Filling Institutional Voids: The Competitive Advantage of an Argentine Multinational in Brazil

Abstract

This paper explores how emerging-market multinationals can compete outside the developed world with firms from these countries by creating competitive advantages that do not rely on either on low-cost production or political advantages. It demonstrates how an Argentine multinational, IMPSA, outperformed even rivals from the developed world to become the leading producer of dams and windmill parks in Brazil by filling institutional voids in its value chains. This firm's knowledge about every part of its value chains enables it to quickly produce any component if the market for it is attractive or suppliers are adversely affected by dramatic changes in economic policies, a common characteristic of emerging markets. This knowledge also helps the firm to train supplier of basic products or services if needed when they first start producing in a particular country, thereby avoiding the need to vertically integrate a product or service with limited margins in the long run. Finally this knowledge also enables IMPSA to turn the production of parts for its existing products into new businesses, sometimes integrating them into completely new goods. This article argues that this firm's capability in filling institutional voids in its value chains in Brazil derived from its previous experience filling them in Argentina.

Keywords: Institutional Voids, Comparisons across Emerging Markets, Competitive Strategies of Emerging Market Multinationals

Introduction

Scholars overwhelmingly agree that the age of the vertically integrated firm so eloquently described by Chandler (1977) has been replaced by the era of globalization and outsourcing. Advanced economy multinationals (AMNEs) have increased profitability by relinquishing control over substantial parts of their value chains and developing intangible assets in more valued added activities such as research and development (Gereffi 2005; Sturgeon 1997). Although this strategy has proven effective in the developed world, the presence of institutional voids in emerging markets limits the value of this strategy in these countries (Khanna & Palepu 1997; 2010). The presence of such voids causes emerging-market multinationals (EMNEs) to be more vertically integrated (Khanna & Palepu 1997) and supposedly less innovative (Awate, Larsen, M., & Mudambi 2012), thereby relegating them to relatively low-return production activities (Awate et. al. 2012; Guillén & García-Canal 2009; Kaplinsky 2000). These companies can attempt to compensate for their competitive weaknesses by purchasing critical assets in the developed world (Luo, Y. and Tung 2007). Although EMNEs may be forced to pursue such strategies if they choose to operate in the developed world, their ability to compete in emerging markets are more likely to be based on their aptness at filling institutional voids in their value chains.

This paper explores this topic by examining how a multinational from Argentina, IMPSA, became the market leader in windmills and dams in Brazil, outperforming multinational companies (MNCs) from Europe and the United States. It argues that this firm's knowledge about every part of its value chains enables it to quickly produce any component if the market for it is attractive or suppliers are adversely affected by dramatic changes in economic policies, a common characteristic of emerging markets. It also helps the firm to train supplier of basic products or services if needed when they first start producing in a particular country, thereby avoiding the need to vertically integrate a product or service with limited margins in the long run. Finally this knowledge also enables IMPSA to turn the production of parts for its existing products into new businesses, sometimes integrating them into completely new goods. This firm was successful in Brazil without

having to acquire knowledge abroad through mergers or acquisitions or relying on it political skills to gain favor with the Brazilian government. This paper contributes to the literature in international business by demonstrating how filling institutional voids can prove an important source of a competitive advantage for EMNEs operating in emerging markets.

Filling Institutional Voids as a Competitive Advantage

Peng, Wang and Jiang (2008) argue that EMNEs can only be successful abroad by overcoming the negative heritage of their home countries. Nevertheless, Berger (2000) argues that even companies in the same industry can adapt different business models and still be successful in the global economy, whereby she contends that the business model adapted by any particular firm is related to the company's history and country of origin. In a similar vein, Guillén (2001) argues that theories in international business should focus on how firms search for their unique place in the global economy based on existing institutions in their home context and their ability to selectively learn from others. However, these three authors only examine how firms compete with each other on global markets, namely those in which products can be produced and sold anywhere in the world. Often firms simply don't compete with each other in this manner. Ghemawat (2003) contends that the cross-border integration of markets is incomplete, reaching a level of only semiglobalization. A survey of the 379 of the world's largest 500 companies showed that 74.6% of their sales were in their home region (Rugman 2009). At the same time, since the 1990s the markets for goods and services in emerging have grown faster than those in the developed world (Khanna 2010). According to Ramamurti (2012) emerging markets will soon come to represent two-thirds of gross domestic product growth in the world

