

Business groups and their corporate strategies on the Argentine roller coaster of competitive and anti-competitive shocks

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Executive Overview

Argentine economic history can be pictured as a series of severe economic ups and downs, which created unique managerial challenges for growing businesses. In this article we show how Argentine entrepreneurs have successfully crafted strategies and organizational forms to cope with this economic "roller coaster." Our work is founded on the resource-based view, state development and market-failure theories, and relies on data from historical evidence, surveys, and thorough interviews with CEOs of the largest Argentine firms—known as Argentine Business Groups (ABGs). We found that ABGs generally expanded their corporate portfolios in periods of higher uncertainty by skillfully maneuvering through labor and capital market deficiencies and leveraging preferred foreign and local contacts and opportunities. We also found that in response to the Argentine market-oriented reforms of the 1990s, many ABGs trimmed their business portfolios and expanded internationally to compete more effectively. As for the recent economic turmoil, internationally diversified ABGs who relied more heavily on managerial teams with local expertise had a competitive advantage over ABGs with an exclusive local market focus or even multinational subsidiaries relying on international managerial teams. We derive lessons for firms managing businesses in similar environments and those wishing to reap opportunities in Argentina.

"One can still see relics of those early days in and around Buenos Aires: amid the skyscrapers and slums, a congress building rivaling any in Europe, mock-French or neo-colonial palaces, art-nouveau town-houses, a financial district of marbled halls worthy of London."¹

The Roller Coaster Described

Throughout most of the last century, Argentina drew world attention mostly for its drastic, unparalleled ups and downs. In its economic heyday about a century ago, Argentina's fertile land supplied meat and grain to Europe. For three decades up until about 1914, GDP grew 5 per cent a year, turning Argentina into one of the richest countries

on earth, ahead of Germany and France. In contrast, in the late 1940s and early 1950s, beef and grain exports no longer bought their way into prosperity, and Argentines retreated into protectionism. Then-president Juan Perón heavily financed social benefits for a large, uneasy, and starving working class with populist, lax monetary policies.

Argentina dived into a long period of political and economic instability. Through the 1980s, though democracy was reinstated, GDP per person still shrank in excess of 10 per cent. By then, with two world-champion storms of hyperinflation and two banking system collapses, the confidence of investors had vanished, and the wealthy had shipped their capital abroad. Following this amazing decline, the early 1990s saw new, pragmatic

political leadership sweep the country with market-oriented reforms. The government swiftly modernized the state, retreated from enterprise ownership, and deregulated once-sacred markets such as oil, mining, telecommunications, roads, railways, subways, and much else.

After hardening the currency by law and creating basic regulatory agencies, such as an independent central bank, Argentina lured investors back in. GDP grew in excess of 6 per cent a year for most of the 1990s. World financiers pointed to Argentina as a model of modern economic growth. IMF officials praised Argentina to worldwide audiences as their most brilliant and savvy pupil.

In another astounding turnaround, as of almost two years ago, Argentina had made news again. After four years of economic crisis, recession turned into depression.² Amid social unrest, two presidents and three economy ministers were ousted. After staging the largest public debt default in world economic history (US\$155 billion), Argentina saw the peso slip almost four-fold against the dollar within a few months. The banking system dived into disarray, breaking down the chain of payments between consumers, businesses, and suppliers and bringing the economy almost to a halt. The government returned to regulating markets as well as commodity prices and implementing populist emergency welfare programs to stave off hunger. Companies drastically shrank operations, enacted layoffs, and simply tried to survive day to day.

In view of these ups and downs, our focus is on a few important questions: What is it like to grow a business in such an environment? How does one craft strategies and devise organizational forms to endure such a gut-sucking roller coaster? What can we learn from Argentine businesses? Although these questions may be answered only after decades of study, if ever, with this article we aim to offer a small but important contribution by analyzing corporate strategies devised by Argentine Business Groups (henceforth ABGs or grupos económicos) in response to these changes. Our focus on business groups and their corporate strategies is highly warranted; they represent a large chunk of Argentine GDP³ and are a common organizational form in the region. Additionally, our longitudinal approach offers unique insights into successful corporate strategies in emerging markets, given the shifting political, social, and economic challenges of such nature and magnitude. Further, because creating wealth and growing larger are undisputed measures of success, especially within this environment, we believe these firms and their leaders have a lot to teach not only to other Argen-

tine firms, but also to entrepreneurs and multinationals willing to establish businesses in Argentina and other emerging markets.

In the following section we review theoretical perspectives that can help us better understand how business groups best cope with environmental distresses. Then, armed with historical evidence, results from a survey of the 33 largest business groups, and in-depth interviews with their CEOs, we analyze the evolution of ABGs' corporate strategies through four major periods: (a) their emergence, from the mid-20th century till 1990, (b) their responses to the market-oriented reforms of the early 1990s, a condition we refer to as competitive shock,⁴ (c) their responses to the competitive shock in the last part of the 1990s, and finally (d) their likely new strategies in light of the recent setback in the competitive ambiance, a condition we refer to as anti-competitive shock. We believe the emerging picture should help answer the questions posed above.

