The interaction between multinational and domestic firm entry in emerging markets

Dr. Scott Droege
Western Kentucky University

Dr. Michelle Lane
Western Kentucky University

Abstract

This research investigates the effect of multinational company (MNC) entry rates on domestic firm entry rates in emerging markets. Although research on competitive exclusion suggests that MNC entrants present entry barriers to potential smaller domestic entrants, it is suggest instead that MNC entry signals industry munificence, drawing rather than repelling new domestic entrants. This places boundary conditions on the accepted conventional industrial organization wisdom. MNC entry barriers indeed inhibit entry of potential small domestic players. However, when small, potential domestic firms have access to idiosyncratic resources that are less available to MNCs, these potential domestic emerging market entrants may overcome strong MNC entry barriers thus viewing MNC market entry as market munificence rather than market entry barriers. The net result is aggressive challenge by small domestic firms as large MNCs enter emerging markets. Still, this is circumscribed by the height of entry barriers, but not to the extent alluded to in previous industry organization analysis research. The results indicate less predictable competitive dynamics than previous research would suggest, especially in the context of emerging economies. This research examines the literature related to MNCs and domestic entry patterns in emerging markets. Data from the Thai banking industry is then examined in order to explore the theoretical relationships proposed.

Keywords: emerging markets, market entry, MNCs
INTRODUCTION

There has been considerable interest in multinational entry into emerging markets (Werner, 2002). However, research considering industry entry of multinational companies (MNCs) and domestic firms would benefit from clearer insights on whether there is an interaction effect between MNCs and domestic firm in emerging markets having less developed institutional structures. The purpose of this study is to explore this underdeveloped area. Two questions are considered. First, how does industry entry of multinational companies (MNCs) affect entry of domestic firms in emerging markets? Second and conversely, how do domestic firms affect MNC entry in emerging markets? In other words, are there interactions between MNCs and domestic entry in emerging markets and if so, what are they?

Industry analysis suggests that strong, established multinational competitors with access to global capital and well-developed capabilities should present a high barrier to entry to potential domestic entrants. One reason is that potential domestic entrants typically have less access to capital combined with capabilities that are less well developed to exploit market opportunities relative to large multinational corporations. In essence, entry barriers arise at least partly from resource barriers (Moore, Bell, and Filatotchev, 2010) especially when such resource barriers are combined with relatively adverse institutional environments that are often characteristic of emerging markets (Meyer, Estrin, Baumik, and Peng, 2009). The question, then, is whether there are idiosyncratic differences within emerging markets that encourage rather than discourage domestic firms to enter industries after multinational firms have established a strong foothold despite differences in resources that should erect entry barriers (Porter, 1980) to domestic firms. That is, does the presence of strong competitors attract rather than repel new entrants in emerging markets when those strong competitors are foreign-based multinational firms?

Thailand presents a theoretically interesting context from which to base this research; Thailand’s historically recent institutional changes provide a unique lens to view industry entry patterns (Newman, 2000). Interestingly, Newman’s conceptual work predicted the inverted U-shaped empirical results find by Li (2008). Li’s work was confirmatory in his study of savings and loan firm in California; strong players entered first, but then drew in weaker, local players. Although previous research has elucidated specific industry entry patterns among financial institutions, such research has been predominantly based in developed Western nations such as Li’s work. For example, California’s banking system in the United States resulted in an inverted U-shaped pattern of domestic bank entry in response to foreign competition; that is, foreign competition initially resulted in decreased domestic bank entry but as foreign competitors became successful, domestic banks increasingly entered the market until density-dependent market saturation resulted in a tapering off of new entrants by both multinational and domestic banks (Li, 2008). However, Saurez and Oliva (2005) who also a developed market study, prior to Li’s (2008) work, found no evidence of an inverted U-shape pattern as multinationals enter markets and spur domestic firms to enter at a critical density. This discrepancy further motivates the current study. However, a second factor motivating this research looks at the other side of the coin: Does entry of strong multinationals in emerging markets attract or repel domestic entry?

