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INSIGHTS

@ CENTER FOR EMERGING MARKETS

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Center for Emerging Markets

INTRODUCTION

We are excited to share the second issue of Insights @ Center for Emerging Markets, a twice-yearly publication that focuses on cutting edge ideas about emerging markets for managers and policy makers.

Insights @ Center for Emerging Markets aims to translate rich and exciting research about emerging markets by our Northeastern University faculty into manager-oriented briefs that encourage interdisciplinary conversations on emerging markets.

The current issue brings together researchers from the fields of strategy, corporate governance, accounting, entrepreneurship, international business, and legal studies. Contributors examined many interesting ideas and trends in the areas of strategy, governance, sustainability and trade policy, such as how Chinese companies are implementing best practices for innovation, how property rights are impacted by bankruptcy practices in India, how blockchain technology is enhancing global supply chains, how emerging market companies' social, environmental and governance initiatives are generating financial gains, and how emerging economies are reshaping the global trade order.

Thank you for reading!

Please visit the Center for Emerging Markets' website to access the online version of the current and previous issues of Insights @ Center for Emerging Markets.

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SIX PATHS TO CHINESE COMPANY INNOVATION

By Mark Greeven (IMD Business School) and George S. Yip (Imperial College London and Northeastern University's International Business & Strategy Group @ D'Amore-McKim School of Business)

The idea in brief: *China is rapidly moving from imitation to innovation, with Chinese companies taking a key role in the emerging paths of Chinese company innovation. Non-Chinese executives need to understand the six major paths to innovation taken by Chinese companies. While all these paths have also been taken by many Western companies, we discuss here the unique Chinese adaptation or intensification of each approach. Our findings indicate that the innovation advantages of Chinese companies may well be in the creative combinations of available innovation practices.*

China Is Innovating via its Companies

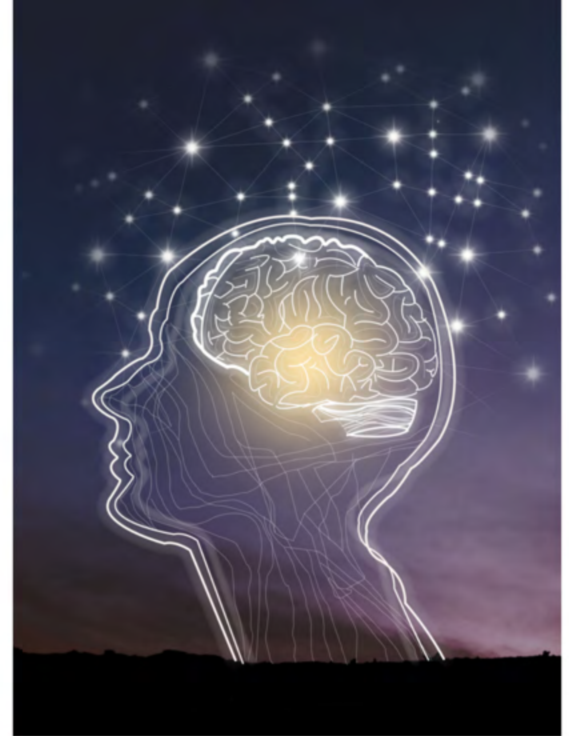
There is a continuing misperception in the West that China imitates rather than innovates. But this perception underestimates the rapidly growing potential of China for commercially oriented innovations that make money rather than win prizes. Chinese companies have long had a reputation for imitation, but some of them are now beginning to innovate, not only in processes but also in products and technology. Many Chinese companies, such as Huawei in telecoms equipment and Haier in major appliances, are also taking their innovations globally.

How Chinese Companies Innovate

Path 1: Ascending steadily from incremental to radical product innovation. Because of China's catch-up situation, most of its companies began life as imitators, innovating only incrementally. But, in a typically Chinese way, they pursued incremental innovation, relentlessly implementing innovation after innovation.

Path 2: Localizing business models: Building embedded business ecosystems. Business model innovation is particularly attractive to Chinese companies for two reasons. First, there is no need for world-class technical capability, which many Chinese companies may lack. Second, China is so different from the West that some business model innovation is essential for local adaptation, which can be more easily and better executed by Chinese than foreign companies.

Path 3: Relying on experimentation: Fast trial and learning. Even more than Western companies, Chinese companies use fast trial and error to test the market, adjust, and learn. Often, market testing, product development, and business model design takes place all at the same time. Experimentation and risk taking fit well with Chinese pragmatism and the transitional nature of a market with much uncertainty.



Path 4: Focusing on customer rather than technology, in terms of local needs and product variety. Chinese companies are skilled in customer-driven innovation, even for foreign markets in the USA and elsewhere. Chinese companies not only respond more quickly to local customer needs, but also cater to a larger variety of needs. They meet such needs not by building more sophisticated products but by bringing more versions of the product to market.

