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THE EFFECTS OF STATE OWNERSHIP IN THE INTERNATIONALIZATION OF EMERGING MULTINATIONALS

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Tese Doutoral apresentado à Escola de Administração de empresas de São Paulo da Fundação Getúlio Vargas, como requisito para obtenção do título de Doutor em Administração de Empresas.

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Orientador: Prof. Dr. Rodrigo Bandeira-de-Mello

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Socrates: Then tell me: since you want to become wise in politics, do you suppose that you'll become wise by going to anyone else than the politicians, the ones who are outstanding at politics, and work with their own city all the time, and many others, conducting business with both Greek and foreign cities? Or do you believe you'll become wise in what these men do by associating with other people and not with the politicians themselves?

ABSTRACT

This thesis is a collection of three different research projects analyzing the effect of state ownership in the internationalization of Emerging Multinationals (EMNEs). The participation of the state as shareholder is a phenomenon that can bring new light into the governance, management and strategic impact of having states participate as owners in different levels. These studies will allow us to explore, from different perspectives, the extent to which states, while owners, can impact the EMNE. The studies thee contained go from exploring the selection mechanisms for a firm to become the target of state ownership to its effect on the internationalization pace, passing through the revision of the mechanisms available for the state to gain control and access to a firm's decision making, through changes to its corporate governance.

RESUMO

Esta tese é um compendio de três trabalhos de pesquisa que visam analisar o efeito da participação do estado na estrutura de propriedade das Multinacionais de Países Emergentes (EMNEs). A participação do estado como acionista é um fenómeno que pode trazer novas contribuições no âmbito da governança corporativa, administração da empresa e a tomada de decisões estratégicas. Os estudos aqui inclusos permitem identificar, a partir de momentos, diferentes, até que ponto o estado, na posição de proprietário da EMNE, pode impactar a mesma. Os trabalhos vão desde os mecanismos de escolha de firmas nas quais investir ate o impacto no ritmo de internacionalização das empresas, explicando também os mecanismos que o estado usa para ganhar aceso à tomada de decisões por meio de mudanças na governança corporativa.

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Chapter 1

1.1 Presentation

This thesis is a collection of three essays on the subject of state ownership and its effect on the internationalization of Emerging Multinationals. The thesis reflects the results of different methodologies and approaches used by the author to objectively assess the effects of state ownership in general and minority state ownership in particular, in the internationalization of EMNEs. The work thee contained is presented as follows: in the first chapter we introduce the three works as well as the main theoretical, empirical and research considerations for all essays. Following, in Chapter 2, we present each essay individually, for their best comprehension and consideration. Finally, in Chapter 3, the author makes a summary of all contributions, opportunities for further research and implications from the aggregated results of the three works.

1.2 Introduction

This thesis is a compendium of three essays on the topic of State Ownership and its effect on the internationalization of Emerging Multinationals (EMNEs). The study of EMNEs is a topic of increased interest in the academic, political, economic and business environment. In the last century, emerging markets went from being perceived as places that offered opportunities for investment to becoming hosts to some of the most important global players in the commercial arena. Alongside this rapid internationalization has come the need to understand the factors that have fostered the growth of these new players, their characteristics and strategic objectives. For one, we are aware that the growth of many of these firms has been possible thanks to the creation and execution of industrial policy and government incentives (Katz & Stumpo, 2001). In the case of Brazil, firms in the aviation sector benefitted from the increased national interest on developing a global company Embraer. In Peru, the Grupo Gloria consolidated its position at the time it received indirect government investment (Grupo Gloria, 2005). As for Mexico and Chile, the signature of trade agreements and opening of their markets has fostered the quick expansion of firms like Falabella or Cemex.

The international expansion of these firms evidenced that they carry burdens or advantages associated with their home country (Guillen & Garcia Canal, 2009). It also revealed that their competitive advantages have characteristics that do not necessarily correspond to the degree of innovation and uniqueness that was critical in developed-country entrants (Ramamurti, 2012). These new organizational designs have caused tremendous interest in observing the establishment of EMNEs offering opportunities to research the phenomena that are unique to these nations, and also to question their relevance and role. As frequently positioned, the environment of these countries, usually constrained by their factor markets, infrastructure and institutional environments, is responsible for a large portion of the decisions and internationalization routes that their companies undertake (Hoskisson, Wright, Filatotchev & Peng, 2013). Furthermore, these economies governments' have become active participants of the business life, mediating in the creation of policies and incentives to favor their EMNEs (Peng, Wang & Jiang, 2008).

The increased participation of governments in the business arena can be traced back to the recent liberalization, democratization and creation of conditions to favor foreign direct investment. These changes resulted in states creating a new arena for business competition and establishing new institutions responsible for regulating the environment. Following this came the privatization of many of the largest firms (formerly owned by their governments in the form of State-Owned Enterprises) and the consolidation of key "*national champions*". These national champions are firms in a variety of sectors "may be created or protected in a number of ways, such as by the granting of state aid, the encouragement of domestic mergers, or the opposition to a takeover of a domestic company by a foreign company" (OCDE, 2009, p.11). The selection of these firms tends to correlate with the pursuit of industrial and economic objectives (Stal & Cuervo-Cazurra, 2011), as well as the expansion of sectors that are deemed strategic for the nation, e.g., the IT industry for India or the animal protein sector for Brazil.

The interest of states in controlling and also in supporting a select group of its EMNEs also led to the emergence of a new variety of state ownership very different from the SOE model. This new participation of states in the ownership structure of the firm, called by Lazzarini & Mussachio as *"Leviathan in Business"* is widely more complex and exists in alternative modes (2014). In this variant of firm-ownership, the state can decide to become either majority or minority investor of privately or publically owned companies and participate directly or indirectly, either through its own ministries, state-owned companies, pension funds and development banks (Paula, Ferraz & Iootty, 2002; Lazzarini & Musacchio 2010).

This thesis calls attention to the issue of state ownership in general and minority state ownership in particular, as it questions how the presence of the state as shareholder can have either beneficial or detrimental effects to the internationalization of the firm, the selection considerations to invest in firms and what the governance mechanisms are through which governments affect the decision-making inside of the EMNE. The presence of the state in the ownership structure of the firm can represent contradiction in term's of issues like the creation of jobs nationally or the collection of taxes locally. By understanding the political perspective of states and the presence of a variant of capitalism that favors the existence of such a new form of ownership, we have the opportunity hypothesize the justification and effect of the state's presence as an owner in the EMNE.

Research in the subject of state ownership has already found that in fact, different types and levels of state ownership seem to have varying outcomes when it comes to internationalization (Wang, Hong, Kafourous, & Wright, 2012; Cui & Jiang, 2012). Must prior empirical analyses of the state ownership via the SOE are performed with Chinese firms and use SOEs that have never been private before. We suggest that this is not a context that satisfies the appearance of state ownership as a phenomenon in other emerging markets. Research to date has neither accounted for liberalized economies where the states actively pursue becoming minority firm-owners, nor has it accounted for the different types of investment (direct vs. indirect), nor questioned the selection criterion that leads governments to participate as shareholders of the EMNE (Lazzarini & Musacchio, 2014).

This thesis is therefore a collection of three essays on the subject of state ownership and its effect on the EMNEs. The first study focuses on understanding the selection mechanisms used by governments to decide in which firms to hold stock. This first research consists of an assessment of state-stockownership as a previously unforeseen outcome of non-market strategies in emerging economies. This essay points out to minority state ownership as by-product of corporate political activity. As firms signal their alignment with government objectives through the use of political connections, they come under consideration as targets for ownership. From the government's viewpoint, ownership is a way of rewarding electoral support, backing an industrial activity, participating in the decision-making of the firm and concerting the achievement of its economic and political goals (e.g. economic growth, development of a sector, protection of sovereign resources).

The second study reviews the phenomenon of minority state stock ownership in emerging multinationals and its effects on the internationalization of the firm. By using principal-principal agency theory, the authors examine the under explored outcome of the state's participation in the ownership structure of the emerging multinational. The results suggest that different forms of state ownership (namely direct, via state-owned firms, pension funds or development banks) have a different effect on internationalization outcomes. The results are in line with the expectation that the state uses minority ownership as a way of controlling the firm and that it is in its own interest to reduce the pace of internationalization of a firm. We consolidate such suggestions by pointing out to how direct ownership modes negatively affect the internationalization of the firm as opposed to indirect ownership modes whose increased transparency, governance standards and responsiveness to other stockholders safeguard the EMNE from any intervention.

The third research paper consists of an analysis of the mechanisms of leverage and influence of minority state ownership from a governance perspective. Following the principal-principal agency theory, we unveil the internal governance changes through which states are able to influence the EMNE. As states gain access to the decision making of the firm this can create issues that affect its management and strategy. By using an in-depth case study of a Brazilian EMNE it is possible to observe some of the mechanisms through which states, as minority shareholders, gain access to the decision-making of the firm and exemplify some effects of their participation in the internationalization process.

In all three-research studies, the author contributes to our understanding of the phenomenon of state ownership and its effect on the EMNE. The author contributes to principal-principal agency theory by pointing out to states as another set of controlling shareholders, evidencing some of the consequences of principal-principal conflicts. The author also contributes to International Business literature by evidencing additional aspects of the ownership structures of EMNEs and their particular effects on the prospects of international growth.

Following this we explain some of the key aspects necessary to understand state stock-ownership: from what it entitles, to the reasons why this phenomenon is expected to exist as a new mode of ownership in many emerging economies. After exposing the context of state ownership in emerging economies, we present the three papers on the matter (Chapter 2), which are complemented by a final conclusion on the effects of our discoveries, contributions and future opportunities for research (Chapter 3).

1.3 State ownership modes in emerging markets

Prior to embarking on an analysis of state ownership it is important to discern the very definitions of government and state. Used often in management literature as synonyms or complements, the meaning of these concepts signifies a difference in our interpretation and understanding of the role and participation of each in the ownership structure of the firm. Originating in ancient Greece, both terms were coined to represent a mixture of responsibilities and statutes that defined the operation of polis or city-states. The state, a demarcated piece of land bounded by its own laws, is a unit of analysis that aggregates all functions and structures that institutionalize power. It is an autonomous collectivity with sovereignty (Nettl, 1968). Governments, on the other side, were created to provision an organized and stable place to live (Leviathan, 1994). A government is thus a group of representatives of a state that administer the decision-making, provision of justice and execution of new laws. These individuals hold positions in the institutions of the state and their authority is temporary in nature. In case of the ownership structure of the firm, although the propriety is a feature of the state, it is the government, and the individuals representing it, that decide which companies to invest in.

