

**The effects diffuse and direct of political strategy on the diversification of business groups**

**The Role of the state and state owned enterprises in the development of business**

**Business Groups, Diversification, Political Strategy**

## **The effects diffuse and direct of political strategy on the diversification of business groups**

**Abstract:** Diversification is an important aspect of business group's strategy. Existing explanations about political foundations of diversification are too broad (Schneider, 2008). We conducted an in-depth qualitative research through interviews and extensive secondary data to unveil the mechanisms by which firm's political strategy influences business groups' diversification. Political strategies stressed by literature (Hillman and Hitt, 1999; Claessens et al., 2007; Faccio, 2006; Bandeira-de-Mello and Marcon, 2011) are present in sixteen diversifications analyzed. We contribute to theory by adding an explanation about how political strategy mechanisms affect business groups' diversification.

### **1 Introduction**

The Business Group (BG) is an organizational model characterized by legally independent firms, with a stable relationship, which operates strategically in multiple sectors and are under common control and property (Colpan and Hikino, 2010; Cuervo-Cazurra, 2006; Khanna and Yafeh, 2007). Diversification is one of fundamental characteristics of business groups' strategy. The mainstream theory – transaction costs (Williamson, 1975, 1981), argues that diversification is necessary to increase the groups' internal market and as consequence reduce the transaction costs (Khanna and Palepu, 1997). Economic politics theory offers a second explanation to diversification. Business groups diversify seeking to be big enough to enhance his influence on governmental actions. Authors argue that business group patterns of diversification vary enormously across countries and often within countries as well. In this stream, variation can be explained through government pressures and politics resources (Schneider, 2008).

The existing explanations of the Business Groups diversification are too broad and it does not explore the mechanisms of political strategies (Schneider, 2008). We advance existing theory through unveil the mechanisms used by groups to diversify. We evidence the mechanisms showing the relation between the dimensions of diversification proposed by Schneider (2008) and the political strategy of the business groups (Bandeira-de-Mello and Marcon, 2011; Claessens et al., 2008; Hillman and Hitt, 1999; Faccio, 2006; Fisman, 2001).

The Brazilian context is adequate for this study because groups' relation with government is pervasive. There were a recent growth and diversification after 30' decade. Government has a high participation as actionist (Schneider, 2008; Xavier, Marcon, and Bandeira-de-Mello, 2013). The existence of a relationship between firm and government is taken as a phenomenon rooted in the national culture (Aldrighi and Postali, 2010). And finally, in Brazil there is available data to isolate and analyze the mechanisms of diversification. In 2012, the Brazilian Ministry of Defense called upon business group contractors to enter the military sector and as an incentive proposed a purchasing budget of R\$ 70 bi until 2015 and billions more are expected until

2030 (O Globo, 2012). In the same year, an example of a response from the firm to the governmental incentive, which demonstrates the existence of political connections between the BG and the Government, was the hiring of Henrique Meireles, ex-president of Banco Central do Brasil, to preside the administration council of J&F Investimentos SA, JBS S.A.'s holding, the largest processor of animal protein in the world (Exame, 2012).

In this context we analyze how political strategy affect business groups diversification. We conducted an in-depth qualitative research in order to unveil the mechanisms through which the politic strategy affects diversification process. We followed the Rama (2013) suggestion to tackle such a sensitive issue using both primary and secondary sources. We analyze 16 diversifications of 6 business groups, with 16 interviewees and 435 documents of secondary sources.

Our main contribution is proposing an alternative approach to business group diversification, which focuses on how political mechanisms influences it. We propose that reactive and proactive behaviors have different effects on diversification of business groups. If the diversification has origin on a groups' strategy the relationship between political strategy and diversification is easier to establish and we call it as "direct effect". If the origin of diversification is a government action the effect of political strategy is not that much clear and to that cases we call it "diffuse effect". Both situations could suffer group's political history influences.

## **2 The diversification of Business Groups: A political perspective**

Diversification is one of the fundamental characteristics of business groups (Khanna and Yafeh, 2005; Schneider, 2008, 2009). The act of diversifying the economic activity in which the BG operates may or may not be related (Chang and Hong, 2000; Colpan and Hikino, 2010; Granovetter, 1994; Khanna and Yafeh, 2007; Leff, 1978). The business group may enter a sector in which it does not operate (from animal protein to civil construction, for example), or may expand to a sector in which it's already present (from cattle slaughter to leather processing, for example). The literature suggests that this decision of diversifying is influenced by government actions and by the political strategy adopted by the BG (Khanna and Palepu, 2000; Schneider, 2008, 2009).

### **2.1 The Governmental Influence**

The Business Group is defined as a formally independent firms which operate in multiple sectors, sometimes unrelated, and that are under common control of a family or people with whom they have a personal, trustworthy relationship (Chang and Hong, 2000; Colpan and Hikino, 2010; Granovetter, 1994; Khanna and Yafeh, 2007; Leff, 1978). They are present in several countries under various denominations: in Korea they are called "*chaebol*", in Japan by "*Keiretsu*", in Latin America by "grupos econômicos", in Pakistan "the twenty two families"(Granovetter, 1994), in Russia "*oligarchs*", in China "*QiyueJituan*" (Lee and

Kang, 2010). According to Cuervo-Cazurra(2006) the groups can be classified by the type of ownership: Family groups, controlling group and State-owned group.

The approach of economic political strategy considers the influence of the government in the diversification of the business groups (Schneider, 1998, 2008). The group is considered to be an instrument to reach the government's political and economical goals (Yiu, Lu, Bruton, and Hoskisson, 2007). There is no doubt about the influence that the government has on the business groups (Khanna and Yafeh, 2007). The Japanese groups, *keiretsu*, emerged during the post-war era as a result of a program of government privatization, they expanded and diversified their activities in response to governmental contracts granted under special conditions (Shimotani, 1997). In Korea, the business groups had a very close relationship with the government and were able to enjoy the benefits because of the preferential access to allocation of credit resources in foreign currency made by the government (Khanna and Yafeh, 2007). In Israel, the groups emerged as a result of some economic governmental policies (Maman, 2002) and the increase of the "oligarchs" in Russia is another recent example of the rise of groups under government rule (Guriev and Rachinsky, 2005; Khanna and Yafeh, 2007). However, there were periods in which governments have harmed business groups instead of assisting them. In Chile, during Pinochet's government, in 1973, free market and anti-concentration of property policies were adopted. When the communist party took power in China in 1943, it generated hostility between the government and business groups. Despite some negative relationships throughout history, the relationship between government and business groups has helped to develop economically diverse sectors in a simultaneous manner (Colpan and Hikino, 2010).

