Manuscript’s History

- **Original Title:** Business groups research: A comprehensive review, theoretical framework, and future research agenda.

Manuscript’s Current Status

- **Current Title:** Many Janus faces: Unresolved puzzles in the business group literature.
- **Status:** Revise and Resubmit at *Journal of World Business*.

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Future of the Manuscript

Currently, the paper is under Revise and Resubmit at the *Journal of World Business*, a leading international business journal that is publishing a special issue about business groups in 2016. The editor has indicated that, if our study is accepted, he wants it to appear in the same volume as the special issue. Though not part of the special issue *per se*, our study would serve as a companion piece. Thus, while disappointed in the outcome at *Journal of Management*, we are excited about the visibility of publishing a review of business groups not only in a respectable international business journal, but also in the same volume as a special issue devoted to its subject matter.

Project Summary

We have modified the paper based on the feedback received from the *Journal of Management* and the *Journal of World Business*. Whereas earlier versions of the study focused more on reviewing the business group literature, this version adopts more of a critical eye and seeks to provide a more provocative future research agenda. The remainder of this document summarizes our paper.

Business groups are collections of semi-autonomous firms bound together through common ownership, interlocking directorates, commercial ties, and social relationships. Outside of the United States, business groups are the dominant structure used to organize and govern large businesses (Yiu et al., 2014), particularly in emerging economies (Khanna & Palepu, 1997). For example, CEMEX (Mexico), Lenovo (China), Petrobal (Brazil), Samsung (Korea), and Tata Industries (India) are business groups. However, business groups also have a strong presence in several Western economies, such as Sweden and Canada (Colpan & Hikino, 2010; Morck, 2010).

Partly because of their ubiquity, business groups have received considerable scholarly attention in the international strategy literature. For example, we identified over 200 articles about business groups in leading strategy and international business journals. And, the data in these articles comes from more than 50 countries and covers each populated continent. Business groups also are the subject of large literatures in our sister fields, especially in finance and economics.
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Moreover, business groups are interesting theoretically, because they represent a hybrid organizational form that lies between arm’s length contracting and hierarchy (Hennart, 1993). Relative to independent firms that collaborate via arm’s length contracting, the business group affiliates are connected more tightly. Yet, relative to the wholly-owned business units typical of multidivisional hierarchies, the affiliates are connected more loosely.

The size, diversity, and geographic expanse of business group research has produced an eclectic, multi-theoretic, and insightful literature. However, this literature is fragmented and lacks a theoretical framework to tie it together. In addition, despite the volume of research, the literature lacks consensus about even the most fundamental questions, such as why business groups are more common in some countries than others. Thus, we structure our review, critique, and future research agenda around a series of theoretical puzzles in the business group literature. In this document, we summarize these theoretical puzzles and our suggestions for future research on them.

**Theoretical Puzzle 1: Are market imperfections a sufficient explanation for business groups?**

The market imperfections view is the most common theoretical explanation for business groups. According to this view, business groups emerged in response to two market imperfections in pre-industrialized societies: (1) weak factor markets and (2) institutional voids. These market imperfections hinder firms’ efforts to conduct exchange and mobilize needed resources.

Business groups circumvent these market imperfections: the presence of multiple affiliates under common governance creates the potential for internal markets that allow the affiliates to share, develop, and leverage resources within the boundaries of the group, reducing the need to conduct exchange with outsiders. In this way, groups substitute for weak external factor markets and institutions (Khanna & Palepu, 1997; Hoskisson et al., 2000; Leff, 1978; Wan, 2005).

In support, several in-depth historical analyses of particular business groups have revealed that firms became business groups by adding affiliates to secure resources in environments with weak external factor markets and institutions. Examples include Aguilar and Cho’s (1985) analysis of LG, Khanna and Palepu’s (1997) analysis of Tata, and Jones and Colpan’s (2010) analysis of 19th-century British merchants. Likewise, scholars have estimated that between 20% (in Chile) and 67% (in Indonesia) of registered firms in emerging economies are in business groups (Khanna & Yaffe, 2005) and that groups account for between 6% (in India) and 28% (in Colombia) of gross domestic product (GDP) in the emerging economies of Latin America and Asia (Guillén, 2001).

