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Business groups and market failures: A focus on vertical and horizontal strategies

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Abstract Drawing from transaction cost economics and strategic management, this paper develops a series of propositions that link market failure with corporate strategy. In doing so, the paper focuses on both vertical and horizontal strategies as strategic approaches that could be used to address different types of market failure. The significant contribution of the paper lies in its deconstruction of the various types of market failure and developing a theoretically grounded set of propositions that identifies appropriate corporate strategic responses that can be used to ameliorate the negative consequences of each type of failure. In doing so it also explores the evolution of business groups and the viability of strategic choices that groups are likely to make as they navigate the emerging market terrain.

Keywords Business groups · Diversification · Vertical integration · Market failures

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The antecedents and consequences of corporate diversification and integration are arguably among the most widely researched topics within the domain of strategic management (Casson, 1984; Chandler, 1962; Goold, Campbell, & Alexander, 1994; Palich, Cardinal, & Miller, 2000; Williamson, 1971). While this stream of research has provided valuable insights into the costs and benefits associated with a diverse array of corporate strategy alternatives (Gulati, Lawrence, & Puranam, 2005; Martin & Sayrak, 2003; Williamson, 1971), very little is known about the context specific nature of the viability of these strategic positions (Carney & Gedajlovic, 2003; Chu, 2001; Luo & Chung, 2005; Silva, Majluf, & Paredes, 2006).

Khanna and Palepu (1997, 1999b, 2000b) offered what is perhaps the first systematic synthesis of a variety of theoretical strands to argue that horizontal strategies (defined as concentric and conglomerate diversification, with an emphasis on the latter) are particularly relevant in contexts rife with incidence of market failures spanning capital, labor, and product markets. Implicit in much of this stream of literature and reasoning is the belief that horizontal strategies can be effectively deployed to ameliorate the negative impact of market failures, and that the organizational system most suited for managing such organizations is the business group structure (Chang, 2006; Khanna & Palepu, 1997; Kim, Hoskisson, Tihanyi, & Hong, 2004).

A related school of thought (Hennart, 2001; Williamson, 1971; Wu & Choi, 2004) propounded by the transaction cost economics argues that groups arise because they can be used to reduce transaction costs by using vertical strategies (including quasi, tapered, and full vertical integration). In other words, this approach allows groups to achieve significant transaction cost reductions without the burden of having to realize internal scale economies in the activity that it performs internally, a difficult proposition for each constituent firm within the group.

Much of the extant effort has been expended in examining the role of horizontal strategies, specifically conglomerate diversification, in alleviating market failures. However, there is sufficient theoretical evidence to suggest that vertical strategies might be equally relevant (Lee & He, 2005; Shiba & Shimotani, 1997; Williamson, 1971, 1975). Similarly, past work has tended to treat all institutional voids as imposing similar demands on organizations. Anecdotal evidence suggests that different forms of market failures require unique strategic responses. Taken together, we believe that substantive progress can be achieved in the empirical realm once we are able to develop a more refined, theoretically sound model of the nature of the relationship between the choice of corporate strategy and institutional context. This paper proposes such a theoretical model. We provide a systematic assessment of the association between market failures, and vertical and horizontal strategies. In extending our conceptual framework, we offer ideographic evidence from business groups in India and Korea to highlight some key issues relating to the evolution of groups in such settings. Finally we explore possible future research directions. We aim to ask the following questions: What relations are there between different types of market failure and business group strategies? How will business groups evolve to respond to market failures?