The vast majority of research in state ownership has favored the review of the State-Owned Enterprise (SOE) model, analyzing many of its performance characteristics when compared against privately owned firms (Peng, 2004; Sun & Tong, 2002; Firth, Fung & Rui, 2006). In emerging economies this phenomenon has been given increasing amounts of attention, perhaps given the vast presence of SOEs and the importance they represent for the international economy, as well as for their remarkable presence as some of the largest multinationals (Fortune, 2013). This increased interest has led to many scholarly works, where researchers have attempted to unveil antecedents and consequences of different types of state ownership (Ramaswamy, Yeung & Laforet, 2010; Chen, Firth & Xu, 2010; Wang, Hong, Kafourous, & Wright, 2012; Cui & Jiang, 2012). With the exception of very few cases such as Wang, Hong, Kafourous, & Wright (2012), these studies propose a one-dimensional definition of state ownership, overlooking other forms of ownership that include minority and indirect participation.

In general terms, research on the subject has not been extensive enough as to capture the influence of other types of non-majority state ownership that are also common to emerging nations. A recent discussion paper by the OECD recognizes the existence of various modes of state ownership that include mixed and minority ownership either composed by the state, institutional investors or other strategic shareholders (OECD, 2012). Inoue, Lazzarini & Musacchio gathered in 2007, data showing that firms with at least 10% state ownership represented 33% of all Brazilian, and 50% of all Chinese market capitalization of those top firms. Empirical evidence shows that states tend to hold stock in privatized firms as well as acquire stocks of firms that have no prior linkage to the SOE structure, investing in firms directly and indirectly, through pension funds, development banks and sovereign wealth funds (Paula, Ferraz & Iootty, 2002; Lazzarini & Musacchio 2010: Bremmer, 2010).

The author of this thesis suggests that ownership modes should therefore be treated separately depending on their source and distinguished by either direct or indirect state ownership. We call direct ownership the traditional investment that is made by the state, where the same holds direct influence on the day-to-day operability of the investment. This comprises all types of commitments including investments made by local, state and federal governments, ministries, central banks as well as by majority state-owned companies themselves (Wang, Wong, Xia, 2008).

In terms of indirect ownership, we use this term to refer to all investments made through intermediary institutions that, although under the scrutiny of the state, act under other management and governance mechanism. These institutions were created in late-industrializing economies and occasionally used to inject capital into the market and also to improve the selection mechanisms for more profitable and accountable investments (Amsden & Hikino, 1998). As these investors are gaining more importance for emerging economies (Khorana, Servaes & Tufano, 2005) a new emphasis has emerged on the appropriate analysis of the role these ample investment actors play (Inoue, Lazzarini, Musacchio, 2013). Separating state-funded institutional investors not only from direct state ownership but from other forms of institutional shareholding also fits within a call for attention as to the need to further segment the characteristics of different investor profiles (Ryan & Schneider, 2002).

Studying the behavior of institutional investors also adds to a growing body of literature that weights the informational advantages of these in stock investments (Baik, Kang & Kim, 2010).

Either directly, or indirectly, state stock ownership in the emerging nation must be explained by market and non-market factors that lead the disbursement of state funds into the stock market. Further, it is important to note if either ownership mode has effects on the performance of the firm and how these changes are achieved through the scope of corporate governance.

1.4 State Ownership in EMNEs

The presence of state ownership has been captured and discussed by scholars in many areas including political science, economy, management, international business and public administration. Its resurgence as a topic of interests relates to its meaning as an alternative form of capitalism. This variant is often referred to as State-Capitalism, where the state attempts to have an increased participation in business affairs, attempting to use the business environment for its own political gain (Bremmer, 2010).

The appearance of such term or its characteristics, as well as the study of its repercussion in many multidisciplinary recent works (Mussachio & Lazzarini, 2012; Mussachio, 2014; Bremmer, 2009; Wade, 2004; Rodrik, 2007), calls the attention to extent to which state ownership is a prevailing phenomenon that is worth comprehending, even more, where it appears in emerging economies. As shown in tables 1 and 2, state ownership around the world has maintained an even more relevant standing in terms of the number and proportion of state-owned firms in emerging economies.

Table 1– SOE Presence in OECD countries

	Number fo SOEs	Minority Positions
Australia	12	0
Austria	78	21
Belgium	15	0
Canada	100	15
Czech Republic	>1,000	>120
Denmark	27	10
Finland	55	19
France	100	33
Germany	37	20
Greece	50	14
Italy	25	4
Japan	77	n.a.
Korea	30	4
Netherlands	44	16
New Zealand	34	3
Norway	26	6
Poland	1189	691
Slovak Rep.	115	55
Spain	40	15
Sweden	58	7
Turkey	39	n.a.
United Kingdom	80	14

Emerging Economies

Source: Adapted from Lazzarini & Mussachio, 2014 with the use of OECD and Waclawk-Wejman,2005 data

Table 2 – Emerging Market SOE presence in Emerging Markets

	Number of SOEs	Minority Positions
Argentina	112	89
Brazil	147	109
Chile	33	3
Colombia	105	87
Ecuador	24	3
Mexico	110	NA
Peru	31	8
Czech Republic*	>1,000	>120
Greece*	50	14
Korea*	30	4
Poland*	1189	691
Slovak Rep.*	115	55
Turkey*	39	n.a.

Source: Adapted from OECD, 2009. Shows Federal SOEs only

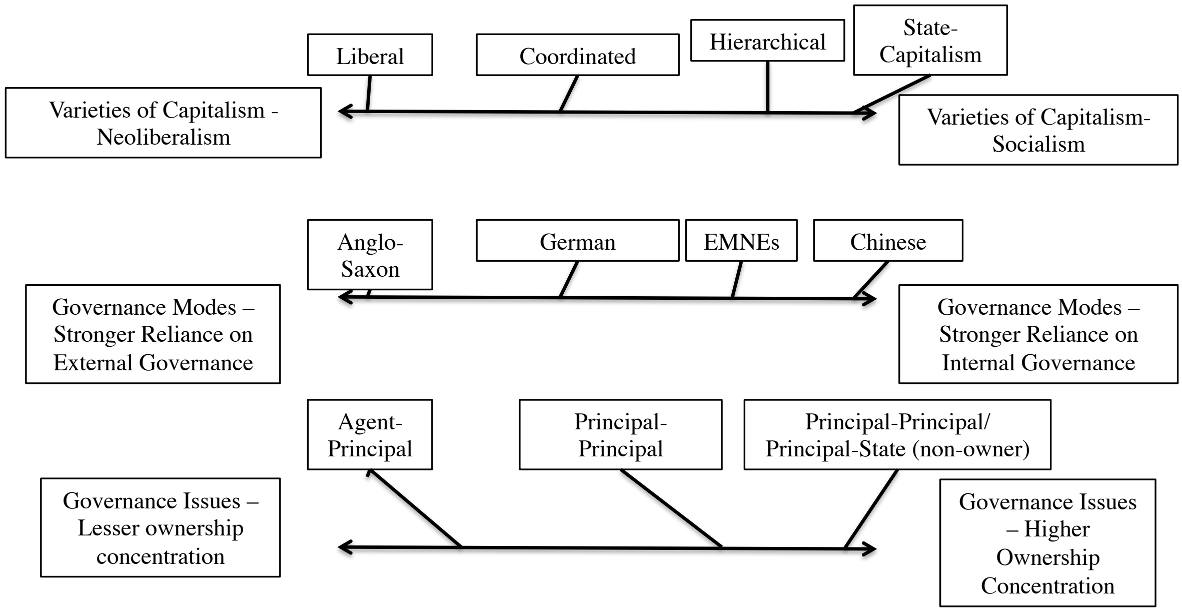
***Source: Adapted from Lazzarini & Mussachio, 2014 with the use of OECD and Waclawk-Wejman,2005**

The empirical evidence of the relevance of state ownership can also be accounted for in the business literature. However, there is an opportunity to further understand the extent to which different market conditions can have an effect on the state ownership modes and the extent to which governments can be expected to intervene. For instance, existing research on the matter of state ownership have largely used China as empirical ground (see Wang et al., 2012; Luo, Xue & Han, 2010; Buckely et al., 2007).

The author of this thesis suggest that the use of the Chinese context in the study of state ownership carries additional challenges given the nature of the Chinese regime, their very gradual market-opening (with the government controlling very closely FDI flows and currency rates) and the tight control that Beijing holds over economic reforms. We find state participation in business affairs in China to be part of the political and governmental model, inherent to the communist tradition. This situation, although gradually changing from what is known as fragmented authoritarianism into a more coordinating government role (Mertha, 2009) is not an equivalent political reality to what other emerging economies are experiencing.

Recent work has also pointed to the inadequate fit of existing categories of capitalism modes when describing the governance, institutionalization and policies that reign in emerging markets (Schneider, 2009). Emerging market firms in Latin America, and many South-East Asian economies are known to have state-designed policies to benefit the local development of specific sectors, highly concentrated ownership structures, with a large portion of foreign MNEs operating in their territories as well as powerful business and family groups with ownership of the main local EMNEs (Schneider, 2009; Fields, 1997; Biggart & Guillen, 1999; Filatotchev et al., 2001). In figure 1 we depict a graphic representation of what we believe to be alternative capitalism modes and their corresponding corporate governance standing in response to the institutional spectrum with their matching theoretical approximation. Our suggestion borrows from Bremmer (2010), Schneider (2009) Lazzarini & Mussachio (2014), in suggesting that the various degrees of state involvement in the economy range from commanded regimes to free-market/liberal ones.

Figure 1 - Alternative capitalism modes and their corresponding corporate governance standing and theoretical approximation



Different sources of governance issues responding to different contexts of governance as related to varieties of capitalism.

With the use of Brazil as an empirical example we believe that we can capture a different representation of state intervention through ownership, where the state can be portrayed as an additional independent investor and firms with no prior linkages to the state structure can become part of the analysis. In our view, the use of Brazil allows us to depict a case similar to that of many emerging economies, which while not being what is sometimes defined as a "planned economy" such as that found in China, do operate in environments under which the state can take an important role. As recognized by Musacchio & Lazzarini, the state's presence as shareholders in countries other than China (namely Brazil, and Russia) shows a greater inclination towards minority stockownership (2014).

1.5 Corporate Governance of firms carrying state ownership

As previously acknowledged, the participation of the state in the ownership structure of the firm is not a new topic in strategy literature. Many researchers have used the SOE model and the privatization of the state enterprise as a laboratory to study the effect of state participation in the performance of the firm and more specifically to understand its consequences in issues as important as competitiveness and technological leadership (Lin & Germaine, 2003; Nolan & Xiaoqiang, 1999). These studies tend to incorporate a one-dimensional view of states, considering only its direct participation and establishing a division between the privately and publicly owned firms.

The ownership structure of EMNEs is a wide reflection of the process of economic liberalization and the years of dominance of certain elite classes in the industrial and commercial arenas. For instance as noted by Khanna & Yafeh, group ownership is so commonly found in emerging economies that the number of firms classified as "group affiliated" accounts for a fifth of all firms in Chile while in the economies of Mexico, Brazil and Argentina these demonstrate a large presence and economic importance (2007). Family participation also has an important position in the ownership structure of the emerging multinational, where a large portion of firms is still under control of the founding family (Young et al., 2008). The nature of this distribution of power in the firm is clearly aligned with the business context in which these firms participate. As posited by Young et al., these firms are particularly vulnerable to lax regulatory systems and weak institutional environments (2008). Under these circumstances, a position of control of a specific group of owners tends to favor the ability of such to make decisions.