The interaction between multinational
The institutional environment between developed nations such as the U.S.A. and emerging markets such as Thailand are clearly different. As Ahlstrom and Bruton (2010: 533) assert, “Institutions are typically situation specific; therefore, researchers should evaluate institutional characteristics of a country with regard to a specific phenomenon rather in terms of general arrangements.” This motivates us to select a specific industry, banking, given the prior contradictory studies by Li (2008) and Suarez and Oliva (2005). In addition, Thailand has had a rapidly changing institutional environment since the devaluation of the Thai baht in 1997 that will shed light on whether an inverted U-shaped pattern that is typical of domestic entry in developed nations when multinational corporations gain traction in a particular market has similar configurations when compared to an emerging market undergoing rapid institutional change.

This research differs from Li’s (2008) and other developed Western-based studies in two important ways. The first difference involves the extent to which study parameters considered emerging market idiosyncrasies rather to focusing solely on more developed Western samples. For instance, although certain regulatory changes in California’s banking industry were present during Li’s study period, the overall macroeconomic background was that of a developed, first-world economy. In contrast, Thailand represents an emerging market—a market with low income compared to developed nations but with higher potential for rapid growth relative to its baseline spurred by economic liberalization policies (Hoskisson, Eden, Lau, and Wright, 2000). Financial liberalization has improved domestic bank competitiveness; efficiency gains from foreign entry tend to extend this improvement as the density of market players accelerates (Bayraktar and Wang, 2005). In addition, foreign banks on average achieve higher profits than domestic banks in emerging markets, while the reverse is true in developed countries (Claessens, Demirgüç-Kunt, and Huizing, 2000). Conflicting evidence, however, suggests that this is not the case in Thailand (Menkhoff and Suwannaporn, 2005).

To the contrary, Thailand’s financial liberalization policies inadequately addressed risks taken on by what were assumed to be “safer,” well-regulated foreign-based multinational banks (Menkhoff, 1999). Given this background, this research intends to further explore idiosyncratic differences of Thailand’s emerging market that may have contributed to counterintuitive patterns of industry entry. Bruton and Lau (2008) have recently argued that researchers studying contextual variables in Asian emerging markets are essential to furthering understanding not only of firms in the focus country, but also of firms with different contextual variables. This research is an effort to advance this agenda.

The second area this research differs from Li’s (2008) and other developed market studies involves the relative stability of the institutional environment. The regulatory changes in the Li (2008) study, for instance, represent a more stable operating environment than the Thai banking industry. This relative institutional stability is similar when comparing developed with emerging markets even despite the egregious examples of fiduciary mistrust and malfeasance recently reported in the mainstream media concerning developed markets including bank failures, relative lack of leveraged exchange-traded fund oversight, and private equity Ponzi schemes, “flash crashes” in the U.S., and austerity programs enacted in nations such as Greece, Portugal, and Ireland even while Middle Eastern nations strive for democratic changes. Despite these global upheavals, developed nations’ financial systems such as the U.S.A., Germany, and others have continued to maintain a stronger regulatory institutional environment than emerging economies, while recognizing that such developed markets are in flux. Still, domestic market institutional flux pales in comparison with that of emerging markets such as Libya, Egypt,
The interaction between multinational Bahrain, and Yemen. Despite the “jasmine” uprising in the People’s Republic of China, the strong institutional environment characteristic of China with its dual goals of economic prosperity concomitant with social stability (Droege and Brown-Johnson, 1997) has prevented widespread institutional upheaval.

Thus, there are theoretical reasons to believe there may be different results than the Li (2008) study previously mentioned. Haller (2008) found that as multidomestic firms increase total investment in an industry, they do so at the expense of domestic firms. That is, multidomestic firms tend to crowd out domestic investments. A brief illustration from the Li (2008) study period of 1979 – 1988 is informative when considering the influence of regulatory institutions. For example, the U.S Federal Reserve Bank (the Fed) maintained oversight of California’s banking industry during Li’s study period, but the Thai banking industry has had a much different and more dynamic regulatory institutional structure. Although the Fed reports to the U.S. Congress, it is relatively autonomous. In Thailand, however, the central Bank of Thailand (CBT) is influenced by political interests, thus creating goal convergence between economic policy and political power. This is despite the 1942 Bank of Thailand Act requiring the Bank of Thailand to be directly managed by the Minister of Finance (Marakanondh, 1978). Consequently, Thailand’s financial crisis of 1997-1998 was brought about more by its political autonomy than its economical responsiveness (Overholt, 1999) as the devaluation of the Thai baht precipitated a regional financial collapse. In the following sections there will be a review the literature related to these areas in more depth.