A multinational's success depends on the extent to which its strategy fits the institutional context in which it is implemented (Jackson & Deeg 2008; Peng et. al. 2008; Saka-Helmhout & Geppert 2011). Although institutional voids are generally thought to limit the ability of EMNEs to be able to compete with multinationals from the developed world (Awate et. al. 2012; Cuervo-

Cazurra & Genc 2008; Guillén & García-Canal 2009; Khanna & Palepu 1997; Peng et. al. 2008), the skills of the firms in addressing problems that arise from institutional difficulties can prove to be a competitive advantage (Khanna and Palepu 2010). Although work in the field of International Business tends to suggest that EMNEs should focus on establishing a presence throughout the world, these companies may be well advised to focus on emerging markets because there are ample opportunities in these countries and their competitive advantages are well suited to operating in them.

The advantages that EMNEs can gain from their political capabilities is the factor most highlighted in the literature. Some scholars emphasize the skills of DMNCs in dealing with institutions ranging from working effectively with unpredictable and/or overly bureaucratic governments (Cuervo-Cazurra & Genc 2008; Guillén & García-Canal 2008; Khanna & Paleupu 1997) to handing inefficient judiciaries (Cuervo-Cazurra & Genc 2008). These factors are all political in nature. According to Cuervo-Cazurra and Genc (2008) EMNEs have advantages over AMNEs in the least developed countries because the former are accustomed to working in countries with difficult governance situations, causing the apparent disadvantage of coming from a country with poor institutions to become a competitive advantage. According to their assessment this advantage can enable these firms to potentially outperform companies even from the developed world when they compete in emerging markets. These authors contend that scholars need to broaden their approaches and focus on the resources firms use to work in difficult institutional environments in addition to examining traditional manners in which firms compete. The potential competitive advantages EMNEs can have when operating even in relatively advanced emerging markets go beyond their political capabilities. The competitive advantages of these multinationals also reside in their ability to fill a wide variety of institutional voids (Khanna and Palepu 2010 Doh Lawton and Rajwani 2012).

When the institutional structure does not support the operation of the market, MNCs often have difficulty finding components that meet their demands for quality (Dunning and Lundan 2008; Khanna and Palepu 1997). In such cases, these firms have to create markets either by bolster the capabilities of existing suppliers or vertically integrating the production of the component. (Teece 2014; Khanna and Palepu 2010). Often firms in emerging markets can not simply import their required inputs because governments regularly place limits on this activity (Dunning and Lundan 2008). EMNEs are adept at operating in environments plagued by unreliable power sources, crowded ports and roads, weak educational institutions and similar institutional difficulties (Ramamurti 2009b). Working with suppliers in emerging markets can prove challenging because of the risks of market failure resulting from disruptions in supplies, problems with quality, difficulties honouring delivery dates, unacceptable rises in prices and general unreliability (Dunning and Lundan 2008) Morrision, Pietrobelli and Rabellotti (2008) point out that the low level of skills possessed by most suppliers in emerging markets cause them to face substantive difficulties in managing even basic technologies, thereby leading to problems with quality. MNCs can attempt to overcome such difficulties by training their suppliers with their own workers. These companies may even invest its own resources in upgrading its suppliers. However, larger companies have to have the knowledge of how to upgrade their supplier's products. (Dunning and Lundan 2008). By making such investments, MNEs can assist in the creation of better ecosystems for themselves and even their competitors (Teece 2014). Paradoxically, this type of behaviour is not the type of asset seeking investment describe by (Luo, Y. and Tung 2007) but rather an "external asset developing investment", so one that is designed to develop assets within its suppliers.

