Seen as dinosaurs in the West, conglomerates can still add value in other contexts.

Why Focused Strategies May Be Wrong for Emerging Markets

by Tarun Khanna and Krishna Palepu

Core competencies and focus are now the mantras of corporate strategists in Western economies. But while managers in the West have dismantled many conglomerates assembled in the 1960s and 1970s, the large, diversified business group remains the dominant form of enterprise throughout most emerging markets. Some groups operate as holding companies with full ownership in many enterprises, others are collections of publicly traded companies, but all have some degree of central control.

As emerging markets open up to global competition, consultants and foreign investors are increasingly pressuring these groups to conform to Western practice by scaling back the scope of their business activities. The conglomerate is the dinosaur of organizational design, they argue, too unwieldy and slow to compete in today's fast-paced markets. Already a number of executives have decided to break up their groups in order to show that they are focusing on only a few core businesses.

There are reasons to worry about this trend. Focus is good advice in New York or London, but something important gets lost in translation when that advice is given to groups in emerging markets. Western companies take for granted a range of institutions that support their business activities, but many of these institutions are absent in other regions of the world. (See the insert "What Is an Emerging Market?") Without effective securities regulation and venture capital firms, for example, focused companies may be unable to raise adequate financing; and without strong educational institutions, they will struggle to hire skilled employees. Communicating with customers is difficult when the local infrastructure is poor, and unpredictable government behavior can stymie any operation. Although a focused strategy may enable a company to perform a few activities well, companies in emerging markets must take responsibility for a wide range of functions in order to do business effectively.

As a result, companies must adapt their strategies to fit their *institutional context* – a country's product, capital, and labor markets; its regulatory system; and its mechanisms for enforcing contracts. Unlike advanced economies, emerging markets suffer from weak institutions in all or most of these areas. (See the table "How Institutional Context Drives Strategy.") It is this difference in institutional context that explains the success of large, diversified corporations in developing economies such as Indonesia and India and their failure in advanced economies such as the United States and the United Kingdom.

In our research, we have found that highly diversified business groups can be particularly well suited to the institutional context in most developing countries. From the *chaebols* of Korea to the *business houses* of India to the *grupos* of Latin America, conglomerates can add value by imitating the functions of several institutions that are present only in advanced economies. Successful groups effectively mediate between their member companies and the rest of the economy.

Filling the Institutional Voids

Emerging markets are hardly uniform. Nevertheless, they all fall short to varying degrees in providing the institutions necessary to support basic business operations.

Product Markets. In the case of product markets, buyers and sellers usually suffer from a severe dearth of

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information for three reasons. First, the communications infrastructure in emerging markets is often underdeveloped. Even as wireless communication spreads throughout the West, vast stretches in countries such as China and India remain without telephones. Power shortages often render the modes of communication that do exist ineffective. The postal service is typically inefficient, slow, or unreliable; and the private sector rarely provides efficient courier services. High rates of illiteracy make it difficult for marketers to communicate effectively with customers.

Second, even when information about products does get around, there are no mechanisms to corroborate the claims made by sellers. Independent consumer-information organizations are rare, and government watchdog agencies are of little use. The few analysts who rate products are generally less sophisticated than their counterparts in advanced economies.

Third, consumers have no redress mechanisms if a product does not deliver on its promise. Law enforcement is often capricious and so slow that few who assign any value to time would resort to it. Unlike in advanced markets, there are few extrajudicial arbitration mechanisms to which one can appeal.

As a result of this lack of information, companies in emerging markets face much higher costs in building credible brands than their counterparts in advanced economies. In turn, established brands wield tremendous power. A conglomerate with a reputation for quality products and services can use its group name to enter new businesses, even if those businesses are completely unrelated to its current lines. Groups also have an advantage when they do try to build up a brand because they can spread the cost of maintaining it across multiple lines of business. Such groups then have a greater incentive not to damage brand quality in any one business because they will pay the price in their other businesses as well.

