Firm Strategy in a Polarized Latin American Region

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Abstract

The recent financial crisis has exposed an increasingly polarized global economic order: stagnation in advanced developed economies and growth and rising affluence in emerging countries. Global polarization is shaping the regional order, in particular in Latin America. A group of economies, led by Brazil is experiencing sustainable economic growth and strong domestic markets. A second group, led by Mexico, is stagnating economically and facing the challenges of violence and social instability unleashed by criminal organizations. The most remarkable feature of the polarization in Latin America is its rapid development – within the last five to seven years. Polarization creates structural economic and market differences in the two regional hubs. This paper explores the impact of regional polarization on macroeconomic performance, foreign direct investment, and global competitiveness of countries in the two hubs and speculates on how firms’ strategies may adjust to these different contexts.

Keywords: Regional Strategy, International Macroeconomic Context, Latin America

Introduction

The new global economic order of stagnation in advanced developed economies and growth and rising affluence in emerging countries is evident in Latin America. One group of economies, led by Brazil, is achieving sustainable economic growth, and strong domestic markets; a second group, led by Mexico, is stagnating economically among conditions of growing insecurity, and immersed in social instability. Robles, Haar and Simon (2002) anticipated such polarization and predicted that Latin American economies would align either with the U.S. or Asian economies in terms of trade and investments, creating structural differences in the region. A recent study by Izquierdo and Talvi (2011) also provides evidence of regional polarization. They identified a group of growing economies experiencing exchange rate appreciation and inflationary pressures, yet thriving in a surge of middle class driven domestic markets. Another group of depressed economies exhibit large fiscal imbalances, loss of competitiveness to Asian more efficient producers, and dollarization. Both groups share a legacy of issues that include poor educational systems, income inequality, poor infrastructures, a large informal sector, corruption, and obsolete legal and regulatory frameworks. Table 1 shows the composition of these two groups.
Table 1: Latin American Economic Clusters

<table>
<thead>
<tr>
<th>Country</th>
<th>Two clusters + outliers</th>
<th>Two Clusters</th>
</tr>
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<tbody>
<tr>
<td>Belize</td>
<td>1</td>
<td>1</td>
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<tr>
<td>Guyana</td>
<td>1</td>
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<td>Costa Rica</td>
<td>1</td>
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<td>Honduras</td>
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<td>Panama</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Mexico</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Dominican Republic</td>
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<td>1</td>
</tr>
<tr>
<td>Suriname</td>
<td>1</td>
<td>1</td>
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<tr>
<td>Guatemala</td>
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<tr>
<td>Nicaragua</td>
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<tr>
<td>Bahamas</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Barbados</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>El Salvador</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Jamaica</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Brazil</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Colombia</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Argentina</td>
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<tr>
<td>Paraguay</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Chile</td>
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<tr>
<td>Peru</td>
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<tr>
<td>Uruguay</td>
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<tr>
<td>Bolivia</td>
<td>2</td>
<td>2</td>
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<tr>
<td>Ecuador</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Venezuela</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>Trinidad &amp; Tobago</td>
<td>3</td>
<td>2</td>
</tr>
</tbody>
</table>

Source: Izquierdo & Talvi, One Region-Two Speeds, Inter-American Development Bank, March 2011.

In the past, Latin American firms, particularly Argentinean and Brazilian firms, expanded internationally to compensate for stagnant and highly inflationary domestic markets. Their expansion targeted mostly advanced markets (Bonaglia, Goldstein & Mathews, 2007; Boggs, 2001; Da Rocha & Da Silva, 2009; Fleury & Fleury, 2009; Haar & Ortiz-Buonafina, 1995; Ramsey & Almeida, 2009). Under a new global order, Latin American firms from the growing Brazilian hub face a case of wealth of riches: strong domestic as well as export markets, particularly in Asia (Mathews, 2009). On the other hand, Latin American firms in the depressed Mexican-led group, struggle with contracting domestic and export markets. In both cases, Latin American firms are hard pressed in developing effective and efficient strategies to adjust to rapidly shifting environments of either dual growth opportunities or recessions abroad and at home.

The purpose of this article is to provide a better understanding of the extent and scope of regional polarization and its impact on strategic reconfiguration among Latin American firms. Given that polarization is a recent phenomenon, there is a paucity of research on how firms cope with either expansionary or depressed domestic and global market conditions.

The paper is organized in five sections. The first section identifies and describes clusters of polarization in the region. The second section examines the macroeconomic differences
among clusters. The third section discusses Foreign Direct Investment (FDI) flows into the clusters. The fourth section analyzes the competitiveness of countries and firms by cluster. The final section sets the tone for management and strategy implications and proposes an agenda for research on this topic.

The importance of this research lies in the need to determine the strategies and best practices that fit regional polarization. Such knowledge is important to provide guidance to firms contemplating changes in their strategies, and to assist them in establishing informed public policies that sustain successful strategic restructuring. This paper advances a conceptual framework to explore how firms may realign their strategies and competencies for these scenarios. This is an important topic as the successful alignment of firm capabilities is key to sustainable future growth in Latin America.

