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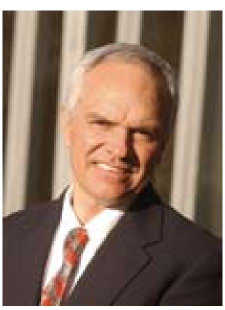
# Chilean Regional Strategies in Response to Economic Liberalization

## Estrategias regionales chilenas como respuesta a la liberalización económica





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## 1. INTRODUCTION

Chile has been a leader in the worldwide trend toward liberalization of markets that has characterized recent decades. The liberalization process began in that country in 1975, spreading a decade later to the rest of Latin America. Chilean firms responded to the process by completely reformulating their competitive strategies, making a multiple set of choices regarding scope, assets, resources, capabilities and geographic markets. The most significant commitments made by these companies since the 1990s were their unprecedented outbound foreign direct investments (FDI) across Latin America.

Economists have long been addressing a number of important questions relating to the launch of competitive liberalization processes (see Bergara *et al*. (1998), Büchi (1993), Corbo *et al.* (1996), Edwards (1995), Kennedy (1998), and Majluf and Raineri (1997)). Business strategists, however, are just starting to examine the issues surrounding how companies operating in countries that have undergone such reforms should respond to them. Khanna and Rivkin (2001) exemplifies a recent stream of research focusing on strategy and competition in developing countries that have adopted liberalization policies (see also: del Sol (2002), Fisman and Khanna (1998), Ghemawat and del Sol (1998a), Ghemawat, Kennedy and Khanna (1998), Ghemawat and Kennedy (1999), Ghemawat and Khanna (1998), Khanna (2000), Khanna and Palepu (1997, 1999a, 1999b, 2000a, 2000b), and Toulan (2002)).

Cuervo-Cazurra (2007) studies the sequence of value-added activities in the multinationalization of firms from Latin America. The same

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**EXECUTIVE SUMMARY**

The article analyzes the foreign investment decision as a response to the economic liberalization in Chile, using data obtained from a survey of 102 managers. I argue that the knowledge on strategies in response to reforms was a source of competitive advantage for Chilean firms, which enables them to successfully invest in other Latin American countries that were undertaking pro-market reforms similar to the ones Chile did in the previous decade.

**RESUMEN DEL ARTÍCULO**

Este artículo analiza las decisiones de inversión en el extranjero en respuesta a la liberalización económica en Chile, utilizando datos recolectados a través de una encuesta a 102 gerentes generales. Argumento que el conocimiento sobre estrategia de negocios en tiempos de reformas fue una fuente de ventaja competitiva para las empresas chilenas que les permitió invertir exitosamente en otros países latinoamericanos que estaban realizando reformas económicas pro mercado similares a las que había realizado Chile en la década anterior.

author also shows (2008) that Latin American companies have been induced to establish foreign direct investment (FDI) after changes in their home countries stemming from structural reform spurred them to upgrade their competitiveness to international levels. Cuervo-Cazurra and Dau (2009a, 2009b) analyze how pro-market reforms impact the performance of domestic firms and subsidiaries of foreign firms operating in Latin America.

The present article, written in the context of this new body of research, discusses the impact of the reforms in Chile and other Latin American countries on the competitive strategies of firms operating in Chile. These strategies include their investments across Latin America.



***Chile stands out as a pioneer in this new trend, implementing its liberalization process mainly during the 1970s and 1980s***

## 2. ECONOMIC REFORMS ACROSS LATIN AMERICA

Over the last few decades Chilean firms have experienced a dramatic turnabout in the context in which they operate, which has changed from a local, regulated and protected government-led environment to a global and highly competitive one.

In the 1940s most Latin American countries embarked upon a trend toward increasing participation of the state in economics affairs and a reduction in the role of competitive forces in determining the pattern of wealth creation and distribution. In the 1980s this tendency was reversed as a growing number of political leaders moved to adopt the opposite development strategy. They increasingly turned to free market forces to promote domestic and international competition through the active participation of the private sector in the economy, retaining only a subsidiary role for the state (Edwards (1995).

Chile stands out as a pioneer in this new trend, implementing its liberalization process mainly during the 1970s and 1980s. It involved a coherent set of reforms that touched almost every aspect of economic life, covering prices, the public sector (including taxation), trade and exchange rates, the financial sector, the labor market, privatizations, utility regulation and anti-trust measures (including electricity and telecommunications) and social security. Other reform initiatives affected areas such as education, public health and public housing. One of the most novel aspects of these changes was the creation of a wide network of interwoven institutions explicitly designed to minimize the discretionary power of government authorities. These institutions were created by statute law or constitutional amendment, thus making them difficult to change (Corbo *et al*. (1996)).