In addition, many economies have undergone “state-engineered industrialization” in which business groups played critical roles in economic development and, in turn, have accumulated significant power (Hobday & Colpan, 2010: 777; Morck, 2010; Schneider, 2010). According to this view, business groups did not arise spontaneously but instead were developed and supported by governments for the explicit purpose of addressing market imperfections. In support, Carrera, Mesquita, Perkins, and Vassolo (2003), Dieleman and Sachs (2008a; 2008b), Kim (2010), and Morck and Nakamura (2007) have documented the role of business groups in the state industrialization policies of Argentina, Indonesia, Korea, and Japan, respectively. Second, over time, the importance of business groups in many economies allowed them to accumulate power and extract rents (Langlois, 2010). In fact, there is evidence that business groups have incentives to protect their privileged positions and, thus, frustrate institutional and factor market reforms that threaten the status quo (Fogel, 2006). Thus, although business groups may begin as responses to market imperfections, they might perpetuate such market imperfections over time.
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By extension, as external factor markets and institutions improve, business groups should enjoy fewer advantages and should decline in importance (Chang, 2003; Kim et al., 2010: 1156). However, empirical studies on whether business group membership provides performance benefits for the affiliates has provided mixed results (Carney et al., 2011; Chacar & Vissa, 2005; Khanna & Rivkin, 2001). And, the studies which show that group membership does provide firm performance benefits are divided over whether these effects persist (Majumdar & Bhattacharjee, 2014; Ramaswamy, Li, & Pettit, 2012), weaken (Khanna & Palepu, 2000b; Chang & Hong, 2000), or turn negative (Lee, Peng, & Lee, 2008) as emerging economies mature. Moreover, also in contrast to the market imperfections view, the business groups in some countries have become stronger—not weaker—as their economies have grown. For example, the share of China’s GDP attributable to business groups more than doubled between 1998 and 2007 (Lee & Kang, 2010), and the largest chaebol accounted for 53% of Korea’s GDP in 2002 but 82% of it in 2012 (Lee, 2013). Thus, evidence suggests that the market imperfections view has merit but is incomplete.

Thus, more research on the market imperfections view is needed. We offer two research suggestions in this regard. First, we need large-scale longitudinal studies to provide fresh insights on business group founding and failure. In particular, the roles of path dependence, economic shocks, and crises in perpetuating and undermining the ubiquity of business groups warrant additional attention. Second, we need finer-grained theory and measures of market imperfections. For example, recent evidence suggests that factor markets and institutions evolve separately and affect economic development in different ways (Hoskisson et al., 2013).

**Theoretical Puzzle 2: Do internal markets add value or destroy value in business groups?**

Internal markets are among the defining features of business groups. In particular, scholars have identified three types of internal markets. First, internal capital markets (e.g., intragroup loans) allow affiliates to share financial resources. Second, internal labor markets (e.g., employee transfers) allow affiliates to share human capital. Third, intragroup trade (e.g., buyer and supplier relationships) allow affiliates to share input and distribution resources and to coordinate their respective production processes (Chung & Luo, 2013; Gerlach, 1992; Toulan, 2002). It is plausible that the presence of internal markets provides advantages over independent firms that lack such markets, particularly when external factor markets and institutions are weak.

However, internal markets also have downsides. First, they allow groups to prop up weak affiliates and, thus, enable suboptimal resource allocation (Gedajlovic & Shapiro, 2002). Second, they allow majority owners to expropriate wealth from minority owners. For example, absent strong investor protection, owners with controlling stakes in multiple affiliates may use internal markets to tunnel profits into affiliates where their cash flow rights are greater (Bertrand et al., 2002). Third, repeated intragroup transactions can reduce the diversity of resources within the group.

Reflecting the positive and negative implications of internal markets, the evidence on whether affiliates outperform independent firms is mixed (Carney et al., 2011). Thus, more research in this area is needed. First, scholars should elaborate the conditions under which internal markets create versus destroy value. Second, rather than simply assume they exist, scholars should differentiate and measure the different internal markets. Third, scholars should consider interactions between or among the different internal markets. For example, internal labor markets might transfer knowledge within the group (Mursitama, 2006) and, in turn, enrich the benefits of intragroup trade.

**Theoretical Puzzle 3: What factors explain business group scale and scope?**
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Scholars have devoted considerable attention to business group scale and scope. First, scholars have shown that business groups often exhibit high product diversification, especially in unrelated industries (Delios & Ma, 2010; Hoskisson et al., 2005). Second, there is an emerging research stream on restructuring, which occurs when business groups reshuffle their portfolio of affiliates (Hoskisson et al., 2004; Wu & Delios, 2009). Third, consistent with increasing internationalization in business groups, recent research has examined business group international diversification.

There are several unresolved questions in this literature. First, although product diversification should reduce risk and help business groups leverage their competitive advantages in new markets, scholars have found that affiliates do not exhibit lower risk (Khanna & Yafeh, 2005) and that, in fact, product diversification lowers performance (Carney et al., 2011). Second, restructuring measures tend to combine portfolio expansion and reduction into a single measure (e.g., Hoskisson et al., 2004), producing confounds. Third, it remains unclear whether affiliates are more (Kim et al., 2015) versus less (Gaur & Delios, 2015) likely to internationalize than independent firms are.