**Defining Regional Polarization**

The strong rebalancing of the global economy has had differential impacts on Latin America’s economies. Strong demand from growing Asian economies has favored Latin American countries which are net exporters of mining and food commodities. On the other hand, countries, which have mostly relied on manufacturing exports and services, find themselves facing stiff Asian competition in global markets. Izquierdo and Talvi (2011) analyzed the structural differences of regional economies as they readjust to the new world economic order. They clustered 26 Latin American and Caribbean countries based on: a) whether the country is a net commodity export balance (importer/exporter); b) their share of exports to industrial countries; and, c) the share of investment in the output of their economies (investment/GDP). The authors found that a two-cluster solution provided a representative and robust solution. Furthermore, they advanced that the clusters discriminate well across macroeconomic indicators of aggregate demand, aggregate supply, fiscal balance, sectorial and external balances and, money demand between clusters. With such differentiation, they concluded that the new global economic order has shaped economic structural differences in the two revealed clusters. Furthermore, they observed that these differences are increasing over time. Their analysis shows that country variance decreases within a cluster and increases between clusters over a ten-year period. They conclude that these two sub-regions seem to be growing apart in many respects with important implications for everyone. Furthermore, Izquierdo and Talvi (2011) note that the Mexican cluster has become more compact over time as evidenced by the reduction of its mean squared error over time— a suggestion that these economies are increasingly becoming isoformic in their structural commonalities.

Izquierdo and Talvi’s, (2011) two-clusters shown in the far right column of Table 1, were obtained by calculating the ratio of the investment percent to the exposure to advanced countries. Since the two-variable solution yields the same clustering of countries, they propose to use this more parsimonious representation. The first group, labeled the Mexico-led cluster, includes net commodity importers and countries with a low ratio of investment to exports to industrial countries. This first group populates the lower left corner in Figure 1. The second group, labeled the Brazil-led cluster, is composed of net commodity exporters with higher ratios of investments to exports to industrial countries. This second group occupies the upper quadrant and is spread through the horizontal axis of Figure 1. In their interpretation of the clustering solution, Izquierdo and Talvi (2011) note that Venezuela and Trinidad & Tobago, which are part of the Brazil-led cluster, seem to be outliers, as they do not clearly fit the profiles of either cluster. Venezuela is a net commodity exporter due to its oil exports, but other macroeconomic
indicators do not fit well with the rest of the second cluster. A similar situation describes Trinidad & Tobago. Their analysis shows clearly that these two countries join the larger Brazil-led cluster in the last step of agglomeration. Chile, also an outlier, has a macroeconomic profile that fits more closely with those countries in the second cluster. In this paper, Venezuela and Trinidad & Tobago are excluded from the analysis.

**Figure 1**

Source: Reproduced from Figure 6 in Izquierdo & Talvi (2011); Data sources: DOT, WEO and WITS. Industrial Countries as defined in DOT.
Analysis of Key Differences between Clusters

Macroeconomic Differences

One important aspect of global realignment is differential economic growth between advanced and emerging economies. As posited in the introduction, this differential growth is evident in Latin America. As indicated in Table 2, average economic growth for the Brazil cluster was 7.14% in 2010 whereas the Mexican cluster grew at 3.17 percent. A longer-term analysis shows a more marked difference. The ten-year average for 2001-2010 shows the Brazil-led cluster growing at 5.04 percent and the Mexican-led group at only 2.78 percent. It is clear that the economies in the group led by Brazil have benefited the most from the shift to emerging markets growth in the global economy. These differences are significant.

Table 2: Macro Economic Differences Between Mexico and Brazil Led Clusters

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mexico –Led Cluster 1</th>
<th>Brazil-Led Cluster 2</th>
<th>All Countries</th>
<th>F (1,22)</th>
<th>P &lt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Growth 2010 **</td>
<td>3.17</td>
<td>7.14</td>
<td>4.73</td>
<td>8.76</td>
<td>0.0075</td>
</tr>
<tr>
<td>Ave growth 2001-2010*</td>
<td>2.78</td>
<td>5.04</td>
<td>3.66</td>
<td>6.47</td>
<td>0.0189</td>
</tr>
<tr>
<td>Inflation 2007-2010</td>
<td>6.55</td>
<td>6.14</td>
<td>6.39</td>
<td>0.10</td>
<td>0.7504</td>
</tr>
<tr>
<td>Inflation 2010</td>
<td>5.65</td>
<td>5.52</td>
<td>5.6</td>
<td>0.10</td>
<td>0.9213</td>
</tr>
<tr>
<td>Current Acct Balance 2010**</td>
<td>-6.22</td>
<td>-0.71</td>
<td>-4.0</td>
<td>9.93</td>
<td>0.0048</td>
</tr>
<tr>
<td>Public Sector Balance 2010**</td>
<td>-3.80</td>
<td>-0.81</td>
<td>-2.63</td>
<td>16.17</td>
<td>0.0006</td>
</tr>
<tr>
<td>Public Sector Debt as % of GDP* 2010</td>
<td>58.1</td>
<td>34.6</td>
<td>48.92</td>
<td>3.41</td>
<td>0.0789</td>
</tr>
</tbody>
</table>

* p<.05 ** p<.01

Source: IMF, Latin American and the Caribbean: Main Fiscal Indicators, 2011; Economic Commission for Latin America (ECLAC) Regional Economic Outlook: Western Hemisphere, 2011; Author analysis.

