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**THE ROLE OF FAMILY CONGLOMERATES IN EMERGING MARKETS: WHAT  
WESTERN COMPANIES SHOULD KNOW**

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# **THE ROLE OF FAMILY CONGLOMERATES IN EMERGING MARKETS: WHAT WESTERN COMPANIES SHOULD KNOW**

## **Abstract**

Large, diversified, family-owned businesses are dominant players in the economies of most emerging markets and can be excellent business partners for Western companies. This article highlights the evolutionary patterns of Family Conglomerates (FCs) and delineates principal drivers of their growth, expansion, and internationalization. Those aspects of FCs examined in this study include early mover advantages, foreign alliances, competitive market positioning, and diversification. Also discussed are entry-mode considerations for Western companies contemplating doing business in the fast-growth markets of East Asia, Latin America, and elsewhere.

**Keywords:** Family conglomerates, emerging markets, internationalization, market entry.

## **THE ROLE OF FAMILY CONGLOMERATES IN EMERGING MARKETS: WHAT WESTERN COMPANIES SHOULD KNOW**

The Hyundai Group, one of the top five conglomerates (chaebols) in Korea, recently experienced a financial crisis. In response, the Korean government and Hyundai's major creditors provided well over \$400 million in assistance, including credit extension and short-term loans, to secure some of the major business units of the group from bankruptcy. It is not easy for most small and medium-sized firms in Korea to obtain that type of assistance, but the family-owned and -operated Hyundai Group had no great difficulty (Chung, 2000). Historically, the group was led by its founder, Joo Young Chung, in all strategic moves, which included diversifying into many different industries, but the business is in the process of transition to the second generation (Drozdow and Carroll, 1997). The recent crisis resulted from a battle for power between the founder's two sons, and the bailout reflects the heavy dependence of the Korean economy on this major family conglomerate (FC) (Chung, 2000; Donga, 2001; Hwang, 2000).

Several months earlier, the Daewoo Group, another top chaebol and FC, also experienced a severe financial crisis and was restructured. Creditors and the government sought the highest bidder for one of the group's major business arms, Daewoo Motors. Despite successful growth at home and abroad, the group's persistent inefficiency and exuberant business expansion—financed largely by loans (Chung, 2000; Hwang, 2000)—drove the conglomerate to the brink of ruin (Donga, 2001; Khanna and Palepu, 1999; Nachum, 1999).

Large, diversified FCs are not unique to Korea. Indeed, they are dominant players in many emerging markets (EMs). Known as chaebols in Korea, business

houses in India, holding companies in Turkey, and *grupos* in Latin America, huge FCs represent a unique business enterprise in such countries. Table 1 provides a sample of FCs from select EMs. The role of such groups is substantial. For example, the top 30 FCs in Korea generate more than 46% of industry revenues, and their combined assets account for 47% of the whole economy. Andrade, Barra, and Elstrodt, (2001) describe grupos as “the backbone of the economies in Latin America.” The origin and growth of FCs can be attributed to a special relationship with government and with the economy itself.

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Insert Table 1

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Several aspects of FCs contribute to their relative success (Andrade, Barra, and Elstrodt, 2001). Their informal structure facilitates quick decision making, a key attribute in rapidly growing and often turbulent economies. FCs also exhibit strong shared values, often rooted in the founder’s vision and legacy. Loyalty of workers is high, and management turnover tends to be low. Equally important is a deep understanding of local markets and customers. Furthermore, close ties with governmental agencies and ruling political parties translate into competitive advantage and staying power.

Because FCs play such a significant role in many emerging markets, it is critical for Western companies that aspire to enter these markets to develop a comprehensive understanding of their nature and impact. The objective of the present article is to contribute to such an understanding through a study of nineteen FCs in eight emerging markets: India, Indonesia, Korea, Mexico, the Philippines, Taiwan, Thailand, and Turkey.

## **FAMILY CONGLOMERATES IN EMERGING MARKETS**

Emerging markets exhibit high growth potential and present a mixture of opportunities and risks for Western companies (Cavusgil, 1997; Garten, 1997a; Kock and Guillen, 2001). Their attractiveness lies not only in cheap raw materials and labor but also in the potential to generate revenues. Companies in industrialized countries depend on overseas markets for economies of scale in production as well as profits. EMs are not just suppliers but also buyers of goods and services.

There are risks to doing business in the EMs. These include an inadequate marketing infrastructure, such as poorly developed distribution systems; limited communication channels; lack of regulatory discipline and frequent changes in regulation; a high level of product diversion; various market failures; and political and economic instability (Arnold and Quelch, 1998; Garten, 1997a; Khanna and Palepu, 1997, 2000). In many EMs, Western companies have poor market information, and sometimes regulation misguides foreign businesses (Khanna and Palepu, 1997). Consequently, strategic alliances are an important entry mode in these markets (Kock and Guillen, 2001; Lane and Beamish, 1990; Osborn and Hagedoorn, 1997). Through alliances, Western companies can share risk and resources, gain knowledge, and obtain access to markets (Kock and Guillen, 2001).

FCs are potential allies and are a universally observed ownership type across many EMs (Andrade, Barra, and Elstrodt, 2001; Khanna and Palepu, 1997; Kock and Guillen, 2001). In this study, we characterize an FC by referring to specific attributes. The typical FC is owned and controlled by a family (Ben-Porath, 1980) and has a single founder who dominates, although family members may serve as executives in the business (Church, 1993; Drozdow and Carroll, 1997). Traditionally, the family

holds the majority of controlling rights (Church, 1993; Khanna and Palepu, 1999; Kock and Guillen, 2001). Therefore, FCs are not the same as business groups, which are not necessarily owned by a family (Granovetter, 1995). Business groups may include firms linked by personal relationships that stem from a similar personal, ethnic, and/or regional background (Granovetter, 1995; Leff, 1978). FCs also differ from family businesses (FBs), though they possess several similar characteristics. For example, both FCs and FBs are owned and controlled by a family (Davis and Harveston, 2000), and inherit similar behaviors such as leadership and entrepreneurship (Dyer 1986, Sorenson, 2000). Nevertheless, FCs are considered to be a large network of corporations that are owned by the same family. They are more diversified, and have a larger size when compared to the family businesses. Their economic impact (jobs, revenues, branches of activity, technology, etc.) in the respective countries is much more substantial. The present study attempts to examine the characteristics of FCs, considering the relatively significant impact they have on their respective economies.