If an MMC decides to produce a particular component, it can often convert its production into a new business by selling it to other companies. An MNC can also use this product to make totally new ones in which the product serves as an important input for it (Khanna and Palepu 2010; Teece 2014). Sometimes these companies produce only a part of their needs so as to control potential opportunism of suppliers. In Argentina for, example, some companies vertically integrate

the production of a portion of their needs for a particular product as a means for taking advantage about uncertainty regarding real rates of inflation (Author's own 2001). The case of IMPSA illustrated in this paper shows the benefits of a firm retaining knowledge on how to produce a particular component and deploying it if uncertainty or unpredictable government behavior leads to sudden market failure. At the same time, the case shows that by maintaining a portion of the production of a component in-house, an MNE can also put downward pressure on prices by increasing competition. IMPSA trains suppliers for products or services that traditionally have low margins.

AMNEs have difficulties filling institutional voids in their value chains because, according to Kogut (1985), these companies have traditionally sought to purse a competitive advantage by focusing on those elements in their value chains that contain the most important components desired by their clients. This focus limits their ability to vertically integrate and/or train suppliers in emerging markets. Although these firms do work with some suppliers in the developed world in efforts to improve the latter's performance, they are accustomed to working with developed suppliers (Helper, MacDuffie & Sabel 2000; Helper & Sako 1995), not ones that sometimes even lack basic skills. These firms take for granted that their suppliers are relatively advanced. The ability of AMNEs to confront such problems can grow as they continue to accumulate experiences in emerging markets. However, their skills would not be as developed as EMNEs that have generally always dealt with such difficulties in their home countries.

Methodology

Guillén and García-Canal (2009) contend that MNEs from outside the developed world are becoming more important on world markets. In Spanish-speaking Latin America they claim that Mexico and Argentina have the most formidable global companies. They contend that one of these firms is IMPSA. It is the second largest Argentine multinational company active in the metal-mechanic sector in Brazil and Argentina. Guillén and Toulan (1997) maintain that studies of metal-

mechanic firms in Argentina provide an ideal setting for examining alternative models of internationalization because they do not possess competitive advantages based on natural resources, the most prevalent type of advantage in Latin America. Furthermore, the case of IMPSA controls for the possibility that the success of an EMNE has to be related to is political abilities because the current crisis faced by this company resulted from its inability to foresee changes in economic policies in Brazil.

This article uses an inductive, qualitative approach because it is the most appropriate methodology for grasping how agents understand their environments (Pratt 2009). It also enables scholars to gain insights into complex processes of understudied phenomenon (Eisenhardt and Graebner 2007; Yin 2003). This author had unique access to a variety of managers at this firm through his initial contact with an executive vice president at IMPSA. In total he personally conducted thirteen interviews at this company. They consisted of five meetings with an executive vice president, four interviews with a project manager in this company's hydroelectric business in Brazil, one appointment with a project engineer in the company's hydro division, one meeting with a project engineer from its wind division, one interview with the director of its research laboratory, and one meeting with the director of its commercial activities. These interviews occurred over two-and-a-half years. They generally lasted an hour-and-a-half and were conducted in Spanish. All of them were digitally recorded and transcribed. The interviews were semi-structured and consisted of open-ended questions. This author relied extensively on face-to-face interviews because this methodology is the most appropriate for gaining access to information in emerging markets (Hoskisson, Eden, Lau & Wright 2000).

IMPSA in Brazil

IMPSA is an Argentine multinational that is the leading producer of dams in Brazil. Until recently it was also the leader in the sales of windmill parks in that country. Since 1981 IMPSA has undertaken 150 projects in 40 countries. It currently has 7,000 employees and continues to be

owned by the Pescarmona family (Boschi 2009). While Suzlon, an Indian multinational enterprise also operating in the windmill business, grew by purchasing other firms abroad with skills in research and development (Awate et. al. 2012), IMPSA hired only a few engineers from foreign countries and created its own research and development capabilities without buying other firms either in the developed world or in other emerging markets (interview, executive vice president, September 9, 2011).