This liberalization process was not without its difficult moments, however, surviving two deep recessions along the way. The first was in 1975, the very year the reforms began, when the GDP growth rate fell to –16.6%, and the second occurred in 1982 when growth dropped to –10.7%. After a long process of trial and error, the economy started on a phase of sustained expansion in 1984 that lasted until 1998. During this period the annual rate of growth averaged 6.9%. (**Table 1** presents a number of macroeconomic and social indicators).

Ten years after Chile initiated its economic liberalization, other Latin American countries began implementing similar reforms. Bolivia and Mexico launched their processes around 1985; Jamaica, Uruguay, and Trinidad and Tobago around 1987; Costa Rica around 1988; Guyana, El Salvador and Venezuela around 1989; Argentina, Colombia, Honduras and Nicaragua around 1990, Paraguay, Peru and Brazil around 1991; and Guatemala and Panama around 1992. Though similar to the Chilean process, the particular characteristics, intensity and scope of the changes varied from one country to the next (see Edwards (1995)).

As liberalization spread across the region during the 90s, Chile pursued bilateral free trade agreements to eliminate trade tariffs with as many countries as possible, signing treaties with Mexico (1991), Venezuela (1993), Colombia (1993), Ecuador (1994), Canada (1996), and Peru (1998). In 1996 Chile became an associate member of Mercosur, a free trade area that includes Argentina, Brazil, Paraguay and Uruguay. More recently, Chile has signed free trade agreements with the European Union, the United States, and China.

**KEY WORDS**
Pro-market reforms, responses to economic liberalization, global strategy, emerging market, multilatinas

**PALABRAS CLAVE**
Reformas pro-mercado, respuestas a la liberalización económica, estrategia global, mercados emergentes, multilatinas



## 3. RESPONSES OF CHILEAN FIRMS

The Chilean liberalization and those that followed it in other Latin American countries dramatically changed the structure of the industries in which Chilean firms operated. The reforms integrated most of the country's industries internationally through imports, inbound foreign direct investments, exports or outbound foreign direct investments. These four variables have grown vigorously since the Chilean reforms began (see **Table 2**).

Table 1. **Chilean macroeconomic indicators**

| YEAR | CURRENT GNP PER CAPITA (US $) | POPULATION (THOUSANDS) | GDP GROWTH (%) | GROSS DOMESTIC INVESTMENT/ GDP (%) | INFLATION (% CHANGE IN CPL) | UNEMPLOYMENT (% OF LABOR FORCE) |
|---|---|---|---|---|---|---|
| **1975** | 920 | 10,413 | -16.6 | 17 | 343.3 | 14.8 |
| **1976** | 910 | 10,566 | 5 | | 198 | 12.7 |
| **1977** | 1,080 | 10,715 | 9.9 | | 84.2 | 11.8 |
| **1978** | 1,350 | 10,862 | 7.8 | | 37.2 | 14.2 |
| **1979** | 1,760 | 11,014 | 7.1 | | 38.9 | 13.6 |
| **1980** | 2,160 | 11,174 | 6.6 | | 31.2 | 10.4 |
| **1981** | 2,610 | 11,344 | 3.1 | | 9.5 | 11.3 |
| **1982** | 2,200 | 11,523 | -10.7 | | 20.7 | 19.6 |
| **1983** | 1,790 | 11,710 | 0.5 | | 23.1 | 14.6 |
| **1984** | 1,600 | 11,903 | 5.4 | | 23 | 13.9 |
| **1985** | 1,410 | 12,102 | 3.2 | 17.2 | 26.4 | 12.0 |
| **1986** | 1,410 | 12,305 | 5.6 | | 17.4 | 12.2 |
| **1987** | 1,550 | 12,513 | 6.6 | | 21.5 | 11.0 |
| **1988** | 1,800 | 12,726 | 7.3 | | 12.7 | 10.0 |
| **1989** | 2,060 | 12,948 | 10.6 | | 21.4 | 8.0 |
| **1990** | 2,180 | 13,179 | 3.7 | | 27.3 | 7.7 |
| **1991** | 2,390 | 13,419 | 8 | | 18.7 | 8.3 |
| **1992** | 2,860 | 13,666 | 12.3 | | 12.7 | 6.7 |
| **1993** | 3,190 | 13,916 | 7 | | 12.2 | 6.5 |
| **1994** | 3,490 | 14,161 | 5.7 | 26.8 | 8.9 | 7.8 |
| **1995** | 4,160 | 14,395 | 10.6 | | 8.2 | 7.4 |
| **1996** | 4,860 | 14,617 | 7.4 | | 6.6 | 6.5 |
| **1997** | 5,020 | 14,828 | 6.6 | | 6 | 6.1 |
| **1998** | 5.265 | 15,029 | 3.2 | 26.13 | 4.7 | 6.0 |
| **1999** | 4.923 | 15,223 | -0.8 | 20.84 | 2.3 | 10.0 |
| **2000** | 4.841 | 15,412 | 4.5 | 20.73 | 4.5 | 9.7 |
| **2001** | 4.599 | 15,596 | 3.4 | 21.72 | 2.6 | 9.9 |
| **2002** | 4.316 | 15,776 | 2.2 | 21.32 | 2.8 | 9.8 |
| **2003** | 4.317 | 15,951 | 3.9 | 20.15 | 1.1 | 9.5 |
| **2004** | 4.928 | 16,124 | 6.0 | 19.29 | 2.4 | 10.0 |
| **2005** | 5.870 | 16,295 | 5.6 | 21.16 | 3.7 | 9.4 |
| **2006** | 7.990 | 16,452 | 4.6 | 19.02 | 2.6 | 8.1 |
| **2007** | 7.995 | 16,285 | 4.7 | 19.93 | 7.8 | 6.9 |
| **2008** | 9.400 | 16,454 | 3.2 | 23.99 | 7.1 | 7.7 |