Another feature of FCs is that they have been operating for many years and have a substantial history (Ben-Porath, 1980). In the second and third generations, FC owners may become more removed from management, and this gap may gradually widen (Drozdow and Carroll, 1997). Eventually, few family members may actually work in the company, but the family tends to control the board of directors. Also, they are highly dominant in their home markets (Granovetter, 1995). The typical FC has significant investments in a wide variety of businesses, ranging from manufacturing to banking to construction. Finally, FCs tend to use internally generated capital as well as government loans for expansion and growth.

The contribution of FCs to their home economies is considerable (Granovetter, 1995; Kock and Guillen, 2001; Nachum, 1999), and they can add value to it in several ways (Khanna and Palepu, 1999). For example, the subsidiaries of the top 30 Korean conglomerates numbered more than 600 in 2000, and the top five chaebols accounted for 59% of total value of firms listed on the Korean Stock Exchange. The conglomerates in Korea, which are mostly FCs, make a significant contribution in terms of employment, tax revenues, foreign currency generation, and general economic growth (Hwang et al., 2000). More specifically, as of late 1990s, the annual revenue of Samsung chaebol in Korea exceeded \$70 billion whereas Daewoo employs more than 265,000 employees. Koc accounts for 19% of Istanbul (Stock) Market Trading ,while Sabanci is responsible for 5.3% of country's tax revenue in Turkey. Further more, Siam Cement in Thailand has 64 subsidiaries, and Tata in India has around 300,000 employees with eight percent of total public capitalization in the country.

FCs tap funds and management talent from within their operations to start new ventures rather than relying on intermediaries (Khanna and Palepu, 1999). Guillen (2000) suggests that those who learn to combine their resources will be able to create new business ventures across a wide variety of industries, and the expansion capability of FCs encourages them to diversify, rather than specialize in one product line, and take advantage of scale and scope. As a result, FCs hold the largest market share in many sectors of the economy. For example, Mahindra & Mahindra focuses on automobiles and related businesses in India but invests in a range of other projects. In most cases, FCs command assets that give them a competitive edge. Also, they invest in training programs and education (Khanna and Palepu, 1999). In addition,

they seek partnerships with foreign firms because these may bring new managerial or technical know-how, insights, and experience.

Indigenous FCs have several advantages over foreign companies intent on entering EMs. They have a well-established local distribution network that would take years for Western companies to replicate. Their longstanding relationships with government officials are not available to foreign companies (*Asiamoney*, 1994; Kock and Guillen, 2001). Their distinctive products appeal to local tastes (Ger, 1999). FCs also access natural resources or labor that can give them a cost advantage (Dawar and Frost, 1999) and competitive prices (Prahalad and Lieberthal, 1998). Usually, FCs become aware of a Western company's new product strategy long before the brand is launched in the local market and can adjust their product line accordingly. In sum, FCs play an important role in the industrialization of their country and make up ideal partners for Western companies as they tend to possess valuable local market expertise and understand local preferences (Kock and Guillen, 2001).

An FC can use its group name to advantage when entering into new businesses (Khanna and Palepu, 1997). Hyundai, Samsung, and Koc are examples. The goodwill, reputation, and the positive image that surround the name, even if limited to the local market, often symbolize world-class quality and customer service (Khanna and Palepu, 1999), and can help FCs compete with well-established multinational brands (Prahalad and Lieberthal, 1998). In contrast, it is costly for Western companies to build a credible brand identity in markets with relatively poor communication infrastructure (Khanna and Palepu, 1997; Kock and Guillen, 2001).

The present study addresses three basic questions. Why are FCs so important to their home economy? What advantages do FCs offer to Western companies? What

does the future hold for FCs? Our research provides a better understanding of the concept of FCs and identifies similarities as well as differences with respect their to origins, governance, drivers, foreign partnerships, internationalization, and transition to professional management.

## **THE STUDY**

### **Content Analysis**

A replicable experiment is essential for a reliable and objective analysis, and categorizations should be consistent with the applied rules to avoid researcher bias (Holsti, 1968). Since this is an exploratory investigation, we specified the scale and scope of the study in advance, according to a set of qualitative and quantitative factors. First, the investigation excludes non-family conglomerates, i.e., those that are publicly owned and/or state owned. For example, in some emerging markets such as China or countries in Africa, the majority of conglomerates are owned by the state. These are not the focus of present inquiry. Second, the selection of FCs and EMs was based largely on quantitative factors, such as economic, financial, and business-related indicators.

In classifying EMs, most observers tend to include Argentina, Brazil, Chile, China, Colombia, the Czech Republic, Egypt, Hong Kong, Hungary, India, Indonesia, Israel, Malaysia, Mexico, Peru, the Philippines, Poland, Russia, Singapore, South Africa, South Korea, Taiwan, Thailand, Turkey, and Venezuela (see, e.g., *Economist*, 2001; Garten, 1997b). initially, we ranked these countries by growth in GDP, industrial production, and consumer prices. Eight were eventually selected: India, Indonesia, Korea, Mexico, the Philippines, Taiwan, Thailand, and Turkey. The selection criteria were as follows: large population and resource base; major participant in the

critical political, economic, and social activities taking place on the world scene; among world's fastest expanding markets and responsible for the growth of global trade; and GDP increasing two or three times faster than that of developed countries.

The FCs were selected based on their origin, revenues, diversification, foreign partnership, and internationalization. The following criteria were used: founded by a family; have a number of subsidiaries and businesses; year-end sales in 1998; mode of market entry; formation of joint ventures; and existence in foreign markets. The FCs we analyzed have 10-400 domestic or foreign subsidiaries with annual sales of \$0.85-72 billion. They maintain joint ventures ranging from 1 to 23, while the number of foreign markets they operate ranges from 6 to more than 130. In each EM, we selected from one to four FCs that were usually among the top ten such companies in the country. In the final analysis, nineteen FCs were classified into different stages (introduction, growth, and maturity) based on certain indicators (such as sales and number of products). We then verified the drivers for each stage and determined those for each company.