Future research should consider the different ways in which business groups alter their scale and scope. For example, there is little evidence on the conditions under which they expand scale and scope via wholly-owned subsidiaries, acquisitions, or alliances. Likewise, there is little evidence on why they choose divestitures versus spinoffs to reduce scale and scope. Moreover, it is necessary to account for endogeneity between environmental conditions and business group scale and scope. For example, the pursuit of the same market opportunities may lead affiliates from the same group to enter a particular country, irrespective of group effects. Lastly, we need a meta-analysis to resolve equivocal findings about the factors that shape business group scale and scope.

Theoretical Puzzle 4: Does the business group structure aid or hurt corporate governance?

Corporate governance in business groups is important and interesting, because the affiliates are not fully independent yet there is variation in the ownership structures that bind them together. Some affiliates are partly-owned, some are wholly-owned, and some are owned either in part or in whole by other affiliates. As a result, ownership is an important issue in business group research.

Research in this area has focused on three issues. First, ownership concentration exists when a few shareholders own large chunks of equity. Second, pyramidal ownership exists when owners control some affiliates, which in turn own other affiliates. Third, scholars have identified different types of owners, including families, banks, the state, and institutional owners.

As in most other areas of the business group literature, there are conflicting views and ongoing debates on each of these topics. First, whereas concentrated owners have more incentive and ability to monitor managers, they also may use this influence to expropriate minority owners (Joh, 2003; Jiang et al., 2010). Second, pyramidal ownership can promote greater intragroup collaboration, but it also can enable majority owners to tunnel profits (see above) and expropriate minority owners (Guzzini & Iacobucci, 2014; Morck, 2005). Third, different types of owners have different preferences, and it remains unclear which and under what conditions different types of owners create versus destroy value (Gedajlovic et al., 2002; Gerlach, 1992; Ramaswamy et al., 2002).

Thus, there are several opportunities for future research on business group corporate governance. First, it is necessary to disentangle the conflicting effects of different ownership conditions. For example, under what conditions does ownership concentration create versus destroy value in business groups? Second, scholars need to examine other types of corporate governance.
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arrangements in business groups. Research on incentive compensation, boards, and the market for corporate control, for instance, have received much less attention than ownership has received.

Theoretical Puzzle 5: Does the business group structure increase or decrease innovation?

Mahmood and Mitchell (2004: 1348) identified conflicting effects of business groups on innovation. On the one hand, the groups create “innovation infrastructures” in which affiliates can share resources, protect intellectual property, and leverage political ties, brands, and reputations to secure outside resources. Business groups also can use their internal markets to access and integrate technology via acquisitions (Amsden & Hikino, 1994) and alliances (Zhao, Anand, & Mitchell, 2005). Further, the group structure allows the affiliates’ to draw on one another’s knowledge to identify and exploit opportunities while also preserving their autonomy and protecting their incentives to innovate (Manikandan & Ramachandran, 2015). On the other hand, as economies advance, the environments of smaller firms that focus on specialized knowledge might be more conducive to innovation (e.g., Alvarez & Barney, 2001). If so, business groups’ scale, scope, internal markets, and political favors may hinder innovation by erecting entry barriers, reducing competition, and preventing the influx of new knowledge. Likewise, on the grounds that affiliates often compete in unrelated industries, Belenzon and Berkovitz (2010) questioned whether intragroup knowledge sharing contributes positively to affiliate innovation.

Consistent with these arguments, several studies have found that business groups have curvilinear effects on innovation. Mahmood and Mitchell (2004) found an inverted-U relationship between the market share of business groups and industry innovation in Korea and Taiwan. Similarly, Lamin and Dunlap (2011) found that Indian affiliates in moderately diversified groups had more complex technological capabilities than did not only independent firms, but also affiliates in groups that were less or more diversified. Lastly, Mahmood, Chung, and Mitchell (2013) found that intragroup trade had an inverted-U relationship with group innovation and that institutional development lowered the threshold at which intragroup trade began to hinder innovation.

We see two opportunities to enrich research on business group innovation. The first relates to measurement. Although many studies use patents to proxy for innovation, firms often hesitate to patent innovations when intellectual property protection is weak. Thus, especially in emerging economies, patents are not an ideal measure. Second, it is important to distinguish among types of innovation. For example, whereas business groups may have the resources to pursue radical innovation, they may be reluctant to pursue innovations that challenge the status quo. In addition, the business group structure may provide more significant advantages in technologies that require collaboration across more (e.g., transportation) rather than fewer (e.g., pharmaceuticals) industries. Despite the interesting possibilities, there is little research on these topics.

Conclusion

I am grateful for the funding provided by the College of Business to write this paper. As this summary reveals, the review and critique has been comprehensive and the future research agenda has the potential to enrich international strategy research on business groups.

Though we were disappointed that the paper was rejected after receiving a Revise and Resubmit at Journal of Management, the paper has another Revise and Resubmit and has the opportunity to receive considerable visibility as an addendum to a special issue on business groups at the Journal of World Business, which is a respected and widely distributed international business journal.