The author of this thesis suggests state ownership to be an additional variant of a controlling group taking an ownership stance in the EMNE. As political science literature suggests, the state holds an unequivocal condition of power as the operator of industrial and regulatory processes (Fogel, 2006). As it has been shown in SOEs, we would expect state ownership to be affected by the various political objectives of government officials involved (Dewenter & Malatesta, 1997). Considering the above, the government is likely to use its own understanding of its influence in the regulatory environment and marketplace as a way to find the appropriate governance configurations to enforce its own interests in the firm. We expect the state to exercise its influence beyond its own voting or shareholder rights as a way to obtain results that are parallel to its need for satisfying constituents, increasing tax income, avoiding currency devaluations or winning elections (Wells, 1971; Shleifer, 1998).

The ownership conflicts that derive from the clashes between powerful controlling groups have been analyzed under the view of a new variant of agency theory known as the "principal-principal" theorem. In traditional agency theory terms, the firm is responsible for setting up the mechanisms necessary to first coordinate the motivations and desires of agents and owners (in order to guarantee the accomplishment of the latter's financial objectives) and second, to understand the way in which the firm can create a strong governance structure that allows the appropriate functioning of the firm, all while protecting the interests of majority and minority investors (Jensen & Meckling, 1976; Berle & Means, 1932). The principal-principal variant recognizes that given the particularities of many emerging economies with weaker institutions, lesser external governance mechanisms and concentrated ownership, there can be increased transaction costs given the divergences between principals (Young et al., 2002; La Porta et al, 2002; North, 1996).

This new perspective helps question the power that some groups have in the organization and the waterfall effects on the firm operation. The principal-principal agency theory proposes that specific owners in the emerging firm can have a powerful position capable of exercising its voice and expropriating the desires of others, causing principal-principal conflicts arising from their different motivations (Young et al., 2008). In the case of EMNEs, we argue that states have an important participatory role in the ownership structure of the firm, and that although it has been changing in nature (in response to new economic policies and orientations) it continues to be considered as a route to exercise its participation in the decision-making of the firm.

The existing works examining the impact of state ownership under the principal-principal perspective have mainly focused on the exercise of power in SOEs or recently privatized enterprises. For example, Wang and Judge show that state ownership can bring disruption to the interest of the firm (2010) while Buckley et al, suggest that the use of SOEs as engines of national policy-enactment leads to a permanent principal-principal conflict (2007). We suggest that the role of states as the third large incumbent in the control structure of many EMNEs can occur in firms with no prior linkages to the SOE model and that this should be explained and accounted for in the management literature.

1.6 Objectives

General Objective

Study the phenomenon of State Ownership and describe its relationship with the internationalization of Emerging Multinationals

Specific Objectives

- Explore the selection mechanisms that lead states to choose targets for state ownership
- Describe the variants of state ownership
- Unveil the potential effects of variants of state ownership in the internationalization of the EMNE
- Explore the mechanisms through which states create conflicts of interest inside of the firm

Chapter 2. THREE ESSAYS ON THE ROLE OF STATE OWNERSHIP IN THE INTERNATIONALIZATION OF EMERGING MULTINATIONALS

State ownership as an outcome of political connections in the EMNE

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Abstract

We study the phenomenon of state ownership in emerging multinationals. Our proposed research consists on assessing a previously unforeseen outcome of political connections in emerging economies: minority state ownership. We suggest that this by-product of corporate political activity responds to the fact that emerging market governments share the commonality of having an active role in the business life. As firms signal their alignment with government objectives through the use of political connections, they come under consideration as targets for ownership. From the government's viewpoint, ownership is a way of paying back electoral support, backing an industrial activity, participating in the decision making of the firm and concerting the achievement of its economic and political goals (e.g. economic growth, development of a sector, protection of sovereign resources). We also take the opportunity to separate and describe two different modalities of state ownership that we term as direct and indirect ownership.

Keywords

Internationalization, Ownership/Control Structures, Emerging-Market MNEs, Government, Non-market Strategies, Principal-Principal conflicts

Introduction

Defenders of liberalism and trade theories would oppose the idea of having governments actively participate in the management of firms, suggesting that markets balance the offering of goods and services while the state provides a body of observing institutions. However, historically speaking, most nations have undergone periods of large state intervention that helped structure the business arena and assigned different resources to individuals or firms varying on their fit, readiness or influence. As pointed out by Shapiro & Taylor "Historically, no country has entered into modern economic growth without the state's targeted intervention or collaboration with large-scale private sector entities" (pg. 323 1990).

The latter democratization and economic consolidation of emerging economies provides an example of the extent to which states participate in business affairs. The evolution of Emerging Multinationals (EMNEs) has had a strong relationship with the industrial development objectives of their local governments (Sauvant 2005). Furthermore, governments have kept an eye on the consolidation of many of its so-called "national champions" and maintained a close relationship with the business arena in many instances (Khanna, Palepu & Sinha, 2005). States in many of these nations have enforced this nearness through stock-ownership (Shapiro & Taylor, 1990) which appears in many forms; from state-owned firms, to investments in "born private" (privately held) ones; from majority to minority holdings.

The phenomenon of state ownership in general and minority state ownership in particular is appearing more frequently in the business literature (Musacchio & Lazzarini, 2012). Its importance derives from its recognition as a conduit of the state; a way to advance specific developmental policy objectives, solving market failures and accessing rents (political contributions, donations and access to constituents). On the policy advancement end, governments are interested in using state ownership to promote issues like job creation, regional development and access to goods and services (Shirley & Nellis, 1991). As pointed by Shleifer & Vishny, state ownership exists in environments where politicians assume that they can get tangible benefits from it (1994). As a whole, EMNEs with state ownership are likely to appear as instruments to achieve the developmental goals set by the state, accepted by EMNEs as a way to secure support to their growth or capital needs in the long run (McDermott, 2003).

In this study, we test the selection variables the lead states to hold minority shareholdings in EMNEs. We posit that the behavior of the state as shareholder is distinct from traditional investors and also that it varies according to different ownership modes. We base our overall findings upon the precept that governments use ownership as part of their efforts to achieve industrial development (Lazzarini & Musacchio, 2012; Trebat 1983) and rent seeking (Chen, Li, Su & Sun, 2011; Majumdar; 1998). The choice of a firm is therefore in line with the government's perception of the likelihood of the EMNE's adherence to its developmental goals.

In order to select EMNEs, states and interested in finding targets that show their closeness to the government's objectives. We find that political connections explain this proximity as they allow for a direct window of communication between firms and governments (Hillman, 2005). As already shown in other studies, political connection can lead to access to resources, capital and financing from the government, making of ownership and additional outcome of political connectivity (Claessens, Feijen & Laeven, 2008; Kroszner and Stratmann, 1998).

In addition we separate two different modes of minority state ownership that we term as direct and indirect ownership. We borrow this distinction from recent efforts to disaggregate the actors that partake in the ownership structures of emerging multinationals (Young, Peng, Ahlstrom, Bruton & Jiang, 2008; Inoue, Lazzarini, Musacchio, 2013). In differentiating direct ownership, arriving from state-run institutions such as central banks, ministries, local governments and state-owned companies and indirect ownership, including development banks and pension funds, we are able to capture the extent to which the motivations for investment vary amongst these very different types of state-structures. We suggest that while indirect ownership behaves more closely to an institutional investor, posing greater importance on a EMNE profitability in addition to political connectivity (Lazzarini, Musacchio, Bandeira de Mello & Marcon, 2012), direct ownerships are made in EMNEs that, along with showing politically connectivity, act in sectors that have been deemed strategic for the state (Chen & Young, 2010; Ramaswami, Li & Veliyath, 2002).

We use principal-principal theory in order to explain why governments expect, through state ownership, to be capable of participating of the decision-making of the EMNE. Principal-principal agency theory recognizes that specific groups of owners may have an advantage of control or power that allows them enforce the execution of their own interests, thus creating conflicts with other principals (Dharwadkar et al., 2000; Young et al., 2008). We recognize state ownership as an additional principal that can lead to such conflicts. Recent research has supported the idea, that even from a minority position, state ownership can create greater agency costs as a reflection of the conflicts that their presence entitles (Su, Xu & Phan, 2008). The weaker institutional environment in emerging nations also plays a noteworthy role as a factor that benefits the influence of state ownership (Dharwadkar et al., 2000*; Wade, 1990)*

To test our propositions that political connections, profitability and belongingness to a strategic sector leads to the presence of minority state ownership we use Crisp-set qualitative comparative analysis (csQCA). QCA is an innovative analytic technique that permits the examination of causal relationships between a specific group of cases and an expected outcome (Ragin, Drass & Davey, 2006). The use of this methodology allows us to understand the direction of causality of the relationship between our dependent variables and state ownership, mitigating reversed causality (Fiss, 2011). We use panel data (2006-2011) of a set of 110 Brazilian publically traded EMNEs with information gathered from Fundação Getúlio Vargas' (FGV) *International Business Research Forum*, the SOBBEET-Valor Internationalization ranking as well as the *Observatorio de Multinacioanis Brasileiras* from the Escola Superior de Propaganda e Marketing (ESPM) to test our propositions, from which we pick publicly traded EMNEs leading to a total of 39. The choice of Brazil is a reflection of its importance as an emerging economy that has advanced market reforms, a characteristic that is often exemplified as typical of emerging economies (Ramamurti & Singh, 2009). The ownership information was gathered from Economatica, allowing us to classify all incidences into direct and indirect investments. Finally, we collect information on campaign donations for the 2006 election as well as former politicians sitting on boards for the period of 2006-2011.

We contribute to management literature in several ways. First, our results indicate that the selection of firms that become targets of indirect state ownership is influenced by campaign donations, former politicians sitting on the EMNE board as well as firm profitability. This result presumes that minority state ownership is a previously unforeseen outcome of non-market strategies in emerging economies. We also show that direct ownership cannot be self-explained by non-market variables, although they do influence the eligibility of firms. Additionally, we shed light on the phenomenon of state ownership and the implications of minority state shareholding in EMNEs. By differentiating between direct and indirect investment, we contribute to a body of literature concerned in understanding not only the characteristics of different types of state participation in business affairs (Musacchio & Lazzarini, 2012) but also the different motivations of the modes of participation in the business environment available to governments (Bremmer, 2009; Musacchio & Lazzarini, 2012; Inoue, Lazzarini, Musacchio, 2013).

EMNEs and minority State Ownership

Emerging markets bring a set of distinctive environmental, governance and market differences that lead to alternative explanations concerning investors' choices (North, 1990; Wright et al., 2005). These nations have a recent history of economic development where governments have had a significant role in the consolidation of the business environment. As a matter of fact, governments participate in what some envision as "a challenge (r) to laissez-faire economics" (Bloomberg, 2012) by having a large participation in economic affairs.