Theoretical Examination

Thailand’s political institutions have a powerful effect on investor confidence with a political system lower in stability relative to the U.S. in which similar studies have been carried out. Jensen and Fellow (2005) as well as Crystal, Dages, and Goldberg (2001) note that foreign ownership may provide important positive effects on the stability and development of emerging market banking systems by providing models of efficient resource development and deployment (Menkhoff and Suwannaporn, 2005). Indeed, Ratanakomol (1981) suggests that domestic banks’ industry structure becomes less intense in terms of competitive rivalry as foreign multinationals enter the market. This is partially the result of consolidation (Gelos and Roldós, 2002); however, the consolidation argument alone is an oversimplification of the competitive dynamics characteristic of emerging economies. Clearly, consolidation can build market power and gain efficiency through scale economies. Classic industrial organizational economics (i.e., Porter, 1980) predicts such market power and efficiencies gained through scale economies should present strong entry barriers. However, an argument can be made that under certain emerging economy boundary conditions, rather than multinational presence posing entry barriers, this presence signals to small domestic players an entry opportunity rather than an entry barrier. That is, rather than MNCs serving as entry barriers, they signal munificent environments. This appears to be particularly salient in emerging markets such as Thailand.

Li (2008) argues that the success of foreign competition in the California banking industry signaled a munificent environment, drawing in domestic competition over time. Li’s research sheds new light on the previous zero-sum assumption of the competitive exclusion hypothesis in which foreign and domestic firms compete head-to-head and assumes the entry of one group of competitors will have a negative effect on another group of competitors as both groups vie for the same customers. However, the competitive exclusion hypothesis does not take
into account competitive asymmetry and how the competitive dynamics between strategic groups can create signals of munificence for strategic subgroups. Li’s study provides evidence that such signals of munificence by foreign competitors result in competitive interactions that increase rather than prohibit industry entry of domestic competitors. This stands in stark contrast to the conventional wisdom that strong incumbents provide barriers to industry entry. On the contrary, it may be that foreign competitors, despite the liability of foreignness, may actually attract domestic players into an industry by signaling a munificent industry environment especially in the relatively weak institutional environments such as in Thailand.

In addition, although path dependence is not as deterministic as some prior research has portrayed (Ozcan and Eisenhardt, 2009), the path dependent nature of industry structure certainly has at least some influence on patterns of industry entry. Particularly within industries that are highly regulated such as banking, it would seem that regulatory hurdles would present competitive barriers to entry. However, even within industries with strong regulatory institutions, firms can approach perfect competition; Oliver (1997), for instance, demonstrated that nearly perfect competition exists side by side with intense regulation in the Canadian construction industry. In addition, Ozcan and Eisenhardt (2009) suggest that industry formation patterns do not always follow intuitive path dependence. Their study of the formation of alliance portfolios illustrates that firms taking a counterintuitive, non-path dependent approach achieve higher performance than firms following more deterministic path dependence. By researching similar issues in the Thai banking industry, this research should shed light on patterns of industry entry in highly regulated but highly competitive industries in emerging economies given that there is likely substantial variation in industry structure between developed and emerging markets (Hillman and Keim, 1995).

As noted previously, Li’s (2008) study examined California’s established banking industry. The overarching research purpose here is to explore whether Li’s research conclusions are also applicable to an emerging market context. The distinction between these two contexts relate to both international and domestic competition. This leads to the following research questions:

1. Would foreign competition elicit the same U-shaped entry pattern seen in the Li (2008) study in emerging markets with weaker institutional edifices?

2. What effect would domestic competition have on the evolution of foreign competition in an emerging market?

3. Might there be an interaction effect among foreign entry originating from relatively stronger institutions in emerging markets with relatively weaker institutions?