Advances resulting from studies on the diversification of BGs have helped to comprehend the part political strategies play in this process. Costa, Bandeira-de-Mello and Marcon (2013) demonstrates evidence of the influence of donations given to political campaigns in the diversification of Brazilian business groups. Bandeira-de-Mello and Marcon (2011) suggested that the BGs moderate the effect of political connections with preferential loans and that national groups use their political capacity better than foreign groups (Bandeira-de-Mello and Marcon, 2011). On the other hand, Xavier, Marcon and Bandeira-de-Mello (2013) suggest that the institutional environment significantly affects the performance of the business groups and that this effect is moderated by political connections when this is made through the federal government as a minority stakeholder of the group.

The diversification of business groups is not homogeneous when compared from the perspective between different countries and inside the country, the political relations between BG and government help to comprehend this (Schneider, 2008). The Asian groups are approximately double the size of the Latin American groups (in percentage of sales of the Gross Domestic Product). In the 20th century the policy of promoting exports allowed the Asian groups to expand, whilst the replacement of imports in Latin America limited the development of the groups. Furthermore, the incentive to set up multinationals in Latin

American countries also restricted the growth of local groups (Schneider, 2008). There is evidence that the diversification of business groups is more common in less developed markets (Khanna and Yafeh, 2007). However, business groups are also present, even with less intensity, in developed countries. In the USA, the government's actions have had great influence on the development of the groups (Schneider, 2008). Before 1930 the groups were common in the country, however, with the advent of Roosevelt's administration they were practically extinguished, as taxes were imposed, stopping their development. Decade's later incentives were created and groups started having representativeness again (Morck, 2010; Schneider, 2008). In Italy, after WWI there was an accentuated development of business groups, especially due to governmental incentive in favor of fusions and acquisition of firms of non-related sectors (Amatori, 1997).

According to Schneider (2008) the strategic choice for diversification may occur due to the existence of institutional deficiencies, an explanation that comes from the theory of transaction costs (Williamson, 1975, 1981) as well as by motivation better understood from the perspective of political relations (Schneider, 2008). In most cases, especially in developing nations, political motivations are present and influence the diversification of business groups (Ghemawat and Khanna, 1998; Schneider, 2008; Yiu et al., 2007). According to a study done by the Inter-American Development Bank, in 2003, Latin America is more volatile in relation to politics than Europe and Asia, for example, and thus the business groups have more incentive taking them to sectors of their interest (Ghemawat and Khanna, 1998; Schneider, 2008). Evans (1995), Wade (1990) and Amsden (1989) argue that the government plays a central part in modeling the trajectory of growth and investment of the firms, influencing and disciplining businessmen to make investments that are of interest to the government, using incentives, such as selective subsidies and protection against foreign competition. Research about this perspective argues that diversified business groups are a mechanism to promote public politics and industrial development (Khanna and Fisman, 2004). Government incentive can vary from direct promotion, such as incentives so that a certain group can enter a sector of interest of the government, or even indirect promotions, such as incentives to an entire sector through fiscal benefits and tariff protection (Schneider, 2008). These government choices enable and constrain the operation of the groups. They establish limits of expansion and incentivize diversification by stimulating fusions and acquisitions, tariff protection, access to capital, norms for joint ventures and expansion control of multinationals and state-owned enterprise.

## **2.2 Business Groups Political Strategies**

The government has, therefore, enough power to influence operations and processes of firms (Pearce, 2001). The BG's is not a passive character in this process. With the aim of obtaining better performance and competitive advantage, the group uses various tools to influence government's decisions. In general use their growth to have access to politicians and legislative and regulatory processes (Hillman et al., 1999), to have preferential treatment (Faccio, 2006) and easy access to funding (Claessens

et al., 2008). There is, therefore, interdependence and constant exchange between groups and government (Salisbury, 1969). According to Hillman and Hitt (1999) there are three dimensions of a firm's political strategy: (i) approach of political strategy; (ii) level of participation; and (iii) strategic mechanisms. These three dimensions represent the sequence used by the firms to formulate their political strategy. There are two main approaches, reactive and proactive. The reactive characterizes the firms that only follow the development of public politics and the proactive refers to companies that operate and search for involvement with the development of public politics (Hillman et al., 2004). The researchers added another characteristic to these dimensions, they point out that the proactive behavior as the engine of political strategies, as a consequence the firm can take a transactional and the relational approach. Transactional approach the firm takes sporadic measures of political strategy and has a relationship on an ad hoc basis with the government. In the relational approach, the firm takes measures of political strategy in a more systematic and lasting manner, building a relationship with the government (Hillman and Hitt, 1999; Hillman et al., 2004). The level of participation of the firm may be characterized as individual or collective. An example of individual strategy is the practice of lobbying, which searches for direct influence on decision-making politics by the government. The collective strategies are normally implemented by associations or entities, which also have great influence on political decisions (Hillman and Hitt, 1999). The decision to adopt individual or collective strategies is also conditioned by the size of the company, for example. A large company, which has more political power, tends to opt for an individual strategy. Firms with less financial power tend to opt for a collective strategy (Hillman and Hitt, 1999), which increases the representativeness of their actions.

After the firm has opted for the transactional or relational strategy, collective or individual, the third division includes tactics or specific mechanisms or generics used by the firms (Hillman and Hitt, 1999). Some of these tactics were described by Bandeira-de-Mello and Marcon (2011): (i) corporate donations to political campaigns (Claessens et al., 2008); hiring of politicians to the administrative council (Faccio, 2006); and, (iii) participation of businessmen in the public life, aiming to influence legislation, obtain privileged information and even influence government spending favorably towards their companies (Bandeira-de-Mello and Marcon, 2011; Hillman, Zardkoohi, and Bierman, 1999). The referred tactics are denominated political connections (Faccio, 2006).