Many authors often refer to the participation of the state in business affairs as state capitalism (Bremmer, 2008; Musacchio & Lazzarini, 2012). In our view, this categorization may over-classify the actual participation of all emerging market governments. In these nations, governments do tend to have a general interest in coordinating the economic game by granting some access to resources, funds and trade-protection (Bremmer, 2008). However, this does not imply that there is a politicized control of all-economic markets nor that the government is capable of manipulating all market outcomes for political purpose. Simply put, emerging market governments are involved in the business life by showing interest in the performance of strategic sectors or industries (Wade, 1990). In fact, they may strive to lead some winners take advantage of unique environmental and regulatory conditions (Goldstein, 2009). Governments and public office representatives will often justify this behavior as being part of the cultural and historical conditions of their markets.

As pointed out by La Porta, Lopez de Silanes & Schleifer governments have different ways of participating in the backing of firms including financing, regulation and ownership (2002). Ownership however is the only approach that allows a government to exercise "extensive control over the choice of projects being financed" (page 266). Schleifer and

Vishny contend that one of the main issues of state-owned firms is that governments interfere by pursuing political rather than economic goals (1998 p. 10).

Many forms of state ownership exist most notably separated between minority and majority (Musacchio & Lazzarini, 2012). Minority state ownership is prevalent throughout most emerging markets as it can be accessed through different vehicles such as development and central banks (Lazzarini, Musacchio, Bandeira de Mello & Marcon, 2012), is easy to deploy and not as simple to trace (Bortolotti and Faccio, 2009). In practical terms, states can take minority equity positions in publically traded firms by simply paying the market price of the share at the time of acquisition. However, as by Lazzarini & Musacchio, ownership is hard to trace, due to lack of disclosure as well as for the use of state-owned holding companies to purchase stock (2012). For instance, state investments are not as transparently communicated in emerging economies as they are by some developed countries counterparts (an example is the case of France that publishes a state of affairs of all public shareholdings[1]). The lack of traceability benefits the flexibility of the state in deciding in which firms to invest.

Minority state ownership has been devised as a conduit of state; a way to advance specific developmental policy objectives, solving market failures and accessing rents (political contributions, donations and access to constituents). From the policy advancement side, governments are interested in using state ownership to promote issues such as job creation, regional development and access to goods and services (Shirley & Nellis, 1991). Corporations with state ownership are likely to appear as instruments to achieve the developmental goals set by the state. This is supported by the idea that emerging market governments achieve industrial development through economic incentives and industrial policies (Wade, 1990). Corporations may also be interested in receiving ownership in exchange for a state's commitment to support their growth or capital needs in the long run (Hayri & McDermott, 2005). Countries like India, Brazil, South Korea, Singapore, Mexico and Taiwan have embarked on numerous efforts to create policies that boost the growth of targeted firms, often referred to as "national champions" (Sauvant, McAllister & Maschek, 2010). The rise of these firms is well aligned to their governments' concern with providing examples of progress and coincides with the first appearance of emerging multinationals in the 1980s (Yeung, 1999). The growth of these companies has been highly linked to political

[1] For more visit http://www.economie.gouv.fr/agence-participations-etat/portefeuille-letat-actionnaire-par-secteur

considerations (Encarnation, 1982) with states often providing the capital or creating an institutional infrastructure that facilitated the challenges of operating in vulnerable environments.

Considering the above, we can expect governments to take minority positions in EMNEs that they hope can satisfy their concertation and development needs (Schneider, 2009). We do not question if such decisions will carry either positive or negative effects, as our interest is to find the specific factors that lead states' decision to undertake minority ownership positions. States expect, through ownership, that their political objectives will infiltrate inside of the EMNE (Dewenter & Malatesta, 1997).

The influence of the state can be better understood from the optic of the principal-principal agency theory. Principal-principal agency theory recognizes that, when controlling shareholders participate in firms in Emerging Economies, where weaker external governance mechanisms exist, these are able to influence the decision-making, thus creating clashes between other principal's and agents objectives (Dharwadkar et al., 2000; Young et al, 2008). The state is an additional case of a principal that can produce such clashes even from a minority position, through virtue of its own power as regulator, customer and provider (Fogel, 2006). States are a very unique type of owner, one that can control beyond its voting rights (Boubakri et al., 2008). A recent study on the influence of state ownership shows it to have an inverted U-shape negative effect on firm performance (Sun, Tong & Tong, 2002), capturing the extent to which a minority position can have an effect comparable to that of larger holdings. This is an indication on the degree to which minority state ownership lead to a position of influence inside of the EMNE. Other recent research efforts have also supported the idea that either low or high state ownership concentrations create greater agency costs, thus a reflection of the conflicts of interest they produce as principals (Su, Xu & Phan, 2008). Conflicts between different powerful principals (families, business groups & as per our arguments, governments) often result in the expropriation of other shareholder's rights and the appropriation of the direction of the firm (Young et al., 2008).

Selection Process

Aware of their ability to influence the firm, states will be willing to invest in firms that show a higher likelihood to align to their own goals so that the gains from the rents that they can extract from ownership can overcome its cost. This corresponds to the political view that governments can better enact an agenda in areas of agreement amongst them and EMNEs (Bennett & Sharpe, 1978). Therefore, the selection of EMNEs depends on how they signal their closeness to the government's objectives. As firms signal their interest to work along the lines of the government's purposes they are more likely to be chosen as recipients of ownership.

Firms can show their association with the government's goal by becoming visible through close political ties that are in their own an outcome of non-market strategies. Non-market strategies lead to the creation of political connections which can be observed in the form of increased access to politicians, information, participation in the legislative process (Schuler, Rehbein, & Cramer, 2002), preferential treatment by regulators (Bonardi, Holburn, & Vanden Bergh, 2006), and even protection from non-facilitative governments (Pearce, 1991). Political connections allow for a direct window of communication between firms and governments (Hillman, 2005) leading to the noticeability that is necessary for becoming a target of ownership.

The relationship between political connectivity and state-ownership has been accounted for in the study of State-Owned Enterprises (Ang & Ding, 2006; Firth et al., 2009; Wu, 2011). Listed, politically connected firms in China are used as vehicles of fulfillment of political goals (Chen, Fan & Wong, 2004). Other studies show that maintaining a residual ownership stance protects the firm from potential expropriation by the government in addition to likely providing it with subsidies, financing and tax breaks (De Soto, 1989; Shleifer & Vishny, 1994). State ownership can also provide protection from unfavorable regulations, as these will likely affect the rents that politicians can extract from them (Shleifer & Vishny, 1994).

The EMNE's interest in creating strong political connections in emerging economies also responds to these country's weaker market institutions, legal protection and law enforcement (La Porta, Lopez-de-Silanes, Schleifer, & Vishny, 1999) making of political connections an alternative to overcoming such institutional deficiencies (Pearce, 1991). Political intimacy also helps mitigate market risk, and reduces the cost of financing firm activities (Boubakri, Cosset & Saffar, 2008; Khwaja & Mian, 2005). The exchanges between firms and states allow the communication of interests and the alignment of specific concerns. Through these interactions governments are able to consider collective action leading to economic bipartisanship where firms wager on a combination of market mechanisms and concerted collective actions as a formula

The value of a political connection is more often built through financial contributions, where their results can be captured by analyzing the type of recipient candidate, the office for which he or she is running, and the electoral results (Claessens et al. 2008). Many studies to date have chosen the importance of campaign contributions to secure policy outcomes and benefits for the firm (Kroszner and Stratmann, 1998; Claessens & Laeven, 2006). Securing campaign contributions is of ultimate importance for the state, and therefore while state ownership may be perceived as a way of repaying campaign contributions it can also serve secure future rents if the state is able to control the use of funds inside of the firm.

Political strategies also include hiring former politicians or individuals with previous experience in the government (Hillman, Keim & Schuler, 2004). Resource dependence theory points to the relevance of board members as source of political connectivity as they can provide the firm with information that reduces uncertainty and transaction costs (Pfeffer & Salancik, 1978). Further, firms find in government-affiliated board members as a way of accessing or influencing the government (Hillman, 2005).

Preferential treatment by the government accrued by politically-connected firms is particularly important in countries where the government controls important resources or where the weak institutional apparatus cannot by itself reduce information asymmetries, or secure property rights (North, 1990). The government acknowledges the scarcity of financial resources and uses this as a way to reciprocate political support (Dinc, 2005; Sapienza, 2004). Governments with tight political connections are inclined to participate shareholders in response of support to those that have signaled their interest in coordinating efforts with the government, making ownership an outcome of political activity.

Proposition 1: Political connectivity leads to the selection of EMNEs as targets of state ownership

Direct and Indirect State Ownership

While political connectivity, deriving from board members affiliated with the government as well as campaign donations, there are different modes of state ownership that will also have an effect on the parameters considered for investment. We recognize two different modes of investment: direct and indirect. We borrow this distinction from recent efforts to disaggregate the actors that partake in the ownership structures of emerging multinationals (Young et al., 2008; Inoue, Lazzarini, Musacchio, 2013). In differentiating direct ownership, arriving from state-run institutions such as central banks, ministries, local governments and state-owned companies and indirect ownership, including development banks and pension funds, we are able to capture the extent to which the motivations for investment vary amongst these very different types of state-structures.

We call direct ownership the investment that is made by states, where the same holds direct influence on the day-to-day operability of the investment. This comprises all types of commitments including investments made by local, state and federal governments, ministries, central banks as well as by majority state-owned companies themselves (Wang, Wong, Xia, 2008). Direct ownership in the emerging economy has been subject to a lot of attention considering the large number of SOEs that existed thirty years ago (IMF 1999). While many emerging countries have privatized a large number of SOEs (in sectors such as banking and industrial production) many others have remained under government control, even after being listed on the stock exchange (Painter, 2005; Yamakawa, Peng, Deeds, 2008; Xu & Meyer, 2013).

In terms of indirect ownership, we use this term to refer to all investments made through intermediary institutions that, although under the scrutiny of the state, act under other management and governance mechanisms (Inoue, Lazzarini & Musacchio, 2013). These institutions were created in late-industrializing economies and are seldom used not only to inject capital into the market but also to improve the selection mechanisms for more profitable and accountable investments (Amsden, 1997). As these investors are gaining more importance for emerging economies (Khorana, Servaes & Tufano, 2005) a new emphasis has emerged on the appropriate analysis of the role these investment actors play (Inoue, Lazzarini, Musacchio, 2013). Separating state-funded institutional investors not only from direct state ownership but from other forms of institutional shareholding also fits within the need to further segment the characteristics of different investor profiles (Ryan & Schneider, 2002). Studying the behavior of institutional investors adds to a growing body of literature that weighs the informational advantages of these in stock investments (Baik, Kang & Kim, 2010).

Direct and indirect state equity investments differ in that they are carried by institutions that respond to different market motivations. While indirect investment is more prone to securing financial rents (Lazzarini, Musacchio, Bandeira de Mello & Marcon, 2011; Bruck, 1998), direct ownership has long focused on supporting sectors deemed strategic for the state (Bremmer, 2010; Shleifer, 1998; Wei & Varela, 2003; Pearson, 2005).

