Conglomerates in Emerging Markets: TIGERS OR DINOSAURS?

BY ZAFER ACHI, CHIPPER BOULAS, IAN BUCHANAN, JORGE H. FORTEZA AND LANDO ZAPPEI

Disparaged in the developed world, emerging-market conglomerates are here to stay, provided they adapt to their ever-changing environment. If they do adapt, what role are they likely to play?

"UNDERVALUED INVESTMENT opportunity," claims the effervescent broker's report. A chance to invest in a company with $2 billion in sales, $100 million in earnings, 100 companies with more than 15,000 employees in areas as diverse as manufacturing, banking, distribution, telecommunications, property and plantations, it professes. "Return on equity is at 10 percent but growth prospects are fabulous."

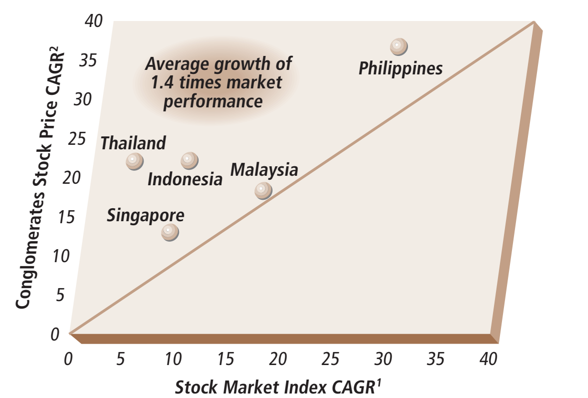
Undervalued or overstretched? Is this investment advice you would follow?

Most Western investors would probably respond in the negative. Today analysts apply a "conglomerate discount" in their equity evaluations, while some conglomerates in the United States and Europe are breaking up or actively refocusing their capabilities and contracting their business portfolios.

Yet in emerging economies from Chile and Brazil to South Africa, India, Indonesia and Korea, many highly diversified groups are growing handsomely, raising considerable funds in the international market and creating substantial gains in shareholder value in the process. (See Exhibit I.)

Is this success simply a question of time, or are there some fundamental reasons that emerging-market conglomerates seem better able to adjust to their marketplaces and exploit their advantages?

EXHIBIT I
STOCK PRICE GROWTH — SOUTHEAST ASIA CONGLOMERATES VERSUS STOCK MARKET



(1) Stock market index compound annual growth rate (CAGR) from 1991-1996
(2) Representative sample 5 to 8 listed conglomerates per country

Source: Extel, Booz-Allen & Hamilton Analysis

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WHAT ESSENTIAL FACTORS FAVOR DIVERSIFICATION

Recent research indicates that in markets where institutional voids exist, conglomerates can provide an effective second-best solution in overcoming such market failures. Indeed, Tarum Khanna and Drishna Palepu, assistant professor and professor respectively at the Harvard Business School, argue in their ground-breaking article in the August 1997 Harvard Business Review that diversification is a legitimate response in emerging markets.

This raises several questions that are paramount to understanding why emerging-market conglomerates may have a sustainable future:

1) Which institutional or "context" factors provide a fertile breeding ground for conglomerates in emerging countries?

2) How does this institutional framework evolve as these countries embark on economic reform processes, and is a high level of corporate diversification sustainable?

3) Which are the alternative strategic responses that highly diversified companies are adopting as their institutional environment evolves?

4) What recommendations can we derive for shareholders and senior managers of these companies?

INSTITUTIONAL CONTEXT: WHY DOES IT MATTER?

Advanced economies generally exhibit two important characteristics: the economy is reasonably open with little state intervention and the underlying factor markets are well developed.

In an emerging economy, however, these two conditions are absent, or only partly met. (See Exhibit II.)

In addition, in most emerging countries, government intervention is an acquired taste. In the years after decolonization, governments set out ambitious development goals but generally lacked the civil service capability to make them happen, notwithstanding exceptions such as Singapore. They relied instead on a handful of local companies that made it their business to help governments put their policies into operation. A symbiotic relationship developed that survives today. It has served national interests well and has provided bountiful opportunities to a number of entrepreneurs. They have lobbied and influenced public policy, while serving it, and have thereby extracted rents that

RENONG BERHAD

While the Asian currency crisis of 1997-1998 captured the world's attention, Renong Berhad once again demonstrated its ability to perpetuate the preconditions for conglomerate emergence: government patronage and institutional voids, particularly in capital markets and government regulations.