Political connections play an important part in the biggest economies in the world (Fisman, 2001) and are present in the firm-government relationship in every country (Faccio, 2006). However, there is an emphasis on this in the emerging markets, where the part the institutions play is not fully developed, where corruption is more latent and in which there are certain impositions over foreign investment (Faccio, 2006; Fisman, 2001; Li, He, Lan, and Yiu, 2011). The way the groups are composed and formed facilitates the use of political connections between the affiliates (Bandeira-de-Mello and Marcon, 2011). Many studies

show that groups that possess political connections have greater benefits than ones that don't (Bandeira-de-Mello and Marcon, 2011; Claessens et al., 2008; Faccio, 2002; Fisman, 2001). Benefits such as access to funding, lower taxes and fees and market power. For example, in 1998 the International Monetary Fund forced the then Indonesian president to sign a deal in which companies controlled by his family would no longer accept government concessions that protected them from the competition in the domestic market (Faccio, 2002). The firms that had political connections in Indonesia lost market value, after rumors about the health condition of the then president emerged (Fisman, 2001). The value of the firms with political connection in Malaysia, during the Asian crisis, also dropped after the reduction of government subsidies and the imposition of capital control (Johnson and Mitton, 2003). Other studies show that political connections lead firms to diversification in different sectors and that these connections depend on institutional issues in which the firm is inserted. For example, a study done with 1.280 Chinese corporations, between 2002 and 2005, showed that political connections influence the non-related diversification in firms with emerging economies (Li et al., 2011). Empirical results show that in Brazil politics guarantee business group's diversification, instead of only the economical mechanisms (Costa; Bandeira-de-Mello and Marcon, 2013).

Economical, social and political factors can coexist when explaining the diversification in a determined business group (Schneider, 2008). The perspective of transactions costs (Williamson, 1975, 1981) limits itself when it discards the strategy of the expansion of the firms without the political element (Hoskisson, Johnson, Tihanyi, and White, 2005; Schneider, 2008). It is important to highlight that the business groups are influenced by the government and the government is also influenced by the groups (Schneider, 2008).

### **3 Methods**

We opted for a qualitative methodology because the objective of this study is to analyze the mechanisms of the political strategies in the diversification of the Brazilian Business Groups. Therefore, it is coherent to proceed with research, which presents a detailed report of a social phenomenon, aiming to find patterns in the researched data from conceptual categories which may or may not reinforce the presented literature (Eisenhardt, 1989; Yin, 2005).

The unit of analysis is diversification of Business Groups. Our study was conducted with primary and secondary data. To assure its validity and reliability, three principals were respected with regards to sourcing and collecting data: (a) we used various sources of evidence for each diversification prioritizing data triangulation (Eisenhardt, 1989; Yin, 2005); (b) we created a database for each diversification, considering data to be all of the reports, such as texts, charts, collected notes; and (c) we maintained the sequencing of evidence seeking to ensure that initial questions lead to conclusions of the case study (Eisenhardt, 1989).

The sample of Business Groups was selected from the quantitative data of Costa, Bandeira-de-Mello and Marcon (2013) and

Camilo, Marcon and Bandeira-de-Mello (2012). We set up a matrix showing the variation of diversification and types of political connections of 95 business groups, with open capital, present in the studies mentioned. Among the selected groups there are families, an ownership and a controlling group. This choice was not randomly made, as suggested by Eisenhardt (1989), taking in consideration the behavior and diversification of the BG throughout the years that were analyzed. As a main source of evidence we conducted interviews with representatives of business groups and specialists on the subject matter. We used a semi-structured script of questions and the interviews had an average duration of 50 minutes. This process started in June 2013 and lasted until October 2013. In total there were 16 interviews, in which 10 were with members of the board and employees of Institutional Relations of 7 business groups and 6 of them with specialist. These specialists are relevant in the analysis because they work for the state government; they are consultants of governmental relations, ex-politicians from the federal government or ex-employees from the Banco Nacional de Desenvolvimento Econômico e Social (BNDES).

We used many sources of secondary data as a way to validate the data collected from the interviews (Rama, 2011). The sources of secondary data we used were: (i) the compendium of official documentation of the groups, from the formation of the group until the present time; (ii) studies and evaluations already made about the business group; (iii) newspaper articles and stories published in the media; (iv) economic and sector studies; videos; (v) data from the Senate and Chamber of Deputies websites; (vi) the Sudene and Banco Nacional de Desenvolvimento Econômico e Social websites; (vii) the quantitative data used in Costa's (2012) studies to capture the diversification and political campaign donations; and (ix) quantitative data used in Camilo, Marcon and Bandeira-de-Mello's (2012) study to capture politicians present on the group's board. In total 435 documents from 13 sources were used as font of secondary data. As a way to guarantee the necessary confidentiality of the identity of the interviewees and their groups, a non-disclosure agreement was offered. This way, all of the interviewee's names and their respective groups or entities, which they are a part of, were preserved as much as possible. A group of codes was used in order to have the possibility of establishing a relationship between individuals, groups and diversifications analyzed in this study. At table 1 we codified all secondary data in order to keep the confidentiality.

We resorted to the construction of categories of analysis that emerged from the concepts covered in the literature of diversification and political connections (Eisenhardt, 1989) to recover, organize and condense all of the collected data (Miles and Huberman, 1994). From the categorization, the information was codified into the categories in a way that the descriptive or inferential information could be compiled and attributed to a unit of meaning during the study (Miles and Huberman, 1994). The codifications used in Table 1 can be seen below.

**Table 1.** Categories of analysis of political strategies

<b>Categories of Analysis</b>	<b>Operational Definition</b>	<b>Authors</b>
-------------------------------	-------------------------------	----------------