Inflation in 2010 is similar in both clusters. The similarity of inflation performance in both clusters reflects the region’s adoption of inflation-targeting monetary policies and thus, one would expect similar results. Although similar inflation is found in both clusters, the Brazil cluster suffers from higher inflation pressures due to the overheating of these economies and strong capital inflows. On the other hand, in the Mexico-led cluster, prices tend to remain at their current levels despite the measures to reduce inflation by their central banks or other agencies.

The analysis of current account balances show how region have adjusted to global imbalances in recent years. In general, emerging economies driven by their domestic markets are gradually shifting from a position of surplus in the current account to a deficit position as industrialized economies move in the opposite direction. The Mexico-led cluster suffers the largest adjustment with an average 6.22 percent deficit in current accounts, against only 0.71 percent for the Brazil-led cluster.

The fiscal balance differences between the two clusters also show how governments are adjusting to their particular economic conditions. In the Mexico cluster, counter-cyclical
programs to stimulate and compensate for stagnant growth appear more effective. The primary public sector balance deficit is at 3.80 percent and the public sector debt average is a high 58 percent. The differences are clear in the Brazil-led cluster with an average public sector debt of 0.81 percent and an average public sector deficit of 34.6 percent in 2010.

In sum, the analysis shows the differential impact of a new global order on the macroeconomic conditions of the two regional clusters. As Izquierdo and Talvi (2011) comment, these differences suggest that government macroeconomic policies should fit the structural conditions of each cluster. As such, fiscal policies in the Mexico-led cluster compensate for sluggish growth and lower levels of capital inflows whereas prudent counter-cyclical policies for the Brazil-led cluster deal with the inflationary pressures of overheating economies and currency appreciation.

**Polarization of FDI flows**

One would also expect FDI flows to reflect the shift of investment opportunities in the region. The Mexico-led cluster economies have traditionally attracted investment flows based on their proximity to the U.S. market and low labor costs. These comparative advantages and market access benefits cemented through trade agreements have attracted investors interested in setting up assembly and manufacturing facilities and services that take advantage of tourism and English fluency competencies. These two comparative advantages, however, have been quite vulnerable to the rise of Asian competition. With the slowdown in the U.S. market, these countries have lost their attractiveness to foreign investors. With a recession in the U.S., these countries are further suffering from a slower rate of remittances.

In contrast to the more manufacturing-led strategy in the Mexican-led northern countries, the Brazil-led cluster is capitalizing on abundant natural resources to compete in world markets. These countries tend to export to geographically diversified markets, as transportation costs to many destinations are equally expensive. On the other hand, their distance to world markets is a detriment to tourism flows. A relatively low level of foreign language fluency discourages investments in the service sector.

Table 3 shows FDI flows to the regions by cluster. In 2010, the average FDI flows into the Brazil-led cluster were $10.3 billion vs. $2.18 billion in the Mexico cluster. The analysis of FDI flows in the 2001-2010 period shows that that investors have shifted interest from Mexico-led to the Brazil-led cluster. In the period of 2001-05, the Mexico cluster exhibits a compound annual growth (CAGR) of FDI flows of 12.49 percent. FDI flows of the Mexico cluster reverse to a negative CAGR of 2.02 percent, an outflow of capital, in the period of 2005-2010. By contrast, the Brazil-led cluster, which attracted FDI at a mere CAGR of 2.27 between 2001-05, grew at the impressive rate of 9.84 percent from 2006-2010. These differences are found to be statistically significant.

Analysis of the sectorial destination of the FDI flows also reveals significant differences between clusters. In the Brazil cluster countries, 40.7 percent of FDI is invested in natural resource extraction activities, whereas only 10.9 percent of such investment is in the same activity in the Mexico cluster. These differences are significant. As FDI is also driven by the level of business risks, differences in country risk perception should have a differential impact on flows between clusters. Using Transparency International’s Corruption Index as a proxy of country risks should reveal differences between clusters (Transparency International, 2010). Table 3 shows the average perception of country risks by cluster. The differences between clusters are not significantly distinct. The perceived levels of corruption seem to permeate all countries in the region leading to the conclusion that the high
levels of corruption are present across clusters. Investors may have a similar perception of risks but they are able to differentiate the opportunities.

In conclusion, FDI flows react to investment opportunities and risks. Foreign capital is flowing into natural resource-based investments geared to exporting commodities to other emerging economies.

Table 3: FDI and Corruption Differences Between Mexican and Brazil Led Clusters

| Variable                                      | Mexico-Led Cluster 1 | Brazil-Led Cluster 2 | All Countries | F (1,22) | P <  
|-----------------------------------------------|----------------------|----------------------|---------------|----------|------
| FDI 2009 in US$ million*                      | 1740                 | 7188                 | 3879          | 6352     | 4.71 | 0.041
| FDI 2010 in US$ million                       | 2183.85              | 4943                 | 10315         | 15010    | 5668 | 10980 | 3.12 | 0.934
| CAGR in FDI 2001-05 (%)                       | 12.49                | 13.11                | 2.27          | 24.19    | 8.49 | 18.45 | 1.74 | 0.2018
| CGAR in FDI 2006-2010 (%) *                   | -2.02                | 9.84                 | 9.83          | 11.41    | 2.61 | 11.81 | 7.02 | 0.015
| % of FDI in Natural Resource Extraction* 2010 | 10.9                 | 12.84                | 40.7          | 23.4     | 0.25 | 0.23 | 11.25 | 0.004
| Transparency International Corruption Index 2011 | 3.68                 | 1.57                 | 3.91          | 1.84     | 3.78 | 1.65 | 0.09 | 0.767

* p< .05


Global Competitiveness and Polarization

It is well understood that productivity is an important driver of country competitiveness. The productivity of firms is driven by the quality and efficiency of factor inputs. Firms’ productivity also depends on the quality of business and institutional environments in which they operate. In this section, the differences in the competitiveness of countries across regional clusters is explored using the WEF’s Global Competitiveness Framework (World Economic Forum, 2010).