Linking market failures to corporate strategies

Figure 1 presents a framework that provides a comprehensive view of the contours of corporate strategy initiatives, both horizontal and vertical, in addressing market failures (note we emphasize the critical connections between market failure and business group response via bold font cells). Building on the classification of market failures that

	Product Market Failure	Labor Market Failure	Capital Market Failure
Horizontal Diversification Strategies	• Leverages brand equity across multiple products / services • Address distribution bottlenecks to gain scope economies	• **Managerial talents are developed across a wider range of functions and industry settings** • **Internal labor market for managerial skills can be used across group companies**	• **Leverages privileged access to internal pool of risk capital** • **Builds on relationships across benevolent financial institutions to obtain debt capital for growth** • **Strategic position offers early signal of pockets of opportunity**
Vertical Integration Strategies	• **Overcomes transaction cost inefficiencies and helps organize stable supply chains and distribution systems** • **Enhances quality assurance for input product and materials** • **Establishes after sales service channels where external providers are typically absent**	• **Internalizes skilled labor resources that are difficult to obtain** • **Allows for retention and training of skilled labor in ways that the market cannot** • **Allows for effective utilization of skilled labors**	• Concentrates risk capital within the confines of a few industries it can dominate

Figure 1 Types of market failure and choice of mitigating corporate strategies

distinguishes between three broad sources of failures—namely product market, labor market, and capital market—the framework explores the viability of using both horizontal and vertical strategies to address each of the three types. In doing so, where appropriate, we draw research propositions that address the differential viability of the two broad strategic responses namely horizontal and vertical under the three conditions of market failures.

Under ideal conditions, a market entails the exchange of goods and/or services via demand and supply mechanisms (Bator, 1958; Khanna, Palepu, & Sinha, 2005; Williamson, 1971) without the interference of extra-market mechanisms such as regulations, or other factors that introduce friction into the exchange. However, such conditions seldom prevail across a broad spectrum of industries especially in emerging economies (Khanna et al., 2005; Stiglitz, 1989; Wright, Filatotchev, Hoskisson, & Peng, 2005). In fact, market failure is more the norm than the exception in such settings. It is in this regard that research has explored the use of corporate diversification strategy to mitigate these inherent shortcomings of the market.

Product market failure

A vertical strategy (quasi, taper or vertical integration) (Casson, 1984; Grant, 2002; Grossman & Hart, 1986; Hallwood, 1992; Williamson, 1971, 1975) is believed to allow greater internal administrative efficiency and greater control. Vertical integration is an internalization strategy (Casson, 1984; Grossman & Hart, 1986; Hallwood, 1992; Williamson, 1971) that incorporates key value chain activities either upstream or downstream or both to reduce transaction costs and uncertainty. This approach is usually geared to address failures occurring within the general domain of product markets largely because of the incidence of failures that directly impact the primary value activities (Galbraith & Nathanson, 1978; Porter, 1985) namely materials sourcing and procurement, and distribution of finished goods.

Compared to a vertically integrated firm, a highly specialized firm, which focuses on a few key activities within the value chain, relies primarily on market transaction cost efficiency and reasonable certainty that the upstream/downstream markets entities will act in unison in delivering value. In the case of acute product market failure, an enterprise may

explore the strategic advantage of vertical integration as a mitigation mechanism that will help circumvent the negative effect of inadequacies in the upstream markets (e.g., sourcing critical raw materials, supplies, services). Similarly, forward integration can help a firm to reach downstream markets more effectively thus circumventing distribution bottlenecks, and information bottlenecks that limit the free exchange between an organization and its customers.

In the case of emerging economies, market failures will in general push companies to internalize key activities as long as internal administrative costs are lower than external transaction costs (internalized activities are coordinated and managed through administrative mechanisms). External transaction costs include identification of possible partners (such as suppliers and customers), negotiation of contracts, enforcement of contracts, and conflict resolution. Product market failures (either upper stream or downstream) would certainly push companies to internalize these key activities.

Despite its apparent attractiveness as a mechanism that can be used to address product market failures, vertical integration might also present significant challenges (Grant, 2002) as well as business risks. For example, different value creating activities may have different optimal scale level. Mixing those together under one umbrella (ownership and control) may represent a significant compromise and therefore lose scale advantages. Excessively vertically integrated firms may also experience problems developing distinctive capabilities. Incentive structure can be another challenge. Those value creating units under full vertical integration may be forced to use somewhat sub-optimized incentive structure and system. For example, while R&D, operation and marketing employees may be driven by different goals (Lawrence & Lorsch, 1967), under full vertical integration, the incentive system may adopt overall performance as the benchmark. Finally vertical integration may lead to lost flexibility, and may prevent a firm from securing cash flow stability especially in cyclic businesses or highly changing industries.