The Korean chaebols are famous throughout the world for extending their group identity over multiple product categories. Samsung, for example, has used its name for a range of goods from televisions to microwave ovens. Groups in India and Malaysia are beginning to follow suit. The business media in India, for example, abound with advertisements that promote group identity rather than emphasize the products or services of individual companies within a group.

What Is an Emerging Market?

Most analysts define an emerging market according to such characteristics as size, growth rate, or how recently it has opened up to the global economy. In our view, the most important criterion is how well an economy helps buyers and sellers come together. Ideally, every economy would provide a range of institutions in order to facilitate the functioning of markets, but developing countries fall short in a number of ways.

For the purposes of our argument, there are three main sources of market failure:

□ **Information Problems.** Buyers – broadly defined not only as consumers in product markets but also as employers in labor markets and investors in financial markets – need reliable information to assess the goods and services that they purchase and the investments that they make. Without adequate information, they are reluctant to do business.

□ **Misguided Regulations.** When regulators place political goals over economic efficiency, they can distort the functioning of markets. Many emerging markets, for example, restrict the ability of companies to lay off workers. These rules do add some stability to society – and in some cases, they may even be intended to overcome market failures from other sources. However, the result is that companies are less able to take advantage of opportunities than they are in advanced economies.

□ **Inefficient Judicial Systems.** Companies are reluctant to do business without ways of ensuring that their partners will hold up their end of the bargain. Contracts can facilitate cooperation by aligning the incentives of the different parties. Markets therefore depend on judicial systems that are strong enough to enforce contracts in a reliable and predictable way.

In advanced economies, companies can rely on a variety of outside institutions that minimize these sources of market failure. In such a context, companies create value primarily by focusing on a narrow set of activities. At the opposite extreme, stagnant or declining economies usually suffer from near-complete market failure because of the utter absence of basic institutions.

Emerging markets, in the middle of this continuum, offer the prospect of substantial growth because they have developed at least some of the institutions necessary to encourage commerce. But institutional voids are still common enough to cause market failures; as a result, companies in emerging markets often have to perform these basic functions themselves. In our view, that is the crucial distinction between doing business in an emerging market and operating in an advanced economy.

How Institutional Context Drives Strategy

Institutional Dimension	United States	Japan	India
Capital market	equity-focused; monitoring by disclosure rules and the market for corporate control	bank-focused; monitoring by interlocking investments and directors	underdeveloped, illiquid equity markets and nationalized banks; weak monitoring by bureaucrats
Labor market	many business schools and consulting firms offering talent; certified skills enhance mobility	few business schools; training internal to companies; company-specific development of talent	few business schools and little training; management talent scarce
Product market	reliable enforcement of liability laws; efficient dissemination of information; many activist consumers	reliable enforcement of liability laws; efficient dissemination of information; some activist consumers	limited enforcement of liability laws; little dissemination of information; few activist consumers
Government regulation	low; relatively free of corruption	moderate; relatively free of corruption	high; corruption common
Contract enforcement	predictable	predictable	unpredictable
Result	**diversified groups have many disadvantages**	**diversified groups have some advantages**	**diversified groups have many advantages**

Capital Markets. Similar problems occur in capital markets because, without access to information, investors refrain from putting money into unfamiliar ventures. The U.S. capital markets minimize these problems through institutional mechanisms such as reliable financial reporting, a dynamic community of analysts, and an aggressive, independent financial press. Venture capital firms and other intermediaries specialize in investigating and assessing new opportunities. The Securities and Exchange Commission and other watchdog bodies make it difficult for unscrupulous entrepreneurs to mislead unsophisticated investors. As a result, investors have a free flow of largely accurate information about companies. And they can hold corporate managers and directors accountable through the threat of securities litigation, proxy fights, and hostile takeovers. By reducing risks to investors, these institutions make it possible for new enterprises to raise capital on approximately equal terms as big, established companies.