Renong Berhad is Malaysia's largest conglomerate, with major interests in toll-road operations, construction and engineering, property development, financial services, telecommunications, and oil and gas. It is symbolic of Malaysia Inc. and its ambitious national development plans to the year 2020.

In Renong's attempts to embark on large national projects, especially in infrastructure — coupled with large doses of government intervention — it racked up large debts including foreign-denominated loans. At one point the currency crisis saw the ringgit plummet by almost 45 percent — increasing the cost of debt servicing, and causing the equity market to plunge — and threatening Renong with calls on billion-ringgit loans that were backed by collateral in Renong subsidiaries worth only a fraction of their value from before the crisis.

On November 19, 1997, United Engineers Malaysia, a cash-rich Renong subsidiary, announced its purchase of a 32.6 percent stake in its parent (at a 12 percent premium over the open-market value) with a waiver from having to extend a general offer to minority stakeholders — granted by Malaysia's Foreign Investment Committee.

"Malaysia Shares Dive 6.8% on U.E.M., Renong Deal"
Asian Wall Street Journal (November 19, 1997)

"KL Stocks Plunge 11% as Market Braces for More Bail-outs"
Singapore Business Times (November 21, 1997)

have helped them fund an increasing array of new ventures.

The mere concentration of opportunities in a limited set of hands has in turn slowed the emergence of strong-market institutions. This has provided an additional advantage to the companies that had sufficient scale to invest in internal capabilities that could substitute for the deficiencies of the market. Management development, proprietary channels, corporate brands, self-owned banks and trustworthy reputations were some of the attributes conglomerates used to add value to their businesses and endow them with competitive headstarts.

The combination of their unique ability to exert influence on policy and of their corporate-level umbrella in filling institutional voids has provided

Institutional Factors	Advanced Economies	Emerging Economies
Influence	• Influence cannot be bought • Uninhibited access to policy makers	• Active market for buying and selling influence • Selected policy-making access for influential parties
Information	• Widely available • Competitively priced	• Privileged access • Limited exchange • Priced to reflect privilege
Human Resources	• Wide range of skills • Functioning job market	• Preciously low availability • Limited specialist skills • Skills developed internally
Business Practice	• Accepted code of conduct • Functioning contract enforcement mechanisms	• Ill-defined code of conduct • Inefficient contract enforcement mechanisms
Capital Markets	• Liquid, sizeable • Perfect (or near to) information • Regulated	• Weak or non-existent • Highly segmented • Limited access to large corporations • Incomplete, unreliable, information exchange
Financial Institutions	• Homogeneous • Access and prices do not vary widely between users	• Highly segmented • Small players can only fund at large spreads • Directed lending
Corporate Control	• Efficient market to reallocate corporate control (shareholders, raiders, LBO funds)	• Inactive markets • Right is vested with majority shareholder/family members • Limited protection for minority shareholders
Alliances	• Active market for alliances • Limited search and screen costs	• Opaque market for alliances • Significant 'learning' and search costs • Premium to established, trustworthy players • High perceived risk in tying up with unknown players due to lack of contract enforcement mechanisms

Source: Booz-Allen & Hamilton Analysis, Harvard Business Review

EXHIBIT II
INSTITUTIONAL CONTEXT

Although it was subsequently overturned, the less-than-transparent deal raised two immediate questions: "Is Renong a precedent for more corporate bailouts of government-linked majority shareholders?" and "Will minority-shareholder interests be protected?"

Minority investors clearly displayed their lack of confidence as the stock market plummeted 6.8 percent in one trading day. Over a period of six months, a United States investor in United Engineers would have lost 90 percent of the investment — 60 percent as a result of the stock-price drop and 30 percent as a result of the currency devaluation.

The Malaysian government answered the first question three days later in the form of a multi-billion-ringgit bailout of the Bakun Dam project in East Malaysia. The stock market dropped by another 11 percent.