Why Business Groups Exist

Business groups are a peculiar type of organizational form, different from most others observed in developed markets. Definitions abound but here we consider ABGs to be a set of companies which, though legally independent of each other, are controlled by the same local owner or group of owners, participate in either related or unrelated economic sectors or in the same value chain, share a common top management team, and have a clear financial link.⁵ Although the Japanese "keiretsu," or vertical network, is often seen as a form of business group, keiretsus are excluded from our definition, since they are not a common form of organization in Argentina.⁶

Business groups are a peculiar type of organizational form, different from most others observed in developed markets.

Three confluencing forces generally help the formation of business groups in developing countries like Argentina. The first is the absence of market information on the costs and benefits of goods and services. Given the lack of proper pricing information, business groups help improve executive decision-making⁷ because both sellers and buyers are members of the same group and enjoy more information and higher trust in their relationships.⁸

The second driving force is the role of govern-

ment. Governments sometimes use their resource allocation power to encourage investors into new industries.⁹ Governments bless entrepreneurs and existing groups with their magic wands either fueled by honorable sector developmental purposes¹⁰ or in search of political support.¹¹ Business groups, in turn, exploit the opportunities provided by such government action. They use their favored access and political connections to exploit the new business opportunities.

The third driving force fueling the growth of business groups is the growth of foreign investment in the country. Since government policies generally favor local firms and prohibit direct entry by foreign corporations, multinational corporations (MNCs) need to partner with local ABGs to enter the market.¹² Additionally, even where MNCs are permitted direct access, partnering with locals will provide access to seasoned managers who are able to navigate through the maze of local economic and business uncertainties, build the required relationships, and deal with government bureaucracies. Thus, as gatekeepers to the local market, ABGs are in the unique position to marry market-access permissions and local managerial expertise with foreign capital and technology. This results in ABGs expanding into new industries not to seek cross-business synergies, but simply to exploit new opportunities.¹³ To sum up, better executive decision-making, favored access to opportunities caused by government policies, and linkages with foreign companies are the three major drivers of growth in BGs in many developing countries.

The Appearance and Growth of Argentine Business Groups

Most Argentine grupos económicos blossomed in the early 1950s, toward the end of the populist presidency of General Perón.¹⁴ Changes in the business environment caused by shifting, politically motivated market regulations have been a constant in Argentina, but these uncertainties took stronger root during Perón's presidency. Perón decided that the state should actively direct the economy and, in fact, even own large parts of it. Government led investments in telecommunications, roads, and even real estate. While some private businesses suffered in the face of frequent market distortions and politically motivated unstable regulations, others were favored with exclusive supply contracts¹⁵ and protected home markets.¹⁶ Most such policies failed to deliver GDP growth, but many favored Argentine firms grew into larger business groups, seeking more stable cash flows in unrelated, often protected markets.

When Perón's failed populist policies turned into uncontrolled public deficits, he sought foreign investment to revive the moribund economy. During this period, armed with favored government permits, a strong reputation, and borrowed technology from MNCs, ABGs further expanded into new industries, especially fueled by the cash flows generated in the profitable, protected, domestic markets.¹⁷

Other important economic motives lie behind the appearance and growth of the grupos económicos. As explained before, conditions known as market failures lead firms to prefer integration with other firms so as to enable more fluid transactions in product, labor, and financial markets. In the specific case of Argentina, such conditions abounded. For example, Argentina never had a vibrant stock market, with adequate disclosure and a robust independent audit industry to ensure appropriate and trustable corporate governance and lower-cost financing.¹⁸ In addition, market intermediaries such as analysts and investment bankers have historically been less sophisticated than their developed market counterparts, and securities transparency regulations seldom existed.¹⁹ In such imperfect financial markets, and with threats of politically motivated policy shifts creating price distortions, firms within ABGs always had better and quicker access to cash, thus enjoying a competitive edge over standalone competitors.²⁰

ABGs also enabled their businesses to deal with Argentina's judicial system. Argentine law is known to be characteristically slow, and often suspicious of favored political connections.²¹ This exacerbates uncertainties about transacting parties holding up their end of the bargain²² and creates favorable conditions for unscrupulous opportunists.²³ In fact, in Argentina, the popular saying goes: "It is better to be friends with the judge than to be right."²⁴ Because larger firms often tend to have stronger business connections and political ties in Argentina,²⁵ individual firms belonging to a group often have a competitive edge when it comes to judicial disputes.

In sum, in this environment, entrepreneurs maximized their firms' survival chances and growth by forming business groups. The uncertainties above enabled buyers and sellers in input, labor, and financial markets to have transactional advantages as members of the same firm. In other words, ABGs were best equipped to quickly assemble resource packages as well as leverage rare resources such as contacts, reputation, and quick financing to overcome the so-called market failures. Business groups became the predominant organizational form in Argentina, holding related

and unrelated businesses. In the 1990s, the largest 37 ABGs represented an average of 10 per cent of Argentina's private sector. They are listed in Table 1. Their sizes varied immensely. For example, Techint, the largest group, had earnings of US\$7 billion in 1997, compared to US\$134 million for Karatex.²⁶