Source: GNP per capita: World Bank and Nation Master (since 1998, Atlas method).
Population: Nation master
GDP growth: Central Bank of Chile
Gross Domestic Investment/ GDP: World Development Indicators CD-ROM, World Bank, February, 1997 and Central Bank.
Inflation and Unemployment: INE (National Bureau of Statistics).

Table 2. **Chilean Exports, Imports, Outbound and Inbound Foreign Investment (US$ Million)**

| | EXPORTS FOB | | | OUTBOUND FOREIGN DIRECT INVESTMENT | IMPORTS CIF | | INBOUND FOREIGN DIRECT INVESTMENT | |
|---|---|---|---|---|---|---|---|---|
| YEAR | TOTAL (US $, CURRENT YEAR) | % NON COPPER | % TO LATIN AMERICA | TOTAL | TOTAL (US $, CURRENT YEAR) | % FROM LATIN AMERICA | TOTAL (US $, CURRENT YEAR) | % FROM LATIN AMERICA |
| **1975** | 1,590 | 45 | -- | | 1,708 | -- | 35 | 11 |
| **1976** | 2,116 | 42 | -- | | 1,655 | 33 | 45 | 21 |
| **1977** | 2,186 | 47 | -- | | 2,417 | 33 | 28 | 3 |
| **1978** | 2,460 | 50 | 26 | | 3,243 | 29 | 286 | 5 |
| **1979** | 3,835 | 51 | 25 | | 4,708 | 25 | 304 | 8 |
| **1980** | 4,705 | 55 | 24 | | 6,145 | 28 | 307 | 11 |
| **1981** | 3,837 | 55 | 22 | | 7,318 | 22 | 427 | 12 |
| **1982** | 3,706 | 55 | 19 | | 4,094 | 21 | 478 | 8 |
| **1983** | 3,831 | 51 | 12 | | 3,171 | 26 | 208 | 7 |
| **1984** | 3,650 | 56 | 15 | | 3,654 | 26 | 196 | 9 |
| **1985** | 3,804 | 53 | 15 | | 3,229 | 26 | 167 | 11 |
| **1986** | 4,191 | 58 | 17 | | 3,099 | 23 | 261 | 4 |
| **1987** | 5,303 | 58 | 17 | | 3,994 | 24 | 541 | 4 |
| **1988** | 7,054 | 52 | 13 | | 4,844 | 28 | 844 | 2 |
| **1989** | 8,080 | 50 | 12 | | 6,595 | 27 | 981 | 2 |
| **1990** | 8,373 | 54 | 12 | 15 | 7,089 | 25 | 1,280 | 2 |
| **1991** | 8,942 | 60 | 14 | 192 | 7,456 | 27 | 982 | 5 |
| **1992** | 10,007 | 61 | 17 | 671 | 9,285 | 25 | 993 | 5 |
| **1993** | 9,199 | 65 | 20 | 742 | 10,189 | 23 | 1,739 | 4 |
| **1994** | 11,604 | 63 | 21 | 2,795 | 10,872 | 26 | 2,517 | 5 |
| **1995** | 16,024 | 60 | 19 | 4,158 | 14,642 | 27 | 3,027 | 3 |
| **1996** | 16,627 | 64 | 20 | 6,368 | 19,097 | 27 | 4,856 | 3 |
| **1997** | 17,870 | 63 | 21 | 4,731 | 20,800 | 28 | 5,227 | 3 |
| **1998** | 16,323 | 68 | 22 | 2244 | 19,853 | 29 | 6,039 | 3 |
| **1999** | 17,162 | 65 | 22 | 1417 | 15,962 | 30 | 9,230 | 2 |
| **2000** | 19,210 | 62 | 22 | 1217 | 18,466 | 33 | 3,040 | 4 |
| **2001** | 18,272 | 64 | 20 | 1347 | 17,799 | 35 | 5,023 | 2 |
| **2002** | 18,180 | 65 | 20 | 769 | 17,146 | 36 | 3,381 | 1 |
| **2003** | 21,664 | 64 | 16 | 459 | 19,322 | 38 | 1,236 | -1 |
| **2004** | 32,520 | 55 | 15 | 1561 | 24,794 | 37 | 4,637 | 0.7 |
| **2005** | 41,267 | 54 | 15 | 1503 | 32,735 | 35 | 1,799 | 36 |
| **2006** | 58,680 | 44 | 15 | 2324 | 38,406 | 33 | 3,181 | 5 |
| **2007** | 67,666 | 44 | 15 | 4577 | 47,164 | 30 | 1,359 | 25 |
| **2008** | 66,456 | 51 | 17 | 2882 | 61,903 | 30 | 5,243 | 12 |