In terms of indirect investments, institutions are forced to diversify their portfolios by owning equity in many firms (Kochhar & David, 1996). As rational shareholders they are accustomed to basing their investment decisions on publically available information, having an incentive to carry out an evaluation of the firm as opposed to focusing on short-term fluctuations in stock-price (Black, 1991). Institutional investors have are interest in capitalizing from their position in the market (Shleifer & Vishny, 1999) and they need to base their selection on the financial performance of the EMNE. For instance, Lazzarini, Musacchio, Bandeira de Mello & Marcon find in their cross-sectional study of Brazil's development bank BNDES (one of the country's largest institutional investors) that it favors ownership and lending to large, profitable firms (2011). As per their results profitability seems to be a condition for the appearance of ownership as opposed to the result of receiving equity or loans. They also show that donations and equity show no significant correlation, supporting that these two variables act as separated factors in the decision of state-run institutional investors to choose a firm (Lazzarini, Musacchio, Bandeira de Mello & Marcon, 2011).

In terms of direct investment, the selection of investable EMNE by the state is dependent upon the strength of the EMNE's political connectedness and also upon its national relevance. Strategic industries tend to be large, responsible for thousands of jobs and generators of income tax and foreign currency. These firms also hold influence given that their operations represent objects of national pride or sovereignty (Bagwell & Staiger, 1999). A large number of emerging nations with access to natural resources such as oil have as a matter of fact secured its commercialization either through expropriation or by designing legislation that grants permission to exploit resources solely to national companies (Inkpen & Moffet, 2011). As suggested by Moran, countries try to assist national champions "to ensure that there are national firms participating in (relevant) sectors", to guarantee a "presence in sectors in which economies of scale are specially large, barriers to entry especially high and rents and externalities especially abundant" and due to national security concerns (2008). Direct ownership has already shown predominant both in emerging and developed nations when these strategic sectors are present (Schleifer, 1998; La Porta et al., 2002; Boardman & Vining, 1989). For example, as exposed by Bortolotti & Faccio (2007), the Italian government has an influential shareholder stake in the largest Italian oil-and-gas company, at the airline carrier Alitalia, and Telecom Italia. We would therefore expect that the national relevance of an EMNE, measured by its inclusion in each country's Industry Development Plans, to be more prone to receive direct government investment.

Proposition 2: Profitability leads to the selection of EMNEs as targets of indirect state ownership

Proposition 3: Belonging to a strategic sector leads to the selection of EMNEs as targets for direct state ownership

Methodology

Country setting

There are four main reasons why Brazil constitutes a quasi-natural laboratory that facilitates the isolation of government investment in EMNEs. First, Brazil is an example of a nation that embraced late market reforms (only in the late 1980s and early 1990s) and that followed the old Import Substitution Industrialization (ISI) policy (Bulmer-Thomas, 2003). As is natural to the ISI and to export-oriented growth, there was a wave of privatization that began to erode state assets and transfer them to private agents, particularly after the Real plan succeeded in controlling inflation in 1994. This rosy picture may give the appearance that market reforms in Brazil have already been largely implemented however the implementation of an open-economy agenda in Brazil is not tied to any ideology, and is closely associated with the future reelection prospects of the ruling party (Weyland, 2002), hampering further reforms in healthcare, social security, politics and the judiciary.

As a result, implemented market reforms have actually created new political rents, while democratization has increased the number of politicians competing to distribute rents, and bargaining power has shifted to private business (Maxfield & Schneider, 1997). Political parties have become fragmented, weak and led by personal motives. This situation makes it difficult to form a majority in both the deputy and senate chambers, forcing the ruling party to vigorously engage in bargaining for political support. The necessity of bargaining increases state bureaucracy and fuels patronage, clientelism, and rent seeking. The executive branch, for instance, can appoint roughly 20,000 positions in federal bureaucracy, exacerbating this scenario.

Second, this competitive political environment has been associated with the need to implement developmental policies giving rise to a new wave of large companies also known as national champions. In Brazil, these champions take part in industrial and economic development agendas that have received government funds and support for the last couple of decades (Stal & Cuervo-Cazurra, 2011). The existence of these large, well-known, connected and profitable EMNEs is also found in many other emerging economies such as South Korea, Russia, Mexico and China.

Third, the largest indirect government shareholders are key institutional investors. BNDES, Brazil's largest development bank, is responsible for 15 percent of all investment in Brazil. The largest pension fund in the country, PREVI from Bank of Brazil, is the county's largest institutional investor. This makes BNDES and PREVI the most important institutional shareholders in Brazil (Lazzarini, 2011).

Fourth, several characteristics of the Brazilian polity promote a one-to-one relationship between EMNEs and government officials, or politicians that open avenues for the interest of governments in the control of EMNEs. To begin with, Brazilian political institutions, such as large district size, undisclosed contributions, and open list electoral systems, favor low accountability and particularistic relationships between businesses and the state. In fact, these political institutions attract entrepreneurial candidates, i.e., candidates with individualistic campaign styles seeking personal votes in exchange for group or individual rewards, and those who are responsible for their own political careers (Samuels, 2008). Large districts and open list competitions make reelection too costly, providing incumbents with an incentive to trade "pork" for money instead of votes, and to pay for television advertisements in order to broadcast their accomplishments while in office (Samuels, 2002). What's more, and different from the United States, corporations can make cash donations directly to candidates, which ensures they are mostly given in exchange for personal services and not in support of public policy (Samuels, 2001). There is no restriction on donations from foreign firms. The official limit for domestic firms is 2 percent of gross revenue, but "under the table" donations are pervasive. Finally, business politics in Brazil does not give incentives for collective action. The lack of encompassing peak associations, capable of controlling free riding and their use for personal favors, pushes firms to act by themselves (Schneider, 2004; Maxfield & Schneider, 1997). Business and political associations that existed in the 1930s were increasingly weakened by subsequent governments to the extent that existing associations possess considerable budget and professional structure, but lack political influence (Schneider, 2004). The overall picture is that firms act individually to seek favors.

Sampling Design

Prior to data collection we generated a list of all Brazilian EMNEs between the years of 2006-2011. This list resulted from the combination of all EMNEs as reported by Fundação Getúlio Vargas' (FGV) *International Business Research Forum*, the SOBBEET-Valor Internationalization ranking, as well as the *Observatorio de Multinacioanis Brasileiras* from the Escola Superior de Publicidade e Marketing (ESPM). The combination of these sources resulted in a total of 110 Brazilian Multinationals. All of these sources define as a Multinational any firm with Foreign Direct Investment (FDI) in a foreign country, with presence of at least one subsidiary abroad. After identifying these firms, we selected those that are publically traded leading us to a total of 39. We based our analysis on listed firms in order to alleviate some of the reliability and trustworthiness concerns frequently found in other sources of data from emerging economies (Hoskisson et al. 2000).

Additionally, in order to formulate our tests regarding the choice of state's participation, we gathered information on state ownership. In Brazil, companies offer both common and preferred shares. Common shares have one vote each while preferred shares do not carry voting rights but may benefit from other rights such as receiving dividends first. The distinction between the two allowed us to better contrast the extent to which accessing a control stake is important to impact strategic outcomes. Our primary source of information was the investment analysis software Economatica. It provided financial data for a 6-year panel (2006-2011). We also used Economatica to collect information regarding the ownership structure of the EMNE.

Analytical Approach

In order to analyze the effect of a firm's use of non-market strategies on state ownership of we used Crisp-set qualitative comparative analysis (csQCA). QCA is an innovative analytic technique that permits the examination of causal relationships between a specific group of cases and an expected outcome (Ragin, Drass & Davey, 2006). According to Fiss, the use of this methodology allows us to understand the direction of causality relationships mitigating reversed causality (in Boolean algebra terms, the variables leading to the existence of an outcome are not equal to the negation of such variables leading to the negation of the same outcome). Recent articles in management and international business journals have exhibited the analytical strengths QCA for social and management strategy research (e.g., Judge et al., 2014; Fiss, 2011; Schneider, Schulze-Bentrop, & Paunescu, 2010).

It is important to note that QCA as a research approach is enrooted in qualitative research. Therefore, the use of QCA should be understood as an ongoing research process where cases are added into an analysis for the conceptualization of theoretically supported research outcomes (Schneider & Wagemann 2010). We sustain our use of QCA on two key aspects of our attempted research; first, to arrive at a meaningful interpretation of empirical patterns displayed by our cases of state ownership; second, to show that political connectivity, profitability and sector are both sufficient and necessary conditions for the selection of firms for state ownership.

Due to the size limitations of our sample it is important that we limit the number of causal conditions as each additional one increases the complexity of the model exponentially (Ragin, 2006: 6). In our case we limit the test to the proposition of causality leading to government direct and indirect minority state ownership.

Measurement

Our outcome of interest is minority state ownership a score that accounts for "1" or "0" where absent or present in the form of ordinary shares. To validate our outcome we revised if a firm received minority state ownership in the period of study between the years of

2006-2011. The reason for the selection of this period of time is to leave enough time for the appearance of ownership as an outcome of political activity after the 2006 presidential elections. We assume that some commitments between politicians and firms are likely to occur even after a new electoral period occurs (firms can demand governments to fulfill their promises before or during administration changes).

Our casual relationships arrive from our political connectivity variables, our profitability variable as well as our sector relevance variable. We expect all factors to play a representative role in the selection process. Our first variable campaign donations, is a representation of the positive outcome of campaign donations made by EMNEs in the 2006 elections. This variable results from deducting donations to losers from donations to winners as a way of accounting to firms being favored positively from donations that were appropriately targeted. In Brazil, electoral legislation allows direct corporate donations to candidates, up to two percent of the gross revenue and transparency laws grant access to detailed information regarding donations made up to the candidate level. We used the difference between the number of winning and losing candidates to proxy for firm political connection. Since the election results are not subject to firm decisions, this exogenous variable shows important design properties in order to isolate the effects of changes in political connectedness from one election to another. All information collected was accessed through the Electoral Supreme Court (TSE), Brazil's judicial branch responsible for election legitimacy.

The variable accounting for former politicians working as a board member is a result of an in-depth analysis of the curriculum vitae of all board members of these firms in the studied period. A former politician sitting on the board accounts for "1" and the lack of one is considered as "0". Additionally, we computed an analysis of the average operational EBITDA/Assets for the period of study. In order to determine which firms were over or under performers, we compared all cases against the mean of our sample and coded with "1", all over performers and with "0" all underperformers. Finally, we collected information regarding Brazil's Policy of Productive Development[2] for the period and marked all firms specified as "strategic" with "1" and all other non-mentioned firm-activities with "0". We

[2] Ministério de Desenvolvimento, Industria e Comércio. Accessed June 14, 2014 www.mdic.gov.br/pdp/index.php/sitio/inicial.

used fsQCA software to fit our model [3]

Results

We examined the characteristics that make EMNEs more likely to be picked by the government as a shareholder. Table 1 shows the results for our CRISP analysis for Indirect Ownership while Table 2 shows our results for Direct Ownership. Our results yielded a total of three configurations for Indirect Ownership as well as three configurations for Direct Ownership. We present the intermediate solution because it is most suitable for theoretical interpretation (Fiss, 2011). The interpretation of the results can be seen as the degree of relevance and presence of the casual conditions within each one of the configurations. We also use the difference between the intermediate and parsimonious solutions to review the degree to which our variables are core or peripheral conditions (Ragin, 2008). As the results are the same in both cases, we can confirm that all of the resulting variables are core and not peripheral values.