Governmental Promotion	Government actions to providing funding, subsidies for acquisition of technology, land or purchasing.	Hoskisson et al., 2005; Schneider, 2008
Privatization	Actions of privatization of state-owned firms.	Schneider, 2008
Fusion and Acquisition	Alterations or effects of the antitrust law for fusions and acquisitions, control of the entrance of multinationals and control of activity of the state-owned enterprises.	Kock and Guillén, 2001; Schneider, 2008
<i>Joint Venture</i>	Cases of multinationals, which establish joint ventures with national groups.	Guillen, 2000; Johnson and Amsden, 2001; Schneider, 2008
Fees	Protection of the domestic market via fees, such as import substitution.	Schneider, 2008
Campaign Donation	Evidence of events in which the business groups contributed to candidate's campaigns and in exchange, received advantages.	Bandeira-de-Mello and Marcon, 2011; Claessens et al., 2008
Politicians on the <i>Board</i>	Hiring of politicians to the administrative council as one of the main stakeholders or president of the group.	Bandeira-de-Mello and Marcon, 2011; Faccio, 2006
Personal Relations	Participation of businessmen in the public life.	Bandeira-de-Mello and Marcon, 2011
Transactional/Relational Approach	Transactional: evidence of holding the formulation of public politics with an ad hoc relationship with the government. Relational: evidence of proactive action with public politics aiming for long-term relationship.	Hillman and Hitt, 1999
Level of Individual/Collective Participation	Individual: evidence that the group is communicating to the government individually; Collective: evidence that the group is communicating with the government via association.	Hillman and Hitt, 1999
Related/Non-Related Diversification	Evidence of diversification of the business groups to operate in multiple sectors, related or not.	Chang and Hong, 2000; Colpan and Hikino, 2010; Granovetter, 1994; Khanna and Yafeh, 2007; Leff, 1978

We completed the data analysis in two stages. The first was an individual analysis of the diversifications, in which we analyzed each of the diversifications that emerged from the collection of primary and secondary data, in a way that allowed for insights for better development of the research (Eisenhardt, 1989; Miles and Huberman, 1994). For this first analysis, the use of the software Atlas TI was essential to organize the data and code it, and make notes regarding each case. In the second stage we used the inductive analysis method, which allowed, from the integration between the gathered data and the existing theoretical structure, the deduction of the final conceptual proposition (Eisenhardt, 1989).

## 4 Findings

This section will be divided into three stages. In the first we will describe the 16 cases of diversification and the mechanisms used by groups and the governmental action as an incentive for diversification. The second stage contains the description of political strategies of the business groups. In the following stage we will report the questions raised and the conceptual proposition.

### 4.1 Case Description

The description of group's diversifications through the government incentives and the group's political strategies were

extensively examined by interviews and secondary data. Even when the group did more than one diversification we isolated one as a unique unity of analysis. In order to constitute the description of groups' political strategy in each diversification we asked interviewees to explain how the group operated in that situation. Moreover, we searched secondary data seeking to find more facts that were important to understand how the relationship between group and government was constituted. In some cases, the group started the process of diversification in other cases the origin was a governmental action that gave incentives to groups' diversification. In the Table below we show the description of our 16 diversifications cases.

**Table 2. Case descriptions**

<b>Group</b>	<b>Sector that group diversify</b>	<b>Diversification</b>	<b>Diversification Mechanisms</b>
A	Lumbering, finances and insurance, parts and pieces, commerce, trading, representation of sales and transports	(1) Entry: reforestation sector (2) Entry: port sector	Fiscal benefits from federal government; Group's director with personal relationship; Partnership with financial fund that federal government is shareholder - Previ (Pension Insurance of Employees of Banco do Brasil) and BNDES;
B	Agribusiness, textiles, logistics, construction, real estate developments and finance	(3) Entry: energy sector	Privileged information from the government; PPT (Priority Program to Thermoelectricity), which guaranteed it would have access to natural gas for 20 years at privileged prices. Furthermore, they had the guarantee of purchasing energy generated in the plants in the same period
		(4) Entry: Internationalization of the textile sector and the entrance into retail	The entry into the American market had the support of BNDES-Exim with funding of USD 40 million for the distribution center in the United States; The group participated in the forum of CEOs Brazil-USA, which facilitated the relations and the business developments in the country.
		(5) Entry: factory in northeast	Family relationship with local government; The group was invited by BNDES to take over the assets of an already existing factory. This diversification was supported by Sudene, Banco de Desenvolvimento de Minas Gerais and fiscal incentives available in the Northeast region.
		(6) Entry: factory in northeast (2)	Government fiscal benefits; Financial benefits from government;
		(7) Entry: factory in northeast	The governor of one of the states in the Northeast donated to Group B a plot in a city in the inner state for the construction of another factory. According to the interview granted by the mayor of the city, Group B was very important to the region and they had interest in keeping them in the state.
C	Pulp and paper, financial intermediation and insurance, services offered to companies, environmental licensing consultancy, construction and chemical products	(8) Entry: energy sector	Investments; Government incentives.
		(9) Exit: chemical sector	The group was associated with other companies in the sector together with BNDESPar for the creation of the industrial pole in the southeast of the country; A group controlled by federal government bet R\$ 2,7 bi to buy the group's chemical sector (evaluated at R\$ 1 bi) and it was sold.
		(10) Entry: factory in northeast (1)	Family relationship with local government; Protocol of intentions was signed with the state government, which allowed for better development of the industry in the region. Financial and Fiscal benefits; Developed direct contact with the Secretary of Industry and Commerce, Secretary of State, Secretary of Treasury and Environment, as well as the Secretary of Public Security; In 2010 a financing line was approved with the BNDES program – Program of

			Investment Sustainability; The state where the industry was installed is part of the Sudene territory, and because of this, industries installed in the region have fiscal benefit of income tax of 74% and the industry was benefited with the exemption of AFRMM (additional freight for the renewal of the merchant navy).
		(11) Entry: factory in northeast (2)	Joint venture with BNDES; The BNDES still has today 27% of the preferential shares of this controller of Group C; Protocol of intentions was signed with the state government, which allowed for better development of the industry in the region. Personal relations; The expansion in the northeast counted on financing from BNDES, Banco do Nordeste do Brasil (BNB), ECAs (Export Credit Agencies); This diversification holds federal fiscal benefits with reduction of 75% in income taxes resulting from the profit of its exploration activities, the conversion of 30% of the tax that is owed in modernization projects until the year 2018 and a reduction in municipal taxes from 5% to 2%. In this case, there was a situation of public security in the state where the factory is located and the group handled the matter individually and not collectively.
D	Insurance, chemistry, transports, trading, and commerce	(12) Entry: financial sector	Essential to get credit approval from BNDES, this way the group started to act as a direct representative of the BNDES in the market;
		(13) Expansion: portfolio product	Approximation of the group with the federal government, via association, which generated the necessity of the government to acquire a certain personalized product to serve the rural population; In 2007 a program of R\$ 600 million was approved by the federal government, which was financed by BNDES, where they were given the incentive of tax exemptions, besides financing for the companies that bought products from the group
		(14) Entry: Internationalization to Egypt	The process of internationalization of the group in general was supported directly by BNDES, between 1998 and 2004 there were more than 154 hiring made by the group; Especially for Egypt, aside from the support from BNDES, it was also of extreme importance to associate with the local government, according to the director of the group. In every country the group does joint ventures in order to adapt more easily and in Egypt it was no different. The local partner of the group had a strong relationship with the government and was able to speed up the processes of opening the company, approval products and hiring of personnel, all of which were made in one week. If it weren't for that, according to the interviewee, these processes could have lasted 6 months.
E	High concentration of innovation and technology for transports, parts and pieces	(15) Entry: satellites and submarines sector	National Program of Space Activities of the federal government. There was no bid, just a direct demand from the government for service from this two companies whose developed the geostationary satellite. BNDES and the Brazilian government have supported this group in various ways, (i) funding; (ii) buying of debentures; (iii) support to research and development; (iv) sales support, especially through funding lines to exports; and (v) supporting sales in the internal Brazilian market.
F	Logistics, hygiene and cosmetics, innovation and technology	(16) Expansion: portfolio of products by opening two factories in the North of Brazil	The group petitioned for fiscal exemption, fiscal benefits, a construction license, and an environmental license; One of the documents of the Treasury Secretary of the state of Pará shows that the ICMS charges on the merchandise transported and produced in this factory were granted; There is a constant involvement of the group in institutional relations and public politics. There is also strong involvement from BNDES in the larger investment actions, as well as investments of the ministries, governments and municipalities in the group's actions. According to this group's interviewee (Institutional Relations Manager of Group F): "Without support in the area of institutional relations, it would be complicated