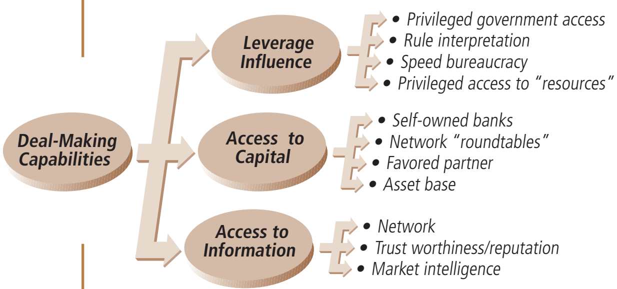
GOVERNMENT BOOSTER

In a developing nation where close links between politics and business are increasingly evident, preconditions such as government patronage and institutional voids have played key roles in the emergence of Renong Berhad.

The government booster (stability and influence over economic activity) in Malaysia was a key reason for Renong's emergence. Since the racial riots of 1969, the government led by the United Malays National Organization (U.M.N.O.) has implemented wealth redistribution and affirmative action programs that have been credited with restoring stability to the nation and boosting the political power of the ruling party, U.M.N.O.

U.M.N.O.'s influence and participation in Malaysia's economic activities began primarily through three companies, the most prominent being Fleet Holdings.This participation came from the need to reduce U.M.N.O.'s dependence on Malaysian-Chinese funding for its activities and to gain control of Malaysia's leading foreign-controlled local publishing media.

Renong's explosive growth since its humble begin-



Source: Booz-Allen & Hamilton

EXHIBIT III
CONGLOMERATES' SUPERIOR DEAL MAKING CAPABILITIES

conglomerates with a formidable platform to capture the deal flow at an opportune time. (See Exhibit III.)

WHEN THE CONTEXT STARTS TO CHANGE

Exhibit IV combines the two dimensions of government intervention and imperfections in the marketplace into a framework for understanding the dynamics of developing economies.

In the situation in which an economy exhibits a high degree of imperfection in its institutional structure (Point A), conglomerates are typically the dominant players in a closed economy, because access to policy-makers and to scarce information is concentrated in a few hands who corner the best deals.

An example of this is Renong Berhad, Malaysia's largest conglomerate, with more than $250 million in sales and $1 billion in net assets. Today its business portfolio embraces interests in construction, engineering, property development, financial services, telecommunications and oil and gas.

In 1989, under the leadership of Dr. Chan Chin Cheung, an entrepreneur with close ties to the Malaysian government, Renong was granted preferential rights to purchase the assets of the ruling party, U.M.N.O. Overnight, Renong was transformed into a significant holding company for the three largest engineering and construction companies, the largest cement manufacturer, a national television station and newspaper publisher and a major local bank. Halim Saad, a close advisor to the government, was appointed the new executive chairman, reinforcing Renong's position as conglomerate of choice for future in-

nings as a small investment holding company can be traced back to the transfer of all U.M.N.O.'s assets to the government's official assignee following a court ruling in 1988 that declared the party illegal. U.M.N.O.'s original investment holding company, Fleet Holdings, formed a major portion of these assets.

While a "new" U.M.N.O. was rapidly reconstituted under the Prime Minister, Dr. Mahathir, there remained an imperative to consolidate U.M.N.O.'s assets to finance an impending political battle in the October 1991 general elections. During a period of opposition attacks on U.M.N.O.'s open involvement in business, Dr. Mahathir's rivals were unsuccessful in legally proving U.M.N.O.'s direct re-ownership of its numerous assets through Renong.

"The way U.M.N.O. has gone through the restructuring (from the Fleet Group to Renong) is remarkable," said an analyst quoted by Reuters in 1990. "With nominees holding U.M.N.O.'s business interests, it will be difficult to prove where the U.M.N.O. connection begins and where it actually ends."

Overnight, Renong was transformed into an investment-holding company for a major bank, the three largest engineering and construction companies, the largest cement manufacturer, a national television station and the largest newspaper publisher.

Daim Zainuddin, the powerful former finance minister and U.M.N.O. treasurer, now a close advisor to Dr. Mahathir, engineered the deal and positioned a protégé and close associate, Halim Saad, as the new executive chairman. Together with his wife, appointed as a Renong director, Halim initially held a 17 percent stake in this conglomerate. As of June 1996, Halim may have had more than 22 percent of direct and indirect shareholdings.