This company had a consolidated EBITDA of AR$ 620 million (US$ 153 million) in the 2010-2011 fiscal year based on sales of AR$ 4.639 billion (US$ 1.146 billion). At that time, fifty percent of its growth derived from the company's windmill business unit and sixty percent of all of the company's sales occurred in Brazil. During this period the vast majority of this company's sales in this country were in windmill projects. IMPSA has been operating in Brazil since the mid-1980s. In general eighty percent of all sales of this firm are derived from hydropower and wind projects (IMPSA 2011). IMPSA shifted its focus to Brazil largely because the Argentine government provided neither assistance in financing nor proper regulatory conditions for undertaking large capital projects in the field of energy generation. This company found the right conditions and support in Brazil (interview, executive vice president, September 21, 2012). At the same time, the Brazilian government wanted to increase its reliance on wind energy from 3% to 10% of its total energy supply (International Energy Agency 2013). In the late 1960s, the current CEO of IMPSA, Enrique Pescarmona, believed that by possessing its own technology and knowledge for all the components of all its products, this firm would be able to survive economic fluctuations in Argentina. He believed that this company needed this knowledge in order to address the fact that the unpredictable economic climate in this country made suppliers unreliable (Boschi 2009). According to an executive vice president at this firm, this guiding philosophy enables this company to be better equipped than their competitors to provide turnkey solutions (interview, executive vice president, September 9, 2011).

IMPSA has five major businesses units, namely energy management, hydropower projects,

wind projects, petrochemical projects, and environmental management. It has also created businesses in insurance, logistics, satellite tracking systems, as well as automation and communication systems. These smaller businesses were largely created to support the activities of the five larger business units and usually arose out of the inability of the firm to find quality suppliers. For example, the firm's crane business emerged out of its need for quality cranes in constructing hydroelectric power stations. Later, it applied what it had learned from this activity to make cranes for ports. Although this business unit is no longer a significant source of revenue for this firm, it had previously generated a large portion of it (interview, executive vice president, September 21, 2012). This company also leveraged the knowledge it gained about frequency converters from building to build windmills (interview, executive vice president, July 5, 2013).

Although IMPSA prefers to rely on its own technology, it licensed patents for turbines to build its first windmills from Vestas, the worldwide leader in this industry, in order to enter the windmill business in Latin America quickly. A few years later, IMPSA patented UNIPOWER, a direct-drive turbine for windmills. (interview, September 12, 2012). Nevertheless, the director of the research laboratory at this firm contends that issuing patents are not always advisable because the process of registering innovations in this manner facilitates the ability of their competitors to copy what it is doing. Even though this firm developed the most efficient Kaplan turbine in the world, it did not patent this product for this reason (interview, Director of Research Laboratory, September 12, 2012).[1] Innovation is also necessary in logistics in Latin America. For one hydroelectric project IMPSA had to design a turbine that could be cut into three parts so that it would not cause the only wooden bridge leading to the construction site to collapse (interview, project engineer in the hydropower division, September 12, 2012).

Executives at IMPSA believe that it is necessary to produce a small portion of their needs for important components. By producing a portion of such products, it can quickly ramp up production if economic conditions or policies change rapidly and undermine the viability of their

[1] Viktor Kaplan patented this design for a turbine in 1913. Its basic design is still widely used and adapted throughout this industry

suppliers. For example this company produces less than half of the windmill blades it needs but could ramp up its production in eight months to cover all its needs if necessary. The ability of the firm to ramp up its production of its important components also enables it to take advantage of situations in which the price for a particular component increases dramatically due to changes in economic conditions or policies. IMPSA maintains its crane business for similar reasons. If their suppliers charge too much or begin to fail to provide the quality of service the firm demands, it can quickly produce the cranes it needs (interview, executive vice president, September 21, 2012).

When IMPSA can not find suppliers for basic goods or tasks, it trains them itself rather than vertically integrating such operations. When this firm set up its first wind park in Brazil in 2009, there were only two suppliers capable of making towers for windmills. They charged excessively for their products even though they did not meet IMPSA's quality standards. Instead of vertically integrating the production of these towers, this company sent its managers from Argentina to Brazil to train the workers at these suppliers for several months. It also sent them to other suppliers that had not previously made these products. Although this strategy initially proved expensive, executives at this firm believed that it paid off after more suppliers were trained, quality improved and prices began to decline as a result (interview, Executive Vice President, November 21, 2012).

