

# Big Business and the Golden Straitjacket

BY PAUL BRACKEN

**T**he rise of big business in Brazil, China, India, Mexico, Russia, and other emerging market countries is one of the most important and overlooked trends in the world today. These firms are not foreign multinational corporations (MNCs) from the United States, Europe, and Japan, but instead are large domestic corporations whose operations remain focused on their home markets. The rise of these corporations has far-reaching implications for emerging market countries where business-government relations are still being defined.

In recent years foreign MNCs have enjoyed virtually a free ride in these countries. They were the unchallenged suppliers of technology and know-how and launched these emerging market economies onto the path of capitalism. Their domination of these markets will soon end, however, as large domestic corporations become increasingly competitive. Foreign MNCs will have to work through domestic companies more and more to gain access to the giant home markets that these countries offer. They will find it easier to work through a big domestic firm than going it alone, dealing with the government directly, or stitching together a network of small businesses.

The rise of these strong domestic corporations in emerging markets will reshape globalization—defined here as the intensification of cross-border relations in trade, finance, communications, and culture. Globalization can be shallow or deep. Shallow globalization can be

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seen in the increases in international transportation, trade, foreign direct investment, and outsourcing over the last decade. In countries more deeply integrated with global markets, international forces are shaping broader domestic issues such as income distribution, education, labor, crime, and the environment. Domestic corporations in these emerging markets are quickly becoming important political actors by working to tackle the difficult challenges of deep globalization. In the process, big business is displacing other institutions such as government, labor, and non-governmental organizations as a source of power and influence.

The emergence of strong domestic corporations in the newly emerging markets has been shaped by traditions of big government, a need to offset the centrifugal economic forces of globalization, the demand for efficiency, and the need to tackle deep structural problems within the country. Emerging capitalist countries cannot resist globalization because it is the fastest route to wealth and development. Consequently, the economic and political policy choices of those in power narrow to the tight parameters needed to foster this wealth and development. In *The Lexus and the Olive Tree*, Thomas Friedman describes this phenomenon as the Golden Straitjacket.<sup>1</sup> Undemocratic regimes opening to globalization must either adapt to the needs of global commerce or face collapse. The straitjacket is golden because, according to the theory, countries that put it on get rich. It is a straitjacket because, as the economy grows, policy choices shrink.

But the straitjacket metaphor is problematic because it does not adequately account for the increased flexibility in policy options that domestic corporations in emerging markets provide to their governments. Such corporations can bargain with outside companies and still produce efficiently. They can address labor and environmental problems better than foreign MNCs because they know the risk landscape better. They can also deal more efficiently with government because they are likely to have a better understanding of politics and personalities than any group of outsiders.

### **The Changing Shape of Business in the Emerging Markets**

Western MNCs and NGOs have become increasingly powerful actors in the globalized world, but when we look back on the first decade of the twenty-first century, they will not have been the most important actors in emerging market countries. The most important ac-

tors, rather, will have names such as Petrobras (Brazil), Haier (China), Wipro (India), Cemex (Mexico), and Lukoil (Russia). These are the big companies that are fast becoming powerful domestic actors. They do not compare in size to Siemens, GE, or Toyota, the great companies of the industrialized world—at least not yet. Just as Toyota was an unknown brand in the United States before 1965, these emerging market domestic corporations are now also relatively unknown outside their home markets. They will soon become household names, however, and will accomplish this feat faster than their Western counterparts did.

Surprisingly, the political economy of big business in the emerging capitalist countries has received scant attention. Historically, big government—not big business—drove the politics and economics of these countries. During the twentieth century in Russia and China, communist regimes barred private business altogether, but government domination of business in these countries goes back much earlier. In tsarist Russia, business was never allowed to flourish beyond a certain size because it was viewed as undermining the tsar's power. Likewise, in imperial China, once a business became sufficiently large the emperor effectively took it over as his own personal property. In the Soviet Union, industry focused on the military rather than the needs of the market. Now, Russia's global energy companies bear no resemblance to those of the past. For example, Lukoil operates a chain of gas stations in Manhattan. Gazprom has joint ventures all over the world and raises its capital on Wall Street. There is simply no comparison of these firms with those from earlier periods of Russian history.