Source: Imports and Exports: Central Bank of Chile. Inbound foreign direct Investment: Comité de Inversiones Extranjeras. (Includes only investments made under DL 600. Excludes those made under chapter XIX, which are approximately 12% of those under DL600). Outbound Foreign Direct Investment: Camara de Comercio de Santiago

This process posed serious threats for Chilean companies, but also opened up tremendous opportunities. Domestic competition substantially increased, as did foreign competition in the form of imports and inbound foreign direct investment. On the other hand, availability of inputs also increased while their prices declined, the improvements affecting not just raw materials and equipment but also capital for financing company projects. Furthermore, liberalization brought about increased domestic demand, the opening up of domestic industries previously out of bounds to private firms (such as electricity) and enormous opportunities to compete abroad, export all over the world and invest in other Latin American countries that have imitated Chile's reforms.



Chilean firms responded to the liberalization at home and elsewhere in Latin America by completely reformulating their competitive strategies. They made a multiple set of choices regarding horizontal and vertical scope, organizational capabilities, assets and resources, alliances, and geographic scope. They also built a variety of world-class tangible and intangible assets, most notable among the latter being management capabilities, and radically changed their geographic markets.

Chilean companies also changed their emphasis from domestic to foreign markets (see **Table 2**). From 1975 to 1998, total exports grew at an average annual rate of 10% and non-copper exports increased at an average yearly rate of 12%. Total imports, meanwhile, rose at an average rate of 11% annually from 1976 to 1998. As for Chilean firms' investments in foreign markets, they grew from virtually nothing to an outbound foreign direct investment of $6.4 billion in 1996, accounting for 9% of GDP.

Typically, these firms substituted imported raw materials and machinery for domestic products. Perhaps even more surprising is that they substituted foreign capital for domestic capital. Among other new practices, Chilean companies have since 1990 been issuing shares in the United States through American Depository Receipts (ADRs). As of 1997, ADRs had been issued for 24 Chile-based concerns. This importation of capital substantially reduced its cost to Chilean firms and enabled them to undertake an enormous amount of investment abroad relative to the size of their home country.

Chilean exports and imports are geographically diversified (see **Table 3**). The percentage of exports to Latin America, and imports and inbound foreign direct investment from that area to Chile, did not change substantially in the wake of the reforms (see **Table 2**). The free trade agreements Chile has signed with some Latin American countries, or groups of countries such as Mercosur, did not have a significant impact at the aggregate level (See Meller and Donoso (1998)).

Table 3. **Origin of Chilean imports and destination of Chilean exports 2008**

| | ORIGIN OF IMPORTS | DESTINATION OF EXPORTS |
|---|---|---|
| European Union 27 | 12.7% | 24.7% |
| China | 12% | 14.1% |
| United States | 19.4% | 11.6% |
| Japan | 4.7% | 10.4% |
| Mercosur | 19.5% | 9.7% |
| South Korea | 5.6% | 5.6% |
| Andean Community | 10% | 4.6% |
| Mexico | 3.1% | 3.2% |
| India | 0.8% | 2.5% |
| Canada | 1.7% | 2% |
| Central América | 0.3% | 1.1% |
| EFTA | 0.6% | 0.5% |
| P 4 | 0.3% | 0.2% |
| Cuba | 0.0% | 0.1% |
| Other | 9.3% | 9.7% |

Source: Relaciones Económicas Internacionales de Chile 2008 (Gobierno De Chile, Ministerio de relaciones económicas).