### **Secondary Research**

Websites, annual reports, press releases, and financial records of the companies were content analyzed. Biographies of founders, which provided some important insights about an FC's evolution, were also consulted. Several directories were used, such as Wright Investors' Service, Hoover's Handbook of World Business, International Public and Private Companies, International Directory of Company Histories, Principal International Business, and Asia's 7500 Largest Companies. Business periodicals and newspapers were examined, including Harvard Business Review, The Economist, and the Wall Street Journal. Also consulted were scholarly journals.

## **THE FORMATION OF FAMILY CONGLOMERATES**

Several factors seem to characterize the formation of FCs in EMs. Especially significant is the role of founders and some unique country features such as employee work ethic and source of capital.

### **Founders**

The critical role of the founder has been noted in the literature. Certain aspects are noteworthy. Founders usually start the business with some capital when they are young. Through foresight and strategic decision-making ability, they become market leaders (Drozdow and Carroll, 1997), although in most cases they are not highly educated. Generally, they are entrepreneurs and risk takers who become nationally prominent (Davis, 1968; Mariussen, Wheelock, and Baines, 1997). Within the organization, they are portrayed as having strong personal ties with employees (Schein, 1983), and their dominant position is rarely challenged (Steers et al., 1989). They assume social responsibilities by endowing schools, cultural and sports centers, and health care facilities (*Economist*, 1997). They also play an inspirational role in the advancement of business groups (Dent and Randerson, 1997). Typical founders are Joo Young Chung of Hyundai, Byung Chull Lee of Samsung, Vehbi Koc of Koc, and Haci Omer Sabanci of Sabanci; they are well known for their creativity, proactive and arduous effort, aggressive and anticipatory decision making, and successful achievements.

### **Country-Specific Factors**

Each country is a unique environment (Woodall, 1998) depending on the evolutionary stage of the economy, political system, government influence, natural resources, work ethic, financial resources, and endowments in land and labor (Kock and Guillen 2001; Nachum, 1999). Some of these factors may cause the decay of family businesses (*Business Week*, 1982), some may foster their growth (Khanna and Palepu, 1999), and each may play a different role in various evolutionary stages of the FC.

### **DRIVERS OF FAMILY CONGLOMERATES**

At each state of FC evolution—introduction, growth, and maturity—certain drivers are influential, as shown in Exhibit 1. We also attempted to assess the relative importance of these drivers in each stage. The following sections are organized chronologically, that is, according to drivers that are prominent in the early, middle, and late stages of FC development.

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Insert Exhibit 1 About Here

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#### **Early Mover Advantage**

Early in their formation, FCs tend to be very good in translating market needs into business opportunities. FCs are generally the first players in many industries to cater to the local market. As early movers, they can capture a high market share and build brand equity ahead of competitors. For example, Koc was the first producer of automobiles, washing machines, and refrigerators in Turkey; it played an important role in the country's industrialization and in the development of those sectors. Mahindra & Mahindra was the first manufacturer of tractors in India and currently has the largest facility. Hyundai Group, one of the early movers among Korean automobile

manufacturers, now has the largest share of the country's auto market (Guillen 2001). The early mover advantage establishes market position for many FCs as they expand into various sectors throughout the subsequent growth stage. Typical expansion sectors include consumer durables, automotive, electronics, construction, information technology, food and confectionery, beverages, retailing, tourism, and education. These companies often were involved in import substitution activities early in their evolution.

### **Government Protection**

In EMs, the government is heavily involved in business decisions (Granovetter, 1995; Kock and Guillen, 2001; Steers et al., 1989). In some cases, it even initiates the FC; examples are Siam Cement Group in Thailand and the Indonesian FCs of Salim, Astra, and Lippo (Shin, 1993). Government protection may take the form of special loans, subsidies, market entry barriers for competitors, and tax incentives, among others (Jones and Rose, 1993). For example, the Indian government regulates commodity prices, raw material imports, and business exit. In most of the countries we examined, government protection has played a significant role in the growth of FCs. LG group in Korea benefited from elevated import barriers until the government opened the toothpaste market to the world in the 1980s. Previously, LG made and marketed toothpaste products without any major competition in the domestic market. The following excerpt from Insideindonesia (1999, Article No. 58) indicated the relationship between Salim and the government.

Since the late 1950s the success of particular business groups in Indonesia has generally been linked to powerful political actors. Bulog, the national logistics board that controls the supply of rice and other basic commodities, functioned as a "centre of the state" during the New Order in the country. Ever since its operations from May 1967, especially in the food sector, Bulog has been playing an important role in promoting private businesses that

could help the state in return. At the same time, it accelerated the growth of the Salim Group, which is owned by Suharto's long-time friend, Liem Sioe Liong. The Salim Group's expansion and growth into many unrelated industries, from shipping to banking, all started with flour. Ever since 1969, the Salim subsidiary PT Bogasari Flour Mills has monopolised the import, milling and distribution of wheat. It became the largest domestic wheat flour producer, and one of the largest instant noodle producers and exporters in the world. It achieved this prominence because of support from Bulog. In return, the Salim group became one of the strongest private supporters of the New Order's high economic growth.

An important part of New Order capitalism in Indonesia was the "tax free charitable foundation", known as the yayasan. Controlled by top New Order officials, several of these bodies served as financial centres for the repayment of Salim's "gratitude" (hutang budi) to Suharto and his regime. The diversified Yayasan Harapan Kita (controlled by Suharto himself) and the Yayasan Dharma Putra Kostrad (run by the elite military unit Kostrad) received huge "financial contributions" –purportedly 26% of their incomes—from Bogasari Flour Mills. The expectation of such a quid pro quo among friends was presumably the reason why Bulog helped accelerate the Salim Group's growth in the first place and was an important element in the creation of a powerful network of conglomerates.

As FCs grow, maintaining a tight relationship with the governmental sector becomes easier (Khanna and Palepu, 1997; Kock and Guillen, 2001). Experience and connections with officials give FCs an advantage in managing their business. Government protection is an important driver in the growth stage and is less frequently observed in the introduction or maturity stages of FC evolution.