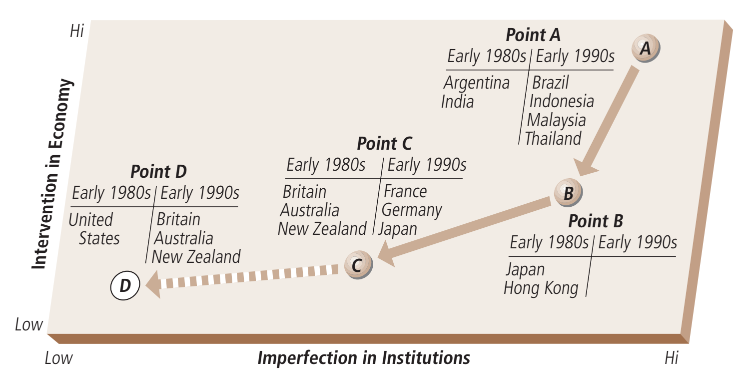
INSTITUTIONAL VOIDS

Although institutional voids have proven to be strong preconditions for the emergence of many conglomerates, they are clearly outweighed in this case by the frastructure projects in the rapidly developing Malaysian economy.

When we start moving to point B in our framework and large-scale privatization is launched, these conglomerates are in unique positions to reap the benefits of their dominant positions with privileged access to influence and financial and managerial resources, as well as being attractive to the most capable foreign partners.

It is not surprising that at the completion of the privatization processes the leading domestic diversified groups have grown in size and complexity. For example, Sime Darby in Malaysia expanded from its roots as a plantation house to enter businesses as diverse as banking and motor-vehicle distribution. In Argentina, the Pérez Companc and Techint groups grew greatly as they capitalized on their management strength to become the "best partners" for global players in the large-scale privatizations of telephone companies; electrical generation and distribution; gas distribution; oil exploration and production, and steel mills. In Indonesia, Lyonnaise des Eaux teamed up with the dominant Salim Group to bid for and win Jakarta's water distribution

EXHIBIT IV
CHANGING INSTITUTIONAL CONTEXT



Source: Booz-Allen & Hamilton

government booster. However, institutional voids in capital markets and government regulations have aided in Renong's current success/failure and have been further perpetuated by Renong's actions as demonstrated by the deal with United Engineers Malaysia.

The future for Renong lies in its ability to positively influence four significant forces that have since determined its success and failure: deal flow, cost of patronage,hubris doom loop and perpetuating preconditions.

DEAL FLOW

Renong is the manifestation of Malaysia Inc., with a key role in realizing Vision 2020, Malaysia's ambitious plan to become a developed nation by the year 2020. Renong's portfolio of engineering and construction, toll-road operation, property development, financial services, telecommunications, and oil and gas companies is involved in sectors that are highly influenced by the government.

The infrastructural development required to achieve Vision 2020, and Renong's strong U.M.N.O. connections, enabled its subsidiaries to win large, high-profile contracts, especially in the engineering and construction and property development sectors, valued at more than $8 billion. Of all the government's large national projects since 1992, Renong has won eight of 13 projects. As of September 1997, estimates of Renong's order backlog range from $8 billion to $12 billion.

In addition, easy access to attractive financing enabled Renong to carry a project load and debt burden that would otherwise be unsustainable under less advantaged circumstances.

COST OF PATRONAGE

While Renong has clearly benefited from the government's support, there is a "flip side" — the cost of patronage that is a spillover from government support and is usually in the form of an "obligation to serve" when asked by the government.

Source: Booz-Allen & Hamilton

EXHIBIT V
TYPICAL CONGLOMERATE PORTFOLIO

privatization. In the process, it has accumulated a large number of businesses; some are performing, some are bleeding, a few are protected and many more are exposed. (See Exhibit V.)

EXPECTED HAZARDS OF OVERSTRETCHING

Over time, the hallmarks of overstretching become evident: shortages of critical skills, growing indebtedness and multiple, increasingly complex, alliances. The extent of diversification is no longer sustainable. An unexpected downturn exposes the fragility of the situation and forces reassessment. This was the situation of conglomerates in Argentina in 1994, Mexico in the Pre-Tequila years, Korea recently and is arguably looming in Southeast Asia in the aftermath of the recent currency crisis.

Observations of the Argentine and Mexican examples indicate that restrictions in the supply of financing, associated recession and greater pressure from the international business community eventually lead to a dual response: at the government level, a steep acceleration in reform and deregulation that moves the country to-

Examples of the effect of the cost of patronage on Renong included the potential $2.4 billion bailout in 1995 of a debt-ridden steel-maker — Perwaja Steel — which had $1.2 billion in accumulated annual operating losses; the potential $480 million bailout in 1997 of the Philippines National Steel Corporation from another Malaysian businessman, and the potential purchase of another company that was alleged to have had complications in constructing the controversial Bakun Dam valued at $10 billion.