Table 4 shows the average scores of global competitiveness and the twelve pillars of WEF’s global competitiveness indicators by cluster. The analysis reveals that there are no significant differences on the overall competitiveness or on any of the indicators of competitiveness across clusters. I conclude that the region as whole is characterized as very homogeneous with respect to its global competitiveness. With the exception of Chile, which ranks 30 in the world, almost all of the Latin American countries rank in the second tier of competitiveness in the world.

A review of the average scores shows that the Brazil cluster countries showed a higher ranking than the Mexico cluster on macroeconomic management, labor force training, and market size indicators. The Mexico-led cluster is slightly higher on market efficiency and
financial market development indicators. Both clusters are very similar in a number of respects including educational systems, infrastructure development, quality of the labor force, and innovation. It is especially notable to observe the poor innovation scores of the countries in Latin America - a factor that is clearly related to advanced global competitiveness. The lack of R&D investment by firms in Latin America is not a surprise (Rodriguez, 2008).

Table 4: Global Competitiveness Indicators in the Mexico and Brazil-led Clusters

| Variable                        | Mexico-Led Cluster 1 | Brazil-Led Cluster 2 | All Countries | F (1,17) | P <  
|---------------------------------|----------------------|----------------------|---------------|----------|------  
| Overall Global Competitiveness  | 3.90 0.36            | 4.01 0.37            | 3.95 0.36     | 0.42     | 0.524  
| Institutions                    | 3.5 0.39             | 3.53 0.80            | 3.51 0.60     | 0.01     | 0.908  
| Infrastructure                  | 3.56 0.54            | 3.60 0.67            | 3.57 0.61     | 0.02     | 0.892  
| Macroeconomic management        | 4.29 0.72            | 4.57 0.38            | 4.42 0.59     | 1.13     | 0.320  
| Health and Education            | 5.50 0.36            | 5.55 0.26            | 5.52 0.31     | 0.14     | 0.711  
| Training Labor Force            | 3.74 0.39            | 4.04 0.55            | 3.88 0.49     | 1.92     | 0.183  
| Goods Markets Efficiency        | 4.05 0.23            | 3.83 0.51            | 3.94 0.38     | 1.55     | 0.230  
| Labor Markets Efficiency        | 4.05 0.31            | 3.86 0.56            | 3.96 0.44     | 0.79     | 0.385  
| Financial Market Development    | 4.11 0.43            | 3.94 0.53            | 4.03 0.47     | 0.56     | 0.463  
| Technology readiness            | 3.50 0.42            | 3.46 0.50            | 3.48 0.44     | 0.02     | 0.876  
| Market Size*                    | 3.30 0.89            | 4.08 0.86            | 3.67 0.94     | 3.79     | 0.068  
| Business Sophistication         | 3.86 0.38            | 3.76 0.45            | 3.81 0.40     | 0.24     | 0.634  
| Innovation                      | 2.86 0.32            | 2.90 0.47            | 2.87 0.40     | 0.04     | 0.837  

* p<.05


The lack of differences in competitiveness factors across clusters suggests that productivity alone does not explain the differences in economic performance. These differences can be attributed to other factors of which market size and natural resource endowments may play a large role. Another factor is the ability of firms to respond to shifting opportunities. Arbix and Caseiro (2011) argue that the flexibility of Brazilian firms to quickly shift their exports to capitalize on the global demand for commodities from other emerging countries has been a key factor of this country’s economic growth. The Mexico led-cluster countries, although also rich in natural resources, may not be endowed in the types of commodities in high demand in other emerging economies- particularly China. Furthermore, their firms have developed competencies more attuned to the demand from industrialized northern markets and less so from emerging economies. This alignment proves to be difficult to reverse to serve the emerging markets of Asia (Castillo, 2006).
Strategy in a Polarized Region

The alignment between firm strategy and environment is a key factor of a firm’s success (Bowman & Singh, 1993; Wan, 2005). In a polarized region, alignment with the changing global order is a necessary condition for success. Such an alignment requires a configuration of the firm’s strategic resources to respond to opportunities. A configuration strategy has been defined as the action of the firm to acquire and utilize resources that add value and allow the firm to obtain a sustainable competitive position in a given market (Rummelt, Schendel & Teece, 1991). Thus, a reconfiguration strategy is the realignment to address changing market conditions.