Only in the 1990s did a strong private business sector develop in India. Before then, overregulation, bureaucracy, and central planning prevented Indian companies from becoming efficient. Government five-year plans decided the fates of businesses. For instance, even though the Tata Group existed for over a century, only recently has it left behind its sleepy strategy of complying with government fiat. The Tata conglomerate's revenues now contribute 5 percent of India's exports and equal 2.6 percent of the country's GDP—higher even than Wal-Mart's share of U.S. GDP. The information technology outsourcing company Wipro is another example of a major domestic corporation that is shaping the Indian economy. By all accounts, Wipro has skills that rival those of IBM and Cisco.

Brazil has had large corporations for many decades, but only in the last few years have companies like Petrobras and Embraer become

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models of technological innovation and efficiency. The Brazilian government has reduced political interference by military officials and politicians. No longer can any retired general get a job at these companies. Petrobras is now a model global oil company. Embraer is the third largest airplane manufacturer in the world, behind Boeing and Airbus, and it dominates the U.S. market for small- and medium-sized airplanes. Brazil has entered a new era of business-government relations. Traditionally, the government told business what to do. Now companies advise the government about business law, competition, and corporate governance. Disciplined by global competition, Brazil is developing a microeconomic and political system designed to support its large domestic companies.

In China, Haier, TCL, and Lenovo have significantly reshaped the role of business in the country. The Haier manufacturing group is a leader in the production of the refrigerators and washing machines that China's growing middle class is snapping up. TCL, a producer of home electric appliances, and Lenovo, a computer manufacturer, are building strong links with Western companies. All three companies provide one-stop shopping for Western firms wishing to use China as their global manufacturing platform and those wishing to gain access to the domestic Chinese market.

In Russia, India, Brazil, China, and other emerging market economies, the presence of a powerful business sector is a new development. Many decades of state control through direct ownership or government interference stifled the power of the business sector. Now, strong business sectors are becoming vitally important to economic and political development in these countries because only they can generate the jobs necessary to cope with the demands of population increases and growing expectations.

### **Why the Power of Big Business is Increasing**

Two factors are driving the growing power of domestic companies in emerging market countries. The first is the economic efficiency of the large corporation. The second is the realization that these domestic corporations can take on a political role, offsetting the power of foreign MNCs and serving as part of these countries' development strategies. The efficiency of the large corporation has long been recognized as the key reason for its proliferation. Business historian Alfred Chandler described how large firms drove out small businesses in key sec-

tors in the United States and Europe. The large corporation is the most efficient machine ever invented for the mass production and distribution of goods and services. Unlike smaller rivals, large corporations can take advantage of economies of scale to keep prices down. This is why the Big Three automotive companies in the United States beat out dozens of smaller car companies in the early twentieth century. It is why Wal-Mart and Target are today's giants of retail distribution and why Barnes & Noble and Borders sell more books than anyone else.

During the 1950s in China, Mao Zedong's Great Leap Forward encouraged backyard industrial production by small producers, resulting in unmitigated catastrophe. Exploiting Russia's energy reserves requires a vast investment in resources and personnel. An entity is needed to put the whole process into what business school professors call a "value chain." The institution that builds value chains is the corporation, not the government or NGOs. Energy requires significant amounts of capital, technology, and workers, that only a vast institution such as the large corporation can deliver.

A similar argument explains why big business dominates the back office of corporate information technology departments. Working with larger corporations provides some assurance of stability and

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dependability, and helps allay fears that a service provider will simply vanish overnight with your money or perform badly because there is a better customer elsewhere. Getting involved with a small,

unknown company might expose the foreign firm to liability and reputation risks. No U.S. company wants to assume the risk of dealing with a foreign entity that might be a front for terrorists or the local mafia. The risks are simply too great for the established firm. In cross-border dealings, big business likes to deal with big business.

Politics is the second driver behind the growing power of emerging market domestic companies. Large domestic corporations have also become a political force, as evidenced by their increasing ability to stand up to governments. As a result, bargaining power has begun to shift from the government to the domestic corporation.

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Large domestic corporations are thriving in the emerging capitalist countries because these countries need a way to offset the power of Western MNCs. Emerging markets need to strike a balance between investment from MNCs and domestic corporations. Western MNCs are needed because they supply the training, know-how, and technology that are in short supply in the host nation. However, foreign MNCs cannot be considered partners in the development of domestic industry. Western MNCs would strive for monopoly positions if they could get away with it. For example, when one Western insurance company gained a foothold in China, it promptly lobbied the government to keep out all other foreign insurance companies. Western MNCs seek to transfer just enough technology and training to get the job done. This way, the foreign MNCs can maintain their positions and forestall the creation of domestic competitors.

