Latin America: Environmental and firm-level challenges

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ABSTRACT

During the last decades Latin America, as the rest of the world, has gone through a process of increased commercial openness and due to the commodities price boom of the last years the region has grown significantly. However competitiveness hasn't improved much, mostly due to lack of concern from governments. Companies, though, cope with the increase in competition resulting from the greater openness by refining their management practices in the different management areas: marketing, finance, information technology and strategy. Academics study these effects in the papers that comprise the special issue of the Journal of Business Research with the best papers from the conferences of the Business Association for Latin American Studies (BALAS).

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1. Introduction

Almost a decade into the 21st century, Latin America is still the area of great contrasts that the region has been for the last 500 years. As with the rest of the world, Latin America has gone through a process of increasing commercial openness, quick access to new technologies, more competition from all over the world, an increase in the influx from external resources and the development of its financial markets. The papers presented in this special issue study the effects of these trends.

The Business Association of Latin American Studies, BALAS, an international organization with members from 30 countries from all over the world, focuses its interest on the study of economics, management, leadership and industry in Latin America and the Caribbean. In each of their conferences, academics discuss papers studying the different issues of doing business in Latin America. Following that tradition, this special issue presents papers in the areas of strategy, finance, marketing and information systems — all of which share the common theme: Latin America.

The best papers of the BALAS conferences, which took place at Instituto de Empresa in Spain in 2005, at the University San Ignacio de Loyola in Perú in 2006 and at INCAE Business School in Costa Rica in 2007, went through an evaluation process by independent reviewers who selected the nine papers for this special issue.

This introductory paper comprises two sections: In the first part, the authors analyze Latin America's ability to compete against other fast growing regions in the world in the context of a good economic environment and growing productivity worldwide. In the second part, the authors make a brief introduction of each paper, its importance for its field and its relationship with Latin America, the geographical region BALAS focuses its research on.

2. The competitive challenge

Academics should appreciate the papers presented in this issue of the Journal of Business Research within the context of the increasingly competitive business milieu in which the region finds itself. Recognizably, the commodity-led boom in Latin America has highlighted the issue of Latin America's competitiveness in the global economy. Latin American economies expanded by an astonishing 53% from 2003 to 2005, when measured in dollars, but their productivity grew less than 4%. The region’s modest economic growth during the last two decades, due to the low rate of accumulation of productive factors and to mediocre productivity performance, is apparent compared to growth competitiveness with other regions of the world, especially East Asia and Eastern Europe.

Granted, the global commodity boom has been a huge boon to Latin America, but has the surge benefited all sectors within commodity-oriented economies? The non-commodity exporters in South America’s resource rich countries would answer: no. As skyrocketing mineral prices have boosted Brazilian, Chilean and Peruvian currencies, for example, less competitive export sectors such as textiles, wines and beverages, and auto parts have all lost ground in international markets.

In the short to medium terms Latin America expects bright economic prospects thanks to a prime supplier position in many
commodity markets. Economically, Latin America is in a better position now than in decades to begin addressing two of the key inputs to competitiveness – education and infrastructure – and hopefully invests heavily in both over the next few years. However, the politically sensitive battles of reforming its labor, taxation, pension, customs, legal and judicial policies and codes will constrain the region’s ability to compete (Haar and Price, 2008).