We should also note that the use of horizontal strategies that entail branching into multiple product groups or industries can also offer some benefits in limiting the negative impact of product market failure. Some researchers (Khanna & Palepu, 2000a, 2000b) have argued these firms overcome the valuation effectiveness problem through the use of a common umbrella brand that is a proxy for value. Furthermore, such firms often are able to utilize the same distribution channel for their various product offers as well. However, we would argue that the ability of a horizontal strategy to mitigate product market failure is indeed quite limited. Its impact is likely to be felt more in the downstream activities rather than in upstream activities. Thus, taken together, it may be argued that the vertical integration strategy may offer a relatively higher level of benefits to organizations that face intractable problems associated with product market failure (Grossman & Hart, 1986; Williamson, 1971).

Many firms in emerging economies cannot afford the luxury of contemplating arms-length transactions either in upstream or downstream activities (Khanna et al., 2005; Stiglitz, 1989). This necessitates integration of some form to allow the firm to transact business successfully. Absent the external market players who can perform specialized value activities, the organization is often forced to build its own resources to mitigate external market failures. Even leveraging economies of scope through multiple product offerings requires some level of downstream integration. Thus,

Proposition 1 Successful emerging market firms will tend to emphasize vertical strategies more than horizontal strategies to mitigate product market failures.

Labor market failure

Labor market failure arises when organizations face shortages of and/or are unable to recruit efficiently skilled labors (those individuals with multiple years of technical training beyond high school level) and/or managerial labor (those individuals with management knowledge and abilities). Typically, such failures are prevalent in settings that have few vocational training schools and institutions of learning that are capable of offering hands-on education to a sizable segment of the employable population. Consequently, this constrains the free availability of skilled labor. Similarly, labor regulations relating to hiring, firing, and benefits administration for employees is also a potentially important determinant of the quality and availability of labor resources. Along similar lines, the availability of managerial labor is constrained by the lack of adequate schools of business and commerce where managerial skills are taught (Khanna & Palepu, 1997; Khanna et al., 2005). This managerial labor pool is also adversely affected by the lack of a sizable number of large enterprises that allow easy mobility from one managerial position to another thus enhancing the overall quality of managerial talent. Absent this crucial infrastructure component in the form of institutions or supportive regulations, organizations will be forced to nurture their own internal labor pool for the type of labor that cannot be sought through the external marketplace (Baker & Holmstrom, 1995; Li & Wong, 2003).

Scarcity of skilled labor is likely to be more easily mitigated through the deployment of vertical integration strategies while the constraints in availability of managerial talent are more likely to be mitigated via horizontal diversification strategies. Since skilled labor, by definition, is more specialized in a smaller range of industry/product settings, a vertical strategy is ideal. In contrast, the growth of a pool of managerial talent necessitates the constant and systematic exposure to a much wider range of business issues than typically found within one single managerial function or one single product typified by a diversified company (Goold, Campbell, & Luchs, 1993; Goold et al., 1994; Katz, 1974; Lawrence & Lorsch, 1967). Such an enterprise would also be able to attract high quality managerial talent because of its market image and prowess, and nurture this talent through its more promising business divisions (Goold & Campbell, 2002). Further, it is only through systematic rotation of managerial talent across businesses that the firm can develop expertise in managing the complex demands of integration and differentiation (Galbraith & Nathanson, 1978; Khanna & Palepu, 1997; Lawrence & Lorsch, 1967) demanded by the environment it operates in. Finally, managerial labors will have the opportunities to seek placement as the internal labor market operates much like a well developed external labor market. Therefore,

Proposition 2 Successful emerging market firms will tend to emphasize vertical strategies more than horizontal strategies to ameliorate the negative effects of skilled labor market failure.