Emerging economies have experienced intense processes of economic reforms and transformation in recent years leading to a certain degree of similarity in their economic and business environments (Ahlmstrom & Bruton, 2004; Hoskisson, Eden, Lau & Wright, 2000). Wright, Filatovech, Hoskisson and Peng, (2005) review of the literature on strategy in emerging markets reveals that emerging markets exhibit weak institutional environments, high transaction costs, mass middle class markets, and high levels of government involvement. According to Filovech, Hoskisson and Peng (2005) firms in emerging markets need to develop strategic flexibility, strong non-market capabilities, and ownership strategies that fit these contextual conditions.

Strategy adjustments of multinationals and local firms in response to economic reforms in Latin America are not new (Connor & Mueller, 1982; Eslava, Hofsetter & Izquierdo, 2010; Filtovech et. al, 2003; Toulan, 2002; White & Linden, 2002). What is new is the rapid pace of polarization of the region and the realignment of the destination of exports. Key aspects of polarization according to Izquierdo & Talvi (2011) are external and internal market conditions and government policies. These two factors differ greatly in the Brazil-led and Mexican-led clusters. This section explores how strategy realignment may fit different conditions across two factors: markets and policies.

Different Market Contexts

The Brazil-led cluster is characterized by economic growth driven by an emerging domestic mass middle class and global demand for commodity exports to emerging markets.

The middle class markets in this group have grown due to a combination of sustainable employment, demographics, life styles and also social programs. In Brazil alone, a middle class market of 100 million people had an infusion of 32 million people in the period of 2005-10. This swelling of the middle class is a result of social programs such as “bolsa familia” – a family subsidy tied to health and educational conditions, and “minha casa”- a housing program introduced in 2002 by the Lula government (Eloy, 2010). Demographics and changing lifestyles have also shaped local demand conditions as families have become smaller and the population ages. These market changes in Brazil have been mirrored or are even more advanced in other economies in this cluster. Chile and Uruguay have already experienced the transformation in progress in Brazil, and Colombia and Peru follow closely behind. As a result, firms are introducing new products and services for this expanding bottom-of-the-pyramid market segment.

External market conditions have been greatly transformed in this cluster. As previously mentioned, exports of natural resource commodities to Asia and other emerging economies have grown rapidly. Chinese foreign direct investment in this cluster has also increased from $7.3 billion in the period of 1990-2009 to $15 billion in 2010 with 90 percent of such recent investment in extractive industries (ECLAC, 2011; Banham, 2010; Yunyun, 2010). As a result,
Brazil-led clusters have reoriented their productive structures to meet Asian demand. As part of this realignment, Brazil-led cluster firms have reconfigured their specific assets to make them more effective in these new markets. For instance, logistics and distribution assets that were geared towards the advanced markets of the U.S. and Europe (south-to-north) have been reconfigured or developed for Asian markets (Arbix & Caseiro, 2011).

It is clear that the new domestic and export market requirements for the Brazil-led cluster require a reconfiguration of strategic focus and skills. For the export market, firms invest in upgrading factor quality and productivity. They also invest in control of natural resource expansion where non-market capabilities (government connections and lobbying) are important to secure access and rights to exploit them. Skills and resources for the domestic middle class market require a greater presence in both urban and rural sectors as well as the development of basic products. Both the domestic and external markets requirements put a premium on managerial talent and firms’ abilities to recruit human resources.

The inverse of the situation above - stagnation of domestic and export markets-poses a different set of challenges for multinational and local firms operating in the Mexico-led cluster. The strategies for these firms are of survival in depressed domestic markets and the realignment of strategic resources and skills to Asian markets. After a long period of building competencies for the U.S. and European markets, firms in the Mexican cluster must invest in skills needed to compete in Asian markets. A deteriorating security environment with increased violence related to drug trafficking in Central America has dampened foreign direct investment as the security risks and costs have steadily escalated.

**Different Policy Contexts**

The differential economic performance between clusters can be attributed not only to favorable or unfavorable external conditions but also to public policies that steer different paths of economic and social development. These differences are important components of the business context as economic agents and investors respond to these signals in different ways. In this section, a short summary of these policies that are discussed fully in other sources is provided (Cardenas & Levy-Yeyati, 2011).

In the case of the Brazil cluster, macroeconomic policies have been aimed mostly at maintaining inflation targets within the context of capital market openness, policy autonomy, and floating exchange rates. Inflation targeting monetary policies have used high interest rates to meet inflation targets. Fiscal policy has been characterized as prudent with the goal of yielding primary surpluses at all levels. The outcome of this policy combination has been low inflation with currency appreciation in most of the Brazil- cluster economies. Such strong currency appreciation hurts exports and favors imports with the undesirable outcome of discouraging domestic investment in productive activities. On the other hand, high interest rates and macroeconomic stability attract short-term and foreign direct investments. As mentioned previously, favorable external market conditions and high commodity prices have been attractive enough to incentivize exports of natural resources.

As a result, economies in the Brazil cluster have experienced a sustained period of overvalued currencies, primary fiscal surpluses, and current account surpluses. Such conditions favor sectors associated with the export boom and have attracted foreign investors in the natural resources sector as discussed above. On the other hand, manufacturing activity has stagnated under the pressure of low cost imports, with pressure from local industry to introduce market protection measures and incentives. The “Buy Brazil” legislation is a good example of such a reaction (Latin Trade, 2011). Shrinkage of the industrial base has been compensated by an
increase in the service economy, especially financial services, which are less vulnerable to import competition.