2.1. Globalization’s push

The emergence of China and India as significant economic powers places great pressure on Latin America to slash waste, boost efficiency, and adopt free market policies. Where the region has, notable benefits have accrued to nations, sectors, industries and individual firms. Wong’s paper “Productivity and Trade Openness in Ecuador’s Manufacturing Industries”, examining industries over a six-year period, is illustrative, providing macro- and micro-level confirmation of trade liberalization’s positive impact on productivity. Recognizably, the region succeeded in attracting and expanding the base of foreign direct investment – especially Brazil, Mexico, Chile and Colombia – pulling in close to $600 billion in net foreign investment during the last decade and a half (Economist Intelligence Unit). Cross-border mergers and acquisitions contributed in no small measure to FDI growth, especially during the first half of the present decade. Pablo’s “Determinants of Cross-Border M&As in Latin America” investigates over 800 merger and acquisition events. His research validates the notion that the behavior of the acquirer depends upon strong macroeconomic conditions and a laissez-faire business environment where laws exist to protect investors and the state enforces those laws. Latin America fares less well in preventing the exodus of capital and brain power from the region, with capital flight alone during that period totaling $200 billion (Economist Intelligence Unit). Brain drain numbers reveal an outflow of 1.5 million college-educated Latin Americans from 1990 to 2005 (U.S. Immigration and Naturalization Service, 2001). These immigrating Latin Americans comprise individuals who come to study in the U.S. but do not return home, people who come for political or economic reasons, and those who emigrate for reasons of public safety.

The cost to Latin America of its lack of competitiveness over the last fifteen years, when measured by net flight of capital and brain power is approximately $1.2 trillion dollars; and the lack of competitiveness continues to cost the region $160 billion per year, equal to 7% of regional GDP.

2.2. Moving beyond the Washington Consensus

While the neoliberal reforms of the Washington Consensus are indispensable to Latin America’s competitiveness, they are not sufficient by themselves. The region needs to address other drivers of competitiveness to even hold its position in the global economy, let alone move upwards.

Logistics costs in Latin America are some of the highest in the world averaging 10 to 30% of the cost of goods sold on imported products and nearly half that amount on exported goods compared with 5% on shipments in and out of the US. Roads, rails, and ports (air and sea) are generally in poor condition. In a region that spends a paltry 2% of GDP on infrastructure, private investment’s contribution supports primarily those infrastructure projects that facilitate international trade, such as air and sea ports. Nevertheless, even these export–import related projects, no matter how successful, will not realize their potential benefits without top to bottom reform of customs operations. In Latin America clearing in-bound air shipments takes anywhere from two days to an entire week. In Taiwan, clearing air shipments takes an average of 18 min. Given the fact that so many manufacturing companies in Latin America depend upon imported components, customs bottlenecks create severe and costly impediments to firms and negatively affect the region’s export competitiveness (InfoAmericas).

Outside of infrastructure, protective laws, such as taxes levied on trucking companies that cross state borders, saddle Latin America’s transportation service industry, add costs and dampen investment (Brazil is a prime example.). The downturn in Latin America’s capital markets in the 1990s came about as local companies chose to list ADRs in the U.S. market where they could earn higher P/E multiples. The rebound of equity market listings in the region during the past five years has more to do with U.S. regulatory hassles – principally Sarbanes-Oxley – than dramatic improvements in the operation of stock exchanges, with the exception of the São Paulo-based Novo Mercado. Issues of governance, transparency and accountability continue to impede the growth and development of thriving capital markets in the region (Calvo, 2005; De la Torre and Schmukler, 2004).

In assessing capital market performance in Latin America, researchers should not overlook the measurement tools by which investors assess equities and debt instruments. Santos Paiva and Savoia in their paper on pricing corporate bonds in Brazil conclude that the type of index that corporate bonds use for indexing interest is the most important factor in those bonds’ pricing.

As for small and mid-size businesses in Latin America, their access to competitive sources of financing has been very limited historically. Given the region’s export drive and further aspirations in global markets, SME suppliers to large firms – national and multinational – have significant disadvantages. The higher cost of inputs from local suppliers negatively impacts the pricing of their large firm customers, thereby eroding export competitiveness (Alvarez and Crespi, 2001; Pietrobelli and Rabellotti, 2004; World Bank, 2005; Arend, 2006).