Proposition 3 Successful emerging market firms will tend to emphasize horizontal strategies more than vertical strategies to ameliorate the negative effects of managerial labor market failure.

Capital market failure

The ability of an organization to successfully attract risk capital for investment is crucial (Gertner, Scharfstein, & Stein, 1994; Stiglitz, 1989). In developed countries, the capital

markets are sufficiently deep for potential organizations to venture into for obtaining risk capital. However, most emerging economies have quite weak and shallow capital markets that significantly limit any organization's potential to obtain money to fuel expansion and growth (Khanna & Palepu, 1997; Khanna et al., 2005; Stiglitz, 1989). In most emerging economies, equity may be a fairly small part of capital raised to the extent these firms are able to raise it.[1] Often, the access to debt capital is controlled by a handful of banks which act in consort with the government to support political initiatives and priorities in the industrial sector (Ramaswamy, Li, & Pécherot Petitt, 2004; Whitley, 1999). Usually, legislative hurdles preclude the firms from looking overseas to attract risk capital. Also, the relatively weak governance norms make it more difficult to seek foreign funding from institutional investors in developed countries.

Given the paucity of funds both in the equity market and in the debt market, firms rely on connections and relationships to overcome financing obstacles and complement such inflows through the creation of an internal capital market (Billett & Mauer, 2000; Houston, James, & Marcus, 1997; Stein, 1997). Large business groups therefore enjoy privileged access to capital resources that stand-alone companies might lack in such settings (Khanna & Palepu, 1997, 1999b). Historically, the availability of a pool of risk capital has proven to be a strong mitigation mechanism that has helped organizations remedy capital market failure. The genesis of the leading business groups in India, Korea, Japan and even in the United States (US) and other developed countries reflects this advantage (Shiba & Shimotani, 1997). The capital access allows these groups to sense and respond to opportunities in the market place, in essence internalizing the role of the unaffiliated investor in a vibrant capital market.

From an investor's point of view, investing in a business group might appear to be more lucrative since it offers perhaps one of a few limited alternatives to diversify risk. Absent investment opportunities in specialized organizations, the paltry investment capital that trickles into the equity market would seek business groups that have built strong horizontal strategies encompassing a range of businesses. For example, banks in India have been known to patronize diversified business groups since there are few good stand-alone investment opportunities available. In targeting the lucrative fee and interest accounts, they naturally gravitate towards the large conglomerates in the country that have historically proven to be the engines of revenue and growth. These business groups are quite profitable and powerful (see Khanna & Palepu, 1997, 2000a for a description of the functioning of Indian business groups) and hence banks and banking companies have a significant vested interest in supporting the management of these firms in their corporate strategy initiatives. Since the average Indian company is much more widely diversified (Khanna & Palepu, 1997, 2000a, 2000b) than its counterparts in the US, capital for diversification often flows from banks and banking company investors under directives from the government.

Conglomerate diversification may enable an enterprise to explore full potentials related to internal markets and greater power because of the scale and reach overall (Hill, 1988; Khanna & Palepu, 1997, 1999a). A business group may indeed be able to utilize its power and scale to secure capital from external sources, and at the same time enjoy internal capital market advantage by investing effectively into business entities with greater potential for success. Essentially, a business group would be able to create and operate an internal capital market, enabling different entities to compete for corporate investment in a setting much like the external market!

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[1] We thank an anonymous reviewer for emphasizing this aspect.

Vertical strategies, although quite useful in remedying other types of failures identified earlier, are quite limited in delivering benefits when it comes to mitigating capital market failure. First, by concentrating capital resources on a single set of value creating activities within the domain of a single industry setting, the organization does not develop any effective response to capital market failure. In fact, it could be argued that in adopting such an approach, the organization might make it unattractive for potential investors to come forward with risk capital. Further, with acute capital market failures, outside investors will have limited ability to assess the true value of a vertically integrated firm given the tight coupling of its assets and activities (Casson, 1984; Grossman & Hart, 1986; Williamson, 1971). Thus, it is defensible to expect that firms would emphasize horizontal strategies in addressing capital market failure.