The Argentine Competitive Shock of the 1990s

In the early 1990s, Argentina went through a major competitive shock. The Argentine government enacted modernizing market-oriented reforms that provoked sudden, significant, and permanent alterations in the ways of doing business. Once more the rules of the game had changed, this time not to protect a smaller group of preferred companies or sectors but to open up markets for free and open competition. The Argentine competitive shock had three main drivers. First, with the newly promoted independency of the central bank, Argentines finally launched a more stable monetary policy, one that was independent of political bickering and interventions. The Ley de Convertibilidad anchored the local currency at par to the US dollar, ending decades of money-printing irresponsibility and populism. Without the muddling of inflation, information on financial markets improved substantially, attracting venture capitalists and for-

eign investors. Firms could finally have more abundant access to cash, foresee the long run, and devise product-market-oriented strategies.²⁷

Second, Argentina opened its market for freer trade by reducing some of its import tariffs for selected goods and also joining the MERCOSUR, a customs union with Brazil, Paraguay, and Uruguay. The massive inflow of imported goods meant stiffer competition, making product markets more transparent.²⁸

Third, the Argentine government backed off from its business ventures²⁹ by privatizing and/or deregulating state monopolies such as oil, telecommunications, electricity, gas, and water. It also rid itself of money-losing companies, which were mostly used as political maneuvering tools, such as Aerolíneas Argentinas, two television channels, steel and petrochemical firms, and almost all other state-owned businesses, down to grain elevators, hotels, and even racetracks, roads, railways, subways, ports, and more. The populist state welfare system was reduced in favor of private pension plans. Re-regulating the economy for its own sake was exchanged for the invisible hand of market-friendly rules.

The massive competitive changes resulted in a new competitive landscape. ABGs' old way of doing business, based on protected markets and personal connections, was bound to fade away, and the gru-

TABLE 1
Argentine Business Groups Throughout the 1990s (Sales in US\$ Millions for 1997)

Groups with unrelated diversification		Sales	Groups with related diversification		Sales
1	Alpargatas	\$422	1	Acindar	\$601
2	Astra**	N/A	2	A.G.D.***	\$841
2	Banco Velox/Disco***	\$2,118	3	Arcor	\$1,070
3	Bulgheroni	N/A	4	Ávila***	N/A
4	Bunge & Born	\$1,340	5	Banco Galicia***	N/A
5	Cartellone	\$560	6	Banco Provincia***	N/A
6	Fate-Aluar*	\$655	7	Clarín	\$1,651
7	Garovaglio & Zorraquín	\$204	8	Fortabat*	\$384
8	IRSA***	N/A	9	Grupo Bemberg (Quinsa)	\$892
9	Minetti***	N/A	10	Isaura**	N/A
10	Organización Techint	\$7,000	11	Karatex	\$134
11	Pérez Companc	\$1,621	12	La Nación	\$179
12	Pescarmona	\$658	13	Ledesma	\$250
13	Roggio	\$508	14	Mastellone Hnos*	\$681
14	Román	\$120	15	Organización Bagó	\$400
15	Soc. Cial. del Plata*	\$360	16	Roberts**	N/A
16	SOCMA	\$2,170	17	Roemmers	\$211
			18	Sancor Cooperativas Ltda.	\$720
			19	Sava-Gancia	\$200
			20	Sidus	\$200
			21	Y. P. F.**	N/A

* These groups were not interviewed.

** These groups had been acquired by multinationals by 2000.

*** New groups that appeared during the 1990s.

pos were required to rethink their strategies so as to survive in this new, tougher environment. We discuss their new strategies in the following section.

ABGs' Corporate Strategies in Response to the Competitive Shock

Understanding how ABGs had to change their corporate strategies in response to the competitive shock may be somewhat challenging in view of the conflicting economic forces discussed above. On the one hand, one might expect that the sell-out of government-owned businesses and the entry of foreign corporations would increase the number of new business opportunities for ABGs and enable them to further expand their sector portfolios.

On the other hand, one might expect ABGs to reduce the scope of their portfolios and pursue larger-scale opportunities through, for example, international expansion. The rationale for this alternative prediction is two-pronged and as follows.

First, competitive shocks are known to foster the appearance of market intermediaries, that is, agents that perform economic support activities more cheaply and reliably. These would make markets more competitive and would enable business groups to focus on their core activities.³⁰ To illustrate the concept, in Argentina, for example, new stock market brokers, a stronger and more professional banking system, and venture capitalists appearing after the competitive shock increased market liquidity, reducing the costs of financing. Further, independent service firms, such as consultants, human resources procurement and training, advertising, and wholesalers who were able to pool demand and risks more efficiently, enabled businesses to outsource services and reduce costs. Last but not least, independent regulatory agencies, such as the new central bank, created regulatory standards based on which firms could finally plan the long-term prospects for each of the businesses they were in. In sum, with market intermediaries performing support functions, firms would no longer have to form business groups to overcome failures in labor, financial, and input markets. In fact, business groups would compete in fewer sectors, with more resources dedicated to each sector.³¹

Another potential reason for portfolio contraction is that competitive shocks heighten the level of competition in the local market and reduce profit potential in once-protected sectors. ABGs, in response, would selectively decide which sectors to exit—the ones where they are not competitive enough—and in which sectors to remain and expand. To remain competitive in selected sectors,

they would need new capabilities and larger scale, which might lead to expansion into foreign markets. In sum, the competitive shock could alternatively lead ABGs to reduce the number of sectors where they compete, while expanding internationally.