Domestic competition brings great benefits to the home country. China is developing its own automotive industry in part to ensure that foreign MNCs do not exploit their positions by holding back technology or refraining from reinvesting their earnings. As long as there are potential domestic competitors, foreign MNCs cannot exploit their positions without running the risk of being pushed out of the market by local firms. Having a large domestic corporation with a global brand of comparable stature to GE or Panasonic also pays off in international markets. It is far cheaper to raise capital in world markets with a well-recognized brand name. Favorable credit ratings can save millions of dollars in lower interest rates. Global recognition invites close ties with global professional service firms in advertising, accounting, and insurance, adding further to the legitimacy and luster of the firm and the country.

The emergence of large domestic corporations is shaping debates over development strategies in emerging market countries. Until recently, these debates centered on issues such as human capital, infrastructure, and trade liberalization. The kinds of global businesses that a country has built are now viewed as an important piece of its development strategy. Consider Cemex, the giant cement producer in Mexico. It is one of the largest private companies in Mexico and arguably the only one that can claim global status. Cemex is the largest ready-mix cement company in the world. It operates in fifty countries and is listed on the New York Stock Exchange. At first glance, cement might appear to be a business that could not possibly be global because it is heavy and expensive to ship. But Cemex sells ce-

ment in a way that meets the distinctive needs of the developing world. In the U.S. cement industry, companies sell huge lots to the big construction companies. Sales in small bags through retailers like Home Depot are only a tiny fraction of their business. In the developing world, small contractors do most of the construction, buying cement in small bags. Cemex has mastered the technology, cash flows, and management of small distribution. They learned this in Mexico and transferred the model to the rest of the world. Cement, however vital and profitable, is not an important technology-driven industry like information technology, energy, or biotechnology. Mexico is unrepresented in these high technology fields, which are becoming important symbols of modernization. Cemex also is not the kind of business from which complementary industries naturally develop. IT businesses create demand for goods and services from component makers, system integrators, university engineering departments, and the military. The biotechnology sector also spurs the creation of complementary firms and industries.

Cemex developed on its own without government attention. The government did not plan for its success. Since Cemex is now one of Mexico's leading companies, Mexico's global image is projected by a cement company. The point here is not to criticize Cemex, which is an admirably managed company. Rather, it is to make the point that countries are now seeing their global corporations in broader terms, such as the image they convey about their country and its capacities. This, in turn, is shaping debates about which types of companies should be nurtured and supported in national development strategies.

Some countries may not bother to foster development of large domestic corporations, relying instead on a mixture of small businesses and foreign MNCs. This has been the pattern particularly in small Latin American countries such as Bolivia, Guatemala, and Honduras. The results have been disappointing because there is no incentive to grow a domestic industry to supply jobs, modernize, or develop technology. In Bolivia, for example, the water supply was privatized in 1999 and sold off to a consortium led by Bechtel. The result was predictable: Bechtel introduced exploitative water charges, local peasants rose up in arms, virtually no modernization of the water system took place, the government pocketed the money, and Bechtel fled the country in disgrace at the first sign of trouble.

The third reason behind the increasing political power of domestic

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corporations in emerging markets is their ability to stand up to their big home governments. Small firms do not stand a chance against big government. Recently in China, for example, the central government expropriated the oil leases of small investors, claiming that a technical violation of the law had occurred. The government seized the oil leases and crooked government officials tried to resell them. Chinese investors were told to take their complaints to the notoriously rigged Chinese court system. Clearly, if this condition persists no one will invest in the Chinese oil sector, an industry in which China badly needs investment. China needs investment in any number of sectors and the only power that can stand up to the government is the large corporation. This is why Haier and Lenovo are thriving. They can make efficient business moves, and they have the size and political clout to prevent the government from expropriating their wealth. If the Chinese government pressures the country's big firms too much, they would be killing the golden goose. The repercussions could be enormous, leading to crises of investor confidence, unemployment, and possibly even social turmoil.