Almost all the institutional mechanisms that make advanced capital markets work so well are either absent or ineffective in emerging markets. Having little information and few safeguards, investors are reluctant to put money into new enterprises. In such a context, diversified groups can point to their track record of returns to investors. As a result, large and well-established companies have superior access to capital markets. This advantage is so pronounced that governments in India and South Korea, for example, have attempted to restrict the amount of credit exposure that banks are permitted to have in large companies.

Conglomerates also can use their internally generated capital to grow existing businesses or to enter new ones. In fact, their superior ability to raise capital makes groups a prime source of capital for new enterprises and gives them a great advantage over small companies seeking funding. Besides acting as venture capitalists, groups also act as lending institutions to existing member enterprises that are otherwise too small to obtain capital from financial institutions. And some Indian groups, especially those in the automobile sector, have set up subsidiaries whose primary purpose is to provide financing to important suppliers and customers.

At the same time, conglomerates are attractive to foreign investors eager to put money into these often fast-growing markets. With so few financial analysts and knowledgeable mutual-fund managers available to guide them, outsiders instead turn to diversified groups and invest in a wide range of industries. Investors trust groups to evaluate new opportunities and to exercise an auditing and supervisory function. The groups thus become the conduit for large amounts of investment in their capital-starved countries.

Labor Markets. Most emerging markets suffer from a scarcity of well-trained people. While the United States has more than 600 business schools training thousands of future managers every year, Thailand has a handful of high-quality business schools that produce far fewer entry-level managers than the economy needs. Vocational training facilities are also scarce in emerging markets.

Groups can create value by developing promising managers, and they can spread the fixed costs of professional development over the businesses in the group. Many of the

large groups in India, for example, have internal management-development programs – often with dedicated facilities. These programs typically are geared toward developing the skills of experienced managers; but some groups, such as the Malaysian conglomerate Sime Darby, have instituted training programs for all levels of employees in an attempt to develop their human capital. And some of the Korean chaebols have set up special programs in collaboration with top U.S. business schools in order to train their own people.

Groups also can provide much needed flexibility for labor markets in general. Governments in emerging markets usually make it difficult for companies to adjust their workforces to changing economic conditions. Rigid laws often prevent companies from laying off their employees, and labor unions insist on job security in the absence of government-provided unemployment benefits. To counteract the rigidities of the overall labor market, groups can develop extensive internal labor markets of their own. When one company in a group faces declining prospects, its employees can be transferred to other group companies that are on the rise – even to companies in otherwise undesirable locations. India's Aditya Birla group, for example, has acquired a reputation for building communities around its manufacturing plants in the remotest parts of the country. Because the group provides services such as schools, hospitals, and places of worship, managers and other trained employees are more willing to relocate. The growing companies benefit by receiving a ready source of reliable employees.

Groups are also able to put new talent to good use. By allocating talent to where it is most needed, conglomerates have a head start in beginning new activities. The Wipro Group in India successfully moved beyond computers into financial services by relocating skilled engineers first to computer-leasing services that would make use of their technical know-how and then to a broad range of financial services. In contrast, unaffiliated companies usually have to recruit publicly in order to build their operations – a difficult proposition in countries where labor varies widely in quality and lacks certification from respected educational institutions.

Regulation. As multinational companies know all too well, governments in most emerging markets operate very differently from those in the West. Not only does the state intervene much more extensively in business operations, but companies also have a hard time predicting the actions of regulatory bodies.

Governments in emerging markets are heavily involved in an intricate array of business decisions. Despite the elimination of the old "license raj," for example, Indian law still requires that companies get permission for a range of decisions, such as exiting businesses, changing prices on commodities, and importing raw materials. The law establishes subjective criteria for many of these decisions, so Indian bureaucrats have a great deal of discretion in how they apply the rules.

Diversified groups can add value by acting as intermediaries when their individual companies or foreign partners need to deal with the regulatory bureaucracy. Experience and connections give conglomerates an advantage. The larger the company, the easier it is to carry the cost of maintaining government relationships. Indeed, political economist Dennis Encarnation found that India's large groups maintain "industrial embassies" in New Delhi to facilitate interaction with bureaucrats. Several groups in India also are known for their ability to manage bureaucratic relations at levels all the way down to the village council.