This paradox of how ABGs would respond—either by further expanding or by contracting their business portfolios—requires careful analysis. We analyzed Carrera et al.'s survey of the 33 largest ABGs in 1996–97 and conducted in-depth interviews with their CEOs in 2001.³² Our conclusion is that the strategic response of ABGs depended on their existing corporate strategies. Those groups with a history of diversification into unrelated businesses (referred to henceforth as Unrelated ABGs) took advantage of the government business sell-out process and their strong political connections to further expand their portfolios into new Argentine industries. The availability of cash and technology from MNCs willing to enter Argentina contributed to this expansion.

In comparison, the ABGs with a corporate strategy of related diversification (referred to henceforth as Related ABGs) did not show a strong preference to enter new industries and markets being privatized by the government.³³ In short, Related ABGs took little part in government business sales, while Unrelated ABGs feasted on them, mainly concentrating in areas such as telecommunications, utilities, oil, transportation, and garbage disposal services. Later in the decade, many ABGs, both Related and Unrelated, contracted their portfolios. This took place after the birth and legitimacy of market intermediaries solidified, enabling business groups to focus on the search for cross-business synergies.

The prevailing factor leading ABGs to expand geographically was the new competitive landscape in the home market.

Throughout the 1990s both types of ABGs expanded internationally. The average number of foreign markets per ABG increased 115 per cent in these seven years (from 4.7 businesses per group in 1990 to 10.1 in 1997). This process included exports, alliances, and direct investments. ABGs with no prior international experience focused on regional, neighboring markets with similar cultural environments. Grupos económicos with previous international (mostly regional) experience expanded beyond Latin America. Results from our interviews indicate that the prevailing factor leading ABGs to expand geographically was the new competitive landscape in the home market.

In conclusion, in response to the Argentine government's market-oriented reforms in the early 1990s, ABGs with a corporate strategy of unrelated diversification expanded their business portfolios. They leveraged this expansion with their business and political connections, striking low-cost acquisition deals within Argentina that were put together with the technological and financial support of foreign investors. The groups with a corporate strategy of related diversification, on the other hand, demonstrated no strong tendencies to change the scope of their business portfolios. International expansion resulted from investments in existing lines of businesses, where ABGs, both Related and Unrelated, sought larger scale and competitiveness.

Factors Behind ABGs' Corporate Strategies in the Late 1990s and into the 21st Century

As discussed above, early in the decade, Unrelated ABGs took advantage of the privatization process and their access to foreign technology and cash to further expand their portfolios. By 1997, however, the government sell-out spree had ended. Additionally, at this point MNCs were seeking to recoup their investments in Argentine alliances and subsidiaries. Throughout the 1990s, but especially in the second half of the decade, business groups were growing increasingly aware that the new dog-eat-dog paradigm would require them to make heavier investments in each industrial sector in which they were involved. Soon, their strategic direction was changing from diversification to one of greater focus. The fact is that not even the largest Related or Unrelated ABGs could raise enough money to compete effectively in all industries and sectors in which they had a stake. While acquisitions into new sectors had made sense in the past, given their low cost, now this strategy no longer added value. The natural response by ABGs of both types at this point was to start selling off businesses that were not strategically important or did not bear synergies with each other and to use the cash to invest in strategically important business units. From 1996–97 through 2001, the average ABG shrunk its large business portfolio empire.

In order to more precisely ascertain the dynamics of the process described above, in 2001 we interviewed the CEOs of all the groups surveyed in 1996–1997, except for grupos Minetti, Y.P.F., Isaura, and Astra (these had either completely disappeared or had been sold out by 2001). We believe an illustrative example can best speak for the numbers. Here, we provide more detailed information on the evolution of grupo Pérez-

Companc—one of the most prominent ABGs—from its birth till 2001.

The Evolution of Pérez-Companc

Pérez-Companc, or PECOM, as the group is known in Argentina, emerged as a prominent group as of the 1950s. Its major operations evolved around supplying large government businesses. Based on its premier knowledge and preferred government treatment, PECOM had expanded into nine sectors by 1990, of which the most important were mining, oil, and gas. Throughout the first part of the 1990s, during the early period of the competitive shock, PECOM was one of the larger groups that expanded even further, effectively utilizing their domestic strengths along with foreign capital and technology. At this time, PECOM had entered sectors as diverse as electricity and telecommunications, which were previously regulated, government-monopolized sectors, as well as transportation and storage. Interviews with Mr. Gregorio Pérez-Companc, CEO and chairman of the group, highlight that by the mid-1990s, the group took a strategic turn when it felt it could no longer remain effective and competitive in every individual sector, given the growing competition. The response was to start a corporate focusing process, by selling out non-strategic businesses and reallocating resources to strengthen remaining ones with new capabilities and larger scale. PECOM proceeded to sell out its holdings in plastics and glass, hotels and restaurants, construction, and financial services.

The trajectory of PECOM is similar to that of most other Argentine Business Groups. Prior to 1990, the average number of business lines in each ABG was 5.2 for Unrelated ABGs and 2.3 for Related ABGs. During 1990–1996, these figures grew to 7.6 for Unrelated ABGs and 2.6 for Related ABGs, confirming that ABGs in fact expanded instead of contracting their portfolios. The trend of corporate expansion was much more dramatic for those groups with a history of unrelated diversification—although it did affect both groups. From the last part of the 1990s until 2001, the average number of business units per business group fell to 5.9 and 2.1, respectively, for Unrelated ABGs and Related ABGs. Here, the lower average number of business lines per ABG confirms our hypothesis.