With certain controls on inflation, Brazil-led cluster economies have introduced a number of policies to address social issues and provide incentives to energize their domestic markets. Policies related to the expansion of consumer and housing credit funded by public development banks, increases in the minimum wage, extension of pensions to informal sector workers, and credit to small farmers are examples of such interventions. Further policies have targeted the issues of poverty through income transfer programs linked to health and education.

The outcomes of these economic and social policies have been a reduction of poverty, the creation of a solid middle class market, a buoyant service economy, and a vibrant sector related to natural resource extraction. Expanding domestic markets have further attracted not only resource seeking but also market seeking foreign investment (Yunyun, 2010). As a result, both the domestic and export markets have become engines for further growth. In fact, Izquierdo and Talvi (2011) found that economies in this cluster are characterized by a net commodity export position and relatively high ratios of investment-to-exports.

Despite these successes, the Brazil-led cluster risks the hollowing out of its manufacturing industries and suffers from the so-called “middle-income and commodity trap” (Inter-American Dialogue, 2012). Future growth of these economies will depend on the effectiveness of policies aimed at escaping such traps. Some experts argue that these economies should move up the development ladder through investments in innovation related to natural resource extraction or productivity improvements of the service economies. Clearly, the improvement of competitiveness in more mainstream manufacturing may not be enough to compete with the formidable Asian economies (Rodriguez, Dalhman & Salmi, 2008). It is within this context that the Brazilian led-cluster firms must reconfigure their strategy to address opportunities in both domestic and global markets.

The Mexican cluster countries have experienced a long period of slow to negative growth, currency depreciation, reduction in manufacturing activity, sluggish private consumption, and greater dependence on short capital flows to sustain current account deficits. Against this backdrop, the economies in this cluster have managed their markets with a different set of policies summarized in the following paragraphs.

As result of the global recession in 2008-09 and dependence on the U.S. economy, exports fell dramatically. In Mexico alone, the U.S. market represents 80 percent of exports. The specialization of exports in assembly operations also amplifies the impact as these plants quickly adjust output and employment to demand contraction. About 50 percent of Mexican manufacturing is produced in maquiladoras (Schwellnus, 2011).

Similar to the Brazil-cluster economies, most of the Mexican cluster economies have practiced inflation targeting and flexible exchange rates. Despite the intent of monetary policies to reduce inflation, prices have remained stable. To a great extent the stickiness of prices has been due to product and labor market rigidities, high inflation expectations, and in some cases, the dollarization of these economies. Initial devaluation of currencies has also added to inflation pressures, as most of these economies also import.

Counter-cyclical policies have been limited to maintaining a low level of reserves and fiscal rules aimed at balancing fiscal budgets. The low level of reserves does not allow the flexibility to exercise counter-cyclical policies to counteract the contraction in the economy. In the case of Mexico, contraction of the manufacturing sector led to a contraction of the service sector, which is closely linked to transport and wholesale trade activities. In Brazil, the service
sector is more diversified with less dependence on export activities. One indication of the different conditions influencing counter-cyclical policies is the difference in the structural fiscal balances between clusters. The average structural balance is 4 percent in the Brazil cluster and 20 percent in the Mexico cluster (Schwellnus, 2011).

A reduction of economic activity especially in manufacturing lowers foreign direct investment and leaves these economies vulnerable to short term capital flows to sustain current account deficits. This dependence aggravates their recovery given the volatility and greater burden of external financing.

To reactivate economic recovery, the Mexican cluster needs to diversify export markets (Vale Columbia Center, 2011). This diversification can only be attained through productivity improvements and realignment to Asian markets and other emerging economies in sectors where these economies have comparative advantages such as energy, mining, and services. Another opportunity is to reduce the link of the service economy to manufacturing and exports through liberalization, innovation, and incentives to create a more consumer-oriented economy. The effectiveness of further counter-cyclical policies may be achieved through the reduction of labor and product market rigidities. Building of foreign exchange reserves through increased exports will help reduce structural fiscal balance deficits in periods of high commodity prices- oil in the case of the Mexico-led cluster.

Discussion

The purpose of this article was to set the foundation to address the reality of increasing economic polarization in Latin America. This paper provided evidence that this region is polarized in many respects with clearly different performance results. Izquierdo & Talvi’s (2011) analysis revealed two clusters of economies that share a number of structural commonalities within and between the two groups: one cluster reaping opportunities in export and domestic markets to yield impressive economic growth, and another suffering from stagnation in both. Despite polarization, Latin American economies share a common historical legacy of issues and challenges. In this section, a contextual contingency framework is advanced that describes the clusters and studies the strategic fit of the firm to regional polarization. The paper ends with suggestions for further research on this topic. As there is an urgent need to develop new theoretical models as to how multinationals address the dynamics of global integration and increasing polarization (Girod & Ranjan, 2010; Goldstein, 2007; Wright, Filatovech, Hoskinsson & Peng, 2005), it is hoped that this article stimuliates further research on strategies in polarized regions.

As this polarization will only intensify in the future, we need to understand how differential contextual environments may impact firm strategy. In this paper, market growth and macroeconomic policies are used to characterize context. Based on these contextual variables, the two clusters were placed on a contingency framework that best describes the strategic fit with the regional context – see Table 5.