### **Foreign Alliances**

Alliances with international business partners prove critical to an FC in the growth and early maturity stages. The need for expansion, access to resources, and organizational learning leads to joint ventures, international alliances, and licensing agreements with Western companies (Kock and Guillen, 2001). Because of poorly developed financial markets, weak institutions for capital distribution, and volatility in economic development, FCs need access to capital at a reasonable cost (Hitt et al., 2000). They also require multiple forms of technological capability and may seek

partners who can provide experience and knowledge (Amsden and Hikino, 1994; Kock and Guillen, 2001). For example, joint ventures between Ford and Koc, Vitro, and Alfa as well as between DuPont and Sabanci, seek complementarities of benefit to each party. Also, Mahindra & Mahindra is licensed by Peugeot to produce automobile parts.

Through their maturity, the need to enhance managerial skills becomes another reason for seeking foreign alliances. These capabilities and decision-making processes are not always well developed in FCs. Hitt et al. (2000) suggest that the need to compete in market-oriented economies and with more managerially sophisticated companies prompts FCs to seek partners. In the initial stage of the relationship, FCs provide a dealer/distribution network, market information, and institutional knowledge about local regulations and laws, as well as language competency. The Western partner requires local know-how, and the FC seeks advanced technology or industry know-how (Kock and Guillen, 2001). It can be expected for the Western partner to seek closer business relationships with FCs as they perceive greater uncertainty about the local market. The nature of the arrangement may move over time; from supplier to licensing agreements, to joint ventures, and to technology/know-how transfers.

### **Expansion to Unrelated Businesses**

Companies grow in many different ways. As they evolve, FCs tend to diversify. This may happen partially because of the entrepreneurial orientation of the owners. Some expand production capacity to meet excess demand, enter new markets, develop new products, form mergers, or make acquisitions (Hwang, 2000). Some diversify within an industry, and others expand across sectors. Although patterns depend on the unique business environment (Kock and Guillen, 2001; Markides, 1997), they also may be a function of internal factors, such as the founder's business

philosophy, financial soundness, and latent connections with other businesses. The following quotation concerns the LG group in Korea.

My father and I started a cosmetic cream factory in the late 1940s. At the time, no company could supply us with plastic caps of adequate quality for cream jars, so we had to start a plastic business. Plastic caps alone were not sufficient to run the plastic-molding plant, so we added combs, toothbrushes, and soapboxes. This plastic business also led us to manufacture electric fan blades and telephone cases, which in turn led us to manufacture electrical and electronic products and telecommunication equipment. The plastic business also took us into oil refining, which needed a tanker-shipping company. The oil refining company alone was paying an insurance premium amounting to more than half of the total revenue of the largest insurance company in Korea. Thus, an insurance company was started. This natural step-by-step evolution through related businesses resulted in the Lucky-Goldstar group (now LG) as we see it today (Koo, Cha-Kyung, son of the LG founder, as quoted in Milgrom and Roberts 1992, pp. 542-43).

There is some question as to whether FCs tend to overdiversify in their home markets (Church, 1993; Hwang, 2000; Kock and Guillen, 2001), but it is clear that an expansion strategy is one of the most important drivers of their growth (Amsden and Hikino, 1994; Kock and Guillen, 2001). Even though expansion occurs in the early and late stages, it is a major driver in the growth stage. FCs tend to deepen their involvement in one industry during the early stage, and they expand into different industries in the late growth and maturity stages (Amsden and Hikino, 1994). For example, Daewoo began as a textile exporting company and moved into clothing manufacturing, garnering Sears, J.C. Penney, and Montgomery Ward as accounts. As the Korean economy took off, it entered construction and heavy industries, then automobile manufacturing and financial services.

In EMs, FCs tend to expand as a way to cope with a poor communication structure, misguided regulations, and an inefficient judicial system (Khanna and Palepu, 1997) as well as to realize some economic benefits from internalizing transactions (Hwang, 2000). In addition, they have to perform the basic functions of

several institutions in order to do business effectively. Sabanci in Turkey, for example, has its own private bank and university. Another reason for expansion is exit barriers in EMs. Most FCs, including the Tata companies in India, continue to stay in business to leverage their large scale and wide scope.

How does investment in unrelated businesses affect FC performance in EMs? Khanna and Palepu (2000) report a curvilinear relationship in their research on Chilean business groups. That is, performance declines until unrelated diversification reaches a certain threshold, beyond which point further increases will improve firm performance. Surprisingly, Hwang (2000) reports that failed chaebols tend to have a higher level of related diversification than do successful FCs in Korea, which implies that the problem may be a lack of institutional infrastructure and individual chaebol competence (Khanna and Palepu, 1999), rather than unrelated diversification.

### **Strong Work Ethic of Employees**

A cornerstone of Korean FCs seems to be the work ethic of employees. For instance, during the 1980s and 1990s, they were willing to work overtime, to achieve assigned goals in a shorter period than expected, and to put the employer first. Biggart (1991) describes this phenomenon as institutionalized patrimonialism. The work ethic has contributed to the growth of FCs in most Asian countries. Indeed there are remarkable stories about the unusual degree of attachment these employees feel towards their companies.

### **Home Market Competitive Intensity**

Later in the growth and maturity stages, FCs encounter domestic and even some foreign competition. As the market becomes crowded, FCs must serve customers better than rivals do, create new markets, and develop their own

technologies (Kock and Guillen, 2001). They diversify and internationalize their businesses, seeking a competitive edge in the global arena. Goldstar, now part of the LG group, enjoyed an early mover position in the Korean electronics market until Daewoo and Samsung entered the industry. As the competition grew fierce, Goldstar merged with Lucky, and the new group acquired Zenith, a major TV manufacturer in the United States, in order to penetrate the North American market.

### **Access to Unique Source of Capital**

Unique sources of capital play an important role in the formation of FCs, including government loans at very favorable interest rates and special investment opportunities (e.g., land and/or real estate investments with extremely high annual returns). Special loans are an outcome of the close FC-government relationship (Dent and Randerson, 1997; Nachum, 1999). In Korea, cross-equity investments and cross-debt guarantees are widely used to finance FC business expansions (Hwang, 2000). Some Mexican FCs, such as Desc and Alfa, listed on the New York Stock Exchange to obtain financing. All of the FCs we analyzed in Korea, plus Koc and Sabanci in Turkey, Vitro in Mexico, and Astra in Indonesia, have their own financial arms (e.g., insurance, banking, and securities brokerage), which are sources of capital (Granovetter, 1995). Even though the capital sources cannot be identified for all FCs, all have various types of financial resources available to them. In addition, unique capital markets in each country contribute to the formation and growth of FCs in various ways.