The saga of ABGs throughout the second half of the past century, especially through the competitive shock of the 1990s, can best be summarized by the four periods in Table 2. In the populist-government Argentina, the key success factor was to cultivate government relationships and diversify

TABLE 2
ABGs and Their Corporate Strategies Throughout the Last 50 Years

Period	(1990s) Competitive Shock			(2002 and beyond) Anti-Competitive Shock
	(Until 1990) Populism and Pragmatism	(1990-1996)	(1997-2001)	
Trend in Corporate Strategy Within Period	↗ Expansion of business portfolio	↗ Expansion of business portfolio	↘ Contraction of business portfolio	↗ Expansion of new groups?? ↘ Contraction of old groups??
Key Management Focus Within Period	Cultivate government relationships in search of protected markets. Diversify portfolio and risks.	Leverage favored relationships with government and MNCs striking low-cost entry into new industries. Expand internationally.	Sell out unrelated businesses and enlarge scale of remaining ones. Expand internationally.	<i>Old groups:</i> sell out financially moribund businesses to boost remaining ones and expand internationally. <i>New groups:</i> buy out moribund companies from financially distressed groups.

risks by expanding business portfolios into protected markets. When the environment changed in the early 1990s, with swift market-oriented reforms turning on the competitive heat in the new business landscape, the success factors changed. By then, ABGs first took advantage of the privatization program (mostly Unrelated ABGs) and sought larger scale through foreign expansion. Later in the decade, the key to successfully managing businesses in Argentina was to focus their corporate strategies while still expanding their scale by entering foreign markets.

The new strategies devised by ABGs at this point, according to our interviews, were beginning to work. CEOs report that by 2001 their firms were finally learning to operate in a market with strong levels of competition. They had learned to focus on a smaller set of businesses, that is, a smaller business portfolio, searching for synergies among them and establishing long-term strategies. Furthermore, ABGs were starting to rely more heavily on market intermediaries (such as labor-seeking agents and venture capitalists) and less on government contacts. The popular press praised such progress and claimed that Argentina was no longer a third-world economy but had actually achieved "second-world" status.³⁴

The Anti-Competitive Shock of 2002

"... the economic crisis that struck Argentina last year has deepened into one of the worst and most intractable such calamities in living memory..."³⁵

All of the competitive experience gained by company leaders, and the energy invested in transforming their businesses throughout the golden decade of the 1990s, mostly turned to dust with the financial crash of 2002. Argentine business groups had barely finished re-adapting to stable market conditions and solidifying their new corporate strategies when they found themselves amidst a new wave of survival-threatening setbacks to the reforms implemented during the previous decade. At the end of 2001, Argentina dived into the most serious economic depression of its history. GDP shrunk 15 per cent in the first quarter of 2002, and unemployment struck 23 per cent of the workforce.³⁶ A default on its US\$155 billion public debt pulled the plug on any new foreign loans and investments.

While not even economists have been able to offer a precise account of what went wrong, in early 2002 a desperate government, trying to revive

its sources of income, clumsily started changing the rules and directions of the economy. It took back control of the central bank and monetary policy and again started regulating prices for public utilities, such as water, electricity, and telephone, as well as petrol products. The government's disastrous approach, new lax monetary policy, and lack of control of each province's bond issuance spree caused the local currency to slip against the US dollar almost fourfold. With panic running in their veins, investors and holders of personal savings tried to recover their dollar-denominated assets, simply turned into pesos by government decree. A freeze on bank accounts, aimed at curbing a total collapse of the banking system, made cash disappear from circulation and become a premium commodity, further asphyxiating the informal economy, estimated at 30 per cent of GDP. Defying the courts and the rules of property rights, long-term certificates of deposits were transformed into worthless government bonds. With the chain of payments between consumers, businesses, and suppliers broken down, and no judicial guarantees for business contracts, the economy entered coma.

Engaged in a tug of war with the presidency, with charges of corruption and deviant malpractices thrown at each other, the judicial system's authority and legitimacy were challenged by the rioting population, who saw the foundations of their democracy's most sacred institutions melt down. The country seemed adrift for most of 2002. Uncertainty skyrocketed, as demonstrated by a country risk assessment repeatedly and stubbornly surpassing extreme levels, second only to that of Nigeria.

The meltdown of Argentine institutions seriously affected Argentine firms, foreign subsidiaries, and most especially Argentine Business Groups. First of all, through an asymmetric devaluation, ABGs' foreign payable accounts remained dollar denominated, while their domestic market sales and net worth, being pesos denominated, were severely downgraded. Second, firms saw their sales fall not only in dollar values but also in real terms. Demand for consumer products fell as much as 30 per cent during the early days of the shock, whereas producers of durable goods (e.g. automobiles) were hit with a decrease in demand on the order of 70 to 80 per cent. Most of these firms were unable to fulfill their obligations, which, with the judicial system in disarray, resulted in tremendous confusion. The environment was characterized by a lack of trust and a complete halt of new investments.

