficient internal capital (Boutina et al., 2013) and labor markets (Belenzon & Tsolmon, 2016; Cestone et al., 2016).<br><br>Consistent with a negative BG perspective, research identifying extraction through coinsurance and related party transactions with positive (Cheung, 2006; Jia et al., 2012) and negative effects of diversification (Chakrabarti et al., 2007). Documentation of BGs negative social consequences (Fogel, 2006). Continued recommendations for dismantling of BGs (Almeida & Wolfenzon, 2006). |

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| | Country-specific longitudinal studies show that BGs performed well before economic reforms, but demonstrated declining performance in post-reform period (Chari & Parthiban, 2012; Kim et al., 2010; Lee et al., 2008; Zattoni et al., 2009). Contrarily, other country-specific longitudinal surveys show that BGs perform better after institutional reforms (Chittoor et al., 2015; Manikandan & Ramachandran, 2015; Siegel & Choudhury, 2012), suggesting that BGs adapt by shifting from a void filling function toward a complementary function.<br><br>Emergence of research suggesting that BGs experience complex and contingent political relationships (Lu & Ma, 2008; Siegel, 2007; Zhu & Chung, 2014), as well as research identifying factors supporting BG persistence during and after institutional transitions regardless of performance consequences (Chung & Luo, 2013; Schneider, 2010). |

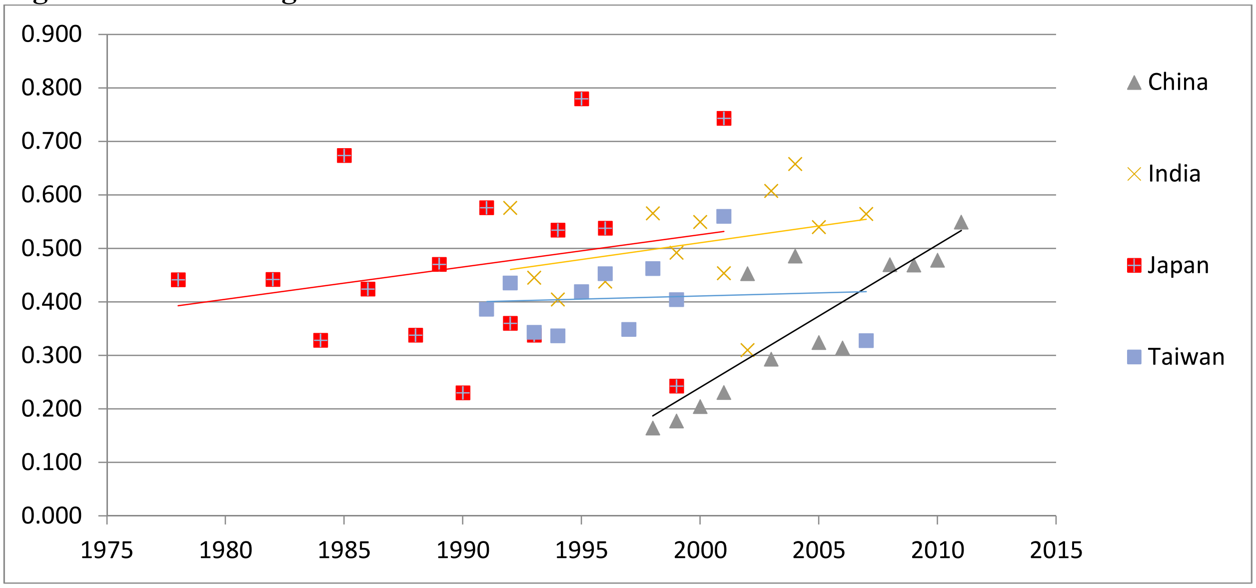
**Table 2: The Institutional Void (IV) and Entrenchment/Exploitation (EE) Perspectives Compared**

| | Institutional Voids (IV) | Entrenchment/ Exploitation (EE) |
|---|---|---|
| **Main Idea** | BGs arise as efficient internal organizational responses to inefficient or missing external markets ("institutional voids"). | BGs arise because business elites use political connections to obtain preferential and protected access to resources. |
| **Main Mechanisms** | 1. BGs use efficient internal capital and managerial markets to create and grow efficient affiliates.<br>2. BGs use efficient internal labour markets to allocate personnel across businesses.<br>3. BGs develop recognized brands that signal quality and reliability. | 1. BGs use political connections to gain monopoly control over critical resources and sectors.<br>2. BGs use their political connections to restrict competition, both internal and external, and to obtain favorable regulations.<br>3. BGs exploit opaque ownership structures to divert funds from affiliates to the ultimate owner ("tunneling"), often at the expense of minority shareholders. |
| **Implication: Affiliate Performance** | Affiliates of BGs will perform better than non-affiliated companies, particularly at lower levels of institutional development, across a wide range of economic and financial indicators. | Affiliates of BGs do not out-perform comparable non-affiliated firms across a wide range of economic and financial indicators because profits are diverted from the affiliate. |
| **Evidence** | The evidence is mixed, with no unambiguous support for either perspective. BG affiliation on average has a negative or zero impact on performance on many measures, but there is considerable heterogeneity in outcomes, depending, for example, on the measure, the time period and the countries under consideration. | |