HUBRIS DOOM LOOP

The hubris doom loop is characterized by the risk of overconfidence in the leadership team because of a failure to understand the importance of deal flow in contributing to its current success.

Renong's steady stream of attractive national projects and easy access to financing have left it highly leveraged (debt to equity of 123 percent) and committed to significant investment in major development projects. This has translated into a growing gap between the application of funds and operating cashflow. In 1996, this gap was as large as $1.6 billion. With the long payback periods of Renong's high-investment projects, this gap is expected to remain until 1999 and beyond.

PERPETUATING PRECONDITIONS

As an economy develops, institutional voids diminish, and as the government releases its reins on business, the government booster disappears. This results in a lower obligation to the government to undertake bad ventures (cost of patronage) and less access to deals (deal flow).

In addition to maximizing beneficial forces such as its parenting advantage and sustainable competitive advantage, Renong can also delay change by perpetuating the continued existence of preconditions (perpetuating preconditions). This artificial delay in change, as symbolized in the recent Renong/United ward Point C in our framework, and at the individual conglomerate level, a radical rethinking of their corporate strategy.

Before discussing what this rethinking is all about, it should first be recognized that it has not been, nor does it have to be, as dramatic as the breakups and refocusing that occurred in some cases in the United States and Europe. The fact is that Point C is in itself a stable institutional end-game and does not necessarily lead to the "efficient" United States-like environment of Point D. If Point D were the inevitable outcome, then the strategic prescriptions against diversification would always prove directionally correct. However, highly developed economies such as Japan, Germany or France are much closer to C than they are to D and do in fact breed a number of successful, yet highly diversified, business enterprises.

It should also be acknowledged that a related hypothesis that underpins our thinking is that while movement along the vertical axis of the framework can be swift — after all, it is a matter of will for governments to reduce their interventions in business — movement along the horizontal axis (Imperfections in the Institutions) is painfully slow. You simply cannot mandate a fair and efficient judicial system to emerge overnight nor can you develop a deep market in managerial talent by fiat. Hence, the transition from B to C — and possibly D — is measured in a decade or more.

STRATEGIC RESPONSES IN INSTITUTIONAL CONTEXT

Emerging-market conglomerates have sensed these realities and understand that while they need to reduce their level of diversification to stay in tune with their evolving environment, they can afford to do it at a measured pace. What they cannot ignore, however, is to have a fairly crisp definition of where they are headed in order to guide their journey. In other words, they need to choose which direction to take and define what they want to be as their operating environment evolves.

In our early research, we have observed three strategies:

1) Assemble a moderately large portfolio of domestically bound businesses. The rationale here is to concentrate in businesses in which the key

Engineers deal, has its benefits and costs for the conglomerate. It is ideal because the conglomerate can still exploit available preconditions and reap the benefits of privileged access to deals (deal flow). However, it is bad because there are associated costs in the form of an obligation to take on unattractive ventures as dictated by the government (the cost of patronage), and because the conglomerate delays its development of true capabilities. In addition, continued access to easy deals (deal flow) also encourages overconfidence within the conglomerate's management (the hubris doom loop), because of the ease of success. Finally, one has to wonder how long a conglomerate can perpetuate preconditions before more overwhelming free-market forces surface.

TOWARD 2020: PERPETUAL GOVERNMENT BOOSTER?

In September 1997, Dr. Mahathir announced a capital injection of $20 billion into the stock market through state pension funds. Renong will likely be a major beneficiary of this stock purchase scheme, alongside 100 listed blue-chip companies.

The relationship between Renong and the ruling party and the government of Malaysia raises some fundamental questions:

1) Is Renong essentially an extension of the Malaysian government?

2) Would the Malaysian economy be worse off without Renong?

Regardless of the answers to these questions, Renong's experience demonstrates that the operating environment in Malaysia is unlike that of most developed Western economies. The issue for Renong and other companies of its kind is whether the pace of diminishing market imperfections through deregulation, globalization, stiffer competition, faster and better information and widely available skilled labor will remove the traditional primary drivers of growth. We believe that such change in the Malaysian economy is inevitable.

success factors are predominantly locally bound in order to minimize exposure to world-class competitors and to maximize the value of the home-turf capabilities in turnarounds and restructuring under difficult labor relations, risk assessment and the like.