To answer these questions, this research establishes the research context by first presenting a brief history of the somewhat path dependent and co-evolutionary nature of the Thai banking industry while also implicating emerging market idiosyncrasies that form unique emerging market institutional environments. Second, the data from the Thai banking system over a 12 year period will be examined in addressing the proposed research questions. Third, managerial implications of MNC moving to emerging markets as well as emerging markets faced with an onslaught of seemingly more powerful MNCS will be discussed.
THEORETICAL CONSTRUCTS

The following theoretical constructs are salient to answering the research question: does the presence of strong competitors attract rather than repel new entrants in emerging markets when those strong competitors are foreign-based multinational firms? It may be discovered that the idiosyncratic differences between the emerging markets tested in this research and the developed markets tested in the Li (2008) research account for dissimilar results. In the following paragraphs, the theoretical constructs of competitive aggressiveness, competitive dynamics, signaling, liability of foreignness, institutional theory and asymmetric information will be summarized to aid in examination of the research questions.

Competitive Aggressiveness.

Marquis and Lounsbury (2007) suggest that competitive aggressiveness occurs when the competing logics accelerate resistance to institutional change of business professionals’ resistance to large, national business’ acquisitions of smaller. Competitive aggressiveness typically leads to industry consolidation processes yielded organizational variation as opposed to homogeneity, which has been the trope of institutional theory. This support enabled an explosion of new community form founding at the same time that massive national consolidation was occurring (Marquis and Lounsbury, 2007). Creative destruction can result in firm exit from certain industries. The interaction in the series of initiative and responsive competitive actions among firms in a competitive situation has been examined repeatedly (Lamburg, Tikkanen, Nokelainen, and Suur-Inkeroinen, 2009). A firm’s actions conjoin both with changes in the business environment (necessitating adaptation) and with the firm’s own history (necessitating continuity) in competitive behavior of long-term firm evaluation.

Competitive Dynamics.

A firm's sequence of competitive actions is conceptualized as four characteristics of the pattern of a firm's competitive attack are team heterogeneity, past performance, organizational slack, and industry context (Ferrier, 2001). The interaction in the series of initiative and responsive competitive actions among firms in a competitive situation has also been examined by Lamburg, Tikkanen, Nokelainen, and Suur-Inkeroinen (2009). The popular conceptualization of competition in competitive dynamics has been that initiative actions directly impact the actions of other firms. Exits of old firms increase entry and that on average new entrants are more productive. Persistent high local rates of entry, however, deter entry. The exit (destruction) of older firms stimulates the entry (creation) of new enterprises that are not constrained by inertial forces as the older incumbents were, and can combine the resources released by exiting firms in new ways so as to increase productivity. The effects of local exit levels of old firms upon entry to the location were found to be stronger than the effects of exits in more distant locations. The effects of exits of younger firms upon entry were purely local.

Signaling

The signaling theory in Li (2008) explains the process of how each organizational population imitates each other. Signaling theory and the search for referents influence the
competitive dynamics when competitors are highly asymmetric in resource endowments. The different strategic moves, competitor distinctiveness and revelation of signals are attributes of the theory. For example, it would be expected barriers to entry to be high when multinational firms enter a market relative to smaller domestic players, however, signaling theory may create a situation in which multinational entry indicates a munificent environment. Contrary to perceived entry barriers, smaller potential domestic players may indicate that the industry has the potential to provide substantial returns. In other words, what would traditionally be perceived as a barrier to entry—the presence of more well endowed multinationals—provides a signal of potential industry profitability. Thus, multinational entry, contrary to being perceived as an entry barrier, solves the search for strategic referents by which potential competitors such as weaker domestic players’ judge potential industry munificence.

**Liability of Foreignness.**

The liability of foreignness is defined as the significant survival premium foreign-owned companies pay due to lack of familiarity and influence in foreign cultures. The relative survival of foreign and domestically owned companies in Denmark over more than a century was examined by the research by Kronborg and Thomsen (2009). This study shows that this foreign liability premium declines over time and eventually disappears entirely. Further evidence indicates that the foreign survival premium is negatively influenced by new foreign entry, and that the long-run decline is caused by increasing competition between foreign subsidiaries. The relationship between first mover advantage and access to political resources in international business and late movers can preempt first mover advantage through political processes (Frynas, Mellahi, and Pigman, 2006). The currently prevailing conceptual framework of first mover advantages (FMAs) specifies various market mechanisms through which first movers can gain pioneering benefits. It is incomplete by failing to consider the role of political resources in creating FMAs. In this context, consideration needs to be given to the political mechanism for FMAs in the long-term process of acquiring, sustaining, and exploiting firm specific political resources in international business. The causal relationship between political resources and FMAs is a complex one. While non-market strategies can be used successfully by first movers, they can also be used by late movers to neutralize FMAs.