An additional major hindrance to small enterprise success is the tremendous administrative costs that they face in complying with myriad laws and regulations — tax laws and procedures, labor laws, as well as safety, health, and environment. Manufacturing start-ups in Mexico still average 58 days versus three days in the US. In Brazil, the number averages over 100 days (World Bank, 2008). While all other nations in the region provide government assistance to small business in greater and lesser degrees (e.g., technical assistance, grants, loans and guarantees), non-profit and private sector initiatives that support small business start-ups and the growth and development of existing small firms provide some of the most innovative models and cases of small business development in Latin America. Sanz and Lazzaroni present one such entrepreneurial endeavor in Nicaragua–Agora – illustrating the challenges and opportunities involved in assisting small, socially responsible companies in developing countries.

Despite the plethora of business environment factors that challenge the competitiveness of Latin America as a region, scores of individual firms can and do compete successfully in global markets. In all cases these companies place a high premium on ensuring that internal processes, operations and customer interface will enhance firm performance in domestic as well as foreign markets. Five of the nine papers in this volume address these firm-level issues.

Companies such as Cemex, Embrabra, Corona, and Techint are but a few of the many multilatinas that have developed and implemented winning strategies on a worldwide basis (Robles et al., 2003). As Grosse and Mesquita note, the strengths that enable Latin American firms to compete successfully against both domestic and foreign rivals are: high-quality products and services; low-cost production; domination of distribution channels; and the ability to deal successfully with governments and other institutions (Grosse and Mesquita, 2007).

3. The papers

Formal processes of strategy formulation and implementation have become important managerial activities in Latin America’s firms since the middle of the decade of 1990s. Openness, economic liberalization and increased competition press firms to develop sustainable competitive
advantages in order to compete even in their domestic markets. As, Brenes et al. (2008) prove, CEO leadership and suitable, motivated management are some of the key success factors for strategy implementation in Latin America. Therefore, the quality and role of the top management teams (TMT) in a given firm are crucial elements that could define their success or failure to perform. On the other hand, the context in which the firm operates is another important element that could alter or moderate the relationship between TMT and firms performance.

The paper “TMT Strategic Consensus in Mexican Companies” studies the relationship between TMT characteristics and firm performance considering how firms’ environment could affect that relationship. Academics define strategic consensus as the degree to which individual mental models of strategy overlap. Previous research on the relationship between TMT strategic consensus and firm performance shows inconsistent results. This paper suggests that these contradictory findings in past research may be due to the fact that some researchers neglect the context (environment) in which top management teams operate. The fundamental question in this research is: Does the environment moderate the relationship between TMT strategic consensus and the performance of the firm?

The results show that environmental complexity moderates the relationship between TMT strategic consensus and performance in Mexican firms. Interestingly, the results contradict initial expectations—lower levels of consensus among the TMT correlate with higher performance in simple more than in complex environments. Furthermore, higher levels of consensus show a relationship with higher performance in complex environments.

The paper concludes adding some interesting implications for managers, including the need to be aware of the degree of environmental complexity that a firm faces and the adequate degree of strategic consensus that they may seek in order to perform well. In particular, managers should be aware of the importance of having strategic consensus in complex environments. Under low complex environment two possibilities arise—one is the search for new and more innovative ways of doing business, always seeking to take advantage of opportunities thus the lack of strategic consensus. The other is the possibility that in low complex environments managers have no need to have strategic consensus.

The process of internationalization and openness of the economies in Latin America affects recent developments of management practices too. As Anand et al. (2006) argue, the process of economic liberalization presses local firms to implement strategic initiatives in order to cope with the influx of external competition. One of the strategies that Latin American companies pursue is going international (Brenes, 2000). However, after deciding to follow this strategy firms usually face alternative options regarding the selection of new locations in Latin America or abroad. For example, the type of initial establishment in other countries or regions ranges from exporting products from the home country, to contractual agreements or licensees, to an acquisition or green field operation in the country of destination. This special issue presents two interesting papers in this regard. The first one – “Determinants of Cross-Border M&As in Latin America” – deals with the internationalization processes and the second one – “Productivity and Trade Openness in Ecuador’s Manufacturing Industries” – pertains to manufacturing productivity increases as a result of the economic openness.