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The governments in all of these emerging capitalist countries have historically resisted any encroachment on their power. As a result of state ownership or control by regulations or fiat, corporations in each of the major emerging market countries have been bound too tightly to the government, but this is now changing. For instance, some of the big emerging companies such as Gazprom and Petrobras are partly government owned, but this tells us little about the degree of government control. Firms can be given wide latitude even when the government holds shares. Governments are loosening their control over domestic big business, a situation more suitable to the fast-changing needs of the global marketplace.

On the other hand, there is a danger that these more independent businesses could defy their home governments, go off in their own direction, or simply refuse to return wealth to the state. In the United States during the early twentieth century, the Standard Oil Company chose to create a giant monopoly without regard for the larger economic and political consequences. The company argued that it was free to do as it chose. The U.S. government disagreed, arguing in

several antitrust cases that monopolies of this kind brought large negative consequences and needed to be curtailed. In any showdown of power such as this, the government invariably wins because it possesses a monopoly on the legitimate use of force.

The Russian oil giant Yukos discovered in 2004 what Standard Oil and many other big companies have discovered when confronting their governments. The Russian government seized the company's assets and threw its leader in jail because the company did not pay enough taxes. Yukos argued that the government had no right to interfere in the private sector, demand taxes, or order the company to cease supporting opponents of President Vladimir Putin. The relationship between Yukos and the Russian government was too loose, and the government responded by seizing and selling off Yukos's subsidiaries.

Pemex, the large state-owned oil company in Mexico, shows the dangers of overly tight business-government relations. The company is tightly controlled by politicians, staffed with faithful hacks, and milked like a cash cow to offset profligate government spending. Pemex is highly controlled and does not threaten the government, but it is badly undercapitalized because no one will invest in it. Moreover, Pemex is technologically backward and poorly positioned to meet Mexico's energy needs in the coming decades.

The emerging market economies are in the midst of redesigning their business-government relations depending on local economic and political conditions. There needs to be a certain amount of space between business and government for the system to be effective. Yukos went too far. Pemex has not gone far enough. Getting the balance right may not be easy, but recognizing the two extremes is a good first step.

### **A Revisionist Take on the Golden Straitjacket**

The Golden Straitjacket is hardly a straitjacket. Governments can use their domestic corporations to address any number of microeconomic and political problems, ranging from income inequality to environmental issues. When emerging market countries had to rely more or less exclusively on foreign MNCs, there was a straitjacket. Misbehave and foreign direct investment would vanish. Now, these countries do not need the FDI nearly as much because they have their

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own companies that are able to transfer technology and know-how.

The core argument of the straitjacket, however, is quite prescient: authoritarian rule will sooner or later conflict with the requirements of a market economy. When this happens, the authoritarian regime will either collapse or adapt to the needs of global commerce. Many believe that a society without liberal democratic values cannot compete globally. But in many restrictive societies, large corporations best embody the liberal, free-market rules valued by advanced Western countries. In many successful societies, including the United States, business culture is the foundation of society. The values held by leaders of large corporations embody many important liberal ideals, including meritocracy, diversity, education, and an aversion to war. Companies need people who contribute to efficiency. Thus, they tend to have meritocratic promotion systems. The MNC is one of the least discriminating promoters of people, hiring without regard for race, creed, or color. Business knows that education is important to staying on top of the latest technologies. In fact, the MNC is one of the greatest learning engines in history, teaching a kind of management and leadership that was once learned only in the military.

Microsoft is a good example of exactly these values. It is a leader in meritocracy and diversity, advancing the cause of strong corporate governance and liberal immigration policies for foreign talent. It emphasizes research and development and is a leader in corporate philanthropy, both in the United States and around the world. However, Microsoft is not a democracy, nor are the large firms developing in Brazil, China, India, Mexico, or Russia. But this does not mean that big government is triumphing in these countries. The institutions driving these countries are shifting from highly inefficient state systems to much more flexible big corporations. Far from acting as a straitjacket, large corporations will prevent the industrialized world's established businesses from using their enormous power to exploit emerging market countries. The large corporation does not spring out of a giant leap to liberal democracy. But it possesses enough of those ideals and adds many of its own, like efficiency, to make it a highly attractive model for national political and economic development. ■

#### NOTES

<sup>1</sup> Thomas Friedman, *The Lexus and the Olive Tree* (New York: Farrar, Straus, and Giroux, 1999).