### **Internationalization**

As a business matures, it seeks growth opportunities outside national borders. Some companies are “born global” and internationalize early, but many others take the gradual approach. Depending on the nature of the company and the type of

industry in which it is engaged, some will do business abroad in the introduction stage, and others will wait until the growth or maturity stage. Exhibit 2 indicates typical internationalization activities in various stages of FC growth.

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Insert Exhibit 2 About Here

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In the introduction stage, the principal activity involves importation of raw materials, followed in the growth stage by technology transfer, licensing, and franchising from a foreign business partner (Sarkar and Cavusgil, 1996). Johanson and Wiedersheim-Paul (1975) argue that internationalization is a consequence of developments in the domestic market, as FCs accumulate expertise from foreign alliances that help them boost their own technologies (Kock and Guillen, 2001). Another strategic purpose of such alliances is to compete more effectively with firms outside the relationship (Kock and Guillen, 2001; Walker and Poppo, 1991). The CEO of Vitro claims that international partnering and exporting helped the company grow faster and are crucial to future growth. Intensified competition in a maturing local market often forces FCs to seek new business opportunities abroad. Exporting can be the first step in the process; for example, Sabanci and Tata have trading companies in London. For most Korean FCs, exporting was a core business that grew rapidly in the 1970s and 1980s. FCs may use intermediaries initially, such as import agents and sales subsidiaries, but they tend to assume the business themselves as they reach maturity.

In the growth and maturity stages, FCs may become direct investors and increase their international holdings. Activities in foreign markets deepen, and major modes of entry are wholly owned subsidiaries, turnkey projects, and joint ventures.

Hyundai, Daewoo, and Samsung have a larger number of wholly owned subsidiaries in foreign markets compared to Ayala in the Philippines, Astra in Indonesia, and Siam Cement in Thailand. In the late growth stage, the switch from exporting to direct investment in overseas operations is a crucial decision. Major obstacles to internationalization are lack of knowledge and resources. As FCs learn about foreign markets, the perceived risk of investment is reduced, and overseas expansion grows rapidly. Late in the maturity stage, FCs may increase the level of resources committed abroad and change the mode of market servicing. Licensing and joint venture agreements are examples of intermediate moves toward direct investment, such as wholly owned subsidiaries.

### **Need for Technology**

Technology is not a main driver in the introduction and early growth stages of most FCs because the initial focus is on production capacity to meet customer demand. When foreign businesses enter the market, however, there is a pressure to adopt new technology in order to increase efficiency and remain competitive. FCs seek know-how and technology through licensing arrangements and joint ventures with foreign partners that can offer the latest technology. The following example reveals how Sabanci started producing synthetic fibers in Turkey:

In Turkey, the industry was developing and the consumption of polyester fibers was increasing steadily during the 1960s. Turkey was obliged to import them with its scarce foreign currency. Sabanci Holding started the idea of setting up a plant for the production of polyester thread and fibers. At that time, the most important problem was the foreign currency. Foreign currency for such plants was allocated by the Association of Chambers. When Sabanci Holding brought its proposal about the polyester fiber factory, it obtained a license for DM 220, 000. Now another problem was to get a license... It was the first time Sabanci bargained about a license. The managers did not even know either how to make a know-how contract or the procedures for paying for the license. Finally, Sabanci signed the licensing and technology agreement with ICI, the British firm, and the SASA company was established. ICI provided the

machinery but could only provide short-term experts. Over time, Sabanci learned to train qualified people, increased the capacity of SASA, expanded its product lines and produced polyester filament yarn, and brought in new technologies. (Sabanci, 1988).

In the maturity stage, FCs are more likely to start high-tech businesses based on their accumulated knowledge and to build their own R&D centers (Amsden and Hikino 1994; Kock and Guillen, 2001). Companies such as Alfa, Koc, and Mahindra & Mahindra are preparing to meet competition through rapid modernization and expansion of manufacturing technologies. Samsung and Hyundai are focusing on high-tech industry more than ever before.

### **HOW FAMILY CONGLOMERATES EVOLVE**

Our research reveals a typical growth pattern for FCs. At the introduction stage, a single founder with limited capital responds to a marketplace opportunity and creates an enterprise that fulfills an unmet need. The Koc Group in Turkey, for example, was an early mover in the period following national independence. Access to capital, government contracts, and lack of any viable competition were some of the factors that facilitated its growth. Siam Cement in Thailand benefited from similar circumstances.

During their rapid growth, FCs expand into related as well as unrelated businesses, building a network of affiliated companies (see Stage I and II of Kock and Guillen, 2001). Foreign alliances may be formed to counter foreign competition and secure technological know-how. As expansion continues in terms of number of industries as well as businesses, many FCs form or acquire financial institutions to meet capital needs. The content analysis also suggests that the second or third generation starts to take over the management of a company in the growth stage, where most FCs in this study were founded in the early 1900s. Several studies have

suggested that there is a positive effect of education and training on the firm's propensity to change and its growth (Datta and Guthrie, 1994; Davis and Harveston, 2000). As members of the second or third generation, who are usually better educated (have a college degree or MBA degree), become involved in the business, they tend to hire professional managers from outside the family (Jones and Rose, 1993). Therefore, the active involvement of the next generation with a higher-level education fosters transformation of the organization, and facilitates globalization activities of the FC (Cavusgil and Naor, 1987; Simpson and Kujawa, 1974). A new organizational structure may be needed to meet the challenges of expansion and global competition, and holding companies may be established to identify strategies and to control and coordinate activities.

In the maturity stage, diversification slows or ceases (see Stage III of Kock and Guillen, 2001), and FCs focus on competing with major domestic rivals and/or seek new business opportunities in foreign markets to gain economies of scale and scope. The usual pattern is to move gradually from exporting and/or importing of raw materials and components, to domestic joint ventures with a foreign partner, and/or to importing of subcontracted components, contract manufactured goods, and licensed or OEM products (Dent and Randerson, 1997). Finally, FCs tend to enter into cooperative agreements related to R&D, production, marketing, and purchasing (Luostarinen and Hellman, 1994). Some imitate world-class companies by creating wholly owned subsidiaries and joint ventures in foreign markets. As technology becomes critical to retaining competitive advantage, they attempt to boost their own technological capabilities (Kock and Guillen, 2001) and fund R&D centers to compete globally.