Proposition 4 Successful emerging market firms will tend to emphasize horizontal strategies more than vertical strategies to remedy capital market failure.

The discussion thus far has focused primarily on three broad types of market failures and how vertical and horizontal strategic response can be used to address them. In summary, we posed that the vertical strategies would be effective for dealing with product market failure and skilled labor market failure, and the horizontal strategies for the capital market failure and managerial labor market failure. We formulated these propositions with an emphasis on a normative approach to business group study, our clear reference to "successful" business groups in emerging settings reflecting that orientation. In the previous discussion we focused on theoretical synthesis and prediction. We believe that offering case illustrations will help further clarify the issues at hand, and also furthermore, start a discussion relating multiple business failures with appropriate business group responses.

Most emerging economies are characterized by a multiplicity of failures several or all of which may occur simultaneously (Peng, 2003). For example, a lack of adequate distribution infrastructure might be coupled with a dearth of skilled labor and shallow capital markets. Thus, organizations might be faced with a need to prioritize their response to such failures based on dimensions that are critical to driving business success. It is therefore conceivable that some types of market failures need to be addressed before others. Hence, an evolution of responses is likely to occur over time as a business group evolves into a self-contained entity that represents a bundle of strategic responses that can effectively insulate the organization from a variety of market failures.

Case illustrations and the evolution of business group strategies

Guillen (2000) and Peng and colleagues (Peng, 2003; Peng, Lee, & Wang, 2005) paint a persuasive picture of the powerful benefits that groups enjoy as they build relationship and reputational capital. The capability to leverage these skills simultaneously to obtain licenses, arrange for financing from shallow capital markets, identify potential technology partners from developed countries, set up distribution chains to overcome infrastructure bottlenecks, and organize a skilled labor pool transcend any specific industry setting. These skills are believed to be fundamental requisites for successful entry across a broad spectrum of industries in emerging markets. Both Guillen (2000) and Peng and colleagues (Peng, 2003; Peng et al., 2005) argue that these skills are particularly relevant in contexts where market failures persist.

The acquisition of these skills is seldom accomplished in short time periods. They are typically nurtured over several decades and it is precisely this diachronic dimension that makes such skills invaluable. One could argue that these skill bundles are what usually attract large multinationals to align themselves with business groups as a means of entering emerging markets. Since successful groups usually have achieved some mastery over the process of overcoming regulatory, political, legal, and institutional hurdles, they are the choice partners in most cases. Apart from the ability to attract foreign technology providers and reputable MNE partners, these skill bundles allow groups to contemplate opportunistic entries into emerging industries as a prelude to building a portfolio of businesses.

The evolution of these skill sets, we would argue, originates from methodical management of market failures within relatively small, well focused business domains. Most often, this calls for managing a set of vertical relationships ranging from vertical integration to arms-length arrangements to address deficiencies in procuring inputs, distribution, and other product market inadequacies. These industry specific skills and resources form the primary basis of competitive advantage. As Collis and Montgomery (1997) suggest, the inherent dilemma for strategy makers at this stage is whether to focus on specialized resources that foster competitive advantage or gather a general set of skills and resources that favor the creation of diversified business portfolios. Given the intractable nature of market failures that firms face in emerging market contexts, the very survival of new firms could depend on their ability to quickly invest in building the specialized skills that are sorely needed.