The Macri group in Argentina, for example, has gradually developed a strategy that combines building presences in regional business, such as information technology services and construction and engineering, with participation in tough privatizations, such as the Argentine post office, where all its strongest local capabilities are utilized. Other Argentine groups, such as the Roggio group, are busily exporting their capabilities in the management of urban environmental services or the turnaround of mass transit systems to other Latin American countries.

2) Focus on a narrower portfolio of businesses that have regional or international potential. The rationale here is to limit the portfolio to businesses that can be leveraged and defended in the home and similarly developed neighboring countries. The conglomerate needs to have "good in class" or better capabilities in the chosen businesses at home, be able to spot and capture opportunities at its doorstep and use good instincts when it comes to operating in a culture that is closer to its own than to those of the global sector leaders.

In fact, in many cases, these global subsequents are not attracting players. A number of Chilean groups, such as Luksic and the Enersis groups, have started leveraging their capabilities in the management of utilities post-privatization or consumer segments such as pasta, beer or "mid-market" financial services to build "regional" presences across the Southern Cone. In Asia, the Salim Group seems to be headed in this direction as it seeks to regionalize its core cement business.

The international variant of this same strategy is much more demanding. Pursuing it requires world-class capabilities. The Japanese keiretsus and to a lesser extent Korean chaebols, two types of federations that operate for all practical purposes as single industrial groups, have played that game successfully.

The playing field is by no means level but we do observe a number of worthwhile attempts including: Techint (Argentina) in steel pipes; April (Indonesia) in pulp and paper, evidenced by its recent strategic alliance with Europe's leading player UPM-Kymene; Indofood (Indonesia) in instant noodles, and a few others.

3) Build a portfolio of national conglomerates in lesser-developed economies. In a way, this is growing by swimming upstream against the tide. The challenge is finding hospitable environments with high degrees of government intervention and market imperfections where the home strategy can be replicated. It is an intriguing strategy and one that is best illustrated by Thailand's Charoen Pokphand (C.P.) group's phenomenal success in China.

C.P. started out as a seed-trading business in rural Thailand, expanding into the feed and poultry processing business, utilizing close connections in the Thai administration. During the 1970's, C.P. applied its knowledge and experience in the agri-food sector to build significant food businesses in 28 of China's 31 provinces. Its credibility as a foreign partner and well-established guanxi network led to C.P. becoming one of China's largest investors, with sales of more than $4 billion in more than 200 companies involved in motorcycle manufacturing, telecommunications, retail and agribusiness.

Other less clear-cut examples include Astra's (Indonesia) push into Myanmar, starting with its information technology business, and Bakrie & Brothers' (Indonesia) dramatic expansion in Uzbekistan's telecom industry. In the future, there could be a new breed of multinationals with headquarters in Jakarta or Manila and regional command centers in Yangon, Asunción and Khartoum.

UNRELATED OPPORTUNITIES

While these strategies provide clear, alternative end-games, they do not nor should they preclude conglomerates from continuing to take advantage of unrelated opportunities as long as they last. Why walk away from another goldmine? If your goal is to build an automotive-components business and a health-care franchise regionally, why would you scorn a lucrative telecommunications license in your domestic market? The key trick is in sorting out the valuable digressions from the bad ones, labeling them and treating them as such. Most importantly, man-

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Building the New Mid-Sized Multinational: Competitive Responses of Chilean and Argentine Diversified Groups

Chile and Argentina are widely considered as two of the emerging countries that have advanced the most in the process of opening up and deregulating their economies. Chile initiated its reform process in the mid 1970´s, and accelerated it after the dramatic crisis of 1982. Argentina struggled with the transition to democratic rule in the 1980´s and initiated its economic reform process in the later years of the decade.