The paper “Determinant of Cross-Border M&As in Latin America” explores the determinants of cross-border mergers and acquisitions (M&A) in the Latin American region during the period 1998–2004 using a dataset of 868 M&A events. The author directs his attention to the effect of macroeconomic and investor protection conditions in the acquirer and target countries and also considers the effect of company-specific determinants in the likelihood of going cross-border. The results show that the economic and business environment determines the likelihood of companies participating in cross-border M&As. The author uses four variables: annual percentage change in the consumer price index, annual currency depreciation in nominal terms, annual change in GDP and average nominal lending rate, to measure economic environment. The larger the difference in the external cost of funds faced by the target relative to the acquirer’s cost of capital, the higher the likelihood of a cross-border merger.

Targets in countries that have better business environments and characterize themselves by respect of property rights and foreign investment, less government intervention, and lower level regulation, are more likely to participate in cross-border transactions instead of local deals.

Finally, the evidence partially supports the idea that company-specific variables also determine the acquirer and the target participating in a cross-border transaction. The company-specific variable used as a proxy was the corporate market-to-book value that the authors assume to measure management quality and investment opportunity. The results also show that the cost of funds strongly determines the likelihood of a cross-border M&A, which opens a new research window for exploring the benefits of corporate geographic expansion.

The other paper analyzes the effects of openness from another point of view. “Productivity and Trade Openness in Ecuador’s Manufacturing Industries” develops an empirical study at Ecuador’s trade liberalization for the period 1997–2003 with the objective of measuring its impact on productivity changes for manufacturing establishments. The paper takes a particular look at how both exporters and import-competing sectors respond to trade openness. The main conclusion confirms the expectations of growing productivity as trade openness occurred at least in some industries.

The paper introduces the importance of international competition in the international and domestic markets as an important element for firms to develop capabilities and skills for competitive advantage. Domínguez and Brenes (1997) discuss these issues and arrive at similar conclusions. From their perspective, firms that go international first or have strong domestic international competitors are strategically better prepared than firms that do not go international and do not face strong challenges at the home market.

The paper seeks answers to several questions: (1) How has productivity evolved during the period 1997–2003 in manufacturing sectors in Ecuador after trade reforms took place in this country? (2) Does evidence exist of productivity gains coming from either the plant’s own improved productivity or from reshuffling resources from less to more productive units, or from both, in the Ecuadorian manufacturing industries?, (3) Does a significant association exist between trade openness and productivity in Ecuadorian manufacturing industries?, (4) Are export-oriented and import-competing industries more productive after trade liberalization?

The study took into account: Changes in trade policies as tariff reforms, reduction in import restrictions, export promotion laws, the modernization of trade institutions, and the simplification of trade procedures. The analysis in this study was not simple given several very important events during the period of study. One of those events was the dollarization of the economy and other economic shocks that researchers had to separate empirically from the effects of trade openness. Results suggest that trade openness has had a positive and significant effect on productivity in Ecuadorian export-oriented manufacturing industries. Increased aggregate productivity might be due to both a positive contribution stemming from the reshuffling of resources towards more productive establishments and slightly increased plant productivity. However, researchers should combine this result with other results, which suggest that economic events that affected all firms in the years under study also played an important role in affecting productivity performance in Ecuadorian industrial establishments. Economic events after 2000 seem to have had a significant negative impact on the productivity of establishments in export-oriented manufacturing industries.
The development of Latin America technology management has been very strong in the last few years and academics and executives consider technology an important factor for increasing the competitive advantage of many firms. As such, technology management is also one of the main concerns in most companies in the region, with problems that do not escape the classical implementation issues common in developed economies. One of the main reasons behind these problems is the lack of correct management processes to allow the outcome to be on time and of excellent quality. The inclusion of two papers in this special issue – “Management of Perceptions of Information Technology Service Quality” and “Information Technology Impact on Market Orientation in E-Business” – is relevant to this issue.