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Insert Table 1 Here

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The interpretation of our results is a combination of the coverage and consistency scores that our outcomes show. As we are attempting to unveil necessary and sufficient variables for the selection of a firm to become a target of state ownership we are interested in finding different set configurations that can lead to such phenomenon to occur. In the case of Indirect State ownership, we can see that there are three different instances of cases of necessary and sufficient variables that should be present in order for state ownership to occur. Our results show two variables of political connectivity (donations and board members with

[3] Ragin, Charles C. 2006. *User's Guide to Fuzzy-Set/Qualitative Comparative Analysis 2.0*. Tucson, Arizona: Department of Sociology, University of Arizona

government affiliation) as well as one market variable (positive accumulated operational return on assets) with sufficient consistency (while Wagemann & Schneider, 2006 report all results over 0.7, Ragin, 2006 suggests using consistency scores over 0.75, only donation has a value in between the two at 0.72) as well as high coverage (0.96 in the solution). The highest coverage (largest incidence of cases) is in the variable of former politicians on boards, also with the highest consistency, followed by campaign donations and profitability.

In the case of Crisp analyses, the consistency represents that a large proportion of the cases present in the proposed causal combinations lead to our expected outcome. As for the coverage, this measurement tells us how many cases with the outcome are represented by a particular causal condition. Necessary conditions must be present in one of the configurations but that might not be enough by themselves. Sufficient conditions are conditions that always lead to the outcome. Our results provide empirical support for our proposition that donations, board members with political affiliation and profitability are all sufficient and necessary for indirect state ownership.

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Insert Table 2 Here

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In the case of Direct Ownership we found three new sets of configurations containing all the variables that were suspected to have a role in the selection of firms. The three resulting configurations are the presence of board members with affiliation to the government, campaign donations and the belongingness of a firm to a strategic sector, contained in the government's developmental agenda. Although our results display very high values of coverage, the solution has a very low consistency, which suggests that the variables, although necessary are not sufficient to become targets of state ownership. As per Bol & Luppi, we further assess the fact that these variables are in fact necessary by using the necessary conditions suite inside of the fsQCA software (2013). The results are displayed in Table 3.

****

Insert Table 3 Here

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Our analysis of necessity displays donations, former politicians on board and strategic sector as variables that together can be deemed necessary although not sufficient to satisfy the existence of direct ownership. Therefore, while we can point to donations, strategic sectors and board directors with former affiliations to the state to make a part of a super group that contains cases of direct state ownership, none of these variables nor their group combinations, are sufficient for the appearance of the direct-state ownership phenomenon.

Discussion

We used a sample of Brazilian EMNEs to explain how direct and indirect state ownership affects the global expansion of EMNEs. We modeled the criteria that government uses to select the firms that will receive minority ownership. While we found that the choice of recipients of indirect ownership depends on political connectivity (measured by former members of the government sitting on the board as well as campaign donations) as well as profitability, we found that political connectivity and sector relevance are necessary but not sufficient to explain direct ownership. We acknowledge that direct ownership can contain additional variables that affect the selection of specific firms, and suggest that further research is necessary in order to adequately assess the configuration of variables that are sufficient and necessary to access direct state ownership.

Our findings contribute to explaining the phenomenon of minority state ownership in the EMNE as well as to show a previously unforeseen feature of the use of political connections. We find that the contextual characteristics of emerging markets have led to the existence of minority state ownership in firms in both previously state owned enterprises as well as in “born private” firms. This responds to the strong relationship between the industrial development objectives of their local governments (Sauvant 2005) and the closeness that these firms gain through political connections (Hillman, 2005) that have deemed necessary for doing business in emerging markets (Khanna & Palepu, 2003).

The phenomenon of minority state ownership is appearing more frequently in business literature (Musacchio & Lazzarini, 2012). Its noticeability arrives from the fact that it has been devised as a conduit of state; a way to advance specific developmental policy objectives, solving market failures and accessing rents (political contributions, donations and access to constituents). On the policy advancement end governments are interested in using state ownership to promote issues like job creation, regional development and access to goods and services (Shirley & Nellis, 1991). We posit that as suggested by our results, the behavior of the state, as shareholder, is distinct from traditional investors and also that it varies according to different ownership modes. We base our overall findings upon the precept that states use ownership as part of their efforts to achieve industrial development (Lazzarini & Musacchio, 2012; Trebat 1983) and rent seeking (Chen, Li, Su & Sun, 2011; Majumdar; 1998). The choice of a firm is therefore in line with the government's perception of the likelihood of the EMNE's adherence to its developmental goals.

We also contribute to nonmarket strategies literature by responding to our lack of understanding on the effect of political connections on outcomes (Bonardi, Hillman & Keim, 2005). By providing empirical evidence on the relationship between these and minority state ownership we open new avenues for further enquiry as to the other mechanisms through which firms can secure types of ownership that are more beneficial for their strategic choices. Our findings also enforce the objectives of corporate political activity as a way to secure resources, protection or advantages (Hillman, 2005). In this case, we show that firms are granted with capital, through ownership, as a response for their participation in the political game through campaign donations and former politicians sitting on the board. On the side of the state, the decision to make an investment is a response to what can be seen as good behavior from a supportive ally. In addition, through ownership, governments are granted further forms or rents; financially, through the natural behavior of their stockholdings and politically, through the opportunity to increase their involvement in some of the nation's most prominent firms. This type of potential intervention is an unanticipated trade-off of state ownership deriving from political connectivity.

Further, as states become part of the firm structures as principal-principal theories suggest, the goal incongruences between key shareholders can lead to the expropriation of the value of minority shareholders and poor performance (Filatotchev, Kapelyushnikv, Dyomina & Aukutsionek, 2001). Emerging economies are different from developed ones, given that ownership and control mechanisms are not separated (Jensen & Meckling, 1976) and therefore principal-principal conflicts come as one major concern of corporate governance (Young et al., 2008). To add to the original proposition of Young et al., we suggest that states, in addition to families and business groups, can think of themselves as a powerful controlling group, and therefore be inclined to invest in the EMNE as a way to influence its strategic outcomes.

As in every scientific endeavor, this paper has some limitations. Through the use of publically traded firms we were forced to reduce our sample from 110 to 39 firms. This decision is in line with the need to get reliable data, which is an important asset for researchers in emerging economies (Hoskisson et al., 2000). Second, more detailed information about the purpose of investments abroad (market versus resource-seeking) and their location would provide more specificity as to the types of investments that are more likely to become successful and potentially play as factors in the selection mechanisms of direct state ownership.

Another limitation refers to the external validity of our findings. One can argue that the participation of the state is not exclusive to EMNEs, as states in many countries of the world have taken or are taking a part as minority shareholders (Lazzarini & Musacchio, 2010), temporary stockholders (Eckbo, 2009; Shahabian, 2009), buyers or creditors. While we acknowledge that other developed nations carry minority state ownership, we assume this ownership to have different characteristics that should be studied under other lenses. For instance, state investments are not as transparently communicated in emerging economies as they are by some developed countries counterparts (an example is the case of France that publishes a state of affairs of all public shareholdings[4]). The lack of traceability benefits the flexibility of the state in deciding in which firms to invest in. We assume our findings to hold promising avenues for further research as for exploring the elements that may cause different outcomes, when governments decide to invest.

Conclusion

State ownership has been a recurring issue in the historical development of the firm. In emerging economies, governments are likely to be interested in investing in profitable and

[4] For more visit http://www.economie.gouv.fr/agence-participations-etat/portefeuille-letat-actionnaire-par-secteur

influential firms, through which they can consolidate their approval and constituent support. The use of political connections in emerging multinationals (EMNEs) has often been addressed as a fundamental component of doing business in these locations (Agarwal 2001). This comes as a response to the lack of institutional development that leads to voids, added transactions costs and unforeseen issues that require the intervention or participation of third parties, more often portrayed by local governments (Diaz Hermelo & Vassolo, 2010; Meyer, Estrin, Kumar & Peng, 2007). The importance of political connections is also accentuated by the state's interest in the creation of industrial policies that foster growth. As governments create agendas to further national development, they affect the consolidation of production activities, the injection of capital into the economy and the establishment of agreements to grant private extraction of local resources (Sauvant 2005). Firms are therefore inclined to return to political connectivity, as a non-market strategy, as a way to influence government's decision-making and to gain access to these various resources.

Our research indicates that such strategies are likely to result in an unforeseen feature: minority state-stockownership. We suggest that this by-product of corporate political activity responds to the fact that emerging market governments share the commonality of having an inclination to have an active role in the business life (Wade, 1990). As firms signal their alignment with government objectives through the use of political connections and profitability and political connections and sector strategy their increase their chances to become targets of state ownership. From the state's viewpoint, ownership is a way of paying back electoral support, backing an industrial activity, participating in the decision making of the firm and concerting the achievement of its economic and political goals (e.g. economic growth, development of a sector, protection of sovereign resources).

States become more aware of firms that are highly visible in their environment, and such visibility can result from the support, donations and personal relationships a firm establishes with officials and candidates. From a managerial standpoint, managers should be aware of the potential trade-offs of state ownership, as well as to the political strategies that it can deploy in order to obtain the type of ownership that favors its strategic plans.

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Table 1 Crisp set analysis of varieties of state ownership – Indirect State Ownership

Variations	**Configuration 1**	**Configuration 2**	**Configuration 3**
Example:	All Logística	Suzano	Totvs
Political connectivity characteristics			
Former Politician in Board	●		
Campaign Donation		●	
Market Characteristics			
Above average Profitability			●
Raw Coverage:	0.857143	0.642857	0.428571
Unique Coverage:	0.107143	0.071429	0.035714
Consistency:	0.750000	0.720000	0.750000

Solution Coverage: 0.964286

Solution Consistency: 0.710526

● Condition Present

Table 2 - Crisp set analysis of varieties of state ownership – Direct State Ownership

Variations	**Configuration 1**	**Configuration 2**	**Configuration 3**
Example:	Tupy	Forjas Taurus	Braskem
Political connectivity characteristics			
Former Politician on Board	●		
Donation			●
Policy Characteristics			
Sector		●	
Raw Coverage:	1.000000	1.000000	0.75000
Unique Coverage:	0.00000	0.000000	0.00000
Consistency:	0.12500	0.125000	0.12000
Solution Coverage: 1.00000			
Solution Consistency: 0.102564			
● Condition Present			

Table 3 – Necessity analysis for direct state ownership variables

Conditions tested: Donations + Former Politician on Board + Strategic Sector	
Consistency:	1.00000
Coverage:	0.102564

Effects of state stock-ownership in the internationalization of the EMNE

Maria Fernanda Arreola

Rodrigo Bandeira de Mello

Abstract

We study the phenomenon of state ownership in emerging multinationals and its effects on the internationalization of the firm. By using Principal-Principal agency theory, we examine the underexplored role of state's participation in the ownership structure of emerging multinationals and the relations of causality that its presence holds with the pace of internationalization of an EMNE. We use the Boolean logic of Qualitative Comparative Analysis in order to analyze data from internationalized publicly traded Brazilian firms and the effects that minority state ownership has had on its international development. Our results suggest that while direct forms of minority state ownership should necessarily not be present in order to allow an above-average internationalization pace of the EMNE, indirect ownership holds no effects (either positively or negatively) in the internationalization outcome. We explain our results by borrowing from political science literature and explaining the reasons that may lead states to interfere, through ownership, in the internationalization of the EMNE.