---

to implement the factory in a way that met the interests and values of the group”.

---

In Table 2 we presented in the first column the code of the group, in second column the group’s sectors, in the third column the group diversification case and in the last column the description of the government incentives and the political strategy used by the groups. For example, Group F operates in the sectors of logistics, hygiene and cosmetics, innovation and technology and diversified its portfolio of products by opening two factories in the North of Brazil. The first was opened in 2007 and the second in 2011. This related diversification started a process of institutional relations in search of public politics that enabled the project. Thereby, in parallel to the construction of the plant, other subjects were dealt with, such as, sustainability issues, fiscal management and logistics. The issues of sustainability were dealt with through the Amazon Program, which was implemented with the aim of developing the Amazonas Center of Knowledge, factory and other initiatives. They petitioned for fiscal exemption, fiscal benefits, a construction license, an environmental license, amongst others. One of the documents of the Treasury Secretary of the state of Pará shows that the ICMS charges on the merchandise transported and produced in this factory were granted. There is a constant involvement of the group in institutional relations and public politics. There is also strong involvement from BNDES in the larger investment actions, as well as investments of the ministries, governments and municipalities in the group’s actions. According to this group’s interviewee (Institutional Relations Manager of Group F): “Without support in the area of institutional relations, it would be complicated to implement the factory in a way that met the interests and values of the group”.

#### **4.2 Groups’ Political Strategies**

The mechanisms used by the groups in order to develop their political strategies, in some cases, can be directly related do the diversification. In other cases are developed throughout time and the majority can be understood as propellers of diversification.

**Group A** implements its political strategies through campaign donations, however, according to the director of the group’s strategy this is not something that the company are concerned with, they understand it as a symbolic issue rather than a strategy in itself. We can notice that it is not directly connected to the diversifications made by the group. For the institutional relation’s director, the main strategy of the group is the fact that they have a member on the council with large experience and institutional influence, which helps with the strategic politics. Diversification 1 made by the group was carried out only when there was initiative from the federal government, Diversification 2, on the other hand, was carried out when the group had a proactive attitude in seeking the government, which also played a key role in the process. They understand that “[...] it is not possible to dissociate from politics and that it is politics that defines the investment strategies.” (a director). In this case it is

very clear how the political strategies are still made intuitively in many groups in Brazil.

On **Group B** the implementation of political strategies such as campaign donations is done via the president of the group. The group has throughout its history a strong involvement and relationship with politics. There is not a department of governmental relations, let alone a clear political strategy. In the diversifications made by the group it is possible to notice the exchange of favors based on personal relations. Furthermore, BNDES has around 18% of the group's preferential shares. According to one of the specialists interviewed, the exchange of favors and relationships are still very common, there is a personalization of individual interests that is still very strong: "I helped you, now you have to help me" (a CEO). The group mentioned, operates in associations and forums and understands that collective action is more effective with the federal government by your side. In the secondary data it is clear that the actions with local governments are made individually.

In turn, **Group C** has a more defined structure in terms of political strategy. The group has an area of governmental relations in its holdings as well as in its controlled companies. In the past, the mechanisms of political strategy were due to family relations. This process started to change and today the political strategies have been based on more professional and structured mechanisms and tactics. As stated in one interview "[...] in the beginning we used to use political strategy as personal relations, but now we have two departments to take care about this subject in the holding and subsidiary" (a director). For example, the donations to electoral campaigns are made as pre-determined strategies by the board and by the area of institutional relations (a government relation manager). The politicians are chosen by the board and by the area of institutional relations, following the criteria of representatively and by the region in which they operate. The petitions with the federal government are made collectively, for example, issues of Reintegration or Reverse Logistics (a government relation manager). For the implementation of the factories in the Northeast, the group acted individually and used protocols of intent with local governments. The group uses an outsourced consultancy, which provides a service of legislation monitoring and government information.

**Group D** uses mechanisms of donations to electoral campaigns. They don't have specific politicians to whom they donate. They don't have a defined agenda to follow up legislation; from this year onwards they have started to structure this, according to the director. Thus, the group's strategy is to always give a small amount to each politician and to not leave anyone without receiving something. It is more of a preventive action rather than connected to some pre-determined strategy. They prefer to act with the government via associations because they understand it is more effective. It's what happened with Diversification 10 described in the previous section. Moreover, someone who's very influential in the government works on the board of the group, and leads the processes of political strategy.

The political strategies made by **Group E** are mainly based on donations made to institutions in the political campaigns and in relationships; donations are made with more emphasis to the institutions rather than the politicians. The institutional area is very small; however, the institutional relation processes have improved every year, because the group has been getting more attention. According to the vice president of the group “the relationship with the government is very natural” (a CEO). The group always has BNDES’ support even after the privatization and this intensified the relationship of the Brazilian government with the group. In Diversification 15, described in the previous section, this relationship is explicit, once the government developed a plan with a direct request from the Brazilian government so that the group would develop a certain product. There is support in terms of financing via BNDES and programs such as Proex and Exim throughout the group’s history. Evidence of this was a fact that was taken to the WTO (World Trade Organization) about the practice of using abusive subsidies in the government’s funding to the specific group.