Path 5: Upgrading technology quickly: "Red queen race" and staying ahead of copycats. Most Chinese companies did not have a strong starting point in terms of technology, knowledge, and experience, so they need to catch up faster. Also, there are so many local competitors in any sector in China—typically 10 to 100 times more than in a Western economy—with relentless competitive practices, that would-be leading Chinese companies are desperate to gain a technological edge.

Path 6: Being organizational agile to enable innovation: Fast decision making. Most Western companies, especially American ones, aim with varying success to engage in fast decision making, with flexibility and a decisive boss. Despite a top-down, CEO-oriented hierarchy, Chinese companies also have a high degree of horizontal flexibility, which allows for smooth and rapid flows of resources and knowledge among peers in different departments and functions. They use a "huddle and act" mode of problem-solving that is heavily based on personal relationships rather than formal processes.

The Future will be Innovated in China

Chinese companies do not tend to use just one innovation path but a combination of paths and perhaps even all six. the future of innovation by Chinese companies is bright, solidifying the increasing recognition that China will become a major global force in innovation in the near future.

Original article

Greeven, M. & Yip, G. (2021). Six paths to Chinese company innovation. *Asia Pacific Journal of Management*, 38: 17-33.

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STRATEGY

MODERNIZING GLOBAL SUPPLY CHAINS WITH BLOCKCHAIN

By Ravi Sarathy (Northeastern University's International Business & Strategy Group @ D'Amore-McKim School of Business)

The idea in brief: *Blockchain solutions can overcome the shortcomings of current supply chain processes. They enhance reliability and efficiency by providing transparent and secure tracking of goods and related digital documentation. One example of a blockchain solution is TradeLens, which provides accurate real-time supply chain visibility, together with collaboration and analytics tools. Another example is Ambrosus, which links Internet of Things (IoT) real-time sensors and electronic IDs with blockchain to improve supply chain monitoring, provide quality assurance, and prevent counterfeiting.*

Blockchain-based Supply Chain Solutions

Traditionally, supply chain and logistics companies generate a significant volume of documentation that accompanies the goods being shipped. These documents verify ownership, stage in transit, regulatory compliance, and change in ownership. Complete and accurate documentation is essential to uninterrupted shipment journey to the ultimate destination because correctly filled, verified, and duly assigned documentation is necessary for shipment clearance and handoff to subsequent stages. However, global supply chains often rely on paper-based documentation. Conflicting information and lost documents lead to errors and suspend transaction approval. This creates a domino effect that results in long lead times, obscured status and location of a shipment, delayed shipments, and inefficient capital allocation (due to higher investment in pipeline inventory and additional costs from detention and demurrage charges). Blockchain-based solutions help overcome these deficiencies

Blockchain, also known as distributed ledger technology – DLT, relies on three inter-related components – encryption to enhance security, decentralized peer-to-peer networks which validate transactions and make tampering evident, and tokenization, which allows for transfer of value of digitized financial and real assets in an immutable fashion, preventing repudiation and double spend, while incentivizing desired behaviors. This makes blockchain an ideal platform for supply chain applications, as it provides a transparent and secure way to track the provenance and movement of goods and ensures that all parties have the same information about the changing status of a shipment. Deploying blockchain makes it possible to attach tokens to goods as they move along the supply chain, facilitating the addition of smart contracts and transfer of title between supply chain members as conditions are met.

How Maersk Uses TradeLens

Maersk, headquartered in Denmark, is the largest global container shipping firm, with over 70 ports and terminals worldwide. In 2014, Maersk sought to deploy blockchain technology and develop a global trade platform. The product evolved to become TradeLens, a permissioned blockchain network, to serve the entire industry and remedy the deficiencies of current supply chain processes. Maersk formed a joint venture with

IBM, owning 51% with IBM owning the remainder, and headquartered in New York, with independent board members. The goal was to keep TradeLens neutral, with a firewall between the TradeLens platform and Maersk, so as to persuade the various industry members who compete with Maersk to join and use TradeLens. By 2022, TradeLens had tracked over 67 million containers and processed over 3.5 billion shipping events. Other competing solutions have emerged, such as Cosco's Global Shipping Business Network (GSBN). A number of government agencies are collaborating using blockchain technologies in a similar manner (e.g., Hong Kong's eTradeConnect and Singapore's Network Trade Platform) to increase their countries' access to global trade, while enhancing the transparency, integrity and security of trade flows.

Monitoring and Control Using IoT

Transporting goods involves tracking provenance and monitoring risks, such as theft, spoilage, and counterfeiting. To address these problems, logistics companies employ Internet of Things (IoT) devices such as Internet-connected cameras, humidity sensors, and identification tags. IoT sensors, if they can be made secure and tamper-proof, can be a source of real-time data when linked to a blockchain network, and used with smart contracts to automate transactions. Once online, they continually provide updated data to track shipments, monitor quality indicators, assess equipment conditions and readiness for maintenance, and help mitigate risk.