| | | |
|---|---|---|
| **Implication: Internationalization** | Not entirely comfortable with internationalization because BGs are not expected to persist, but efficient affiliates *may* develop the internal capabilities to compete abroad. | BGs are more interested in maintaining favored positions in domestic markets and will therefore not expand abroad. |
| **Evidence** | The evidence on balance favors the IV view, but with some nuance. There is increasing evidence that BG affiliates do compete abroad and use the BG network to learn how to compete abroad. However, there is also evidence that the most domestically diversified BGs do not invest abroad. | |
| **Implication: Business Group Prevalence** | BGs will be prevalent as long as market and other institutions are weak, but will tend to dissolve as institutional voids are filled. BG prevalence will decline with institutional development. | BGs will become entrenched because they benefit from, and support, political elites. There will be no tendency for them to become less prevalent with institutional development. |
| **Evidence** | On balance, BGs tend to persist and this result is consistent with the EE view. However, once again, there is considerable heterogeneity in outcomes, so that, while in most cases BG prevalence does not diminish over time, there are important exceptions. | |
| **Implication: Business Group Impact** | BGs may develop innovative capabilities, both internally and through spillovers from foreign firms. As such, they will not necessarily resist foreign entry and may themselves engage in international operations. Thus, BGs may enhance outward and inward FDI and innovation at the national level. BG prevalence is not negatively associated with inward and outward FDI and innovation at the national level. | BGs are mostly interested in maintaining and protecting favored positions in the domestic markets. There is no incentive for them to engage in innovation because higher profits can be earned through political channels at home. Similarly, BGs will seek to limit foreign entry (inward FDI) and will not seek to invest abroad. BG prevalence is negatively associated with inward and outward FDI and innovation at the national level. |
| **Evidence** | There is limited evidence on the impact of BG prevalence on country-level outcomes. However, what evidence does not suggest that BG prevalence is in any way associated with outcomes that are consistent with the EE view. | |

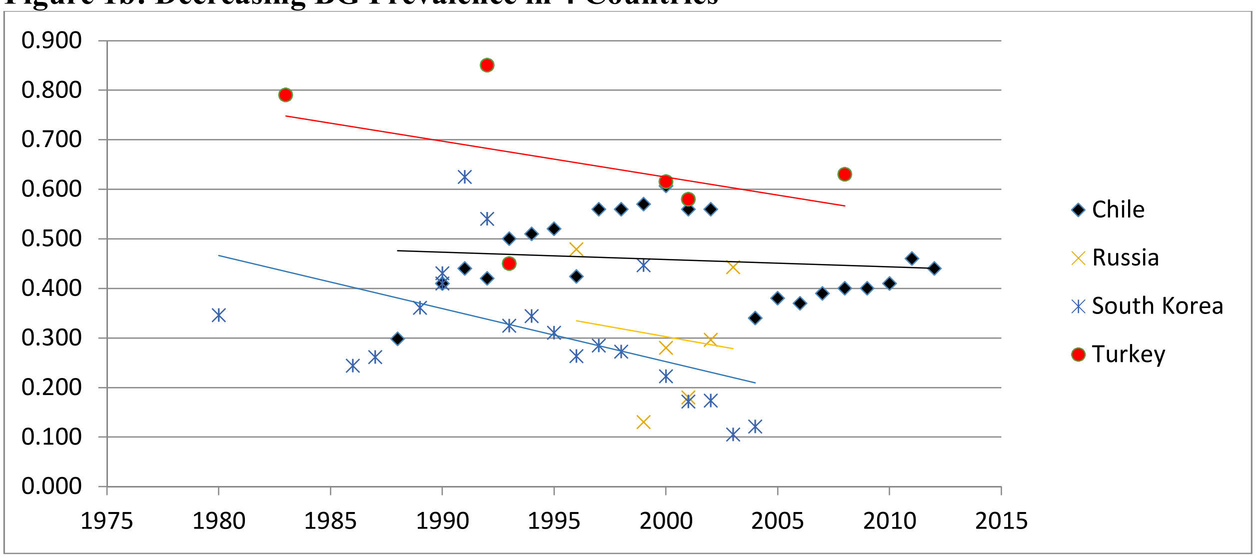
# Figure 1: BG Prevalence

**Figure 1a: Increasing BG Prevalence in 4 Countries***




*BG prevalence also increases in Belgium, Brazil, Indonesia, Israel, Malaysia, Peru, Singapore, and Thailand

**Figure 1b: Decreasing BG Prevalence in 4 Countries***




*BG prevalence also decreases in Hong Kong and Philippines

Source: adapted from Carney et al (2017).

**Figure 2: State Strength and Business Group Adaptability: The Outcome Matrix**

| **Group Adaptability** | | **State Strength** | |
|---|---|---|---|
| | | **Strong** | **Weak** |
| | **High** | ***Competitive BGs*: BGs persist and become nationally and possibly internationally competitive as institutional voids are closed. BGs coexist with, and complement, other ownership structures<br>***Modes of Group Adaptability*:**<br>Refocusing, Internationalization | ***Escape strategies*:** BGs invest abroad to benefit from stronger institutional environments. In very weak states, some may exit the home jurisdiction in favor of locations with stronger property rights<br>***Mode of Group Adaptability*:**<br>Escape |
| | **Low** | ***IV perspective*:** BGs disappear over time as institutional voids are closed<br>***Non-Adaptation Syndrome*:**<br>Collapse/Absorption | ***EE perspective*:** BGs capture state actors to protect monopoly rents<br>***Non-Adaptation Syndromes:***<br>Capture, Contingent Value |