Lastly, in **Group F** the political strategies are implemented through a profound analysis of the strategies of the group with a governmental agenda (a director). Every year the group draws the requests they will defend throughout the year, normally between 4 and 5 requests. They have a relevant participation in the discussion of public policies, which influence their business directly or indirectly. For example, the law on access to biodiversity, in which the request is to allow for a legal framework, which is sufficient so that other companies are also in this agenda. The intention is to promote, beyond the group’s business, the local development in areas of the Amazon and in other areas of the country, The Amazon was chosen strategically by the group. In this case the request was Federal, but they also operate in Municipal and State requests. An example of the municipal request is the issue of solid residues in which the communication is municipal and of the state. The group understands that transparency is important, so they disclose their practices in the annual report in a transparent manner. The mechanisms they use as a way to promote public politics are based on quality information. An outsourced consultancy firm with experience in public politics monitors and selects the information based on the constant relationship with the Congress and Senate and following up the interests of the group, which in its majority are connected to the sector’s interest. Since 2006 they have made no campaign donations, because they understand it doesn’t contribute to the democratic process so they invest the resources that would be donated in the promotion of the conscious vote. **Group F** works to build relations: “A relationship which later may help us build this process of public politics and not put out fires when they arise, or search for the guys when there’s trouble” (a director). In partnership with the specialized consultancy, Group F also developed a tool called “Parliamentary Proximity Index”, which is a system of information management of governmental relationships that generates the profiles and who the groups maintains relations with, and who participates in a process of public politics.

**Table 3: Political strategies of groups and governmental actions**

Group	Diversification	Historic of relationship	Origin	Evidence of link between strategy and diversification	General political strategy (unlinked to diversification)
Group A	1	No	Government	Group: N/A. Government: Fiscal incentive.	Donations to campaigns, relationship with the government, there is no structured agenda.
	2		Group	Group: relationship with the Federal and State Government. Government: Financing.	
Group B	9	Yes	Group	Group: Action via forum of the CEOs and BNDES financing. Government: Financing.	Donations to campaigns, relationship with the government, family ties, politician on the board, BNDES shareholder.
	3, 14,15,16	Yes	Government	Group: N/A. Government: favorable supply contract; land donation, fiscal benefit.	
Group C	5	Yes	Government	Group: N/A. Government: purchases above market value.	Donations to campaigns. Collective actions to deal with the federal government, individual actions to local governments, consultancy of public politics, BNDES shareholder.
	4, 12,13	Yes	Government	Group: Protocol of intent with the local government, relationship. Government: Fiscal exemption, financing, joint venture with BNDESPar.	
Group D	6, 8, 10,	Yes	Group	Group: Relationship with the local government and international; action via association. Government: privileged purchasing, BNDES financing.	Donations to campaigns, there is no structured agenda; influent executive in the federal government; collective actions to deal with the federal government, collective actions to deal with the federal government and individual actions to deal with the local government.
Group E	7	Yes	Government	Group: N/A. Government: joint venture with state-owned enterprise, specific government program.	Donations to campaigns, politician on the board, personal relationship, area of governmental relations.
Group F	11	No	Group	Group: Environmental and tax requests, building relationship with the local and Federal Government, via association and individually (respectively). Government: fiscal incentive, financing, support to environmental programs.	Collective action to deal with the federal government, individual actions with local governments, consultancy of public policies, building relationships with tools of relationship monitoring.

Generally, few groups have their critical agendas or their needs defined together with the government. We notice that a large part of the groups don't have expert knowledge about the decision process inside the government, we also noticed that relationships are still a strong aspect inside the business groups. Not only because of the groups, but there is a parcel of blame in the government in this process. The groups and businessmen need to understand that knowing the decision making process inside the public power is more perennial than having contacts, being close to a deputy and having a relationship. In the majority of the cases dealt with in this study, it's possible to notice that there is no speaker with the specific function of dealing with the governmental issue inside the Brazilian business groups. Normally this activity lies with the CEO or as a secondary responsibility of one of the directors, which makes it difficult to follow up and effectively monitor the government's political activity. In Table 3 the results we found are empirically summarized.

#### **4.3 Differential effects of political strategies on Business Group diversification**

This study proves that political strategies have direct or diffuse influence on the diversification of the business groups. As proposed by Hillman and Hitt (1999) and Hillman, Keim and Schuler (2004) it was possible to detect in the analyzed diversifications the influence of groups political strategies. The reactive and proactive behaviors, the transactional and relational manner and use the individual and collective levels of participation (Hillman and Hitt, 1999). Furthermore, the mechanisms of political connections used by the groups also vary from campaign donations to having politicians on the board, as well as building personal relationships (Bandeira-de-Mello and Marcon, 2011; Claessens et al., 2008; Faccio, 2006). Seven of the analyzed diversifications (1, 5, 6, 7, 9, 12, 15) are a result of government actions which offered benefits, incentives and funding to groups that adopted no direct political strategy relating to these diversifications. They had a reactive behavior. On the other hand, the proactive behavior may be identified in nine diversifications (2, 3, 4, 8, 10, 11, 13, 14, 16). In these cases, the political strategy precedes the government action aiming at diversification. The groups operate using communication with local governments, letters of intent, personal relationships, creation of a necessity for new products, need for funding for a certain diversification. These cases demonstrate the existence of a transactional political strategy approach.

We also identified that the groups opted for individual participation when the communication was made with the local government (province and city) and collective participation when the communication was made with the federal government. This occurred regardless of the size of the group, unlike it was proposed by Hillman and Hitt (1999). For example, in Diversification 2 the group opted for an individual approach, as there was a need for improvement of province roads for the diversification occur. Diversification 11 can also be mentioned, because the group turned to the Secretary of Security of a state in the Northeast to guarantee the integrity of a plant involved in the diversification. Diversification 4 was marked by communication of the group with the federal government. In this diversification the group used a CEO's forum to get resources

through BNDES, which would be important to the process of internationalization. Requests that are not directly connected to the diversification, such as the case of alteration of the guidelines of the Reintegration Program (Special Regime of Reintegration of Tax Values to Export Companies) also used collective communication.