Although IMPSA had a backlog of orders worth US$ $4.2 billion in 2014, troubles with the financing of its operations began to emerge in 2013. In December of that year the state-owned electric company in Brazil, Eletrobras, agreed to pay US$ 136 million in a dispute about energy contracts. As of September 2014, the Venezuelan government owed IMPSA roughly US$ 1.2 billion in back payments for windmill and dam projects. Although Venezuela agreed to pay IMPSA US$60 million in three instalments, it missed the first payment in July 2014 causing IMPSA to have to delay a US$ 7 million payment on bonds that it had issued in Argentina (Porzecanski 2014). Problems in the windmill business in Brazil also contributed to growing financial difficulties at this firm. By 2014 the market share of IMPSA in the windmill park market in Brazil had dropped to 6.4%. Nonetheless, even with such a low percentage of the overall market for these projects,

IMPSA only slipped to being third in overall sales. Over a short period of time, two Brazilian companies, CPFL Energias Renovaveis SA and Renova Energia SA, had come to be the market leaders in this industry (Bezem 2014). The market share of all international companies in this field in Brazil had declined dramatically. Many of the traditional producers of windmills in Brazil, including IMPSA, were having difficulties because they could not meet the sudden changes in the requirements of the Brazilian Development Bank (BNDES) regarding the percentage of their products that had to be produced in Brazil in order to receive loans from this organization. In 2012 the BNDES started requiring firms to source 70% of their steel plates and all of their cement towers from Brazil; before the quota for both of these products was 60%. The BNDES also introduced new regulations that required firms in this industry to buy their nacelles from companies in Brazil. The inability of Vestas and Suzlon to meet these requirements caused them to be unable to receive financing from the BNDES, thereby effectively locking them out of this market (Nielsen 2013). Before these developments an executive at this company had believed that Brazilian economic policies had become stable and predictable (interview, November 12, 2012). The developments after this interview occurred would seem to indicate otherwise.

Discussion and Conclusion

While work on DMNEs has shown the difficulties of undertaking operations in emerging markets, underlying this literature is the basic assumption that firms compete in the same manner in all markets. Firms succeed in different markets for different reasons. Although DMNEs may prove less capable than AMNES in innovating new products and applying the latest technologies to their operations, their knowledge about how to navigate underdeveloped markets by filling institutional voids may provide them a competitive advantage over their rivals from the developed world when they compete with such firms in emerging markets.

This paper contributes to the field of international business by demarcating three ways in which an Argentina multinational reacted to institutional voids in its value chain. It vertically

integrated the production of more sophisticated components and sold them to other firms, while also occasionally using them to develop new products. One example is how IMPSA leveraged its crane business to enter into the market for port cranes. Another example is the vertical integration of 50% of its production of windmill blades as a means for controlling for potential problems with its suppliers of this product. Having some capacity to produce this product enables the company to ramp up production quickly if necessary. Finally, this company also trained suppliers for basic products such as windmill towers. The firm retained knowledge about parts of its value chain so that it could fill institutional voids in one of these three manners when necessary. It is argued that this firm developed this capability in Argentina in the 1960 as a means for addressing institutional problems in this country and effectively applied it in Brazil enabling it to become the largest producer of windmills and dams in that country. The success of this company was determined not simply by its ability to determine when to outsource a component but rather by its dynamic approach to outsourcing and vertical integration. Although DMNEs may have certain advantages over EMNEs in innovation and marketing, this paper argues that these skills may be less important in emerging markets. The ability to fill institutional voids may indeed be more important for companies operating in emerging markets than the traditional competencies that DMNEs have in the developed world.

The conclusions reached in this paper have clear limitations given that it is based on one case study of an Argentine multinational operating in Brazil. Nevertheless, this case covers one of the most successful multinational firms in Argentina in an industry not related to the production of commodities. At the same time, the decline of IMPSA as a result of its inability to predict changes in economic policies in Brazil demonstrates that the success of an EMNE in an emerging market may indeed result from attributes beyond political skills in dealing with governments in these countries. In order to understand how EMNEs can compete against their rivals from the developed world, it is necessary to examine cases of firms that have been successful in doing so. Guillén and García-Canal (2009) contend that emerging markets have enclaves of excellent firms surrounded by

average or inefficient ones. Perhaps more firms have not been successful because they are convinced that they have to copy the strategies of firms from the developed world. In doing so, they could be overlooking the resources that could actually enable them to outperform such rivals.

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