Ambrosus is one such solution, using IoT real-time sensors and electronic IDs with blockchain to improve supply chain visibility, provide quality assurance, and prevent counterfeiting. For instance, the Swiss cheese industry uses Ambrosus to track livestock breeds, milk attributes such as fat content and safety, milk transport conditions, and cheese farm operations such curdling temperatures and salting time, offering comprehensive quality assurance to its customers. These practices help the Swiss cheese industry emphasize its differentiation for increasingly discriminating global customers, guard against counterfeiting, and enhance competitiveness.

Management Implications

Blockchain based supply chains offer a 'single source of truth', providing up-to-date documentation to all interested parties in a transaction, preventing delays and disputes and their attendant costs. Early adopters of blockchain technology and IoT solutions can gain significant competitive advantages through these benefits, while also gaining experience with using blockchain before their competitors. Such early learning will enable them to extend the scope of blockchain applications to global marketplaces linking buyers and sellers, trade finance applications such as electronic Bills of Lading, and forecasting trade flows. Companies will need to make extensive financial and human resource investments to develop these new applications, but in return will gain competitive advantages while competitors struggle to catch up.

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Also see Harvard Business School Publishing 2018. Maersk: Betting on Blockchain. Case # 9-518-089.

If you are interested in learning more about this work, contact Professor Sarathy at r.sarathy@northeastern.edu.

RESHAPING THE GLOBAL LEGAL ECONOMIC ORDER

By Sonia E. Rolland (Northeastern University's School of Law)

The idea in brief: *Emerging countries have been able to make use of the liberal trade and investment regime to support their development strategies without having to adopt the full gamut of neoliberal prescriptions. This is evident in a number of ways, including dispute settlement, the use of flexibilities such as trade remedies, and resistance to the expansion of free trade disciplines. Recent research explores how different emerging countries are positioned in regards to trade and investment law, how tensions develop between development policies and the demands of trade and investment legal frameworks, and how alternative visions will be driven by pragmatism and strategic self-interest rather than neoliberal orthodoxy.*

The Rise of Globalization in Economic Regulation and its Discontents

In the 1990s, international economic regulation quickly expanded to enable a new era of global business. This governance included the widespread use of Bilateral Investment Treaties (BITs), along with the creation of the World Trade Organization (WTO) and other trade agreements. The vision was that, over time, states would converge towards a capitalist, liberal democracy model. This would be facilitated by the WTO's policy of giving "special and differential treatment" to those states that were not yet ready to fully commit to the mainstream free trade agenda. "Washington Consensus" policies, which required privatization and a reduction of state interventions in the economy, were also seen as a way to help achieve this goal. However, a number of emerging countries are unable or unwilling to join this type of political economy contract. While theories abound as to the reason for such failings, international economic governance arguably plays a role. For instance, BITs have been used to attempt to restrict states' ability to enact regulatory measures in public health, the environment, taxation and other fields.

The landscape of development economics has changed dramatically over the decades. Early development economics models based on planned economies and government intervention, as well as trickle-down neoliberal theories, have been largely displaced. Today, developmental policies range from new industrial policies to export-oriented models, to an emphasis on local low-cost but quickly scalable innovation to serve the needs of poorer populations in emerging countries. Yet the content of trade and investment treaties is only beginning to adjust to this diversification in development policies. The gap between what the international economic legal framework assumes, allows and promotes, on the one hand, and what a number of emerging countries seek, on the other hand, is creating rifts.

New Directions for International Economic Law

Emerging countries are seeking a combination of market access abroad and policy autonomy at home. These priorities are reflected in how they seek to influence and reshape trade and investment law.

With respect to investment regulation, some are simply side-stepping the current framework: for instance, South Africa and Indonesia are letting BITs lapse or outright denouncing them. Some are redesigning BITs to rebalance the rights and obligations of investors. For example, India has created a new model BIT, used as a draft in negotiations. The Pan African Investment Code is another instance of such a redrafting. These new templates typically redefine investor and investment, limit investor protection, and create obligations on investors (e.g., around issues of corporate social responsibility, anti-bribery, and regulatory compliance). Some create obligations on investors' home states (e.g., to assist in policing their investors' activities abroad). Others include regulatory carve-outs for investment host states (for instance by excluding public health and other sensitive policies from the ambit of the treaties) and create a more stringent framework for investor-state dispute resolution.