With regards to the political campaigns, a large amount of the groups made donations (A, B, C, D and E). It was possible to see that these donations are used more as a form of maintaining a relationship, as well as creating access to the government, rather than as a way to ensure diversification. The use of politicians on the *board* is also a mechanism used by the groups - half of the groups analyzed used this mechanism. In none of the cases it is possible to directly relate this mechanism to diversification, and is clearly perceived as a way to ensure a lasting relationship. The personal relationships already appear clearly linked to diversifications 2, 3, 5, 6, 7, 10 and 11.

In order to explain the influence of mechanisms of political strategy in the diversification of business groups we propose that the political strategy effect is direct when the origin of diversification came from group, for example diversifications 2, 3, 4, 8, 10, 11, 13, 14, 16. When the origin of diversification came from government the political strategy effects is diffuse, for example diversifications 1, 5, 6, 7, 9, 12, 15.

*Proposition 1: When business group intent to do a diversification the effect of political strategy is direct.*

*Proposition 2: When government intent that the groups diversify the effect of political strategy is diffuse.*

Our study reinforces the history of the group's relationship with the government in the analysis of political strategy especially because in Brazil there is a relevant record of relationship between these entities, as exemplified by Caldeira and Spuldaro (2013) with the sugarcane sector. In the background typology of Hillman, Keim e Schuler (2004), the historic factor of the group is not treated with the emphasis that appears on these cases. We notice that the group's reactive positioning is explained because, historically they develop a very strong relationship with the government that allows them to act reactively when facing the possibility of diversification, as in the Diversifications 5, 6 and 7 and in the diversifications of Group C.

*Proposition 3: When business groups have a good history relationship with government the origin of diversification tend to be the government.*

## **5. Conclusion**

In this article we propose a new understanding of how political strategies influence the diversifications of the business groups, through the dimensions of groups' political strategy and governmental actions. We took into consideration 16 interviews with presidents, vice presidents, executives, directors of 6 business groups and specialists in the field, such as BNDES ex-directors,

ex-ministers, employees with a position of trust in the state government, as well as 435 files of qualitative and quantitative source of secondary data. We argue that the relationship between political strategy and diversification of the business groups has a relative basis, because the effect of the political strategy may be diffuse or direct, depending on the diversification the group will make, the history of the group with the government and the origin of the political strategy. Furthermore, the group's level of participation is individual when the communication is settled with local governments and it is collective when the communication is settled with the federal government. The political connection via electoral campaign donation had a more diffuse effect, rather than directly to the diversification. In general, the government operated by aiding the groups in response to their political strategies as well as having direct participation in the start of the diversifications.

Future research could build into explaining the effects and intensity of each political strategy in the diversification of business groups. Furthermore, future research could look in-depth how the groups develop the political strategies.

## Bibliography

- Amatori, Franco. (1997). Growth via Politics: Business Groups Italian-Style. In *Beyond the firm - business groups in international and historical perspective* (p. 320).
- Aldrichi, D. M., and Postali, F. A. (2010). Business Group in Brazil. In *The Oxford handbook of business groups*. New York: The Oxford University Press.
- Amsden, A. (1989). *Asia's Next Giant: South Korea and Late Industrialization* (1 ed., p. 400). New York: Oxford University Press.
- Bandeira-de-Mello, R., and Marcon, R. (2011). The value of business group affiliation for political connections: Preferential lending in Brazil. In *Annual Meeting of the Academy of Management*.
- Camilo, S., Marcon, R., and Bandeira-de-Mello, R. (2012). Conexões Políticas e Desempenho : um Estudo das Firms Listadas na BMandF Bovespa. *Revista de Administração ...*, 784–805. Retrieved from <http://www.scielo.br/pdf/rac/v16n6/a03v16n6.pdf>
- Chang, S., and Hong, J. (2000). Economic Performance of Group Affiliated Companies in Korea: Intragroup Resource Sharing and Internal Business Transactions. *Academy of Management Journal*, 43(3), 429–448.
- Claessens, S., Feijen, E., and Laeven, L. (2008). Political connections and preferential access to finance: The role of campaign contributions. *Journal of Financial Economics*, 166/2007. Retrieved from <http://www.sciencedirect.com/science/article/pii/S0304405X07001353>
- Colpan, A. M., and Hikino, T. (2010). Foundations of Business Groups: Towards an Integrated Framework. In *The Oxford handbook of business groups*. New York: Oxford University Press.
- Cuervo-Cazurra, A. (2006). BUSINESS GROUPS AND THEIR TYPES. *Asia Pacific Journal of Management*, (23), 419–437.
- Eisenhardt, K. (1989). Building Theories from Case Study Research. *Academy of Management Review*, 14(4), 532–550.
- Evans, P. (1995). *Embedded Autonomy: States and Industrial Transformation* (p. 336). Princeton: Oxford University Press.
- Exame, R. (2012). O preço de Henrique Meirelles para o JBS. *Revista Exame*. Retrieved from <http://exame.abril.com.br/revista-exame/edicoes/1012/noticias/o-preco-de-henrique-meirelles>
- Faccio, M. (2002). Politically-connected firms: Can they squeeze the State?
- Faccio, M. (2006). Politically Connected Firms. *The American Economic Review*, 96(1).
- Fisman, R. (2001). Estimating the value of political connections. *The American Economic Review*. Retrieved from <http://www.jstor.org/stable/10.2307/2677829>
- Franco Amatori. (1997). Growth via Politics: Business Groups Italian-Style. In *Beyond the firm - business groups in international and historical perspective* (p. 320).
- Ghemawat, P., and Khanna, T. (1998). The nature of diversified business groups: A research design and two case studies. *The Journal of Industrial Economics*, 46(1), 35–61. doi:10.1111/1467-6451.00060
- Granovetter, M. (1994). Business Groups. In N. J. Smelser and R. Swedberg (Eds.), *The handbook of economic sociology* (p. 835). Princeton University.
- Guillen, M. (2000). Business groups in emerging economies: a resource-based view. *The Academy of Management Journal*, 43(3), 362–380. Retrieved from <http://amj.aom.org/content/43/3/362.short>