The only conviction among market analysts throughout 2002 was that the damage and uncertainty would take long to dissipate, as market and

capitalist institutions would have to be rebuilt almost from scratch. IMF officials stubbornly refused to sign any support deals, in a demonstration of the international financial community's anger with Argentine policy irresponsibility. With a new heavy-handed government in the economy, market forces were unlikely to be seen as useful signals to crafting firm strategies in Argentina. Populist politicians even proposed that the government should return to its business ownership and regulating days in sectors related to national sovereignty, such as energy, oil, and railroad transportation. All these negative factors appeared suddenly and jointly, synergistically forming a perfect storm within the local business environment. The sudden, significant, and shocking changes in economic rules, involving direct actions of the government, resulted in a complete removal of the effects of self-regulating market forces on corporate performance. We call these events and their lingering effects the anti-competitive shock.

ABGs' Corporate Strategies in Response to the Anti-Competitive Shock

The anti-competitive shock resulted in severe damage to Argentina's economy as a whole and to most of its business groups. The blow hit traditional and prestigious firms hard. The competitive shock throughout the 1990s had already claimed the lives of prestigious groups like Astra, Minetti, Isaura, Roberts, and YPF, which had either been sold or had disappeared completely. The early waves of the anti-competitive shock added Pérez-Companc, Banco Velox/Disco, and Quilsa to that list. Additionally, other groups were severely wounded, mostly being caught off guard by the asymmetrical devaluation, like Sociedad Comercial del Plata, Alpargatas, Román, Banco Galicia, Garovaglio & Zorraquín, and Mastelone Hermanos. The Pérez-Companc Group, for example, already described earlier, was unable to restructure its US\$2 billion dollar denominated foreign debt³⁷ while collecting revenues in pesos in a sector again turned price-regulated by the government. It had to sell out the lion's share of its empire, most specifically its interests in the energy sector, to regional Brazilian competitor Petrobras. The Pérez-Companc family has decided to concentrate efforts in other smaller but aggressive family ventures, such as agribusiness. Another prominent group, Quilsa, with large stakes in beer making (the largest Argentine beer maker), initially sought financial partnerships with AmBev, its major Brazilian competitor. Later, it announced that it had sold options to AmBev for complete takeover. Likewise, throughout 2002,

many other firms not listed in Table 1 either filed for bankruptcy, sold out, or simply faded away into coma.³⁸

What Now?

Analysts and economists predict that until Argentine and foreign investors can again trust Argentine politicians, it will be impossible to predict whether the business landscape will return to a market-oriented environment or remain in the dark ages of politically motivated economic regulation and government ownership of businesses in selected sectors. While some argue that a financially broke government is unlikely to return to business ownership, most expect the government to strike populist, mostly politically motivated, measures aimed at reducing popular tension, like price controls for energy, electricity, and telecommunications. Meanwhile, executives, investors, and entrepreneurs anxiously await the return to credibility of the Argentine institutions of capitalism, such as its fiscal mechanisms, banking system, and the judicial system.

Far from playing the role of futurologists, we argue that in the short term, the major challenge to Argentine business groups is simple survival. Setting aside future planning and strategic thinking, they need cash flow to sustain their businesses. The lack of banking system liquidity, the political instability, and the lack of corporate liquidity have all combined to create an unprecedented survival challenge. At this stage, all decisions are crisis and short-term oriented; groups have no room for strategy.

Later on, as the country emerges from the ashes, we are likely to see a large reshuffle of business-unit ownership. The economic rationale for the formation of new business groups in today's Argentina certainly exists; not only do they confer better access to resources in unstable labor, product, and capital markets, but they also enable better risk diversification and management in Argentina's weak, unstable, and untrustworthy financial markets.

With an avalanche of new low-cost entry opportunities available—mainly as the result of some business groups dismantling or multinationals leaving Argentina—new investment groups may feel encouraged to enter a new growth-through-acquisitions spree. Because the saying "once bitten, twice shy" usually holds true when it comes to investments, this reshuffling of business units is likely to result in the Argentinization of the economy—at least in the early stages—as foreign investors, wary of judicial and economic uncertain-

ties, are initially skeptical about taking on the acquisition opportunities. The only certainty, analysts agree, is that the country offers many "little jewels that need just a small push, with very small quantities of fresh money, so as to take off aggressively again."³⁹ Business groups that miraculously escaped the Argentine financial disaster may represent a key example of such groups of new investors. Another type would be investment-fund groups and multinationals led by local managers with unique expertise in navigating on the waves of Argentine instability and uncertainty.

Examples of the above abound. For one, two Argentine entrepreneurs—owners of various small local businesses—acquired the local subsidiary of Canadian ScotiaBank. Caught in the middle of the Argentine turmoil, having had its credit lines transformed into devalued pesos by government decree, and being required to infuse fresh money to stand up to rioting clients at its doors, ScotiaBank decided to pull out of Argentina. The bank's share price soared the day of the announcement.

At this writing, the supply of other similar acquisition opportunities arising from foreign companies leaving Argentina was still strong. For example, the subsidiary of the French *Crédit Agricole* was in search of a new owner in Argentina. American PSEG's electrical distributor, *Edeersa*, was also on sale.