It is plausible that over time, the aggregation of specialized skills and resources opens the door to the development of general skills and resources that transcend the specific nuances of the primary businesses that the firm is engaged in. These could well encompass the institutional embeddedness skills (Granovetter, 1985; Guillen, 2000; Peng et al., 2005) originating from the relationship capital that the firm has built through successive interactions with regulators, licensing agencies, financial institutions, distributor and supplier networks, and a host other intermediaries that the firm counts on to carry forth its mission. These general skills that are transferable across businesses are typically not harnessed overnight. They are carefully nurtured over years and evolve into highly prized assets because they carry the promise of building a portfolio that is diversified and successful. Seldom do we find organizations originating as diversified entities. Even the most storied conglomerates, such as Tyco and ITT in the US, Bouygues and Vivendi in France, ICI and Imperial Tobacco in the UK, and Haier and Lenovo of China, owed much of their origins to sequential vertical strategies aimed at shoring up their core businesses before they ventured outside their core, sometimes with mixed results. A few vignettes of group origins in Asia help provide some support to our earlier discussion of the market failure strategic response framework, and underline the efficacy of the specialized resources first and generalized resources later approach.

Figure 2 provides a pictorial synopsis of the evolution of two exemplar business groups in Asia—namely Reliance of India, and SK (formerly Sunkyong) of Korea. We reviewed both company documents and websites to generate the necessary data for our analysis. The authors of this article independently analyzed the evolution of these two business groups, and identified the same strategic response pattern. The pattern of evolution mirrored across these groups offers strong anecdotal support for the vertical integration strategies thesis. Both groups distinguished themselves in their home countries first by ameliorating unique sources of market failure. By using examples of successful business groups again we emphasize that we follow a normative approach formulating the propositions in this paper, providing case illustrations, and raising the evolution possibility.