**Institutionalization Theory**

Three central debates in institutional theory are: Is organizational behavior the product of social structure or organizational agency? Does conformity to institutional norms enhance or diminish organizational performance? Can organizational field–level factors explain differences in the pull of isomorphic forces across organizational fields? (Heugens, et al., 2009). Isomorphism is produced when organizations mimic other organizations in the face of uncertainty. Templates suitable for mimicry are those previously adopted by a subset of highly visible organizations, by large numbers of contemporaries, or by highly successful counterparts. The scope of the firm is one of the most fundamental questions in strategic management (Peng, Lee, and Wang, 2005). The focus is on institutional relatedness, defined as an organization’s informal linkages with dominant institutions that confer resources and legitimacy. It is addressed that both longitudinally (firms in developed and emerging economies over time) and cross-sectional (developed versus emerging economies) thus contributing to an institution-based theory of corporate diversification.
Asymmetric Information

Asymmetric information explains the concept that sellers personally identify selling price by market similarity factors while buyers likewise obtain market price information similar items, probably without the same depth of information about the quality of the item as its seller (Auronen, 2003). One study examines how heterogeneity of private information may induce financial contagion (Pasquariello, 2007). Risk-neutral speculators trade strategically across many assets to mask their information advantage about one asset. Asymmetric sharing of information among them prevents rational market makers from learning about their individual signals and trades with sufficient accuracy. Incorrect cross-inference about terminal payoffs and contagion ensue. When used to analyze the transmission of shocks across countries, my model suggests that the process of generation and disclosure of information in emerging markets may explain their vulnerability to financial contagion.

The examination of asymmetry, institutional theory, liability of foreignness, signaling, competitive dynamics and aggressiveness all provide support for the dynamics that occur between MNC’s and domestic businesses which leads to the development of the propositions proposed subsequently.

EXAMINATION OF THE FOREIGN BANKING SYSTEMS

The variation of the entry of foreign banks in both the timing of the new foreign banks’ entries and in their location to estimate the effect of foreign bank entry on domestic credit access was examined by Gormley (2007). Gormley’s study indicates that foreign banks financed only a small set of very profitable firms upon entry and that on average firms were eight percentage points less likely to have a loan after a foreign bank entry because of a systematic drop in domestic bank loans, using the location of pre-existing foreign firms as an instrument for foreign bank locations.

In the South Eastern European banking sector the degree of concentration and competition in an emerging region reveals that the banking industry in the region operates under monopolistic competition, with non-collusive behavior among the banks. Equilibrium is a long run gradual improvement in terms of competition (Mamatzakis, Staikouras and Koutsomanoli-Fillipaki, 2005). Analyzing dyadic competition between pairs of airlines, Joel, Baum and Helaine (1999) find multimarket contact to have a quadratic influence on entry into competitor’s market, and here is an inverted U-shaped relationship between firms’ rates of entry into an exit from each other's markets and the level of multimarket contact in competitor dyads competitors in a focal dyad. The dynamics of competition in emerging markets (including the crisis-affected Asian countries) reveals both the short- and long-term persistence of profitability of firms is lower than advanced countries. The examination of competitiveness in the Japanese banking market revealed that bank revenues behaved as if earned under monopoly (Molyneux, Lloyd-Williams, and Thornton, 1996). But monopolistic tendencies are present due to lack of entry by domestic institutions into commercial banking. As a result of the huge of international merger movement, developing countries definitely need a competition policy as well as privatization and deregulation in these economies themselves (Glen, Kevin, and Singh, 2003).