With respect to trade law, emerging countries use a variety of strategies to challenge the status quo. Some use the flexibilities available within the WTO framework. Over the past 20 years, large emerging countries have built the legal capacity to deal with the rule-based order at the WTO, are winning cases in dispute settlement, and have successfully blocked efforts to impose new disciplines in negotiations. Beyond the limited official flexibilities that are still available, some ignore the rules in a "catch me if you can" game. Industrial support programs such as Inovar-Auto in Brazil and India's National Solar Mission are examples of such strategies: it was very likely from their inception that they would be challenged at the WTO, but by the time the challenges concluded, most of the programs had been implemented anyways and could not be dismantled by the WTO rulings.

Some emerging countries are also seeking alternative trade agreements and new partners. The Asia-Pacific region is the most prominent example, with agreements in force, such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the Regional Comprehensive Economic Partnership (RCEP) and the many ASEAN agreements, as well as arrangements in the making, and China's Belt and Road Initiative.

Implications for Policy-Makers

As they become more disillusioned with trade and investment regimes inherited from the 1990s, emerging powers are asserting their sovereignty in economic relations and pulling back from international and intergovernmental organizations and their adjudicatory systems. They are aiming for more domestic policy autonomy and the ability to experiment with different types of economic policy making and commitments. This legal innovation from emerging countries is reshaping international trade and investment law. Corporate executives also need to realize that some emerging economies may not liberalize much their foreign investment and trade policies for a very long time, if ever.

Reference

Rolland, S. E. & Trubek, D. M. (2019). Emerging powers in the international economic order: Cooperation, competition and transformation. Cambridge University Press.

If you are interested in learning more about this work, contact Professor Rolland at s.rolland@northeastern.edu.

SUSTAINABILITY

EMERGING MARKET FIRMS BENEFIT MORE FROM SOCIAL THAN ENVIRONMENTAL OR GOVERNANCE INVESTMENTS

By Alvaro Cuervo-Cazurra (Northeastern University's International Business & Strategy Group @ D'Amore-McKim School of Business), Saptarshi Purkayastha (Indian Institute of Management Calcutta) and Kannan Ramaswamy (Arizona State University)

The idea in brief: *New research examines how corporate environmental, social, and governance (ESG) programs influence the financial performance of emerging market companies. This research proposes and shows that in emerging markets, social investments have a larger impact on financial performance than governance or environmental initiatives because they help create capabilities that more directly compensate for government failures in the provision of public goods and services needed by firms to operate efficiently. It also shows that government policy nudges enhance the efficacy of such initiatives. Thus, in emerging markets, ESG programs, particularly social initiatives, help improve the quality of life of local communities and companies' bottom lines.*

Identifying the Impact of ESG on Company Performance in Emerging Markets

Companies wonder if their environmental, social, and governance (ESG) investments really help financial performance. New research shows that they do, but that in emerging markets, corporate social investments have a larger positive impact on financial performance than governance or environmental investments. The reason is that social investments help create capabilities that more directly compensate for government failures in the provision of public goods and services needed by firms to operate efficiently. On their part, governance investments require complementary regulations and environmental investments that may not be observed easily or appreciated by customers, resulting in a limited impact on performance. In contrast, in advanced economies in which the government has a higher capability to provide supportive infrastructure and markets are more efficient, environmental investments are more likely to result in higher performance than social or governance ones because of their more direct connection to reputation.

This research also shows that ESG can not only help reduce the effect of market failures in emerging markets, but that this beneficial impact can also be accentuated when used together with other mechanisms that address market failures. The authors discuss two of them, business group affiliation and government policy nudges. First, affiliation to a business group (a collection of legally independent firms connected through common ownership and strategy) enhances the impact of ESG on performance. The reason is that business groups' capabilities and expertise not only help improve performance, but also the creation of economies of scale in ESG that reinforce their efficacy. Second, government policy nudges, or policies that encourage but do not mandate desired behavior, also strengthen the impact of ESG on profitability. Nudges lead managers to reevaluate their ESG investments and focus on those that are more likely to support firms' reputation and eventual performance.

The authors illustrate these ideas with an analysis of ESG programs for a sample of 89 publicly traded Indian companies from 2007 to 2017. They find that social initiatives have a larger positive impact on return on assets than governance or environmental ones. They also find that business group affiliation and the policy nudge, in the form of the passage of the Companies Act of 2013 (which encouraged but not mandated that companies set aside two percent of their profits for ESG programs), reinforce the impact of social initiatives on performance more than the other investments.

Taken together, these findings suggest that the financial implications of ESG initiatives depend on the institutional conditions of the country. In an emerging market, market and government failures tend to be common. Thus, ESG is not just a tool to improve responsiveness to stakeholders concerns but also a mechanism for addressing these failures. Social investments are a more direct solution to government failures, helping not only improve the quality of life of local communities but also firms' bottom lines.