As our "Institutional Development" framework suggests, the process of "opening up and deregulation" initially resulted in fantastic growth for both Chilean and Argentine groups. In Chile, a new entrepreneurial class built highly diversified and effective groups: the Luksics, Angelini, COPEC and Matte groups have all built impressive business portfolios. In Argentina, groups such as Pérez Companc, Techint, Macri, Comercial del Plata, Astra and Roggio all became active participants in the privatization wave of 1990-1994 and by the time of the Tequila crisis had grown substantially. Over the past couple of years, both Chilean and Argentine groups have had to conduct significant strategic reappraisals and reshaping of their portfolios:

➢ Most of the leading Chilean groups have built dominant positions across a wide range of businesses and are facing the "imperative of growth" in what is, after all, a $100 billion economy; this is putting "internationalization" at the top of those groups' strategic agenda.

➢ Most of the Argentine groups, after years of breackneck growth, were starting to face familiar "conglomerate problems".

1) Their business portfolios had become too complex;

2) Several of the businesses in which they had build significant presences via privatization (such as utilities, telecommunications or financial services) were becoming increasingly globalized and coveted by their original privatization partners;

3) Financial stress was becoming apparent and it was becoming increasingly difficult to finance growth across such a wide range of businesses (the Tequila crisis only made this situation worse);

4) Availability of top management resources was becoming another major problem.

Faced with these imperatives, Chilean and Argentine groups have embarked on redesign of their business portfolios and have adopted varying mixes of the competitive responses that we outline in the article:

1) Building world-class, global presence around a market segment that capitalizes on the groups' core competence;

2) Building viable "regional footprints" in a business in which the basis of competition may not become "global" in the foreseeable future;

3) Replicating successful "local" businesses in nearby, relatively familiar countries;

4) Increasing presence in the remaining "local," high-proximity, influence-intensive businesses.

These are some examples of these competitive responses adopted by Chilean and Argentine groups:

➢ Building global presence in a market segment: Possibly the most interesting example here is that of the Techint group. The group has been building a core capability in specialized steel products (such as seamless pipes for the oil industry) over the decades; it now enjoys a 30 percent worldwide market share and operates a global network with production presences in Argentina, Mexico and Italy. Its leaders, the Rocca family, talk about an "industrial vocation," which is the soul of the group. On a parallel stream, Techint is combining decades of experience in engineering and construction with an "energy" capability to build a strong presence in construction, development and sometimes operation of large pipelines and energy complexes. At the same time the group divested its highly profitable participation in Telefónica de Argentina because it saw no possibility of becoming an "operator" in a rapidly globalizing business.

➢ Building regional presences: Several examples can be presented here.

1) The Pérez Companc Group underwent a widescale review of its business portfolio and is concentrating on the concept of becoming a world-class player in "the energy chain" with special focus in Latin America. As a result, it has built significant presences in the oil and electricity chains, is a major operator of utilities and has recently expanded to Brazil. Along the way, the group has reduced its presence in sectors such as real estate, shopping centers and financial services.

2) The Macri Group is undergoing a significant reshuffling of its business portfolio: while reducing its presence in the automotive sector (where it was once the local partner of Fiat), it is placing strong bets in building presence in the Southern Cone in food products and in information technology. The bulk of its efforts are focused on building viable positions for businesses in Brazil, the market that will provide "regional critical mass" for these ventures.

3) The Luksic Group is engaged in building regional presences in segments such as beer and soft beverages (where it is aggressively expanding in Argentina) and retail banking (where it has strongly reinforced its presence in Chile and is partnering with Spanish players to expand in Argentina).

➢ Replicating local plays: Typical examples are those in which a large local group has built management and turnaround expertise in a local industry (for example utilities after privatization) and then rides the "privatization wave" as successive nearby countries launch their deregulation processes:

1) Chilean utility group Enersis built a strong capability in Chile initially, then became an active participant in Argentine privatizations and became the operator of utilities there. It is now expanding to take active part in the Brazilian utility privatization process.

2) The Argentine Roggio group built years ago a significant experience in an urban waste management business that it subsequently exported to Brazil and Mexico. The group also became the operator of the Buenos Aires subway systems and a commuter train line, and now is capitalizing on its turnaround experience to compete in the upcoming concessions of subway systems.

➢ Increasing presence in local businesses: There are still a number of opportunities left in local businesses in the region:

1) New concessions/BOT projects to satisfy the growing infrastructure needs of the countries, such as toll roads, bridges, power stations, etc.

2) Regional privatizations, such as provincial utilities.

3) Mega privatizations, such as large infrastructure projects, airports, the post office, etc.