In a time when foreigners mostly leave the country, in a reverse trend compared to that of the early 1990s, Brazilian *PetroBras* and *AmBev* acquired subsidiaries in Argentina from the debris of *PECOM* and *Quilsa*, respectively, as explained earlier. A business consultant who prefers anonymity stated, "Gone are those without a true vocation to being multinationals, those who have just recently made it into the category of international. Gone are those who don't have experience nor guts to withstand the game in countries where the rules are very distinct from those they are familiar with." *PetroBras*, in a way, represents the entry of companies who have developed a sense for managing crisis and subsidiaries in emerging economies, such as Angola, Paraguay, and many others, now including Argentina.

In this acquisition trend, new business models have also emerged, for example, the distress funds. While in the 1990s investment funds played an important role in reshaping the Argentine business landscape, distress funds have specialized in acquiring and restructuring moribund businesses. In the early 1990s, investment funds were not troubled by the idea of paying US\$200 million for a local record store, *Musimundo*, or US\$630 million for a small supermarket chain, *Tía*. In contrast, today's

distress funds focus on swimming against the trend, acquiring troubled businesses, mostly without cash disbursement but taking over their debt.

Their first action is to infuse the company with enough working capital to keep it afloat and restructure its debt with the idea of reselling the business when the crisis is over. The most important characteristic of these distress funds is that they are not supported by foreign investors but by "local entrepreneurs, who, tired of earning 2 per cent a year in Switzerland, are making their way back into Argentina."⁴⁰ An example of this trend is *CoInvest*, a group founded in 2002 by seasoned Argentine executives aiming at acquisition and restructuring of troubled businesses. *CoInvest* recently acquired *MetroRed* from *Fidelity Fund*. *MetroRed* had invested in excess of \$150 million dollars for 300 kilometers of networked optic fiber.

The Internationalization of Argentine Firms

One interesting aspect within the anti-competitive shock is that among all business groups, the ones that suffered the least were the groups that had a larger reliance on foreign as opposed to local operations and those whose debt was in the same currency as their earnings. These groups are likely to continue pushing the internationalization process of Argentine firms. Three of them are especially worth noting: *Techint*, *Arcor*, and *Sidus*. The first group, *Techint*, has acquired a vast amount of experience in crisis management in its 50 years of existence. It operates in five business sectors: steel, engineering and construction, industrial machinery, energy, and healthcare. The second group, *Arcor*, has kept its focus on food products, such as candies, sweets, and toffees. By 2001, *Arcor* and *Techint* had expanded their international presence across more than 50 countries. Their international assets and dollar-denominated sales helped them sustain the blow back home in 2002. Having diversified their exposure to Argentine risk, they both plan to maintain the growth of their foreign operations.

The third company, *Sidus*, a high-tech bio-products firm, has always aimed at gaining a strong presence (and economies of scale thereof) in pharmaceuticals for third-world country diseases and also enjoys a rather comfortable international presence in most important emerging markets, especially those in Latin America. Their foreign sales in U.S. dollars helped them survive the crash in 2002. The success of firms with foreign operations speaks to the importance of reducing exposure to Argentine country-risk through geographical diversification.

To sum up, once the short-term survival and

cash-crunch mode is overcome, we expect new business groups, new investment funds, or even newly arriving multinationals to populate the Argentine business scene. The investment funds will be driven by financial opportunities. They will act similarly to corporate raiders in the U.S.: buy low, clean up, and sell high. The new business groups will move away from unrelated diversification to related diversification to reduce potential threats and to strengthen their competitive position in each sector. To diversify risk and to capture foreign currency, they will also aggressively pursue foreign markets. The country's low currency rate will certainly facilitate this trend.

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In short, instead of the government, which was posited earlier as one of the drivers of ABGs, this time it is the sell-out by existing firms that will create the opportunities. But this time, we expect to see much more focused and related expansion to better manage business, political, and financial risks. We expect business groups to be more selective in pursuing investment opportunities, following an approach we call strategic opportunism. In the early 1990s they followed a growth path based on almost pure opportunism, expanding in a wide range of businesses. In the wake of the recent events, they will attempt to choose those opportunities that best fit their corporate strategies and where they can have a sustainable competitive advantage.

Growing a Business in a Roller Coaster Environment: Lessons from Argentina

We have aimed to explain some of the strategic management intricacies of emerging markets and competitive environments that are void of stable rules, like that of Argentina. Specifically, we have illustrated the changing strategies of Argentine Business Groups. The most important lesson is that although the competitive landscape may change like a roller coaster, strategies must enact adaptations to the new environment. In other words, growth in such environments is not just a stroke of luck but the result of careful deliberation and reasoning about not only specific economic forces but also the right local and foreign contacts.

While many international strategists and market specialists may term business groups as old business dinosaurs, business groups are actually strong and robust organizational forms devised by savvy entrepreneurs to cope with strong, dynamically changing forces.