Managerial Implications: How Emerging Market Firms Benefit from Social Programs

An important managerial implication from this work is that companies' social initiatives in emerging markets are particularly well suited to help them address market and government imperfections and failures in a manner that improves the quality of life of their communities and has many positive spillovers for their bottom line. Creating healthcare facilities on-site, founding and operating technical training schools, and providing access to clean drinking water and safe housing improve the quality of life for local communities, while also helping companies access a healthier, better trained, and motivated labor force. By improving their community standing and reputation as positive corporate citizens and contributors to local communities, companies can recruit better workers, sell more products, and win preferential treatment from local officials.

Original article

Cuervo-Cazurra, A., Purkayastha S. & Ramaswamy, K. Variations in the Corporate Social Responsibility-Performance Relationship in Emerging Markets. *Organization Science, Forthcoming.*

If you are interested in learning more about this work, contact Professor Cuervo-Cazurra at
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TYPES OF DEVELOPMENTAL ASSISTANCE AND THEIR IMPACT ON ENTREPRENEURSHIP

By Elizabeth M. Moore (Northeastern University's International Business & Strategy Group @ D'Amore-McKim School of Business), Luis Alfonso Dau (Northeastern University's International Business & Strategy Group @ D'Amore-McKim School of Business) and Jonathan Doh (Villanova University)

The idea in brief: *In recent years, private entities are providing more aid to less developed countries relative to foreign governments. Recent research seeks to understand how different types of aid affect the strategic choices local firms and entrepreneurs make in the assisted markets, as well as the resulting outcomes. This will allow for better informed policy decisions that consider a more nuanced understanding of the entrepreneurial process.*

The Role of Developmental Assistance in Entrepreneurship

In recent years, management scholars have begun to pay more attention to the role of management and companies in addressing society's 'grand challenges', such as climate change, inequality, and poverty alleviation, for which economic development plays a key role. At the same time, due to the global financial crisis, government budgets have been reduced, and more emphasis has been placed on private sources of development aid.

Official development assistance (ODA) is defined as financial aid that is given by government agencies to help with economic development, poverty relief, public health, education, and other development priorities. This aid can take the form of grants or loans, and it can be given to other governments or to international organizations. Research on the effectiveness of ODA shows mixed results. Some studies show that ODA is effective in promoting economic development, while others show that it is not.

Donors send aid to promote economic growth and development, alleviate poverty, provide disaster relief, or accomplish other social objectives. Aid comes from a variety of donors, including national governments, international organizations, and private organizations. Each source has different motivations, which affects how the aid is distributed and what its potential impacts are. Multilateral aid is politically neutral and comes from international organizations, while bilateral aid is not politically neutral and comes from donor governments. Private aid is politically neutral and often bypasses national governments.

Recent research shows that the source of a country's aid – whether it be from governmental organizations, non-governmental organizations (NGOs), or foreign investors – affects the way that local entrepreneurship develops in that country. When a country receives aid primarily from NGOs and private investors, there is more "bottom-up" entrepreneurship, which is defined as entrepreneurship that is driven by individuals and groups within a society. In contrast, when a country's aid comes mainly from governmental organizations, there is more "top-down" entrepreneurship, which is defined as entrepreneurship that is driven by changes in a country's institutional framework.

Institutional Support in Promoting Entrepreneurship

For entrepreneurship to flourish, institutional conditions must support new business formation and growth. There are two critical features of this relationship: institutional supports and institutional voids. Institutional supports are elements that help construct and stimulate clearer rules and guidelines, while institutional voids are gaps or weaknesses within a country's institutional framework. Both supports and voids are critical to a comprehensive understanding of the role that institutions play in promoting entrepreneurship.

One of the main decisions that an entrepreneur must make is whether to formally register their business or not. This decision is often influenced by the country's institutional conditions. Formal entrepreneurs follow the national regulatory institutions by paying taxes, abiding by intellectual property rights legislation, and avoiding corrupt practices. On the other hand, informal entrepreneurs operate outside of the legal institutional framework by not registering their business, not paying taxes, and avoiding government regulations and enforcement mechanisms. In some cases, the absence of clear and well-established processes can push prospective entrepreneurs into the informal sector. Developing an understanding of the differences between the two types of entrepreneurship can help uncover insights as to the potential policies and practices that contribute to new business formation and associated economic development.

Main Findings and Policy Implications

Using data for 49 countries across the years 2002-2015, this research shows that multilateral aid (i.e., aid via multinational institutions such as the World Bank) has no effect on the number of formal entrepreneurs in a country, while bilateral (i.e., aid from one country to one other country) and private aid have a significant negative impact. Additionally, multilateral aid discourages informal entrepreneurship, while bilateral and private aid encourage informal entrepreneurship.

From a practical standpoint, these findings emphasize the importance for aid donors to better identify recipient targets, based on the entrepreneurial needs of a country. For instance, countries with sizable rural populations or countries that have strong reliance on informal institutions and community dependence may solicit more private aid. Instead, countries looking to develop more formal entrepreneurs and to improve their formal institutions, such as emerging markets and middle-developed countries, would more likely benefit from reduced levels of bilateral aid.