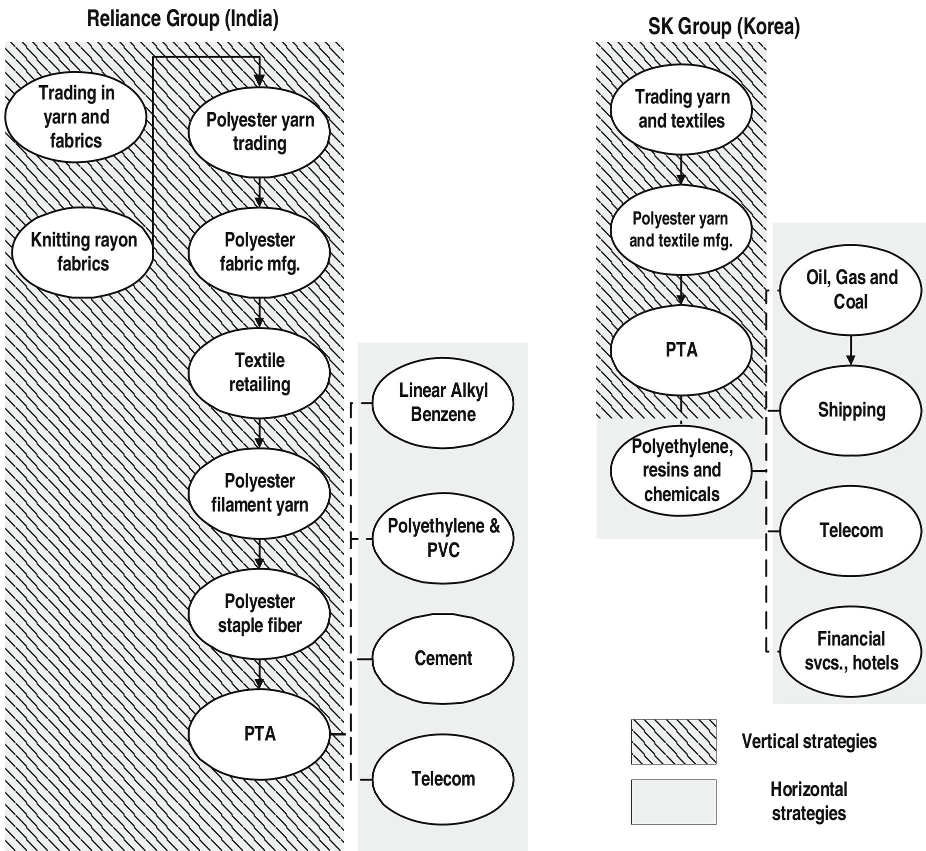

Figure 2 The evolution of two business groups in Asia

Reliance Group Reliance originated in the 1960s as a company engaged in the import and export of textile fabrics and yarns, specializing in rayon, which was in short supply in India. With the onset of modest growth, the company was forced to manufacture its own rayon fabrics since local manufacturers were not able to provide adequate quality and quantity to sustain its trading business. This move into manufacturing in the 1970s and 1980s coincided with the rise of polyester as a replacement for rayon. After having entered the polyester business first as a trading company, Reliance soon integrated forwards to manufacture its own fabrics and opened a significant number of company owned outlets to retail the fabrics. The move into retailing later was meant to overcome infrastructure failures which included a weak wholesaler network and a desire to promote the company brand directly to the end user. It also commissioned a state of the art design studio to help the company create the type of designs that would captivate the Indian consumer. Soon, Reliance's demand for polyester filament yarn (PFY) outstripped locally available capacity. This led to further backward integration, in 1980s to manufacture its own PFY and subsequently into polyester staple fiber (PSF), the two alternative inputs for producing fabrics. Given its large consumption of these

synthetic fibers, the company was using substantial quantities of PTA and MEG which were intermediate chemicals used to manufacture the fiber and yarn. Lack of dependable local supplies led the company to once again integrate backwards ultimately setting up a profitable petrochemicals business. This later led to an entry into oil and gas, which are the feedstock for petrochemicals manufacture during 1990s.

Having marshaled an impressive array of skills and resources in setting up each of these links in the vertical value chain, Reliance leveraged this expertise, as posited by Peng et al. (2005) to enter industries such as cement and telecommunications (Peng, 2003). Interestingly, these industries shared similar features such as regulatory market failure, stringent government involvement, and very high capital requirements for entry—all dimensions that the company had effectively mastered in building it petrochemicals and textiles portfolio.

SK Group The evolution of SK shares many similarities with the story of Reliance. Originally founded as a textiles trader in the 1950s, the company in the 1960s moved into the manufacture of textiles when it saw lucrative opportunities for exports. Given the lack of an adequate supply base at home, this backward integration move was warranted. Very much like the Reliance story, SK in the 1970s moved into manufacture of polyester yarn and fiber to overcome local supply obstacles. It then integrated once again to manufacture the raw material for production of polyester fiber, PTA. A foray in the 1980s into petrochemicals and oil and gas was undertaken for reasons similar to Reliance.

Having established its dominance in managing the petrochemicals and textiles business, the company in the 1990s entered into the telecommunications marketplace with the blessings of the government that was looking to privatize part of the state owned infrastructure. Since SK had demonstrated skills in managing infrastructure projects, combined with an ability to innovate with leading edge technologies, the choice was well founded. The capital market access that the group enjoyed allowed it to make investments in growth areas leading to a diversified portfolio. In 2000s SK Group expanded into IT and life sciences.

These two examples illustrate how business groups can originate as focused ventures that evolve around supporting a fairly small range of products and services. The expansion of such entities is largely a process of addressing debilitating market failures largely within the arena of securing supply chains and consequent need to build capacity in vertical businesses to support the core. This pattern of evolution supports the creation of generalizable skills and resources, which the group then becomes uniquely positioned to leverage through horizontal strategies of concentric or conglomerate diversification. Thus, vertical strategies might indeed prove to be legitimate vehicles for mitigating market failure, an avenue that research has yet to address comprehensively.

The lessons from developed contexts may indeed prove to be quite illuminating. For example, Chandler, in studying the American corporations, portrayed firms as engaging in lock step movements to internalize key activities, respectively, with vertical integration strategy and diversification strategy (Chandler, 1962). Transaction cost economics also advises that firms exist as an alternative to market mechanism (Coase, 1937; Williamson, 1971, 1975). It is therefore conceivable that firms in emerging economies such as Reliance and SK, pursue vertical strategies as a way to gain critically needed skills and capabilities (Galbraith & Nathanson, 1978; Lee & He, 2005), and to overcome the most critical contingencies the environment imposes—product market failure. We however would also note that the similarities might stop there, since firms in emerging contexts may adopt different strategies when beginning to deal with capital market and managerial labor market failures.