Not every group adds value in the same way, and no group can hope to fill every institutional void.

India and other countries may be bearing costs for the uncertainty of their regulatory systems. But as long as government officials have so much discretion, companies often end up working with them. Intricate relations between business and government actually appear to be the norm throughout the developing world. The major Malaysian political parties, for example, all have affiliated conglomerates. Until recently, the ties between government and industry in South Korea have been a centerpiece of that country's economic program. Even today in Indonesia, there are groups whose greatest assets appear to include access to high government officials. Because political leaders are so eager to work with companies, managers must be prepared to deal with the government and the bureaucracy.

Bribes and other corrupt practices may be part of working with the bureaucracy. But that's not the whole story. In many cases, educating officials is more important than exchanging favors. The Enron Corporation, a large U.S.-based multinational, discovered just that when it entered the power generation sector in India. Prepared to invest $2.8 billion, the single largest foreign venture in Indian history, the company had to spend four years and about $20 million educating regulators on the ways international power projects are financed and regulated. Along the way, Enron learned its own lessons about dealing with the Indian bureaucracy and government; the project was almost canceled when Enron's aggressive deal-making style put off newly elected officials in the state where the power plant was to be built. As Enron's executives now acknowledge, experience with Indian politics and bureaucracy might have saved the company a great deal of trouble.

Contract Enforcement. Despite the extensive involvement of government in emerging markets, these economies lack effective mechanisms to enforce contracts. In advanced economies, companies can work together under arm's-length contractual arrangements because

How Groups Can Add Value

Institutional Dimension	Institutions That Groups Imitate
Capital market	venture capital firm, private equity provider, mutual fund, bank, auditor
Labor market	management institute/business school, certification agency, head-hunting firm, relocation service
Product market	certification agency, regulatory authority, extrajudicial arbitration service
Government regulation	lobbyist
Contract enforcement	courts, extrajudicial arbitration service

they know the courts will protect them if their partners break their contracts. Confidence in the judicial system makes it easier for everyone to do business. But courts in emerging markets often enforce contracts capriciously or inefficiently; as a result, companies are less likely to be able to resolve disputes through judicial channels.

In such situations, conglomerates can leverage reputations established by honest dealings in the past. Because the misdeeds of one company in a group will damage the prospects of the others, all the group companies have credibility when they promise to honor their agreements with any single partner. They provide a haven where property rights are respected. As a result, suppliers and customers are more willing to work with them.

This credibility pays off the most in relationships with companies seeking to enter emerging markets. Foreign providers of technology or finance need local partners to carry out their strategies, but they worry about being cheated. A reputation for honesty and reliability thus can be a source of enormous competitive advantage. As Alice Amsden and Takashi Hikino have argued, conglomerates in several emerging markets have based much of their success on their ability to access foreign technology. And in India, the largest and most diversified business groups receive a disproportionate share of technology and financial support from advanced economies around the world. The head of RPG Enterprises, India's third largest conglomerate, considers his group's relations with foreign providers – including 16 of the 500 largest U.S. companies – to be among its greatest assets.

Managing the House of Tata

India's largest conglomerate in sales and assets exemplifies how well-run groups can add value in emerging markets. Spanning most sectors of the Indian economy, the Tata companies employ close to 300,000 people and had sales of Rupees 289 billion (U.S. $8.6 billion) in the fiscal year 1995 to 1996. Of the group's 90 companies, more than 40 are publicly traded, and these account for approximately 8% of the total capitalization of the country's publicly traded companies. The companies are all held together by the internationally recognized Tata name and by interlocking investments and directorates.

The Tatas began as a textile mill in 1874, but Indian independence in 1947 brought antimonopoly legislation and high taxes on dividends that encouraged the group to diversify into a variety of unrelated areas. When India began liberalizing its economy in 1991, removing the barriers to growth within any given sector, the group had a stark choice to make. Outside experts advised executives to concentrate on a few strong sectors of economic activity instead of continuing as an extensively diversified entity. But the executives decided to remain in most of their existing businesses.