The interaction between multinational
The direct ownership of facilities in the target country involves the transfer of resources including capital, technology, and personal. Direct foreign investment may be made through the acquisition of the existing entity or the establishment of a new enterprise. Foreign direct investment (FDI) is a key element in this rapidly evolving international economic integration, also referred to as globalization, creating direct, stable and long-lasting links between economies, improving the competitive position of both the recipient (host) and the investing (home) economy. In particular, FDI encourages the transfer of technology and know-how between economies, and provides the positive effect on the development of international trade, an important source of capital for a range of host and home economies (OECD, 2008). Blomstro, Magnus and Kokko (1996) conclude that MNCs may play an important role for productivity and export growth in their host countries, but that the exact nature of the impact of FDI varies between industries and countries, depending on country characteristics and the policy environment.

Foreign bank entry refers to the process by which foreign banks set up operations in a host country, usually by opening a branch or subsidiary. In general, foreign banks are attracted to countries with fewer restrictions on entry and bank activity. According to a recent IMF report, although foreign bank entry has occurred in many developing countries, the pattern has not been uniform (IMF, 2000). The banking market in U.S.A which has a more competitive banking market following deregulation provides better discipline for bank managers, thereby improving bank performance (Jayaratne and Strahan, 1996). The study in differences and similarities between developing and high-income country foreign banks, suggest that developing country banks have a competitive advantage dealing with countries with a weak institutional climate while indicating that developing country foreign banks have a higher interest margin and are less profitable than foreign banks from high-income countries (Horen, 2006).

**Thai Banking Data**

This study was selectively collected only two commercial bank categories, Thai commercial bank (domestic bank) and foreign bank branch (foreign bank). Being focused on upcoming Thai banking industry development, number of domestic and foreign banks used were based on each bank were required that:

1) domestic banks and foreign banks were operating in Thai banking system,
2) each bank was required to run its operation covering the full period of 1995-2009,
3) the case of bank closed or merger between 1995 – 2009 was excluded.

Following above requirements, all 14 operating domestic banks that had been operating over the period of 1995 – 2009 were selected, whereas among 15 foreign banks those were operating in 2009, 14 were selected. An entry date of all sampling banks were notified by the year of establishment of a new bank, the acquisition merger bank among the bank in Thai banking industry or the bank was taken over by the offshore bank. The density of domestic banks (one sub-population) and foreign banks (other sup-population) was then specified. Each bank entry data was displayed by bank public announcement of its internet website or from bank annual financial reports.

As can be observed in Table 1, there was a significant drop in the number of foreign banks over the 12 year period. The total number of foreign banks dropped from 21 to 15. The Asian banking crisis impacted the number of foreign banks while the number of domestic banks only decreased by two. Figure 1 also shows the changes in the numbers of foreign and domestic banks over the 12 year period. The impact of the Asian financial crisis and post-crisis appears to
have eliminated bank growth from 2001 to 2005. Figure 2 shows the number of banks entering the Thai banking industry over this period. While there were a couple of instances where foreign banks had two new entries to the market (2000 and 2005) the most significant increase was the number of domestic banks where 5 banks entered the market in 2005. There was not, however, an increase in either foreign or domestic banks followed by an increase in the other group lagging by a year. The large increase in the number of domestic banks in 2005 did not result in an increase in foreign banks in the following couple of years.

Another consideration when looking at bank entry and involvement in the market would be to examine the loan values for domestic and foreign banks over this time period. Figure 3 shows the loan values for the 12 year period, in 1 million bhat denominations. The domestic bank sector holds a much smaller portion of total loans, but the increase in loan values showed fairly steady increases from 2003 to 2008. The one big jump was for the foreign banks, where there was a 12 % increase in the value of loans in 2004, after the Asian crisis was over. This could possibly have led to the jump in the number of domestic banks in 2005 when the growth in foreign loans indicated a positive market for domestic banks. It is also interesting to note that although the number of foreign banks dropped over this 12 year period, the amount of money loaned for commercial purposes did not decrease by this group. The discussion of the implications of these findings will now be presented.