Looking back and looking ahead

We have offered a conceptual model that links variations in market failures with different forms of corporate strategy. In contrast to past research and thinking that has painted organizational response to market failure with the same brush, we argue that the important differences in the sources of market failure would call for differences in strategic posture. Thus, horizontal strategies might not always be the best approach to addressing market failure. In developing the model, we clearly identified vertical strategies as a crucial link in understanding business groups. With the help of this cross-sectional assessment, we are able to discuss how business groups might evolve. The conceptual model developed in this paper has broadened our understanding of business groups, market failures, and corporate strategies in emerging context.

This research has important potential implications to business group executives in emerging economies. In the same spirit as Khanna et al. (2005) providing guidance to multinational executives, we believe it is important to have an accurate assessment of the level of development of various important markets and devise each enterprise's strategic responses. Going beyond the extant recommendation, we however would suggest for these executives to evaluate the condition of each market and consider corresponding responses that include both vertical strategies and horizontal strategies. Furthermore, our study would also prescribe that when business groups confront multiple market failures they focus on one or more failures that pose the greatest challenge! In fact if our speculation is reasonable, we would suggest deploying vertical strategies to remedy product market and skilled labor market failures first. Only when business groups are able to deal with those critical contingencies and develop resources and competences should they move to address managerial labor market failure and capital market failure via horizontal strategies.

In addition, it helps identify several important research directions. First, the theoretical discussion has led to several empirically testable propositions. We may be able to evaluate different emerging economies, and examine if uniquely different corporate strategy patterns exist. This theoretical discussion effort nevertheless represents only one preliminary step. For the purpose of our discussion we combined several possible vertical strategies (quasi, taper, and full vertical integrations) together, likewise we also put several possible horizontal strategies (related diversification, hybrid of related and unrelated and finally unrelated diversification) together. Researchers may wish to consider carefully the return on investment as we develop a more fine-grained model linking both vertical and horizontal strategies to market failures. Second, our postulates regarding the evolution of groups is also a worthwhile direction for future research to pursue. Third, our conceptual model can be enriched by addressing a variety of the questions that it raises. What should be the main value added of the headquarters in a business group? Should it focus on internal market operation, and conglomerate group management? Should it also get involved in nurturing and linking primary value chain activities at the group company level? Would these resource and capability management skills change as the institutional contexts change? This research direction can be quite promising as scholars emphasize the importance of corporate headquarters when understanding strategic management (Chandler, 1991; Goold et al., 1994).

Finally, in the current context of rapidly evolving multinationals, it might be crucial to understand the role that emerging market business groups can play in making the transition to the global arena (Lin, Ping, & Chiu, 2005; Peng, 2005). For example, does the

experience of groups in dealing with market failure at home allow them to gain advantages in addressing the challenges of international expansion? Anecdotal evidence from groups such as Samsung and LG seem to suggest that group evolution in these markets might indeed bestow unique advantages on such firms (Lee & He, 2005). Some researchers focus on the unique resources and capabilities these firms develop in dealing with tough competition (Sinha, 2005), others focus on institutional skills and capabilities (Guillen, 2000; Mathews, 2006; Peng, 2005; Peng et al., 2005). Will the emerging economy multinationals be relying upon the market based advantages or institutional based advantages or both when they expand globally? To what extent do these firms will enjoy unique advantages? Interestingly enough, multinationals from developed countries engage in non-market strategies or institutional management strategies as they expand globally (Baron, 1995; Teece, 1981). These firms learn through practice in the new environment. Would emerging economy multinationals with such skills be able to enjoy unique advantage? These are but few of the promising directions that future research might be able to explore in enriching our understanding not only about emerging markets but also the function of groups as mechanisms to address global competition.

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