Original article

Moore, E. M., Dau, L. A. & Doh, J. (2020). Does Monetary Aid Catalyse New Business Creation? Analysing the Impact of Global Aid Flows on Formal and Informal Entrepreneurship. *Journal of Management Studies*, 57(3): 438-469.

If you are interested in learning more about this work, contact Professor Moore at e.moore@northeastern.edu.

HOW DO WEAK CREDITORS' RIGHTS INCENTIVIZE OPPORTUNISTIC BANKRUPTCY? A CAUTIONARY TALE FROM INDIA

By Radhakrishnan Gopalan (Washington University in St. Louis), Xiumin Martin (Washington University in St. Louis) and Kandarp Srinivasan (Northeastern University's Finance Group @ D'Amore-McKim School of Business)

The idea in brief: *In institutional regimes with weak creditors' rights, some company insiders might take advantage of bankruptcy rules by intentionally making their companies look less valuable. This creates problems for creditors and makes it harder for these companies to succeed in the future. To shed new light on the drivers of such opportunistic behaviors, recent research compares bankrupt British, American and Indian firms. It shows that Indian firms were more likely to be classified as "willful defaulters" indicating that bankruptcy decisions may be due to insiders' opportunistic behavior. It also suggests that such fraudulent bankruptcy behaviors can be countered through market reforms.*

Models of Insolvency in Developed Markets

Accounting rules play an important role in how firms can use bankruptcy protections in different countries. In creditor-friendly countries like the United Kingdom, if a company's assets are less than its liabilities, then the directors of that company can be sued for compensation or disqualification. Therefore, declaring bankruptcy is often an undesirable outcome for managers. In addition, secured creditors can veto court-administered insolvency processes and enforce default provisions from their debt contracts. Similarly, in the United States, 70 percent of CEOs are fired in Chapter 11 reorganizations. Clearly, when creditor protection is strong, and clear accounting rules determine bankruptcy eligibility, there is an incentive for managers to overstate a firm's financial position to avoid insolvency.

Given that most academic research on bankruptcy focuses on countries with robust legal institutions, recent work seeks to advance our understanding of the conditions that foster opportunistic bankruptcy behaviors by examining how a country with weak creditor rights impacted local managers' economic incentives. The authors acknowledge that this type of inquiry is challenging because bankruptcy data is scarce in countries with weak creditor protections, particularly in emerging markets.

Creditor Rights in India

India was chosen for its history of weak creditor protections and the authors' ability to obtain robust data on 1,700 Indian companies that filed for bankruptcy between 1990-2013, of which 706 were publicly listed. Moreover, because India recently passed laws that increased creditor rights, this research examines the changes in bankruptcy behavior before and after the new law was implemented. It shows that, especially before the passing of this market reforms, company insiders deliberately managed earnings downward to game the courts and gain eligibility for bankruptcy protection. Weak creditor rights perverted economic

trade-offs, giving rise to opportunistic behavior that allowed insiders to extract private benefits at the expense of creditors and outside shareholders.

This research also shows that Indian firms would see their net worth drop considerably in the year before bankruptcy. In many cases, these results were driven by selling assets to insiders. Part of the reason for the selling was to push firms into negative net worth in order to qualify for bankruptcy protection, often defrauding creditors in the process. The insiders were usually relatives of those who controlled the company. This self-dealing behavior did not occur in solvent companies and those that restructured outside of the Indian court system. Importantly, this work also acknowledges that some companies have good reasons to engage in transactions with relatives. When they find themselves in legitimate financial trouble, suppliers may not want to extend credit that is necessary for the firm's survival. Instead, they might turn to family members to extend credit or help in other ways.

Reducing Bankruptcy Incentives

Although the race towards bankruptcy appears counterintuitive, policymakers have long complained about the failures of India's weak creditor protections. When the Indian government passed the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests (SARFAESI) Act of 2002, it gave powers to secured creditors to override automatic stay provisions and seize assets of bankrupt firms. By increasing creditor rights, the law resulted in a significant decline in the number of firms filing for bankruptcy protection. When creditors have additional powers over delinquent borrowers, bankruptcy filing becomes less attractive for insiders.

By strengthening creditor rights, SARFAESI increased incentives for upward earnings management among insiders to avoid bankruptcy filings, similar to what one normally sees in countries with stronger creditor rights. It also gave powers to secured creditors to seize assets of a firm that has defaulted on its debt obligations. SARFAESI was mandatory, and firms did not have opt-out provisions.

Policy Implications

An important takeaway from this research for policy makers in emerging markets is that designing insolvency law requires a balancing act between competing priorities of debtors and creditors. If the balance tilts too far in the direction of being debtor-friendly, the consequences can be detrimental to the economy.