IMPLICATIONS

The current Thai banking industry dates back to 1888 and is illustrative of path dependence and co-evolution of institutional frameworks similar to Nelson and Winter’s (1985) description of evolutionary economic development. Co-evolution refers to situations in which there is nearly concurrent change in institutions and industries (Lewin and Koza, 2001) and interconnection and reciprocation between the two (Suhomlinova, 2006). Nelson and Winter’s work suggests that profit maximizing market equilibrium is an incomplete explanation if one does not consider the co-evolutionary nature of events. In addition, co-evolution involves not only internal actors but also external events. Indeed, deinstitutionalization can occur when problems are translated in a manner that interrupts existing institutionalized discourse and practices; this can lead to defensive institutional practices in an effort to normalize external shocks (Maguire and Hardy, 2009). Particularly in emerging markets such as Thailand, co-evolution of industries and institutions tend to transition rapidly (Ahlstrom and Bruton, 2010). One advantage of this from a research perspective is that cause and effect are time-compressed allowing us to more readily investigate how co-evolution of industries and institutions co-evolve

Such institutional practices are influenced but not completely determined by path dependence. Path dependence arises from a series of self-reinforcing mechanisms that lock organizations into particular pathways; that is, prior events both constrain opportunities while also presenting alternative opportunity sets. However, path dependence does not imply determinism; Sydow, Schreyögg, and Koch (2009) have recently mapped out a three-stage model suggesting that organizations can and do break free from their historical path. The novelty and ambiguity that results from discursive power struggles among path dependent, co-evolving institutional actors creates the context for new power relationships (Levina and Orlíkowskii, 2009), ultimately changing not only the rules of the game (North, 1990), but also the institutional
actors playing the game. Both the game and the players evolve in a self-reinforcing but malleable discursive context.

This was the case in the emergence of the Thai banking industry. As is typical in many industries, there was initially a large gap between foreign banks’ knowledge of Thai social and business environments while Thai nationals lacked specific industry knowledge given that such knowledge arises from a much wider context including global best practices. This is typical and particularly salient in emerging markets during periods of rapid economic growth (Stark, 1996). Early on, this knowledge gap was bridged by the “comprador,” a liaison with local businesses, credit and risk analysis agencies, and debt collectors (Siam Commercial Bank, 1996). The comprador system, although carrying high interest costs, played a substantial role in servicing credit demand from the local population who would otherwise not have access to foreign banks.

One ramification of these changes is that competition increased among the domestic players while regulatory policy helped erect entry barriers to foreign competitive threats (Spencer, Murtha, and Lenway, 2005). Despite this strong regulatory institutional environment, however, the rapid entry and expansion of domestic banks created a highly competitive market (Alba, Leonardo, and Daniela, 1999) despite government ban on entry by foreign competitors. However, by the 1990’s the Thai government, in conjunction with the central Bank of Thailand, had done much to create a stable regulatory institutional environment and in 1993 began to encourage a trajectory of economic liberalization that encouraged foreign investment. Foreign banks began to reenter the Thai banking industry further intensifying the competitive arena. High interest rates attracted foreign deposits seeking greater returns than those available in more developed economies creating an industry ripe for new entrants. Thus, the industry and regulatory institutions co-evolved on a path dependent nature stemming from the changes ranging from the relatively simplistic comprador system to the aftermath of the complex regulatory institutions that emerged from the Asian financial crises.

Recent evidence suggests that the scale economies of foreign banks, owing partly to acquisition of domestic banks in recent years, have given them an edge in competitive cost structure relative to free-standing domestic Thai banks (Okuda, 2006). This is a typical pattern found in other emerging economy banking industries (Unite and Sullivan, 2002; Havrylchik, 2006). Industry cost structure is at least partially dependent on the host country’s regulatory institutional environment; however, data conflict on whether this actually contributes to increases or decreases in operating cost structure in emerging economy banking industries. For example, Lensink, Meesters, and Naaborg (2008) found that more established regulatory institutions correlate with higher foreign bank financial performance albeit the liability of foreignness remains a factor contributing to reduced overall foreign banking operational efficiency. On the other hand, Bonin, Hasan, and Wachtel, (2008) find that foreign banks have a lower cost structure and higher performance than domestic banks in emerging markets despite the liability of foreignness. Still, in either case, emerging market regulatory institutions have an impregnable impact on banking industry structure and performance whether these institutions in fact increase or decrease cost burdens on foreign entrants.