“Management of Perceptions of Information Technology Service Quality” centers on evaluating the contrasting perceptions on the gap in service quality of the IT Department personnel and the rest of the employees from business and support divisions in a large retail bank in Brazil. The bank poses an interesting question in the paper, which is, how do the perceptions of IT service quality performance between the IT Department and their client divisions align? A secondary objective in the paper is to analyze the perception gaps in the following areas: relationship dimensions including reliability, responsiveness, assurance and empathy and technical or tangible dimensions. The discussion takes us to the definition of expectations and the meaning of service quality performance. The authors conclude that perception of service quality is a consequence of an evaluative perception of the customer, when interacting with the service at a specific moment in time.

The paper evaluates the SERVQUAL model of service quality measurement and management and also the two instruments used: SERVEXP that aims to assess the clients’ and suppliers’ expectations in relation to the service provided, and SERVPERF that aims to assess their perceptions of performance about the service previously provided. The authors decide that the SERVPERF instrument is the most appropriate in this case since SERVPERF has better psychometric properties than the SERVEXP instrument and is better for transversal studies, which is the case of their study.

After several iterations to verify that the model used was correct the authors conclude that IT Department clients are dissatisfied in every area except one in relation to the services provided, which indicate that the clients’ perceptions are lower than that of employees who work in the area. In addition, the paper argues that the SERVPERF instrument is a valid to measure the perception of IT service performance, considering its emphasis on the functional dimension (process), and despite the technical dimension limitation of its original version. On the other hand, the authors also conclude that their study does not confirm the factorial model structure of SERVQUAL, indicating the need to continue its validation process in IT services. Elements that could explain poor performance include the lack of clearly defined demand, which affected credibility, the lack of flexibility due to excessive bureaucratic processes, and the lack of deadline compliance due to work overload and understaffed projects.

Another example of the technology changing the environment in Latin America is the use of information systems to gain competitive advantages. The next paper, “Information technology impact on market orientation in e-business,” precisely illustrates that. Readers should note that the subjects of the research are three e-business companies which operate in Brazil. The paper establishes the degree of market orientation (the generation and dissemination of market intelligence by the firm and its response to the market) for each company. The companies under study are “Submarino.com” (an online store similar to Amazon), “Sonae Brasil” (the second largest supermarket business which also runs an e-commerce operation) and “Pão de Açúcar” (the largest supermarket business in Brazil, which runs another e-commerce operation), all of them in the retail industry.

The paper concludes that all three companies have a strong market orientation supported by different information systems. However, each company emphasizes different capabilities that lead to this market orientation. This emphasis is relevant since a famous paper by Carr (2003), determined that IT does not represent a competitive advantage for firms. However, the author states: “the understanding of the best way to use IT, strategically, is what produces a competitive advantage”. In addition, Saini and Johnson (2005) conclude that if IT capabilities have an adequate market orientation, they positively influence business performance in e-business. The author indicates that three variables define market orientation: market intelligence generation, market intelligence dissemination, and Responsiveness. In the three companies under scrutiny responsiveness (market response behaviors) is the stronger value out of the three components of market orientation. On the other hand, the least developed value is the behavior of market intelligence dissemination.

Twenty years ago, Latin America’s markets were closed, highly regulated and companies serving them did not have such competitive rivalry as today. Global players that enter Latin American markets contribute their share to the increased rivalry and bring refined marketing practices with them. Consequently, Latin America companies discover that nowadays competition is much more aggressive. This forces them to sharpen their marketing capabilities and start developing their market intelligence capabilities. As a result academics in Latin America are producing more attention-grabbing research, and this special issue presents two interesting papers from this area: “Estimating Cellphone Providers’ Customer Equity” and “Derived vs. Full Name Brand Extensions”.

“Estimating Cellphone Providers’ Customer Equity” determines the estimated value of the customer equity and the customer lifetime value of the three cellular telephone operators in São Paulo Brazil. The paper defines customer equity as the potential value of a company’s entire client portfolio and the customer lifetime value as the estimated monetary value that a client will bring to the firm during the entire lifespan of his/her commercial relationship with the company, discounted to today’s value. The authors estimate both values in October 2005 through a survey carried out in São Paulo by asking passersby which cell phone company they use.