Due to their management experience and capital resources, some mature FCs can be counted among the largest industrial and financial conglomerates, not only at home but also abroad. Because of the large scale of their business, these FCs may opt for strategies that focus on lower production costs, diversified product lines, and improved customer service. For instance, Vitro Mexican group seems to excel in cost efficiency, Mahindra & Mahindra in customer service, and the Koc Group in dealer networks to provide fast and high-quality customer service.

### **WHAT DOES THE FUTURE HOLD FOR FAMILY CONGLOMERATES?**

Will FCs continue to prosper in EMs? The optimistic view is that the family influence will remain strong due to accumulated wealth and stockholder power (Chung, 2000; Hwang, 2000). Although ownership tends to become dispersed so that a single owner person is unable to control the entire conglomerate, it is highly likely that the family as a collective owner can continue to exercise power through cross-investments. For instance, according to the Korean Fair Trading Committee, the average cross-investment within a conglomerate is above 35% among the 30 major Korean conglomerates, compared to average ownership by individual family members of around 3.3 percent (Donga 2001). With this sort of arrangement, conflicts within the founder's family could weaken the collective ownership by a conglomerate. The recent financial crisis of Hyundai Group has proved the importance of collective ownership of founder's family through cross-investment. Even though some subsidiaries of FCs are becoming publicly held, the founder's family still has significant influence and control on management.

As the second or third generation inherits the business, more FCs are expected to hire professional managers, and family members are likely to play a less direct role

(Hwang, 2000). The founder's death or transfer of power to the next generation often marks the transition to professional management and the addition of outsiders to the board. One may speculate that management of FCs will become more participative as well as more professional. For example, Koc in Turkey and Vitro in Mexico now include executives from Western companies on their board.

The pessimistic view is that FCs will face pressure from government as well as domestic and international markets to reduce the number of core businesses in an effort to improve market competence. Also, a leadership vacuum may occur in the second or third generation (Church, 1993). There is some empirical evidence in support of the common observation that "the first generation builds the company, the second preserves it, and the third squanders it" (Andrade, Barra, and Elstrodt, 2001). In addition, as the Hyundai and Daewoo cases illustrate, FCs seem to have some degree of vulnerability due to family ownership (Cabrera-Suarez et al. 2001; Hwang, 2000; Khanna and Palepu, 1999, 2000; Kock and Guillen, 2001; Schulze et al. 2001) or the lack of professional management (Kao, 1993; Khanna and Palepu, 1999; Nachum, 1999). Founder- family oriented management decisions rather than market-oriented decisions may create greater vulnerability and inability to respond to changing market developments (Chung, 2000; Hwang, 2000). Even though an increasing number of FCs are hiring professional managers, the family influence on business operations can still affect strategic moves significantly (Drozdow and Carroll, 1997).

Loyalty to founder family is a characteristic of the managers of FCs (Drozdow and Carroll, 1997; Hayashibara, 1997), but this is not always good for business. For example, the founder of the Samsung Group long dreamed of having an automobile

manufacturing arm, a hope not achieved before his death, and the group continued to pour financial resources into the plan. The expansion was undertaken, even after his death, at high financial risk and despite government and industry concerns about overcapacity. The new unit was eventually taken over by a competitor during the restructuring that followed the Korean economic crisis.

Furthermore, FCs usually are less likely to experience pressure from third-party watchdogs such as investors, financial institutions, and government because these sources of external pressure have been internalized to some extent by having their own financial arm and/or networking with government officials (Dent and Randerson, 1997; Granovetter, 1995; Nachum, 1999). The protected and subsidized business environment to which they are accustomed is another source of FCs vulnerability (Jones and Rose, 1993; Shin, 1993). As a result, FCs encounter significant challenges when they enter Western markets, causing them to adopt new ways of competing and managing.

Compared to most Western companies that have been professionally managed for decades, the senior leadership in FCs may be a major liability. Global pressures may accentuate their vulnerability and reduce FCs to smaller players in the future. Indeed, as local markets have globalized, the representation of family-owned businesses in the ranks of the top 100 companies has fallen sharply: from 71 percent to 57 percent in Mexico; from 51 percent to 34 percent in Venezuela; and from 24 percent to 19 percent in Argentina (Andrade, Barra, and Elstrodt, 2001). Deregulation and the advent of MNCs have spurred cross-border integration of economies and industries. FCs are definitely being challenged to match the multinationals' scale, brand recognition, cutting-edge management techniques, and deep pockets. To

survive and thrive, FCs will also need stronger governance models that provide for a smooth succession of power across generations.

### **WHAT WESTERN COMPANIES SHOULD KNOW ABOUT FCs**

FCs represent both a promise and a challenge for Western companies (Prahalad and Lieberthal, 1998; Kock and Guillen, 2001). Strategic alliances have become an important tool for MNC entry into emerging markets, and in many cases the most likely partner is an FC. It is not critically important that the FC be experienced in the particular industry represented by the Western firm. The foreign partner is likely to seek the strengths that complement its own assets: local market knowledge and experience, established networks with suppliers and distributors, and government contacts (Kock and Guillen, 2001). Davidson (1980) notes the importance of long-term experience in a particular market; as familiarity increases, firms become more comfortable with local differences and more confident in their ability to capitalize on local expertise (Shetty, 1979). In other words, as the local FC partner assumes some of the country risks and reduces uncertainty, foreign firms become more willing to commit resources.

Strategic alliances between FCs and Western companies can take several forms, such as joint ventures, licensing agreements, distribution and supply agreements, R&D partnerships, and technological exchanges (Inkpen, 1998). The local market knowledge of the FC and the technical knowledge of the Western company may determine the type of alliance (Dawar and Frost, 1999). Modes of entry depend upon the partners' needs, as shown in Exhibit 3.