The majority of the countries in the two clusters proposed by Izquierdo and Talvi (2011) exhibit a combination of either depressed or buoyant domestic and external markets; these are two extremes of a market contingency. A few economies represent a mixed situation of external market and domestic market conditions. For instance, Venezuela (an outlier not included in the final analysis but a good example of this situation), Ecuador, and Bolivia have a favorable external market for commodities, mostly oil and natural gas exports, but have depressed internal
markets. On the other hand, Colombia is a country with vibrant domestic markets and sluggish export markets due to its poor country image.

As Latin American economies gravitate to the extreme conditions represented by the core countries in each cluster, firms must develop strategies that best fit the market contingency. In the Brazil cluster, success may depend on the ability of firms to secure access to natural resources and human resource talent necessary for growth and investment in strategic assets and resources attuned to exploiting opportunities in other emerging markets, particularly in Asia. Many Brazilian firms have already invested in the control of logistic and manufacturing assets in China—some with a great deal of success, others with failure. In the Mexico-led cluster the success of survival strategies is based on the ability of firms to regain competitiveness vis-à-vis Asian competitors in external and domestic markets. Non-market strategies aimed at securing public policies to protect the domestic market only provide a temporary solution. Selective market focus and market specialization may prove more sustainable. A more successful strategy for some firms in this cluster is to focus on an expansion to the more vibrant economies of the Brazil-led cluster. Such a strategy may require the development of firm specific advantages that are more attuned to key markets such as Brazil and Peru.

Table 5: Strategy in Contextual Business Environments of a Polarized Latin America

<table>
<thead>
<tr>
<th>Markets</th>
<th>Macro Economic Policies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turning counter-cyclical fiscal policies to contain inflationary pressures without obstructing recovery or currency appreciation.</td>
<td>Macro Prudent Growth Controlling exchange rate appreciation without obstructing capital inflows.</td>
</tr>
<tr>
<td>Microstructural policies to improve export competitiveness and restore rule of law.</td>
<td>Microstructural policies.</td>
</tr>
<tr>
<td>Favorable Export and/or Domestic</td>
<td>Periphery of Brazil cluster.</td>
</tr>
<tr>
<td>Favorable export markets but stagnant domestic economy.</td>
<td>Brazil cluster core.</td>
</tr>
<tr>
<td>Strategic Focus</td>
<td>Access to natural resources; alignment with emerging markets; manage domestic and export market growth.</td>
</tr>
<tr>
<td>Manage export market relationships and channels; efficiency. e.g. Colombia</td>
<td></td>
</tr>
<tr>
<td>Stagnant Export and/or Domestic</td>
<td>Mexico cluster core.</td>
</tr>
<tr>
<td>Strategic Focus</td>
<td>Periphery of Mexico cluster.</td>
</tr>
<tr>
<td>Lean Management; efficiency and low cost; realignment to exploit emerging market opportunities.</td>
<td>Strong domestic economy but stagnant export markets.</td>
</tr>
<tr>
<td>Strategic Focus</td>
<td>Alignment with emerging market opportunities. e.g. Panama</td>
</tr>
</tbody>
</table>

Source: Reproduced from Figure 6 in Izquierdo & Talvi (2011)

**Future Research Directions**

Research on how firms prepare for such realignment is sparse. To remedy this void, a research agenda to address this important topic should include the following:

- **Diversification Strategy.** What are the market diversification strategies of Latin American firms in each cluster since 2005? Has the emphasis been more toward domestic market growth or toward global market growth? If global market, is the firm aiming mostly at emerging markets? (Nachum 2004).

- **Reconfiguration Strategy.** How have Latin American firms reconfigured their competencies, skills, and assets in each cluster since the start of the inflexion period (2005)? Are there strategy differences between exporters and domestic oriented firms?

- **Access to Scarce Resources.** How do Latin American firms resolve access to key resources of managerial talent in each cluster? Is the strategy different for competencies and skills for domestic markets as opposed to export markets?

- **Differences in configuration of competencies and skills.** Are market and non-market competencies and skills of Latin American firms important in sustaining competitiveness in other emerging markets? (Fleury & Fleury, 2010).

- **Performance Differences.** What are the performance implications of reconfiguration strategies of Latin American firms by cluster? Do firms targeting mostly at local markets perform better than those targeting mostly global markets?

- **Transfer and Replication of Competencies and Skills Between Clusters.** Could firms from the Mexico-led cluster easily transfer competencies to Brazil-led cluster markets?

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The recent financial crisis has exposed an increasingly polarized global economic order: stagnation in advanced developed economies and growth and rising affluence in emerging countries. Global polarization is shaping the regional order, in particular in Latin America. A group of economies, led by Brazil is experiencing sustainable economic growth and strong domestic markets. A second group, led by Mexico, is stagnating economically and facing the challenges of violence and social instability unleashed by criminal organizations. The most remarkable feature of the polarization in Latin America is its rapid development – within the last five to seven years. Polarization creates structural economic and market differences in the two regional hubs. This paper explores the impact of regional polarization on macroeconomic performance, foreign direct investment, and global competitiveness of countries in the two hubs and speculates on how firms’ strategies may adjust to these different contexts.