Regardless of such conflicting evidence, it is evident that regulatory and other macro-level institutions and industries do not operate autonomously but rather are coupled in a path dependent, co-evolutionary milieu. However, this arrangement, while coupled, is loosely coupled (Weick, 1976); that is, a correlation between one and the other is present but does not always act in a predictable manner. For instance, regulatory institutions precluding foreign entrants would, according to industry analysis (Porter, 1998), decrease the intensity of competition. However,
The interaction between multinational

this was not the case in Thailand’s banking industry—competition was quite intense during the period in which the Thai government prohibited entry of foreign competitors. Thus, research indicates that institutions are malleable, influence industry development, co-evolve as industries respond to external shocks such as financial crises, and importantly, are influential but not deterministic.

In response to the question posed in the introduction of the research about the presence of strong competitors attract rather than repel new competition, yes it appears that the presence of strong competitors, in terms of large foreign banks loaning more money, this seems to attract domestic entry into a market, as shown by the increase in the number of domestic banks in 2004. Addressing research question (1) “Would foreign competition elicit the same U-shaped entry pattern seen in the Li (2008) study in emerging markets with weaker institutional edifices?”: The U shaped pattern presented by Li does not appear to represent what happens in emerging markets. The weaker domestic banks seem to observe the patterns of larger foreign banks and smaller local competitors then enter the market chasing loan opportunities.

Research question (2) “What effect would domestic competition have on the evolution of foreign competition in an emerging market?” is not adequately answered in this research. There was not enough evidence in this data to assess the effect of domestic competition on foreign competition. The data available did not have sufficient information on strategic groups for foreign banks to assess the density and rivalry within these groups.

With regard the third question (3) “Might there be an interaction effect among foreign entry originating from relatively stronger institutions in emerging markets with relatively weaker institutions?” there is still more work to be done to examine this. There certainly appears to be some interaction between growth and the entry into the market. Measures of competitive aggressiveness, signaling and institutional factors are all possible explanations for how these banks interact and make decisions on entry and growth.

FUTURE RESEARCH DIRECTIONS

This research provides a beginning on the assessment of the assessment of market entry dynamics in emerging economies. While it appears that the entry of foreign MNC’s and decisions to grow their business seem to influence smaller local competitors in the marketplace, this should be examined in different contexts. The data used for this study covered a period of financial crisis for the banking industry in Asia and globally. Therefore the normal competitive dynamics were influenced by the economy. Future research should examine banking in other emerging markets to determine the dynamics of firm interaction. Details on loan types would be beneficial in order to examine strategic groups building upon Li’s work (2008). There are differences between established markets and emerging markets and these comparisons need to be explored. The reaction of businesses in a more stable market will certainly be different from the less stable emerging markets, where there is a lot of money to be made, coupled with a lot of risk. The entrance of foreign banks did not appear to result in an increase in domestic bank growth, but an increase in the monies lent for commercial purposes did result in an increase in domestic banks. Market actions as well as market entry need to be examined more closely. This research is important, not only for academic purposes, but also for managerial purposes, as business managers can learn from market entry, expansion, signaling and competitive behaviors as to how to make important expansion decisions.
REFERENCES


The interaction between multinational


The interaction between multinational


APPENDIX

Table 1: Structural Changes in Commercial Banks

<table>
<thead>
<tr>
<th></th>
<th>Number of Commercial Banks</th>
<th>Pre-Financial Crisis, 31st January, 1997</th>
<th>Post-Financial Crisis, 30th December, 2003</th>
<th>Bank Landscape May 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Thai Domestic Banks</td>
<td>16</td>
<td>13</td>
<td>14</td>
<td></td>
</tr>
<tr>
<td>Foreign Bank Branches</td>
<td>21</td>
<td>18</td>
<td>15</td>
<td></td>
</tr>
<tr>
<td>Total Commercial Banks</td>
<td>37</td>
<td>31</td>
<td>29</td>
<td></td>
</tr>
</tbody>
</table>

Source: Bank of Thailand

Figure 1: MNC and Domestic bank changes 1998-2010

Note: Asian crisis 1998-2000
Asian post-crisis 2001-2003
Global banking crisis 2008-2010

The interaction between multinational
The interaction between multinational

Figure 2: Rate of entry of banks

Note: Asian crisis 1998-2000
Asian post-crisis 2001-2003
Global banking crisis 2008-2010

Figure 3: Loan Values
The interaction between multinational