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Insert Exhibit 3 About Here

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A Western company may form alliances in EMs for various reasons. It may be seeking a market for its products, a production site, source of materials, components, or technology. Product marketing, for example, requires warehousing, transportation, and retailing, and the FC may be able to supply facilities, vehicles, and a sales force. If the foreign company is interested in penetrating the market in a relatively short time, the business network and/or consumer recognition of the FC is very important (Arnold and Quelch, 1998; Ger, 1999; Kock and Guillen, 2001). A Western company may not be willing to license its technology at the initial stages of entry, so the appropriate partnership may turn out to be distribution and supply agreements. In this type of arrangement, learning is minimal by the FC, whereas the Western company is more active in acquiring local market knowledge.

In 1988, for example, Ford Motor formed a partnership with Kia to introduce the Sable into Korea. Ford was interested in Kia's distribution and after-service network; Kia wanted a premium model to complement its product line at a time when technology transfer for producing the car was too costly for Kia. In another case, Digital Equipment Corporation designated Tatung, a Taiwanese FC and market leader in computers, as the main distributor of its workstations and related client-server products. With this 1994 agreement, Digital took advantage of Tatung's local experience and distribution network, and Tatung gained the benefit of carrying a technologically advanced product (*Dow Jones International News*, 1994).

Depending upon the business scale of FCs and their unique relationship with the local market, Western companies should consider carefully whether a partnership is the appropriate entry mode (Harrigan, 1984; Kock and Guillen, 2001). In the case of manufacturing, the Western company may want to protect its technical knowledge and

property rights, in which case it will look for an FC whose need for technical knowledge is high. When the Western company requires market knowledge and the FC is interested in technical know-how, entry through a joint venture may be appropriate.

In 1997, Sabanci entered a 50-50 equity joint venture with Danone, a European leader in dairy products and owner of the Evian brand of bottled water. Danone brought ample technical knowledge in packaging and bottling, and a reputation for healthy and environmentally friendly products, but it lacked information on the Turkish market. Sabanci is a leader in Turkey with its bottled water, Hayat, and is knowledgeable about customers, retailers, and distributors. The collaboration with Danone to market Hayat made this brand the market leader within the first year. Danone then introduced its dairy products into Turkey through Sabanci.

Joint ventures have been used to exploit markets and technologies, and they can be very important in maintaining a firm's competitive advantage. Alestra is a joint venture in telecommunications formed by ALFA in Mexico, AT&T, and Bancomer-Visa. Through the collaboration, AT&T addressed a new market, and ALFA provided a network in Mexico and gained access to AT&T's advanced technical knowledge.

In other cases Western companies enter the local market without an ally and put pressure on domestic FCs. For example, India became a major export base for auto components when the economy was deregulated. The entry of multinational automobile giants forced Mahindra & Mahindra to meet the challenge through a rapid upgrade of manufacturing technology. The company built an R&D center to speed the design of products to meet customer needs. It also formed a partnership with Peugeot, which licensed its technology, to manufacture diesel engines. In another case, Sabanci

founded Temsa to provide boilers and ventilation and heating systems; later, it agreed with Mitsubishi Motors to produce buses in Temsa plants, using Mitsubishi engines.

A Western company may gain a good understanding of a local market through previous alliances and then pursue its own wholly owned venture. For example, Ford Motor learned about the Korean market through its partnership with Kia and it launched a wholly owned subsidiary, Ford Motor Company of Korea, in 1996. Similarly, BMW AG, the German automotive company, set up a wholly owned operation in Indonesia, where market knowledge had been gained through an earlier partnership with Astra International (*Jakarta Post*, 2001).

Although FCs are owned and controlled by a family, there are other factors that shape a business. These include national culture and economic policies (Ward, 2000). The evolution of a family business is closely related to the local economic environment. The cultural context is an important determinant of types of ownership and the leadership vision of the family owners. FCs can provide real value to Western companies because they incorporate firm-specific advantages, such as market knowledge, government relations, and network strength (Manikutty, 2000). Western companies entering an EM should conduct an extensive investigation in order to assess the capabilities of the local FCs, as well as the national cultural and economic environment. When complementarities exist, a partnership may be viable.

## **CONCLUSION**

Despite cultural differences in business operations—including government protection, availability of capital, and employee work ethic— family conglomerates in different emerging markets exhibit many common patterns of evolution. Market expansion strategies such as diversification and internationalization are widely

adopted, and FCs benefit from and adapt to their business environment. They play a substantial role in local markets, and Western companies entering those markets should investigate their competitive advantages and market position. A collaborative partnership with an FC can reduce risks as well as the time and capital necessary for foreign market entry.

Family conglomerates have much to offer Western companies: a local business network, government contacts, knowledge of local markets, established channels, an agile decision-making process, and more. FCs also stand to gain from the new business opportunities and know-how that Western companies may bring to the arrangement. By identifying the complementarities that FCs offer, Western companies can enjoy more frictionless entry into emerging markets.

The phenomenon of family conglomerates has received relatively scant attention from business scholars. This is surprising, given their economic dominance in many emerging markets. In the present article, the authors attempted to partially fill this gap by providing a survey of their evolution and significance in a number of emerging countries. A content analysis of select FCs reveal common patterns and allow us to make some statements about their current and future role in such economies. Nevertheless, much more work is needed. Many questions remain unanswered in this context. What accounts for the relative success of some FCs why others in the same country seem to struggle? What are the dynamics of transforming FCs into more professionally managed businesses? How are traditional FCs coping with the globalization of markets and intense competitive pressures from multinational players? What are the principal success factors in FC-Western company partnerships? What lies ahead in terms of the ownership of these companies? These and similar

questions beg scholarly research attention in the future. It is hoped that the present work stimulates the research community to initiate future projects designed to shed additional light on this phenomenon.