Original article

Gopalan, R., Martin X. & Srinivasan, K. Regulatory Protection and Opportunistic Bankruptcy. *Contemporary Accounting Research, Forthcoming.*

If you are interested in learning more about this work, contact Professor Srinivasan at k.srinivasan@northeastern.edu.

HOW BRIBE-PAYERS CREATE A "NEW NORMAL" OF CORRUPTION IN TRANSITION ECONOMIES

By Kimberly A. Eddleston (Northeastern University's Entrepreneurship and Innovation Group @ D'Amore-McKim School of Business), Elitsa R. Banalieva (Northeastern University's International Business & Strategy Group @ D'Amore-McKim School of Business) and Alain Verbeke, (University of Calgary; University of Reading; Vrije Universiteit Brussels)

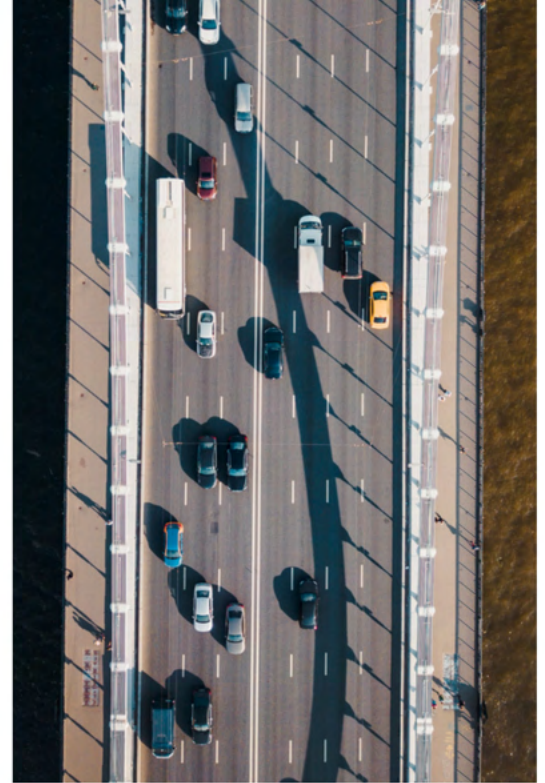
The idea in brief: *Recent research examines 310 privately owned small and medium-sized companies from 22 transition economies in Eastern Europe and Former Soviet Republics to see how the payment of bribes affects entrepreneur perceptions of the business environment. Those who more frequently pay bribes create a "new normal" business environment that is perceived as increasingly harsh. However, for entrepreneurs who infrequently bribe, their "new normal" is likely to be perceived as more supportive of business.*

Bribery and the "New Normal"

Prior research has considered whether entrepreneurs who bribe public officials in order to get ahead actually see any benefits from doing so. While it is possible that they could get some immediate benefits, like favorable treatment or access to limited government goods, it is also possible that over time, this could lead to a more corrupt business environment. The question is, do entrepreneurs from transition economies who frequently bribe see those bribes as helpful in removing business obstacles? Recent research tackles this issue by examining a sample of 310 privately owned small and medium-sized companies from 22 transition economies in Eastern Europe and Former Soviet Republics.

"New normal" is a term used to describe how events that were once abnormal have become commonplace. For example, the introduction of the European Monetary Union (EMU) led to changes in how governments managed budgetary and financial decision-making processes, and how EU-based multinational enterprises (MNEs) addressed institutional risk within the region. In order to assess the content and unfolding of a "new normal" situation, one must identify an impactful event which occurs at a higher level and affects strategic decision-making processes at the micro-level. For instance, post-Soviet economies that were transitioning from socialism to capitalism abandoned central planning and adopted policies supported by the Washington Consensus. This led to a period of chaotic capitalism, with informal networks, cronyism, and bribery becoming commonplace.

Despite efforts to combat corruption, it remains a widespread problem in the former Soviet republics, where institutional frailties take the form of institutional voids (i.e., shortages of effective macro-level institutional mechanisms that support business) and institutional over-kill (i.e., an overabundance of ineffective governance mechanisms that hinder business). In turn, corruption in the region is associated with a variety of downward cascading effects, such as reduced foreign direct investment, misdirected entrepreneurial talent, increases in venture start-up costs, and expansion of the informal economy. As open and fair mechanisms for distributing resources are hindered, everyone in the community suffers.



The burden of corruption weighs most heavily on entrepreneurs, who are the engine of growth and employment in most transition economies. A central assumption is that the only corruption and coercion associated with bribery are on the part of the public officials demanding bribes and bribe paying is portrayed as necessary for survival. However, entrepreneurs can also choose to bribe public officials in order to gain preferential treatment for their businesses. Such entrepreneurs are not only influenced by corruption, but also shaping it.