The greater integration of the Chilean economy into that of Latin America has occurred mainly through outbound foreign direct investment, 97% of which went to Latin America between 1990 and 1998 (see **Table 2** and **Table 4**). This region has thus become very important for Chilean firms. From 1990 to 1998, some 264 Chilean firms participated in this process of investing in foreign markets. This is a relatively large number considering the size of Chile's economy.

Firms have two complementary ways of building sustainable competitive advantage: development of capabilities, which involves many choices that are individually small; and making a commitment, which involves a few relatively lumpy decisions (see Ghemawat 1999, chapter 5). The most significant commitments made by Chilean firms

Table 4. **Foreign investments of Chilean firms from 1990 to 2008 according to destination country and economic sector**

| COUNTRY (87% TO LATIN AMERICA) | PERCENTAGE OF TOTAL INVESTMENT |
|---|---|
| Argentina | 42% |
| Peru | 16% |
| Brazil | 15% |
| Colombia | 8% |
| Venezuela | 3% |
| Other | 16% |

| ECONOMIC SECTOR | PERCENTAGE OF TOTAL INVESTMENT |
|---|---|
| Energy | 32% |
| Industry | 28% |
| Wholesale and retail | 18% |
| Banking and finance Pension funds and insurance | 5% |
| Other | 17% |

Source: Cámara de Comercio de Santiago.



have been their unprecedented foreign direct investments across Latin America.

## 4. LIBERALIZATION KNOW-HOW

In a paper co-written with Joseph Kogan (del Sol and Kogan (2007)) we showed that Chilean affiliates had a competitive advantage in Latin America during the 1990s. We verified this claim by comparing the profitability of foreign affiliates of Chilean publicly held companies operating in Latin America with the profitability of Latin America publicly held companies for the period 1995 to 2002. Controlling for country, industry, year and size effects, we found that Chilean affiliates had higher ROE and a higher probability of returning positive profits. These results were most pronounced and most significant when our specification allowed the Chilean advantage to decrease with time (the model predicted no Chilean advantage by year 2002). By empirically discarding alternative explanations based on factors such as risk and financing structure, we confirmed that the excess profitability must have been due to some competitive advantage.

Our hypothesis was that one source of competitive advantage was liberalization know-how, that is, knowledge of business strategy during economic reform (most of which occurred in the 1980s and early 1990s) that was gained ten years earlier in Chile. This was difficult to corroborate, however, and we recognized the limitations of our analysis, which was hampered by both lack of data and the ambitiousness of our claim. We thus concluded in our 2007 paper that more research was necessary to establish this claim with greater certainty.

In the present paper, we use survey data to measure liberalization know-how. In 1997 we consulted the senior executive officer of each of 102 Chilean companies in all sectors of the economy on how their business strategy changed in response to Chile's economic reforms. As we explain below, the survey demonstrates that companies who made more changes to their overall strategy were also more likely to invest abroad. (In a regression on the decision to invest abroad that controlled for size and group membership, the coefficient for changes to overall strategy was significant at the 5% level). If many changes in overall strategy due to economic reform is an acceptable proxy for liberalization know-how, the results show that firms with more liberalization know-how were more likely to invest abroad.

The conclusion that firms which invest abroad also tend to make many other changes has two other possible explanations. First, it could be that some firms are intrinsically motivated to change more (see Ghemawat and Ricart (1993)), perhaps because they have better managers or different types of managers. On this explanation the strategy change index is a proxy for the firm's tendency to change that is also reflected in the tendency to invest abroad more.

***Although the strategy formulation of any firm requires coordination of choices, this coordination may become a major challenge in environments that have experienced a competitive liberalization***



The second explanation is that there is complementarity in actions so that the profitability of investing abroad is enhanced by the other changes made. Porter (1996) elaborates on the importance of the fit or coherence among all the activities performed by a firm. This explanation is consistent with Ghemawat *et al*. (1998, p. 26) who suggest that "the capacity to coordinate choices along multiple dimensions seems to become more rather than less important in environments that have experienced competitive shocks." To formulate their liberalization response strategy, firms must find the set of choices that maximize competitive advantage over time in the new liberalized context. If the choices are interrelated, the strategy cannot be formulated simply by considering the individual choices independently but rather must focus on the impact of the whole set of choices, which differs from the sum of the individual impacts of each one.

Although the strategy formulation of any firm requires coordination of choices, this coordination may become a major challenge in environments that have experienced a competitive liberalization. Ghemawat *et al.* (1998, p. 23) suggest that the liberalization process brings about a virtual explosion in the set of possible business models, and the impact of the whole set of choices become very complex to predict. In this context they suggest that traditional business strategy constructs (such as Porter (1980 and 1985) and Hax and Majluf (1996)) must be reconsidered.