Keywords: Regional Strategy, International Macroeconomic Context, Latin America
Firm Strategy in a Polarized Latin American Region

Stratégies des firmes dans une région Latino-Américaine polarisée

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Résumé

La récente crise financière a fait apparaître une polarisation croissante dans l'ordre économique mondial: stagnation économique dans des économies développées et croissance économique et la prospérité croissante dans des pays émergents. La polarisation mondiale contribue à façonner l'ordre régional, en particulier en Amérique Latine. Un groupe de pays, amené par le Brésil, connaît une croissance économique durable et des marchés domestiques vigoureux. Un second groupe, amené par le Mexique, connaît la stagnation économique et doit relever des défis de violence et d'instabilité sociale déclenchée par des organisations criminelles. La caractéristique la plus remarquable de la polarisation en Amérique Latine concerne la rapidité du développement au cours des cinq à sept dernières années. La polarisation a créé des différences structurelles économiques et de marché dans les deux sous-régions. Cet article explore l'impact de la polarisation régionale sur la performance macro-économique, sur les investissements directs étrangers et sur la compétitivité globale des pays dans les deux sous-régions et s'interroge sur la façon dont les stratégies des entreprises peuvent s'adapter à ces différents contextes.

Mots-clés: Stratégies régionales, Contexte macroéconomique internationale, l'Amérique Latine

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Unternehmensstrategie in einer polarisierten Region Lateinamerikas

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Abstract


Keywords: Lateinamerika, Regionalstrategie, internationaler makroökonomischer Kontext

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Firm Strategy in a Polarized Latin American Region

Estrategia Corporativa en una Región de Latinoamérica Polarizada

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Resumen

La reciente crisis financiera ha puesto de manifiesto una creciente polarización en el orden económico global: un estancamiento de las economías avanzadas desarrolladas y un crecimiento de la prosperidad en los países emergentes. La polarización global está creando el orden regional, en particular en América Latina. Un grupo de economías, liderado por Brasil está experimentando un crecimiento económico sostenible y fuertes mercados internos. Un segundo grupo, liderado por México, se ha estancado económicamente y debe de hacer frente a los desafíos de la violencia y la inestabilidad social desatada por las organizaciones criminales. La característica más notable de la polarización en América Latina es su rápido desarrollo - en los últimos cinco a siete años. La polarización crea diferencias estructurales, económicas y de mercado en los dos centros regionales. En este trabajo se analizan los efectos de la polarización regional en el desempeño macroeconómico, la inversión extranjera directa, y la competitividad global de los países de los dos centros y especula sobre cómo las estrategias de las empresas pueden adaptarse a los diferentes contextos.

Palabras Clave: Estrategia Regional, Contexto Macroeconómico Internacional, América Latina

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Firm Strategy in a Polarized Latin American Region

استراتيجية الشركة في منطقة أمريكا اللاتينية المتقاطعة

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ملخص

كشفت الأزمة الاقتصادية العالمية الأخيرة عن تزايد الاستقطاب للنظام الاقتصادي العالمي: الركود الاقتصادي في الدول المتقدمة، والنمو المتزايد في الدول النامية/الناشئة. يمثل الاستقطاب العالمي الوضع في المنطقة وتحديدا في أمريكا اللاتينية. تشهد مجموعات اقتصادية بدوية بالبرازيل. نمو اقتصادي دائم وسوق محلي قوي. تحتل المكسيك المرتبة الثانية. حيث تشهد ركودا اقتصاديا وتوافق تحديات العنف وعدم الاستقرار الاجتماعي الناتج عن المنظمات الجنائية. أهم صفة للاستقطاب في أمريكا اللاتينية هو التطور السريع في الخمس إلى السبع سنوات الأخيرة. تدرس هذه الدراسة أثر الاستقطاب في المنطقة على أداء الاقتصاد الكلي، الاستثمار الأجنبي المباشر، والتنافسية العالمية للدول في المركزين ودراسة كيفية تكيف استراتيجية الشركة مع الأوضاع المختلفة.

الكلمات الدالة: استراتيجية المنطقة، وضع الاقتصاد الكلي الدولي، أمريكا اللاتينية

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Firm Strategy in a Polarized Latin American Region

Strategia aziendale in un’area polarizzata dell’America Latina

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Abstract

La crisi finanziaria recente ha esposto economie sempre più polarizzate a livello globale: stagnazione nelle economie avanzate e sviluppo nelle economie emergenti. La polarizzazione sta dando una nuova forma all’ordine dell’aree regionali in particolar modo in America Latina. Un gruppo di economie, condotti dal Brasile, sta attraversando un periodo di crescita sostenibile e saldi mercati domestici. Un secondo gruppo, condotto dal Messico, sta stagnando economicamente e si sta confrontando con la violenza e l’instabilità sviluppatasi da organizzazioni criminali. La più rilevante caratteristica di questa polarizzazione in America Latina è il suo rapido sviluppo nel corso degli ultimi 5 - 7 anni. La polarizzazione crea differenze strutturali, economiche e di mercato fra i due gruppi. Questo documento esplora l’impatto della polarizzazione sulle prestazioni della microeconomia, degli investimenti diretti stranieri, e sulla competitività globale dei paesi nei due gruppi e propone alcune riflessioni su come le aziende si possano adattare ai contesti diversi.

Keywords: strategia regionale, contesto microeconomico internazionale, America Latina

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