One reason for staying diversified was the difficulty of exiting businesses because of some remaining legal restrictions in India as well as the Tatas' reputation as a benevolent employer. But the Tatas also believed that they could leverage their size and wide scope to help their constituent companies in a variety of ways. So they decided to diversify even further.

Historically, the Tata companies have always come together to finance the launch of new enterprises. But initially there was no formal structure for doing so. Then in 1982, the group created Tata Industries, a venture capital vehicle funded with a special pool of investment money drawn from the member companies. Since then, Tata Industries has sought to lead the Tata group into information technology, process control, advanced materials, oil-field services, and other areas. It has provided seed money for several successful ventures, including two computer-manufacturing enterprises – one cosponsored by Honeywell and another cosponsored by IBM. Today the Tatas are leading the way in building an information-technology industrial park in cooperation with the state of Karnataka and with money and expertise from a consortium that includes the government of Singapore.

The Tatas were so active in new ventures that by 1995 they needed additional capital. They decided to sell a stake in Tata Industries at a substantial premium to Jardine Matheson, itself a diversified company based in Hong Kong. As a result of the sale, Jardine Matheson ended up owning 20% of the equity in Tata Industries. The sale gave the Tatas (and the Indian economy) $200 million in "patient" capital from a conglomerate that shared their long-term approach to investment. Jardine Matheson, in turn, gained exposure to sectors across the Indian economy without having to supervise individual companies.

Many of the group's new ventures benefited from being able to borrow skilled managers from the Tatas' existing businesses. Since 1956, Tata Administrative Services (TAS) – an in-house training program with a national reputation for excellence – has aimed to create a cadre of general managers. Entry into TAS is extremely selective and primarily restricted to graduates of Indian management institutes. Recruits spend their first year on courses, interactive sessions with Tata executives, and visits to major Tata plants around the country. Mentoring and career direction continue for at least five years, as candidates are exposed to three different line functions in three industries to gain a general management perspective.

Fully half of these trainees remain with the Tatas over the long term, in contrast to some other large Indian groups that have to reinvent themselves every few years because of high turnover. For those who do leave, the exit options are attractive, increasing the appeal of joining the Tatas in the first place. In effect, the group provides both management education and a certification service in a country where both are scarce.

TAS consciously organizes its recruits into cohorts according to the year they entered. As recruits spread out to the different companies within the group, they maintain lasting ties with their cohort group, and these networks improve information flows across the group. The head office, mindful of the resources invested in these graduates, encourages group companies to "sacrifice" a talented employee to another company if it is in the interest of both the managers' career development and the group. Cross-company teams of "stars" are assembled to resolve knotty problems that individual companies are having. The group now plans a new initiative, the Tata Group Mobility Plan, to improve the mobility of all skilled managers, including non-TAS graduates, across group companies – and without any loss of benefits.

The Tatas are a favorite of foreign technology providers that are comfortable entering India only with a reputable party. Tata executives consider their reputation for honesty and integrity to be among their greatest assets, and that reputation has led to joint ventures with Daimler Benz and AT&T, as well as a number of computer companies. Understanding the value of its reputation, the group is developing an internal code of conduct and other elaborate standards regarding the use of the group name. Special fees from the member companies will pay for an internal auditing function to enforce those standards. To foster an orientation toward quality among its companies, Tata also has set up an internal system of awards akin to the United States' Baldrige awards.

By keeping and extending their diversified holdings, the Tatas have maintained a scale and scope that gives them a host of advantages within India's specific institutional context. And these advantage are mutually reinforcing. The more access Tata or any group has to financial capital, the more business opportunities it can offer to talented employees – which in turn helps the group improve quality and enhance its reputation with consumers. Continued success in existing lines of business has made it all the easier for the Tatas to enter new lines of business. The Tatas today have the largest market shares in many sectors of the Indian economy, from steel to computers to hotels.