The empirical results presented in the next section also show that firms tend to invest abroad more if they are members of a Chilean group. This finding provides new evidence for the conclusion drawn in recent literature to the effect that collective action within groups may be valuable. In particular, the extensive literature by Khanna and various co-authors shows that while conglomerates are being dismantled in Western economies, in emerging ones business groups add value (see, for example, Fisman and Khanna (1998), Ghemawat and Khanna (1998), Khanna (2000), Khanna and Palepu (1997, 1999a, 1999b, 2000a, 2000b), and Khanna and Rivkin (2001). Belderbos and Sleuwaegen (1996) use a logit model to show that in Japan, membership of a group (keiretsu) helps to lower barriers faced by Japanese firms investing in Southeast Asia.



The two conclusions taken together – that firms invest abroad more when they have access to the resources and capabilities provided by membership in a Chilean Group and when they have made greater changes to their overall competitive strategy – are consistent with Ghemawat's "dynamic view of the firm" (Ghemawat, 1999). This view suggests that sustainable advantage depends on 1) the initial resource endowment, 2) "developing capabilities" by correctly making many small choices, and 3) making a few judicious "commitments" (relatively lumpy decisions) (see also Ghemawat (1991), del Sol and Ghemawat (1999) and del Sol (1999)). It also holds that initial resources, small choices and commitments must fit together. Chilean Group membership may be interpreted as a proxy for resources, the strategy change index as a proxy for "developing capabilities" and the decision to invest abroad as a proxy for "commitment."

In the next section we present an empirical analysis of Chilean firms' responses to Latin America reforms between 1975 and 1997. As was already mentioned, the results showed that firms tended to invest abroad more the more changes they made to their strategies in dimensions other than investing abroad, and also displayed this tendency if they were members of a Chilean group.

Table 5. **Responses to liberalization**

| | 27 CHANGE DIMENSIONS | INCREASE | NO CHANGE | DECREASE | VALID ANSWERS |
|---|---|---|---|---|---|
| **Horizontal and Vertical Scope** | 1. Number of products | **80.4%** | 17.7% | 1.9% | 102 |
| | 2. Service emphasis | **98.0%** | 2.0% | 0.0% | 97 |
| | 3. Target client base | **85.0%** | 7.0% | 8.0% | 100 |
| | 4. Change in suppliers* | **74.5%** | 25.5% | - | 102 |
| | 5. Vertical integration towards buyers | **46.9%** | 48.0% | 5.1% | 98 |
| | 6. Vertical integration towards suppliers | **43.4%** | 49.5% | 7.1% | 99 |
| **Organizational Capabilities** | 7. Professionalization of management | **99.0%** | 1.0% | 0.0% | 102 |
| | 8. Incentive compensation for managers (such as bonuses or stock ownership) as % of total managerial compensation | **80.2%** | 18.8% | 1.0% | 101 |
| | 9. Managerial compensation | **81.8%** | 17.2% | 1.0% | 99 |
| | 10. Decentralization of decision-making within the principal product line | **68.6%** | 17.7% | 13.7% | 102 |
| | 11. Use of project evaluation techniques** | **95.9%** | 4.1% | - | 98 |
| | 12. Strategic planning horizon | **52.0%** | 19.6% | 28.4% | 102 |
| | 13. Long-term alliances (national or internat'l)** | **36.9%** | 63.1% | - | 84 |
| **Assets and Resources** | 14. Investment in technology | **99.0%** | 1.0% | 0.0% | 100 |
| | 15. Cost of the required technology | 22.5% | 11.2% | **66.3%** | 98 |
| | 16. Dependence on foreign technology | **43.4%** | 44.5% | 12.1% | 99 |
| | 17. Investment in capital goods | **88.0%** | 11.0% | 1.0% | 100 |
| | 18. Investment in marketing and distribution | **87.2%** | 12.8% | 0.0% | 102 |
| | 19. Access to financing | **80.0%** | 16.5% | 3.5% | 85 |
| | 20. (Real) cost of inputs (raw materials and capital goods) | 19.8% | 9.9% | **70.3%** | 101 |
| | 21. Geographic concentration of the production or operational establishments in Chile | 22.2% | 44.5% | **33.3%** | 99 |
| | 22. Importance of proximity to natural resources in the principal product line | **12.6%** | 85.3% | 2.1% | 95 |
| **Geographic Markets** | 23. International focus of the firm in the principal product line | **70.4%** | 27.6% | 2.0% | 98 |
| | 24. International benchmark** | **70.6%** | 29.4% | - | 102 |
| | 25. Imports of inputs (primary materials and capital goods) | **84.5%** | 12.4% | 3.1% | 97 |
| | 26. Exports | **65.8%** | 32.9% | 1.3% | 79 |
| | 27. Company's outbound foreign direct investments or investment abroad** | **36.3%** | 63.7% | - | 102 |