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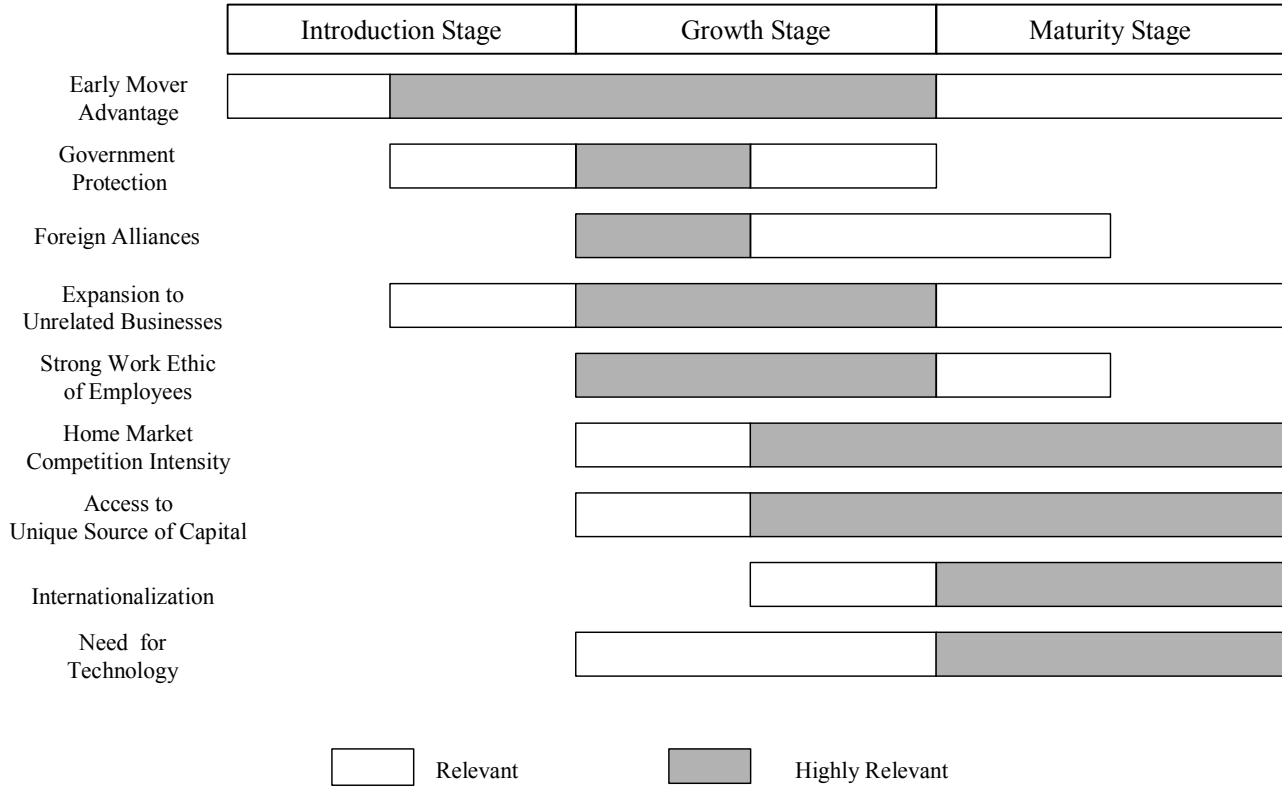
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**Table 1**

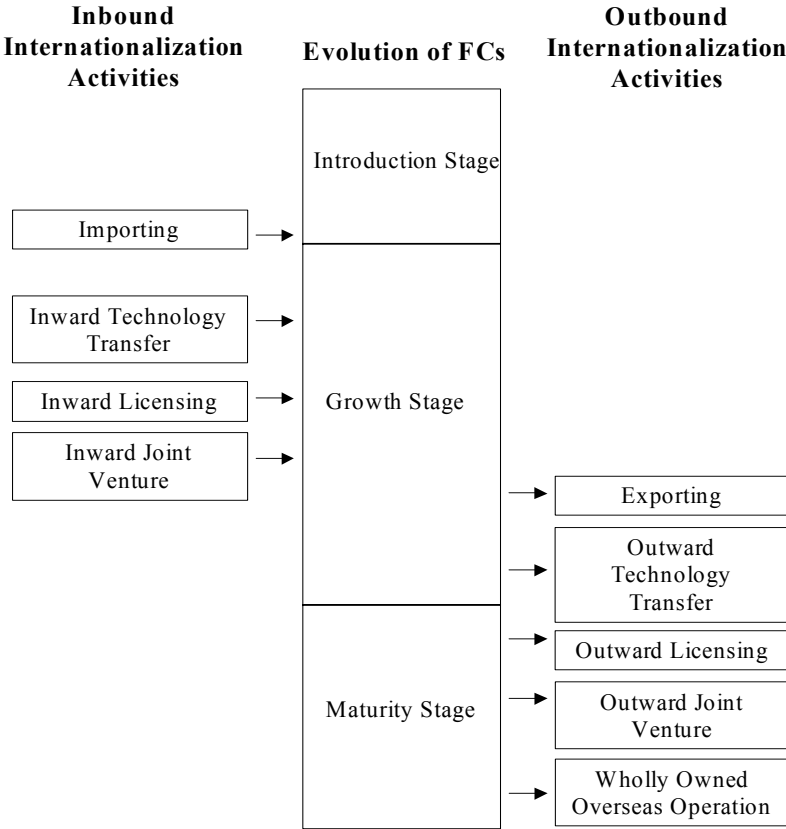
**Sample of Family Conglomerates in Select Emerging Markets**

| <b>Country of Origin</b> | <b>Group Name</b>               |
|--------------------------|---------------------------------|
| India                    | Tata, Reliance, Mahindra        |
| Indonesia                | Astra                           |
| Korea                    | Hyundai, Daewoo, LG,<br>Samsung |
| Mexico                   | Desc, Alfa, Vitro               |
| Philippines              | Ayala, San Miguel               |
| Taiwan                   | Formosa Plastics, Tatung        |
| Thailand                 | Siam Cement                     |
| Turkey                   | Koc, Sabanci, Alarko            |

## Exhibit 1: Drivers of Family Conglomerates



**Exhibit 2: Internationalization of Family Conglomerates**



**Exhibit 3**

**Appropriate Market Entry Strategies for Western Companies in Emerging Markets**

|                                                             |      |                            |                                       |
|-------------------------------------------------------------|------|----------------------------|---------------------------------------|
| Family<br>Conglomerate's<br>Need for<br>Technical Knowledge | High | Technology Licensing       | Joint Ventures                        |
|                                                             | Low  | Wholly owned<br>Investment | Distribution and Supply<br>Agreements |
|                                                             |      | Low                        | High                                  |

Western Company's Need  
for Market Knowledge