This research shows that family firms that frequently pay bribes are more likely to see their environment as corrupt and full of business obstacles, while those that rarely pay bribes are more positive about their business prospects. Those that frequently pay bribes are creating a reputation as payers, while those that rarely pay bribes are seen as protecting the family name. Meanwhile, non-family payers will rationalize their unethical behavior because they see their actions as promoting their personal interests and economic goals. They are also more likely to be morally disengaged, while recasting unethical behavior as acceptable and necessary.

Managerial and Policy Implications

Taken together, these findings point to a bribery paradox, where entrepreneurs may pay bribes to reduce obstacles and gain an unfair competitive advantage in the short run, but at the same time, they enact a longer-term, “new normal” business environment that contains institutional impediments. Owners of family firms view their “new normal” through the lens of the family, leading to greater perceived business obstacles as the frequency of bribes increases. Conversely, the perceived level of business obstacles does not intensify as the frequency of bribes increases for owners of non-family firms. The findings indicate that frequent bribery does not necessarily make business obstacles easier to overcome, but instead creates a business environment where bribery becomes a costly part of business life. Therefore, family firms would be wise to minimize and eliminate their bribery activities and to foster a culture of ethical business practices. At the same time, policymakers should increase punishment and monitoring of bribery to avoid vicious cycles of escalating corruption.

Original article

Eddleston, K. A., Banalieva, E. R. & Verbeke, A. (2019). The Bribery Paradox in Transition Economies and the Enactment of ‘New Normal' Business Environments. *Journal of Management Studies*, 57(3): 597-625.

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GOVERNANCE

THE CONCEPT OF “WASTA” AND HOW IT AFFECTS BUSINESS DEALINGS IN THE ARAB WORLD

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The idea in brief: *Recent research examines business practices in the Arab world and how they differ from Western practices. Wasta is a practice in Arab society where people use their personal relationships to gain favor. The practice is seen differently by different groups, with some seeing it as generally desirable and others seeing it as generally undesirable but potentially necessary. Foreign firm managers operating in Arab societies will need to develop a solid understanding of the practice and its different perceptions among varying Arab groups in order to be successful in conducting business in the Arab world.*

Social Networks in the Arab World

Research on social networks and social capital has focused primarily on China, Russia, and India, while the Arab world has received relatively less attention. Recent research sought to measure the role of social capital in Arab countries, specifically through the lens of Wasta, an Arabic term that encompasses the constructs of reciprocity (Mojamala), empathy (Hamola), and trust (Somah).

Informal social networks are essential to doing business in many countries, especially those that are emerging or transitioning economies. These networks often operate through reciprocity and even bribery to promote exchange. While some scholars view these networks in a positive light, others see them as a reflection of the circumstances predominant in most emerging market economies, where social networks can be seen as a substitute for formal institutions that influence the behaviors of executives and entrepreneurs.

The cultural foundations of Wasta are embedded in Arab societies as a result of historical and social influences. Goals are achieved through links with key persons, and the interaction typically involves one party who is structurally powerful, controls access to resources, or both. The root of Wasta is the Arab manifestation of social exchange theory in which respective obligations are specified and the parties are confident that each will fulfill their obligations based on social norms of exchange.

Mojamala (مجاملة), the affective element of Wasta, is inherently connected to family and nepotism. This is a problem in the Arab world because it has become so widespread that norms have developed to justify it. Nepotism can lead to poor performance in many Arab firms since it discourages hiring skilled management, which limits the size and scope of the firm. Essentially, nepotism is a mechanism for families to hoard power and resources over time.

Hamola (ةلوحم) is the conative component of Wasta, referring to the level of human empathy, benevolence, and favoritism one has with another through owing or being owed favors. Hamola is the largest politico-administrative unit, and belonging to a tribe involves more than successive generations of genetic relationships. Belongingness depends upon thinking the same way, believing in the same principles, assimilating the same values and ethos, acting according to the same rules and laws, respecting the same hereditary sheikh (an “honorific title for an Arab tribe or religious leader”), living together, defending each other, and even fighting together.

Lastly, Somah (ةعسم) the cognitive component of Wasta, is intricately entwined with trust. In the Arab context, trust at the interpersonal level needs to be established before any business relationship can unfold. Trust depends on the length of the relationship, on how business is conducted, and how disputes are resolved.

Managerial Implications

In addition to the reciprocity and empathy components of Wasta connections, trust plays a primary role in the Arab context. For Western firms seeking to build ties in Arab countries, the chief stumbling block to building effective social networks and alliances is the absence of trust. Therefore, building relationships that include reciprocity and empathy is important in negotiations because it creates a sense of trust and understanding. This can make the negotiation process go more smoothly and can help to resolve conflicts. However, building relationships takes time and effort, and may not be possible in all situations.

Original article

Berger, R., Herstein, R., McCarthy, D. & Puffer, S. (2019). Doing Favors in the Arab World. *International Journal of Emerging Markets*, 14(5): 916-943.

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