Keywords

Internationalization, Ownership/Control Structures, Emerging Market MNEs, Government, Non-market Strategies

Introduction

Management literature has explored the tensions that arise from competing agent and principal interests in terms of a firm's development, performance and strategic choices. In the case of emerging economies, an additional level of conflict arrives from issues between principals, which become viable given their underdeveloped institutional environments and lack of sufficient regulatory enforcement (Young, Peng, Ahlstrom, Bruton & Jiang, 2008). Our paper explores the role of the state as one of these principals and suggests the effect this may have in the internationalization of Emerging Multinationals (EMNEs). As the state becomes an actor in the ownership structure of the firm, motivations other than a profit-seeking behavior, can lead to issues in accomplishing a firm's strategy.

State participation in the affairs of EMNEs has called the attention of scholars who have attempted to unveil antecedents and consequences of different types of state ownership (Ramasamy, Yeung & Laforet, 2010; Chen, Firth & Xu, 2010; Wang, Hong, Kafouros, & Wright, 2012; Cui & Jiang, 2012). With very few exceptions (Wang, Hong, Kafouros, & Wright, 2012; & Wang, Wong[5]), these studies propose a one-dimensional definition of state ownership, differentiating between privately owned and state-owned companies and the majority of them use China as an empirical ground.

The use of the Chinese context in the study of state ownership carries specific challenges when trying to extend the results to other emerging economies. First, because state participation in business affairs in China is part of the political and governmental model, inherent to the communist tradition; and second, because we realize that the existing categorization of capitalism modes is not sufficient to adequately describe the governance, institutionalization and policies that reign in emerging markets (Schneider, 2009). We therefore focus on studying emerging economies from the perspective suggested by Haggard, who catalogues them as Newly Industrialized Countries (NICs) comprising Latin American and East Asian developing economies, whose growth can be jointly analyzed (1990). These emerging economies' development has been influenced by similar macroeconomic shocks, their size and the political influence of their states (Haggard, 1990). Neoclassical political

[5] Wang, Hong, Kafouros & Wright and Wang, Wong & Xia, 2008, use a typology of types of investment by separating into federal, local and state-level ownership (2012).

economy highlights that under the different trajectories followed by these nations they have either presented a tendency for state intervention led by rent-seeking (Bhagwati, 1978) or the central role of the state in fostering growth (Evans, Rueshemeyer & Skocpol, 1985).

We attempt to understand the complexity of state participation in EMNEs affairs by analyzing minority state ownership. Minority state ownership is an *organizational mode* (Williamson, 1985) that has been little explored, but that as per a study of state ownership modes by Musacchio & Lazzarini "In most of the countries for which we found data, the Leviathan (state) as a minority investor mode is prevalent and covers about 20-30 percent of the companies in which the government has equity (the rest being fully owned SOEs)" (2012, pg. 7). We further divide state ownership into two; direct and indirect. The state can have a direct position as shareholder, through its ministries and state-owned firms or it can choose to have indirect participation via pension funds or development banks (Paula, Ferraz & Iootty, 2002; Lazzarini & Musacchio, 2010) or development banks.

Although direct and indirect ownership modes represent the state, we expect them to behave differently. While we believe direct ownership to be devised as a way to advance specific developmental policy objectives, we find indirect ownership to embrace further the market. The division between the behaviors of these two modes of ownership is based on the very governance and strategic characteristics of each. Direct ownership is more likely to pursue the maximization of political and social agendas as opposed to maximizing a firm's market performance (Chen & Young, 2010; Ramaswaymi, Li & Veliyath, 2002). Meanwhile indirect ownership tends to behave like an institutional investor, and its presence does not affect the performance of the firm (Lazzarini, Musacchio, Bandeira de Mello & Marcon, 2012).

We use principal-principal theory in order to show the extent to which different ownership modes can affect the internationalization of the firm. We bring a new perspective to principal-principal agency theory by suggesting that the power of the state and its relevance in the business life grants it control attributes, even from a minority ownership position. The differences in terms of the effect of direct and indirect ownership modes will therefore reside on the particularities of the behavior of these investors. We select the internationalization of the firm as the basis of our analysis as we expect this to be one of the key performance outcomes of successful EMNEs. While it is clear from previous studies, that state ownership can bring conflicts of interests to the firm (Wang & Judge, 2012) it is unclear the extent to which state ownership can affect the internationalization pace, and specifically if certain state ownership modes are more favorable to this process than others. Governments are extremely concerned over the foreign direct investment activities of their firms as they implicate the expatriation of money, jobs and currency, which has a direct negative impact on their developmental agenda (Wells, 1971; Wade, 2004). Therefore we expect that while direct state ownership is likely to negatively affect the internationalization of the firm, indirect ownership, contained by better governance mechanisms and stakeholder response, is likely to show no effect.

We use Qualitative Comparative Analysis to test our propositions. We use the systematic necessity assessment in order to identify if, as proposed, the lack of state ownership is a SUIN condition (sufficient but unnecessary part of a configuration that is insufficient but necessary for an outcome; Bol & Luppy, 2013) to achieve a faster pace of internationalization. We use a selection of 44 Brazilian publically traded EMNEs gathered from Fundação Getúlio Vargas' (FGV) *International Business Research Forum*, the SOBBEET-Valor Internationalization ranking as well as the *Observatorio de Multinacioanis Brasileiras* from the Escola Superior de Propaganda e Marketing (ESPM) to test our propositions. Additionally, in order to formulate our tests regarding the choice of government participation, we gathered information on shareholding by all types of government agents, further classifying them into our four groups of ownership. Our research incorporates panel data covering years 2004-2012.

Our study makes several unique contributions. First, we bring a new perspective to the understanding of state ownership modes and their effect on the internationalization of the EMNE. In using the principal-principal agency theory we are able to better describe the unique governance characteristics of EMNEs (Young et al., 2008) and the way in which different actors can create additional conflicts inside of the firm. We also bring a new set of characteristics to the definition of state ownership modes (Musacchio & Lazzarini, 2012; Bremmer, 2009) and we provide empirical evidence for the behavior of a set of EMNEs. Finally, by utilizing Qualitative Comparative Analysis (QCA) we fill a gap in the use QCA for the evaluation of the necessary character of individual conditions (Bol & Luppy, 2013).

Ownership Structure in Emerging Multinationals (EMNEs)

The rapid development of business and trade in emerging countries has unleashed a growing interest in understanding their firms, as reflected in the number of academic contributions that have tried to explain the particularities of EMNEs (Hoskisson, Eden, Lau & Wright, 2000; Cuervo-Cazurra, 2012). Firms from these countries are usually different from both developed and transition economies in terms of their structure, strategic advantages and culture, which has raised concerns as to the extent to which current theories fully encompass the particularities of emerging markets (Ramamurti, 2008 & 2012).

The nature of agency issues in these nations goes hand in hand with the particularities of the business context in which these firms operate. Lax regulatory environments, different institutional frameworks and complex ownership structures aggregate for the idiosyncrasies of these markets (La Porta et al. 1999, 2000). Of special interest is the way in which the ownership structure of these firms has been set up. EMNEs are known for having structures where control groups have a majority position and where questions of minority expropriation, decision-making and control issues appear regularly (Faccio, Lang & Young, 2001). The existence of such distinctive ownership structures has an unquestionable impact as for the strategies that these firms decide to operationalize (Tihanyi, Johnson, Hoskisson, and Hitt, 2003).

For many years, research on the ownership structure of these firms used a perspective that was natural to Developed Countries Multinationals (DCMNCs), questioning the mechanisms that protected the interests of all shareholders from those of management (Daily, Dalton, & Cannella, 2003). Recent studies have extended this traditional agency theory framework to acknowledge the existence of several groups of principals with different drives and motivations (Walsh and Seward, 1990). The principal-principal agency theory suggests that EMNEs face issues of control expropriation in the hands of majority or powerful stockowners (Young et al., 2008). This theory emphasizes that, under the specific characteristics of these environments, stockowners are subject to different weights and outcomes when it comes to exercising their stock rights (Young et al., 2002).

Research to date has mainly studied two large groups of powerful principals including families and business groups (Young et al., 2008). As proof of the control that these shareholders can exercise, studies have shown that, for instance, family owners tend to emphasize the importance of firm survival over shareholder maximization (March & Shapira, 1987). Families are also likely to have risk-aversion relative to the degree of ownership in the firm (Gómez-Mejía, Haynes, Núñez-Nickel, Jacobson & Moyano-Fuentes, 2007) and undermine the decision of other shareholders when it comes to, for example, selecting a CEO. On the other side, business groups have been found to be more supportive of actions that favor other members of their association (Young et al., 2008). Business groups are also likely to be susceptible to family issues of their own, generating problems that affect a firm's performance including nepotism and conflicts outside the business arena (Sargent & Ghaddar, 2001).

We suggest that the third large incumbent in the control structure of many EMNEs is the state, even in a minority position, as the state has many interests that differ from those of the EMNE. Minority state ownership is an *organizational mode* (Williamson, 1985) that has been little explored, but that as per a study of state ownership modes by Musacchio & Lazzarini "In most of the countries for which we found data, the Leviathan as a minority investor mode is prevalent and covers about 20-30 percent of the companies in which the government has equity (the rest being fully owned SOEs" (2012, pg. 7). State ownership has been noted to be a way in which the state can influence the economy (Musacchio & Lazzarini, 2012; Inoue, Lazzarini & Musacchio, 2013) and holding a residual ownership position is a direct response to the needs of the political system of the EMNE (Boubakri, Cosset, Guedhami & Saffar, 2011).

Minority State Ownership

The attributes that grant minority state ownership with sufficient power to influence a firm's direction are in line with its identify as owner (Thomsen & Pedersen, 2000). In emerging economies, where a weaker institutional environment prevails (North, 1990), states gain power above their voting rights from their ability to alter regulatory environment, reduce competition or provide secure-capital in times of financial instability (Bartel & Harrison, 2005; Bremmer, 2010; Bortolotti & Perotti, 2007; Musacchio & Lazzarini, 2010). EMNEs are aware that in allowing state ownership they can also find a way of securing assets that are valuable in these environments and that include financing, long-term investments and lower costs of capital (Wu, 2011).