* Change/no change choices
** Yes/no choices

## 5. DATA AND DESCRIPTIVE STATISTICS

Obtaining data for emerging markets is a considerable challenge. For this study we collected our data directly through a questionnaire filled out by senior executive officers of 102 Chilean businesses in 1997. We began with a list of the 500 firms with the largest sales volumes in 1994 as given in the "Chile Corporate Index 1996 Top 500" diskette published by South Pacific Mail and Dun&Bradstreet. This list excludes banks (and "financieras", or money-lending institutions), pension funds, health insurance institutions ("Isapres") and insurance companies. The same diskette also proved to be a reliable source for the names and contact information of chief executive officers of a subset of 340 firms. To build our sample we invited all 340 to participate in the survey. Industrial engineering students at the Pontificia Universidad Católica de Chile interviewed the CEOs of the firms that accepted our invitation. The companies generally did not answer all of the questions, and some values are therefore missing. The final sample included firms both listed and unlisted, private and stated-owned and from every industry, with sales ranging from $ 10 million to $ 1.25 billion.



The 102 chief executives interviewed were asked how their strategies had changed after economic liberalization in 27 different change dimensions. Given that we were interested in the firms' long-run choices we were fortunate to have carried out our survey in 1997, before the start of the downturn triggered by the Asian Crisis that led in 1999 to Chile's first recession after 16 years of uninterrupted growth. **Table 5** presents the descriptive results that were obtained.

The firms we surveyed tended to widen their horizontal and vertical scope. They generally increased the number of products they offered, put more emphasis on services and broadened their target client base. They also tended to increase their vertical integration toward buyers and their vertical integration toward suppliers. The tendency to increase horizontal and vertical scope suggests that in the first period after liberalization the pressure to take advantage of opportunities to enter new businesses won out over the pressure created by the increased competition to focus on a few activities in which the firms enjoy a competitive advantage. (Khanna and Palepu (1997) explain why focused strategies may be wrong for emerging markets).

The organizational capabilities of the surveyed firms increased in all dimensions. Most of them deepened the professionalization of management, incentive compensation, managerial compensation, decentralization of decision-making and the use of project evaluation techniques. They also invested in assets and resources, including technology, capital goods, marketing and distribution systems, and increased their access to financing while lowering technology and other input costs.

Finally, the survey data confirm the observation made earlier that the geographic markets of the firms changed toward more global ones. International focus, international benchmark practice, importation of inputs and exporting all increased for the majority of surveyed firms. In addition, 36% of the firms in the sample had foreign direct investments (**Table 2** shows that no Chilean firms had invested abroad before 1990).



## 6. DETERMINANTS OF THE DECISION TO INVEST ABROAD: A LOGIT ANALYSIS

**Table 5** shows the overall response of Chilean firms to liberalization. We focus on one of the most significant commitments associated with this response, which is the companies' outbound foreign direct investments. A logit analysis is employed to explore the determinants of the decision to invest abroad using the collected data for the variables in **Table 5**, which are the firms' ownership (43% of the sample was owned by Chilean groups), their industrial classification, and their sales volumes. This last variable is included in all of the analyses as a control variable.

We quickly discovered that the firms which were members of a Chilean group tended to invest abroad more than those which were not. We also investigated whether any of the first 26 variables in **Table 5**, or any subset of them, determined the decision to invest abroad (variable 27), in order to establish whether investing abroad requires changes to be made in any other specific dimension of the strategy. We ran hundreds of combinations but could not find any clear individual determinant of the decision to invest abroad among these 26 variables. We tried by defining each variable as two dummies, one representing a decrease and the other an increase, and also by defining each variable as one dummy, change (increase or decrease) or no change.

We then built an index of overall strategy change (excluding investment abroad), defined as the number of variables among the first 26 listed in **Table 5** that change (increase or decrease) divided by the number of valid answers. Because firms did not always respond to all of the questions, the number of valid answers was sometimes less than 26 (2 firms answered 21 questions, 1 firm 22, 6 firms 23, 25 firms 24, 29 firms 25 and 39 firms all 26). We found that the index did determine the decision to invest abroad. Firms that make more changes to their overall strategy (excluding investing abroad) tended to invest abroad more.

As was noted above, none of these 26 variables determines the decision to invest abroad individually. It does not matter what changes firms make or in what direction. Among the firms that invested abroad the specific changes they made varied from one company to the next, but those that invested abroad tended to make more changes.