Turning the above into specific actions, in Argentina entrepreneurs strategically changed their course of action when necessary to ensure their continued access to valuable, rare, and expensive resources. Many of these groups grew out of the 1950s by leveraging preferred contacts and exclusive government supply agreements, thus being protected from market volatility and unwanted competition. Their unrelated diversification enabled more stable cash flows, allowing easier access to cash, in a market stripped of an efficient stock market and low-cost credit lines. Their size and diversification facilitated their way not only to stable sources of cash flow but also to stable sources of trained and certified labor. Their strong reputation attracted the trust of potential international partners. Later, when the rules of the game changed dramatically and market-oriented reforms were implemented (a period we called competitive shock, borrowing the term from Ghemawat & Kennedy⁴¹), many of these large groups again took advantage of their connections, size, and reputation to link local opportunities with international cash and technology, further expanding into other sectors. Although the crash of 2002 hit all economic sectors in one way or another, debilitating most groups, those with international operations were best able to withstand the blow.

For managers of multinational firms willing to do business in Argentina, or with Argentines, the lessons are many. First of all, in addition to managing resources adequately, as the latest international management books prescribe, one needs to constantly maintain strong ties in the country, both social and political. While Argentina still rebuilds its financial, democratic, and judicial institutions, establishing such ties is likely to help firms increase their chances of not only avoiding unpleasant surprises from the latest macro and micro economic policy changes but also influencing their outcome. Far from suggesting that firms should seek out favored positions or individualistic benefits from such relationships, as some ABGs did during the 1950s, it is these social and political ties that will enable one to positively influence the reorganization of the country. More specifically, these ties are the mechanisms through which firms can help influence policies so as to benefit society, citizens, the local economic and social institutions and, of course, the firm's own chances of survival,

profitability, and future international competitiveness. In sum, devoting especial attention to getting well connected in the local business and political network is a managerial policy that is likely to confer great advantages to organizations in environments that are void of strong institutions.

Second, foreign firms should build a solid management team made up of locals. Specifically, as described earlier, many Argentine managers have grown into all-terrain, savvy executives by leaping common hurdles in order to effect business deals. They have become, by far, Argentine firms' most valuable resources. Their possession of local business heuristics, maneuvering skills, and contacts represents knowledge that is tacit and costly, maybe impossible to acquire elsewhere, but essential for the effective management of a local subsidiary. Further, they are best equipped to understand the changing political winds and thus to move through the maze of uncertainties and strike successful deals. It is no surprise that local entrepreneurs and managers are the ones leading the new acquisition spree described earlier. Local managers are today the key competitive factor for success in Argentina.

Third, firms should diversify their emerging market international portfolios so as to avoid overexposure to skyrocketing market or country risks. Latin American nations, specifically, though having economies that are related in some fashion, may expose firm assets and operations to differing degrees of business and financial risks. As an example, at this writing, Argentina's country risk still exceeded 5200 points with a GDP growth perspective of 5 per cent for 2003. Neighboring Brazil's growth perspectives on the other hand pointed to less than 2 per cent, though its country risk was below 800 points and falling. The experience of multinationals like ScotiaBank, that focused more exclusively on the Argentine market, demonstrates the hazards of a carelessly assembled Latin American business portfolio. Firms should instead pursue the strategies of groups like Techint, Arcor, and Sidus, who diversified their risks by establishing operations in various regional countries. Their dollar-denominated operations are enabling these firms to invest back in today's Argentina, where many low-cost entry opportunities abound.

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Endnotes

¹ Getting from here to there. *The Economist*, 4 May 2000. www.economist.com.

² In the first two quarters of 2002, GDP shrank 15 per cent. For details, see: Argentina's bottomless pit. *The Economist*, 8 August 2002. www.economist.com.

³ Their income represented 10 per cent of the Argentine private sector in 2000.

⁴ In this article we borrow the concept of competitive shock from Ghemawat, P., & Kennedy, R. E. 1999. Competitive shocks and industrial structure: The case of Polish manufacturing. *International Journal of Industrial Organization*, 17(8): 847-867.

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¹⁸ See: The limits of management. *The Economist*, 4 May 2000. www.economist.com.

¹⁹ Ibid.; The death of Peronism? *The Economist*, 14 November 2000. www.economist.com.

²⁰ Acevedo, et al., op. cit.

²¹ Getting from here to there, op. cit.

²² Khanna & Palepu, op. cit.

²³ Williamson, op. cit.

²⁴ Salvadores, O. F. 2002. *López Murphy: Razón o demagogia*. Buenos Aires: Planeta.

²⁵ Acevedo, et al., op. cit.

²⁶ Source: companies' balance sheets.

²⁷ Bisang, op. cit.; Kosacoff, B., & Porta, F. 1997. *La inversión extranjera directa en la industria manufacturera Argentina. Tendencias y estrategias recientes*. Buenos Aires: Editora Alianza.

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²⁹ State-owned companies had reached a revenue share of 29.4 per cent of Argentine top 500 companies in 1989.

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groups to the competitive shock of the 1990s. IAE Working Paper Series.

³³ We used Rumelt's classification of related and unrelated diversification, based on SIC codes, to classify Argentine Business Groups.

³⁴ Getting from here to there, op. cit.

³⁵ Argentina's bottomless pit, op. cit.

³⁶ The death of Peronism? op. cit.

³⁷ In 2001 PECOM's financial report stated total assets as \$3 billion dollars, meaning its debt-to-assets ratio was 2%.

³⁸ See Editorial opinion. Más cambios en el mapa empresarial. *El Cronista* (Buenos Aires), October 2002.

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⁴¹ Ghemawat & Kennedy, op. cit.



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