

## **ROUNDTABLE I**

# **EMERGING MARKETS MNCs CHALLENGES AND EXPECTATIONS**

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# Introduction

- The paper critiques Milton Friedman's The World Is Flat
- Friedman's logic does not apply to emerging markets MNCs
- Significant regionalization still exists
  - Supported by firm-level data
- Emerging markets' MNCs do not seem to catch up with developed nation`s MNCs

# The Bad News Is...

- Aside from a lack of modern internet facilities and individual financing abilities developing countries lack other “soft” infrastructures
  - Financial markets in general are far less developed in emerging economies
  - Emerging markets often lack credible credit rating agencies
  - Individuals without managerial experience are often unable to understand “how” business works and with a lack of business schools in emerging markets corporations often serve as business schools

# The Good News Is...

- The world is still round
- Is the world at least getting flatter?
  - What barriers exist? Why do they exist?
- How can the MNCs overcome the barriers?
  - Coordinated effort that involves firms, governments, media
- Which strategies are more valuable?

# The Good News Is...

- Going abroad, emerging markets MNCs can gain a lot (at least in terms of shareholder value)
  - Compensate for poor legal environments
    - Cross-listing
    - Easier access to capital
    - Stricter disclosure standards and better governance
- Good governance is valued more where it is scarce
  - According to very recent studies based on CLSA data, a 10-point increase in governance is associated with value premium
    - 4.6% increase in Hong Kong
    - 13.2% increase in Russia, India, Brazil, China

# The Good News Is...

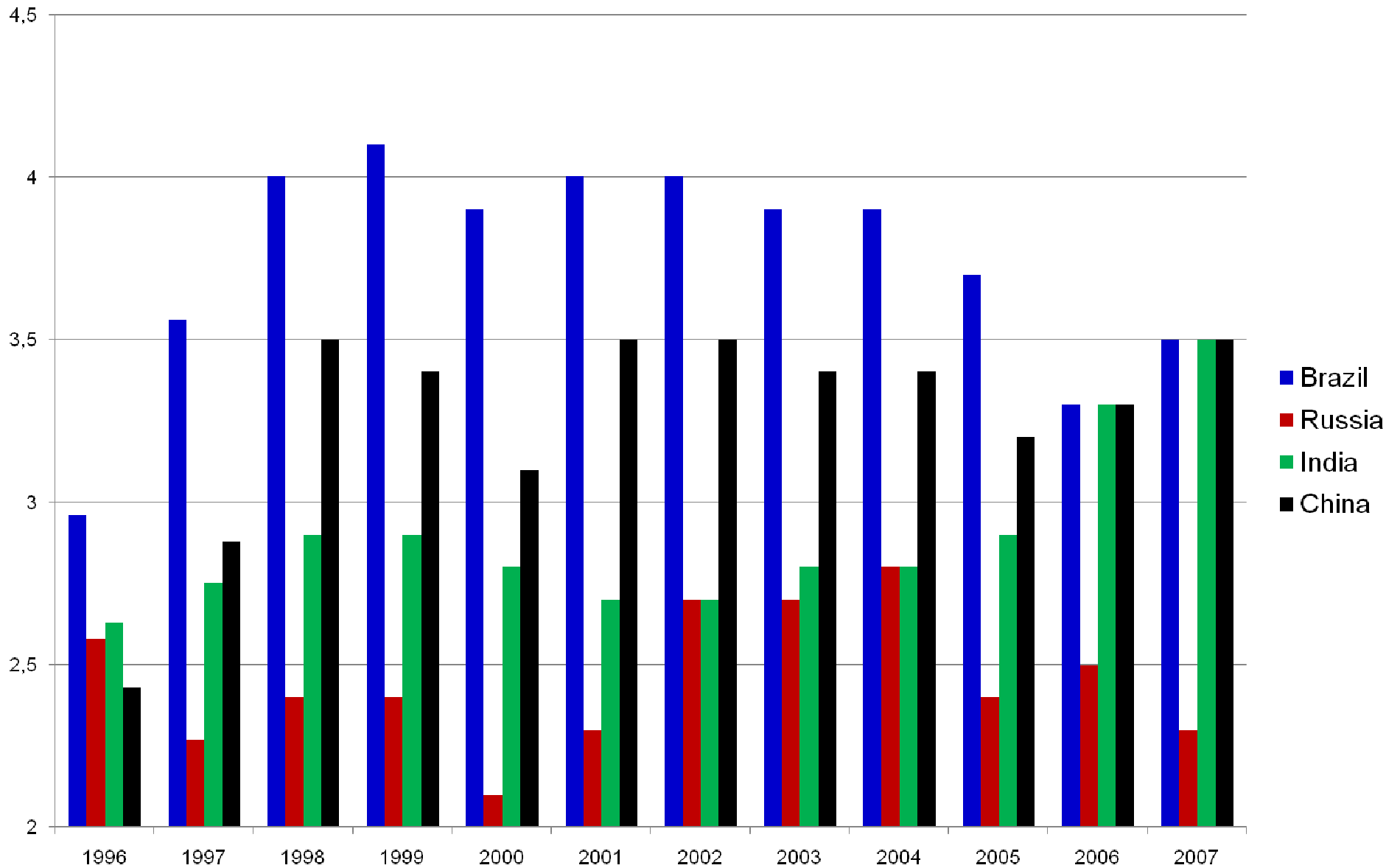
- Economic policies play important role in guiding MNCs toward good governance practices
- Pro-growth policies vs. redistributive policies
  - Greater incentives to practice better governance
- Stimulation of external financing
  - Controlling shareholders of firms with greater dependence on external financing practice better governance