The leading diversified groups in these two countries are pruning their business portfolios so as to exit businesses that are becoming too global or that have no obvious strategic logic, but at the same time are placing ambitious bets aimed at growing in a variety of global, regional and local businesses. It will be fascinating to revisit these cases in five or 10 years to see which of them remain independent and have graduated to the rank of the truly viable and competitive middle-sized multinationals.

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agement attention should be focused on and the resources allocated to those businesses that are consistent with long-term goals. This is where we have seen many conglomerates fail to be self-consistent, repeatedly proving incapable of resisting the tempting opportunities and — most damaging — being overconfident in their ability to turn any venture into a goldmine.

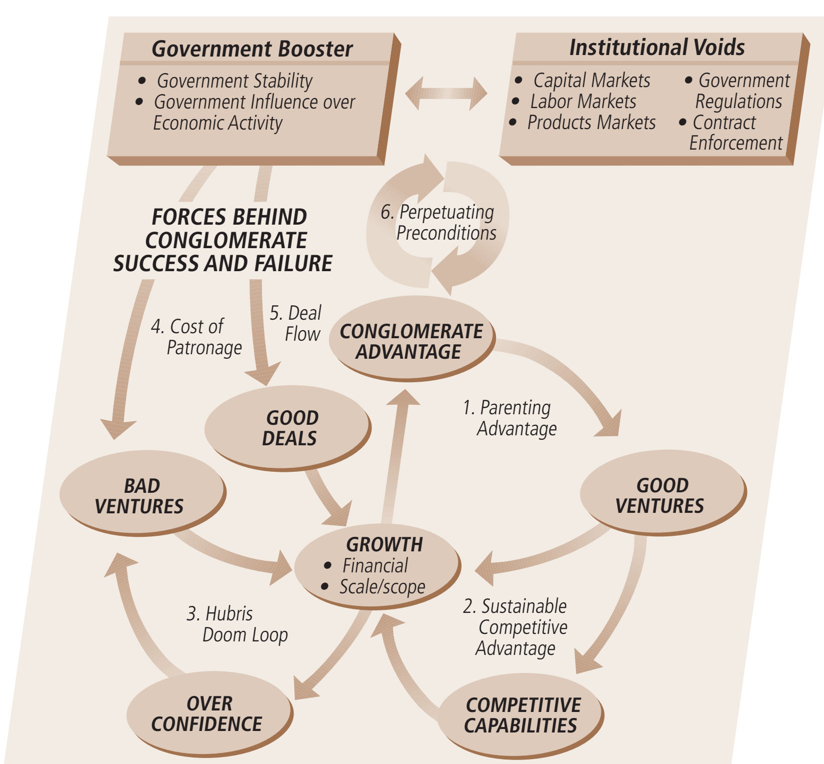
As a final note, while the three strategic plays outlined above are not necessarily mutually exclusive in the short run, we believe that they definitely are so in the long run. Borrowing from Andrew Campbell and the Ashridge Institute's concepts, the "feel" corporate top management needs to add value to its businesses is likely to be very different for a locally bound portfolio, a regionally or internationally oriented portfolio and one that is composed of a federation of national conglomerates. Mixing any two of the three could well prove value destroying.

CONGLOMERATE ADVANTAGE

Diversification is a legitimate response in emerging markets. Conglomerates can indeed act as islands of efficiency in a sea of inefficient markets for labor, products, information and capital. They have the size to achieve the minimum required economy of scale in providing these factors to their businesses at an advantage, and the diversity to leverage the opportunities that are presented. At their best, they have also developed a set of strong business-specific operating capabilities. The combination of both their superior parenting skills in compensating for market imperfections and their business-level operating knowledge constitutes the conglomerate advantage. (See Exhibit VI.) It will continue to serve them well as the on-going processes of economic reform will take a long time to take hold.

However, the extent of diversification may not be sustainable over the long run. Conglomerates need to decide which path to take in the growing and rapidly changing environments in which they operate. So far, we have identified three possible avenues for conglomerates that want to continue thriving in the long run: assemble a moderately large portfolio of domestically bound businesses, focus on a narrower portfolio of businesses that have regional or international potential and build a portfolio of national conglomerates in lesser-developed economies. While these avenues are not exclusive in the short run, conglomerates would be best served by regarding them as deliberately distinct strategic courses.

EXHIBIT VI
PRECONDITIONS FOR CONGLOMERATE EMERGENCE



Source: Booz-Allen & Hamilton

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