The paper illustrates some interesting findings of practical application that might appeal to academics and professionals interested in the telecommunications industry or those interested in marketing topics. For example, the results show that the customer equity of Vivo is 91% larger than those of competing providers Claro and TIM. The customer lifetime value of post-paid customers was in general twice to three times higher than the one of pre-paid customers, a number that is important for marketing decision making. With the estimated customer lifetime value a certain company can make decisions about how much to invest to win over a certain client or which companies’ clients to target in campaigns to steal clients from competitors.

Although academics study brands thoroughly, some characteristics of brand extensions present opportunities for further research. Through an experimental study, the paper “Derived vs. Full Name Brand Extensions" examines the advantages of derived brand extensions (such as Nescáfé) versus full name brand extensions: (such as Courtyard by Marriott) and does so by testing various hypotheses in an experimental study with business students. The study reaches the conclusion that derived brand extensions do less harm to parent brands in the case of extension failures; however, when a brand extension is successful the attributes do not affect the parent brand. The experiment also suggests that consumers, at least in Brazil, prefer derived brand names extensions to full brand name extensions. In most other cases derived brand extensions behavior is similar to full brand name extensions.

Entrepreneurship is a growing field in international business research. Many initiatives exist to foster entrepreneurship in developing nations, and a number of these do so by offering technical assistance to aspiring entrepreneurs or by offering financial support.
However, few of these initiatives are sustainable and most end when the resources stop flowing. Nevertheless, at least one organization in Nicaragua is trying with a sustainable model adequate for developing countries. The case and its teaching note, “Agora Partnerships: A Micro Venture Capital Fund”, describe an organization with the purpose of helping the launch and growth of socially responsible companies in developing countries. Agora provides support to entrepreneurs in overcoming the most important barriers to business development, which according to Agora are lack of business and social networks, education, financing, and management expertise. Agora also provides technical assistance and back office services to the funded companies in order to increase the probability of success. From 2005 to 2006, Agora provided consulting services to nine entrepreneurs and identified six others as potential partners.

Executives using the case as a learning tool need to evaluate different alternatives on how to structure a deal in a context where financial markets are not developed. The options presented in the case are: preferred shares with floating appreciation and fixed sweat equity, preferred shares with a minimum appreciation or a mix of preferred shares with fixed appreciation rate and common shares. Executives should also evaluate the feasibility of allowing third-party investments in the new ventures.

The case portrays the difficulties of creating an entrepreneur’s sustainable support initiative in the Latin American environment. The organization provides support beyond technical assistance or financial resources only, which are the common alternatives available to entrepreneurs in Latin America in 2008.

The teaching note “Agora Partnerships Nicaragua” provides useful suggestions on how to use the case most effectively for teaching at a graduate-level class.

The expansion of Latin American financial markets allows researchers to investigate the behavior of financial instruments in different contexts. The note “Pricing corporate bonds in Brazil: 2000 to 2004” evaluates the factors that influence the pricing of certain debentures first issued in Brazil. Specifically the note analyzes the case of corporate bonds, rated and indexed in relation to the day inter-bank market rate CDI, or the Brazilian inflation index IGP-M.

After performing regression analysis, the paper concludes that the most important factor in determining the price is the type of index that the bonds use as an index in determining its interest rate. The second and third factors in determining the price of bonds are the default probability and maturity. The study then groups the bonds in three groups: short maturity issues with medium credit quality ratings, medium maturity issues with low credit quality issues, and long maturity with high rating.

4. Conclusion

The eight papers and a case with its teaching note from various fields provide a broad idea of the current research topics that academics interested in Latin America are studying. At the same time, they reflect the challenges and opportunities faced by companies working in the Latin American environment. Therefore, they are of great interest for companies operating and/or planning to invest in Latin America.

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