# The Really Bad News Is...

- Governments behave in a predatory manner
  - violation of property rights, corruption, overregulation, confiscatory taxation, blatant expropriation
- Adam Smith:
  - *“In those unfortunate countries, indeed, where men are continually afraid of the violence of their superiors, they frequently bury and conceal a great part of their [capital] stock.”*
- Effect of Yukos affair on other oil companies in Russia:
  - *“... the threat of nationalization is forcing companies to go backward with their corporate governance.”*

(according to Bill Browder, one of the harshest critics of Khodorkovsky)

# Corruption Perception Index, BRIC countries



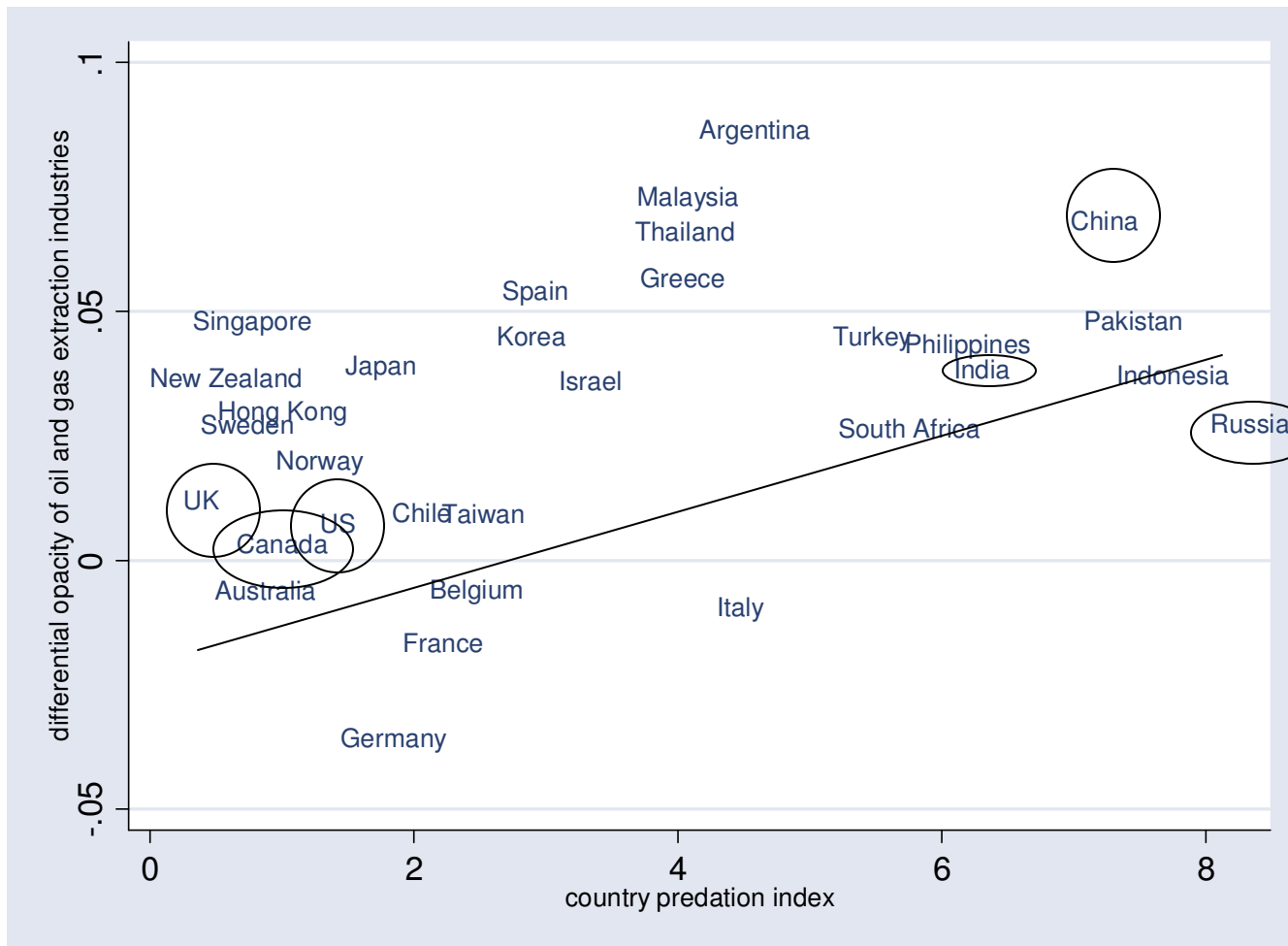
# The Really Bad News Is...

- Profits in oil and gas industries depend on oil prices
- When oil price is high, profit is a rent that is easier to expropriate
- Corporations face a trade-off: high transparency is good for business but may result in expropriation
- Result: when oil price is high, corporations in oil and gas industry – in countries with weaker property rights – are less transparent

# Recent evidence

- Durnev and Guriev (2007)
  - When oil price is high, corporations in oil and gas industry hide profits – in countries with weaker property rights
- Going abroad as a political insurance strategy
  - Safeguard against risk of expropriation
  - Better treatment of minority shareholders

# Will the World Ever Become Flat?



Differential opacity of oil and gas extraction industries relative to other industries plotted against country predation index