The Tatas, in turn, benefit the Indian economy. When management consultants told a Tata executive that diversification into unrelated activities did not create value, he replied, "Don't enunciate a theory that will bring everything to a dead halt. If we don't start these businesses, no one else will either, and society will be worse off."

Ensuring That Diversification Adds Value

Once one understands the institutional context of any given emerging market, it is clear why diversified business groups have the potential to add value. (See the table "How Groups Can Add Value.") Nevertheless, groups do not automatically realize that potential. They must be

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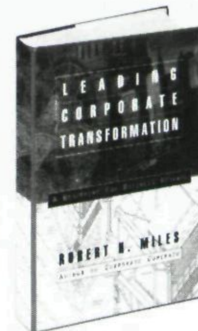

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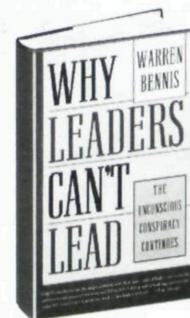

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actively managed to capture the advantages offered by scale and scope. Our statistical analysis comparing groups and independent companies in India – and a similar analysis on South Korean companies that Tarun Khanna conducted with Yishay Yafeh – suggests that many groups add little or no value to their operations. The largest and most diversified groups, however, do add a good deal of value – perhaps because only these groups have the scale and scope to perform the kind of functions we have described.

Indeed, many groups have actually diminished the value of their member companies through poor management. Conglomerates in emerging markets, after all, suffer from the same problems that plague those in the West: the more activities a business engages in, the harder it is for the head office to coordinate, control, and invest properly in them. Unless a group is ready to offer concrete benefits to its affiliates, companies are better off independent.

Group executives should ask in a systematic way whether they are adding enough value to overcome the costs of complexity and coordination. They should start by assessing their conglomerate's strengths. A group that enjoys brand name recognition in rural markets might think of leveraging its name in unrelated products targeted to the same markets. Or a group that enjoys preferential access to large amounts of capital might consider ventures that require substantial investment.

Of course, not every group will be able to add value in the same way, and no group can hope to fill every institutional void. Decisions to diversify should be based on the group's strengths, not just on growth prospects. Today a number of groups are rushing willy-nilly into power plants and other infrastructure projects all over Asia, and their total-capacity plans already appear to outstrip the likely demand. But there are a few exceptions, such as India's Satyam Group. This group has tried to leverage its reputation for honest and efficient partnerships with foreign companies in order to win the better contracts.

What Is the Best Institutional Context?

Even if they admit to the advantages of diversification in emerging markets, some investors or partners may still urge companies to concentrate on a few core activities on the grounds that all markets will eventually develop the West's set of institutions. But their advice assumes that there is one single set of institutions toward which all countries should move. It is unclear, however, whether any one institutional context is obviously superior to others.

Consider the financial system in the United States. That system, based on atomistic shareholders, ensures great liquidity, which generally reduces the cost of funds. Because shareholders can "vote with their feet" if they do not like what management is doing, however, they are less inclined to expend the effort needed to discipline management. As a result, corporate governance may suffer. Similarly, a labor market in which employees freely move from one company to another increases the likelihood that, at any given time, there will be an efficient match between workers' skills and the opportunities to which those skills can be applied. But it reduces the likelihood that workers will invest in anything but the most general skills; as a result, society does not reap the benefits of the long-term, company-specific training of workers.

Japan's institutional context reveals a different resolution to these trade-offs. Japan's capital market is bank centered, not equity centered. Banks monitor managers through equity crossholdings between companies and board directorships, and the difficulty financial institutions have in unloading their shares encourages them to keep management in line. (Banks, in fact, are at the center of Japan's major *keiretsu*, and these groups offer some of the same advantages of conglomeration that are present in emerging markets.) Japanese managers and workers get their training largely within companies. Managers rarely move around because their expertise is geared toward the specific needs of their company and because they lack credentials from such external institutions as business schools.