The statistical results of the base model are shown in **Table 6**. The variable representing Chilean group membership was highly significant (p-value=0.004) and the one measuring strategy change was significant (p-value=0.024). To control by size, in the model presented in **Table 6** we used the variable ln sales (natural logarithm of sales), which was significant (p-value= 0.073). (Louri *et al.* (2000) found that relative firm size was one of the variables contributing to the decision of Greek firms to invest abroad).

Table 6. **Results of logistic model of the determinants of the decision to invest abroad**

| DEPENDENT VARIABLE: COMPANY'S OUTBOUND FDI OR INVESTMENT ABROAD (0=NO, 1=YES) | |
|---|---|
| Index of overall change in the strategy | 5.022 * (2.219) |
| Company that is a member of a Chilean group (0=no, 1=yes) | 1.357 ** (0.468) |
| Natural logarithm of the sales of the company in 1996 in thousands of US dollars | 0.411 + (0.229) |
| Constant | -9.799 *** (2.998) |
| Number of observations | 102 |
| LR chi2 | 22.74 *** |
| Log likelihood | -55.436 |

Significance: * p<0.05; ** p<0.01; *** p<0.001. Standard errors appear in parenthesis. The index of overall change in the strategy of the firm is built from the 26 dimensions of change presented in Table 5 (excludes investment abroad). It is equal to the number of variables that changed (increase or decrease) divided by the total valid answered variables (all firms interviewed have 21 or more valid answers).

Chilean group membership and strategy change were found to be very robust as determinants of the decision to invest abroad. To establish this we first ran the model with ln sales and Chilean group membership, adding hundred of combinations of the first 26 variables of **Table 5**. In all models the Chilean group membership variable was significant (p-value<0.05) and in most of them highly significant (p-value< 0.01). In these runs the ln sales variable sometimes became not significant (p-value>0.1).

Table 7. **Matrix of correlations**

| | STRATEGY CHANGE | SALES | CHILEAN GROUP | OUTBOUND FDI |
|---|---|---|---|---|
| **Strategy Change** | 1 | | | |
| **Sales** | 0.263 | 1 | | |
| **Chilean group** | 0.091 | 0.196 | 1 | |
| **Outbound FDI** | 0.283 | 0.285 | 0.330 | 1 |

We also ran the base model with other functional forms for the sales variable. We ran the base model with 1) sales instead of ln sales, and 2) four ranges of sales using three dummy variables. In these two specifications the sales variables became not significant (p-value>0.1), the strategy change variable become slightly more significant (p-value = 0.012 and p-value=0.023) and the Chilean group member become much more significant (p-value = 0.002 in both cases). When we added dummies for the industries to the base model to control for them, the Chilean Group membership variable again become much more significant (p-value=0.002), while the strategy change variable continued to be significant (p-value=0.028). Adding the industry variable made the ln sales variable become not significant (p-value=0.151).

Aware that the definition of the strategy change index is somewhat arbitrary because it gives the same weight to all valid answers, we generated 26 random variables 100 times. This allowed us to generate 100 different indexes of change, each one averaging the variables for which the firms gave responses with weights randomly selected. We then ran the base model with these 100 different strategy change indexes. The indexes for all 100 runs were significant (p-value<0.1), and for 86 of them p-value<0.05. On all runs the Chilean group membership variable was highly significant (p-value<0.01) and on 6 of them the ln sales variable became not significant (p-value>0.1).

## 7. CONCLUSIONS

This paper studied the responses of Chilean firms to structural pro-market reforms in Latin America. One response was their multinationalization through outbound foreign direct investment across the region. The empirical results obtained showed that 1) firms that are part of a Chilean group tend to invest abroad more, and 2) firms that make more changes to their strategies in dimensions other than investing abroad tend to invest abroad more.



Our hypothesis is that one source of Chilean competitive advantage was liberalization know-how, that is, knowledge about business strategy during economic reform gained in Chile ten years before the country's liberalization was emulated elsewhere in Latin America. This is a secondary benefit of leadership in economic reform. While any country in a given region that undergoes such changes will reap the domestic benefits, only the pioneer will gain a competitive edge in that region. These benefits are transitory, however, and must be nurtured by continuing leadership in reform.

The results of this paper have interesting implications for academics, managers and policymakers. They provide a better understanding of the strategic repositioning of firms in the wake of Chile's liberalization in the 1970s and 1980s and should help corporations operating in countries where liberalization has arrived more recently to reformulate their strategies. Business strategy in developing countries, even those adopting free-market reforms, is different from that for developed countries. The move towards free markets necessitates a period of transition where strategy is distinct both from approaches followed under the economic conditions existing prior to reform and those appropriate in the conditions expected after the reforms are complete.

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