- Guriev, S., and Rachinsky, A. (2005). The Role of Oligarchs in Russian Capitalism. *Journal of Economic Perspectives*, 19(1), 131–150. doi:10.1257/0895330053147994
- Hillman, A., and Hitt, M. (1999). Corporate political strategy formulation: A model of approach, participation, and strategy decisions. *Academy of Management Review*, 24(4), 825–842. Retrieved from <http://www.jstor.org/stable/10.2307/259357>
- Hillman, A. J., Keim, G. D., and Schuler, D. (2004). Corporate Political Activity: A Review and Research Agenda. *Journal of Management*, 30(6), 837–857. doi:10.1016/j.jm.2004.06.003
- Hillman, A. J., Zardkoohi, A., and Bierman, L. (1999). Corporate political strategies and firm performance : Indications of firm-spe ... *Management*, 20(1), 67. Retrieved from <http://search.epnet.com/login.aspx?direct=true&AuthType=cookie,ip,url,uid&db=buhandan=1466628>
- Hillman, A., Zardkoohi, A., and Bierman, L. (1999). Corporate Political Strategies and Firm Performance- Indications of Firm-Specific Benefits From Personal Service in the U.S. Government. *Strategic Management Journal*, 20, 67–81.
- Hoskisson, R., Johnson, R., Tihanyi, L., and White, R. (2005). Diversified Business Groups and Corporate Refocusing in Emerging Economies. *Journal of Management*, 31(6), 941–965. doi:10.1177/0149206305279895
- Johnson, C., and Amsden, A. H. (2001). *The Rise of "The Rest": Challenges to the West from Late-Industrializing Economies*. *The Journal of Asian Studies* (Vol. 60, p. 1120). doi:10.2307/2700025
- Johnson, S., and Mitton, T. (2003). Cronyism and capital controls: evidence from Malaysia. *Journal of Financial Economics*, 67(2), 351–382. doi:10.1016/S0304-405X(02)00255-6
- Khanna, T., and Fisman, R. (2004). Facilitating development: the role of business groups. *World Development*, 30.
- Khanna, T., and Palepu, K. (2000). Is Group Affiliation Profitable in Emerging Markets ? An Analysis of Diversified Indian Business Groups. *The Journal of Finance*, 55(2), 867–891. Retrieved from <http://onlinelibrary.wiley.com/doi/10.1111/0022-1082.00229/abstract>
- Khanna, T., and Yafeh, Y. (2005). Business Groups and Risk sharing around the world. *Journal of Business*, 78(1), 301–340.
- Khanna, T., and Yafeh, Y. (2007). Business groups in emerging markets: Paragons or parasites? *Journal of Economic literature*, 45(2), 331–372. Retrieved from <http://www.jstor.org/stable/10.2307/27646796>
- Kock, C. J., and Guillén, M. F. (2001). Strategy and Structure in Developing Countries: Business Groups as an Evolutionary Response to Opportunities for Unrelated Diversification. *Industrial and Corporate Change*, 10(1), 77–113. doi:10.1093/icc/10.1.77
- Lee, K., and Kang, Y. S. (2010). Business Groups in China. In *The Oxford handbook of business groups*. New York: The Oxford University Press.
- Leff, N. (1978). Industrial Organization and Entrepreneurship in the Developing Countries: The Economic Groups. *Chicago Journals*, 26(4), 661–675.
- Li, W., He, A., Lan, H., and Yiu, D. (2011). Political connections and corporate diversification in emerging economies: Evidence from China. *Asia Pacific Journal of Management*, 29(3), 799–818. doi:10.1007/s10490-011-9265-5
- Maman, D. (2002). The Emergence of Business Groups: Israel and South Korea Compared. *Organization Studies*, 23(5), 737–758. doi:10.1177/0170840602235003
- Miles, M. B., and Huberman, A. M. (1994). *Qualitative data analysis : an expanded sourcebook*. Thousand Oaks: Sage.
- Morck, R. (2010). The Roddle of the great Pyramids. In *The Oxford handbook of business groups*. New York: The Oxford University Press.
- O Globo, J. (2012). Empreiteiras terão incentivo para ampliar industria bélica. *Jornal O Globo*. Retrieved from <http://oglobo.globo.com/economia/empreiteiras-terao-incentivo-para-ampliar-industria-belica-5478894>
- Pearce, J. L. (2001). Less Epistemology; more Government and Social Status. *Human Relations*, 54(1), 85–89. doi:10.1177/0018726701541011
- Rama, M. (2011). Corporate Governance and Corruption: Ethical Dilemmas of Asian Business Groups. *Journal of Business Ethics*, 109(4), 501–519. doi:10.1007/s10551-011-1142-0
- Salisbury, R. H. (1969). An Exchange Theory of Interest Groups. *Midwest Journal of Political Science*, 13(1), 1–32. doi:10.2307/2110212
- Schneider, B. R. (2008). A comparative political economy of diversified business groups, or how states organize big business. *Review of International Political Economy*, 16(2), 178–201. doi:10.1080/09692290802453713
- Schneider, B. R. (2009). Business Politics in Latin America - Patterns of Fragmentation and Centralization. In *The Oxford Handbook of Business and Government* (p. 808). Oxford University Press.
- Shimotani, M. (1997). History of Business Groups in Japan. In *Beyond the firm - business groups in international and historical perspective* (p. 320).
- Strauss, A., and Corbin, J. (2008). *Pesquisa Qualitativa: Técnicas e Procedimentos para o desenvolvimento de teoria fundamentada*. Porto Alegre: Artmed.
- Wade, R. (1990). *Governing the Market: Economic Theory and the Role of Government in Taiwan's Industrialization* (1 ed., p. 492). Princeton: Princeton University Press.
- Williamson, O. (1975). *Markets and Hierarchies: Analysis and Antitrust Implications* (p. 303). New York: Free Press.
- Williamson, O. (1981). The Economics of Organization: The transaction costs approach. *American Journal of Sociology*, 87(3),

548–577.

- Xavier, W. G., Marcon, R., and Bandeira-de-Mello, R. (2013). Institutional Environment and Business Groups Resilience in Brazil. *Journal of Business Research* (forthcoming).
- Yin, R. (2005). *Estudo de caso: planejamento e métodos* (p. 212). Bookman.
- Yiu, D. W., Lu, Y., Bruton, G. D., and Hoskisson, R. E. (2007). Review Paper Business Groups : An Integrated Model to Focus Future Research, (December).