Institutional context also takes a long time to evolve. Because different aspects of the institutional environment have often co-evolved into a well-functioning system, changes along any one dimension of an institutional environment can have unanticipated, adverse effects along other dimensions. Economies around the world today are experimenting with moving from one system to another using either "shock therapy" or gradual adjustment – there is much debate about which is the better approach. Deep-seated institutional voids might take decades to be filled. The United States is an extreme example of a country where there are relatively few such voids.

Even if the institutional context of emerging markets evolves to the point that there are no advantages to diversification, executives there should realize that their current opportunities will persist for some time. They are much better served by developing corporate strategies that match their particular contexts instead of blindly applying the management mantra of the day.

Once a group identifies its opportunities, its executives need to install systems to ensure consistent execution. For example, they must impose discipline over field managers, who will be tempted to take advantage of ready financing to try to build empires. The most successful groups usually have a strong internal auditing system. Sime Darby, the Malaysian conglomerate, benefits from a tradition of strict financial controls and planning that began under its original British managers. Its recent entry into financial services by acquiring UMBC bank was welcomed by the Southeast Asian stock markets, which saw the conglomerate adding value through its management discipline to a large but underperforming company in a rapidly growing sector.

Another strategic imperative for groups is to manage their corporate identities. Given that much of their success depends on the trust of their customers and partners, diversified groups must enforce standards of reliability and quality. The head of Mahindra & Mahindra, a group operating in automobiles and infrastructure in India, grabs every symbolic opportunity he gets to dramatize the importance of never compromising on the product and after-sales service offered to customers.

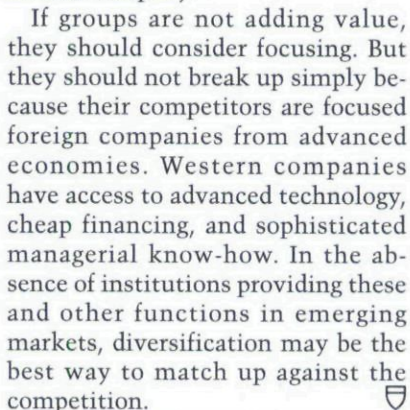
When a group's strategy depends on supplying functions that are absent in the institutional context, it is important to move with deliberation. Mimicking institutions that are undeveloped in the economy at large requires time and effort. A group that acts as a venture capital firm, for example, needs to develop a track record for nurturing businesses in order to become a magnet for risk capital. It needs to train and retain individuals who are skilled at identifying deals and who can bring their start-up expertise to bear on a variety of situations; it also needs to have disciplined managers to run its high-risk ventures.

Communicating the Strategy to Investors

Even successful conglomerates still face resistance from Western investors and partners who believe that focus is always best. Although many executives may well be tempted to concentrate their operations in order to win favor with outside analysts, a better solution for well-managed groups is to educate investors about the logic underpinning the group's corporate strategy. (See the insert "What Is the Best Institutional Context?")

Institutional investors are often most worried not about diversification per se but about the lack of openness in internal group operations. Under the current structure of many conglomerates, investment analysts find it difficult to tell which business segments are creating value within a conglomerate. They fear that a group executive will shuffle funds from one company to another. Faced with these concerns, managers of conglomerates should increase the transparency of their operations, communicate this change to investors, and develop a reputation for doing so.

The Indian group Mahindra & Mahindra is doing just that. While it focuses on automobiles and closely related businesses, the group has set up a holding company to invest in a range of other projects. The automobile company has made a onetime, fully documented infusion of capital to start the holding company so that the group will not have to make repeated transfers of funds for ad-hoc line extensions. If and when the holding company's ventures take off and require new capital, the group will take the company public rather than draw on funds from the automobile company.



If groups are not adding value, they should consider focusing. But they should not break up simply because their competitors are focused foreign companies from advanced economies. Western companies have access to advanced technology, cheap financing, and sophisticated managerial know-how. In the absence of institutions providing these and other functions in emerging markets, diversification may be the best way to match up against the competition.

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