States take advantage of such power to use ownership as a devise for enacting their policy, cohesion and support needs (Boubakri et al, 2011) making of ownership a devise that carries fewer cost to operationalize that can carry more immediate results (Murtha & Lenway, 1994). The objectives of states respond to political or social concerns (Hart, Shleifer & Vishny, 1997; Shleifer, 1998) and are aimed at improving a government's chances of staying in office after elections (Boubakri, Cosset & Saffar, 2008). This forces them to transfer issues of social concern such as full employment, access to cheaper goods and services, regional development or higher wages into the firm in which they participate as owners (Boubakri, Cosset & Saffar, 2008).

The study of the political economy of state ownership has traditionally focused on majority investments, leaving an opportunity to understand the impact of minority investments on the private sector. Some recent studies argue that minority state-ownership, when carried by institutional-type investors (development banks and pension funds) can actually create positive outcomes in terms of firm performance (Lazzarini & Mussachio, 2010). Other studies, focusing on state ownership through directly controlled state-institutions show that states can have negative effects on performance both at very low and very high ownership levels (Wu, 2011). These studies reveal, that either at low (minority) or high (majority) ownership concentrations, state hold their position of power, having an ability to influence the firm at different levels depending on on the mode of entrance, either directly through state-operated institutions or indirectly through development banks.

Minority State ownership and the internationalization of the EMNE

As several studies have already pointed, having the state's presence as principal, can create divergences in a firm given its interest in issues different from firm value maximization (Shleifer 1998; Pedersen & Thomsen, 2003) creating consequences for the firm's strategies, its profitability targets, dividend distribution and growth objectives (Kush et al., 2012). One of the key aspects of a EMNEs strategy that will therefore be impacted by the presence of minority state ownership is the internationalization of the EMNE. With such, we suggest that an additional factor influencing a firm's pace of internationalization is the presence or thereafter lack of minority state ownership.

In emerging markets, governments are extremely concerned with the development of their Multinational Corporations, and the way in which they capture value abroad (Dunning, 2013 pg. 370; Kee, Neagu & Nicita, 2013). This is better exemplified by the denomination of the so-called "national champions" – a select group of large corporations that are usually showcased as examples of development. While the government abides by the national pride that represents to have an international player, it is also concerned by the way in which this visibility points to actions that contradict its own discourse. As it is the case with Brazil, many emerging economies try to encourage the growth of key national sectors locally, by providing them with special protection that they hope, helps them protect areas of extreme concern such as the labor, tax and currency markets and the availability of excess cash for electoral support.

When companies operate abroad one of the first consequences is on the offshoring of production and service facilities and the unemployment these create. Although it is argued by some economist that the excess wealth generated by outsourcing to firms is later spread in the local economy (Farrel & Agrawal 2003) in emerging firms this excess wealth in the hands of shareholders and executives is more likely to exacerbate income differences (Kaplinsky, 2010). Less employment also damages the perception of constituents over the loss of local favoritism of its own national champions. In response the government is likely to have a strong response when confronted with the fact that a firm where it holds a minority stake is taken a specific activity abroad. For instance, in 2011 Vale's CEO Roberto Agnelli was directly confronted by the government, a minority shareholder, as per his "failure to invest enough at home" (Reuters, 2011). Agnelli, although achieving an impressive operative performance for the Brazilian firm, was ousted as per reported "heavy government pressure… following years of accusations it was not doing enough to bolster Brazil's economic development" (Reuters, 2013). At the time of his demission, Brazil's government owned a direct participation of 6.8% (Marketwatch, 2011).

In addition to job creation, governments are also concerned with internationalization allowing firms to circumvent monetary policies by setting operations in another country, transferring capital, avoiding taxes, worsening account deficits, reducing the development of the national workforce (by operating and investing oversees), causing brain-drain (with the expatriation of personnel) and leading to technology or national security information leakages (Wells, 1971; Kumar, 2000). Tax avoidance is an issue of paramount concern not only amongst EMNEs but also amongst developed countries as demonstrated by the large media coverage of the latest wave of internationalization of corporate headquarters of U.S.

multinationals. For instance, by establishing its headquarters in Ireland, Apple paid a myriad 1.9% corporate tax in 2011 (NY Times, 2012).

The concern for the effects of the fast internationalization of its EMNEs will force states to intervene those decisions that can affect its own interests, using its tenure as principal. Therefore, the state's presence as minority shareholder of EMNEs is likely to take a toll on the pace of growth abroad. However, such efforts will be mitigated by the very structure of the apparatuses that are used in order to intervene the firm. As noted, State ownership in the EMNE can occur in two different modes; directly, via state-owned firms or ministries or indirectly by pension funds or development banks. Although all forms of state ownership are driven by the rent-seeking behavior (e.g., power or contributions) the level of control gains will be different between direct and indirect ownership given their own governance and structure characteristics.

Direct ownership is denoted by any type of state ownership coming straight from a state's arm such as the treasury, ministries, the central bank or state-owned enterprises (SOEs). This type of ownership is directly exposed to the government's nucleus of decision-making, serving as a direct channel to influence a firm. We are aware that for instance, its presence can influence a firm's propensity to distribute rents, patronage, or to serve favoritism purposes (La Porta & Lopez-de-Silanes, 1999).

In the case of SOEs, these are accustomed to navigating through the political environment, serving different governments, adjusting their actions to the program of new operators and facilitating the use of their resources in favor of a political agenda. In addition, SOEs traditionally have government representatives or even the governing party's highest ranked members in the organization's leadership positions, which facilitate the enactment of government-established objectives. We argue that both state-owned firms and directly state-run institutions should be as effective in attempting to adapt an EMNE's agenda. In addition direct investments can gain leverage considering their dual position as owners and customers, as many of these large institutions are also large users of the products produced by the firms they invest in. We therefore expect direct ownership to negatively impact a firm's efforts to internationalize, as it serves as a direct channel to voice the government's concerns, and therefore, an immediate way to influence a firm.

Indirect ownership is represented by any type of state ownership where the firm is insulated from pure political or electoral purposes. This type of ownership includes institutional investors, indirectly controlled by the government, such as development banks and state-owned pension funds (Paula, Ferraz & Iootty, 2002; Lazzarini & Musacchio, 2010). Their insulation arrives from the fact that these institutions respond to various stakeholders which forces the government to be accountable to economic agents, helping curb opportunistic rent-seeking behavior by the government and firms.

Indirect state ownership is a more sophisticated form of government participation. It is a natural result of the development of the insurance, pension and financing systems that allowed the creation of new financial entities. While direct ownership facilitates larger government interventions in support of political interests (Bortolotti & Faccio, 2007), indirect ownership responds to different market rules. For instance, the stock-ownership of institutional investors encourages more accountability to economic agents and the market (Bushee & Noe, 2000). Institutional investors are also expected to demonstrate appropriate managerial attitudes and conduct good governance practices (Carleton, Nelson & Weisbach, 1998). Even more importantly, the nature of, for instance, pension funds, requires those to have a clear long-term performance objective. Transparency and conformance with international accounting methods are highly related to the attraction and ownership participation of institutional investors (Aggarwal, Klapper & Wysocki, 2005). Therefore, when using the institutional investors at its disposal, the government needs to find equilibrium between economic and political rents, suggesting a more efficient and market-oriented result.

Institutional investors also possess a larger portfolio of influential stakeholders (representing agency issues of their own) as opposed to direct ownership. We can expect this to create pressures into the activism that the former will take as to its influence (Connelly, Tihanyi, Certo & Hitt, 2010). These other stakeholders will also seek that institutional investors deliver good returns and this additional pressure is likely to benefit the invested firm's own performance (Yuan, Xiao & Zou, 2008). Institutional investors also benefit from the efficiency pursue of their own agents, who are more likely to work on productivity and corrective actions (Chaganti & Damanpour, 1991). All in all, governments will have no effect on the internationalization of the firm, through indirect actors, and the firm will be dependent on market components to achieve its internationalization, showing indirect ownership to hold no effect on its pace when compared with other EMNEs.

Considering the above we propose the following,

P*1: Direct state ownership modes, via state-owned firms, and state-run institutions treasury, will have a negative effect on the internationalization of the Brazilian EMNE.*

P2: Indirect state ownership modes, via development banks and pension funds, will have no effect on the internationalization the Brazilian EMNE.

Methodology

Country setting

Existing research on the matter of state ownership and the internationalization of the EMNE has focused on understanding the resource and institutional-based perspectives (Wang et al., 2012) to explain different internationalization outcomes. These studies have supported the idea that state ownership in SOEs is likely to increase chances of internationalization, as firms will receive favorable treatment, access to cheaper resources, increase their capabilities, receive valuable knowledge and lower their transactions costs (Luo, Xue & Han, 2010; Wang et al., 2012). However, as they have used China as empirical ground, we argue that other countries, with different economic and political systems, are likely to yield different results. In the end not only has China's government set a widely known strategy to pursue the acquisition of natural resources overseas through SOEs (Buckley, Clegg, Cross, Liu, Voss & Zheng, 2007) but actually these SOEs have long operated as publicly-owned firms as opposed to privately-owned firms with public ownership.

The use of the Chinese context in the study of state ownership carries additional challenges given the nature of the Chinese regime, their very gradual market-opening (with the government controlling very closely FDI flows and currency rates) and the tight control that Beijing holds over economic reforms. State participation in business affairs in China makes part of the political and governmental model, inherent to the communist tradition. This situation, although gradually changing from what is known as fragmented authoritarianism into a more coordinating government role (Mertha, 2009), is not an equivalent political reality to what other emerging economies are experiencing.

Recent work has also pointed to the inadequate fit of existing categories of capitalism modes when describing the governance, institutionalization and policies that reign in emerging markets (Schneider, 2009). Emerging market firms in Latin America, and South-East Asia are known to be similar in that they have state-designed policies to benefit the local development of specific sectors, highly concentrated ownership structures, a large portion of foreign MNEs operating in their territories and powerful business and family groups with ownership of the main local EMNEs (Schneider, 2009; Fields, 1997; Biggart & Guillén, 1999; Filatotchev et al., 2001).

We therefore focus on studying Emerging Economies by using Brazil, which as per Haggard, falls within the category of Newly Industrialized Countries (NICs) comprising Latin American and East Asian developing economies (Mexico, South Korea, Taiwan, Singapore, Hong Kong, Brazil, Argentina and India being the most important representatives) whose growth can be jointly analyzed (1990). Neoclassical political economy highlights that under the different trajectories followed by these nations, they have either presented a tendency for state intervention led by rent-seeking (Bhagwati, 1978) or the central role of the state in fostering growth (Evans, Ruechemeyer & Skocpol, 1985).

Additionally Brazil constitutes a quasi-natural laboratory that facilitates the isolation of government investment in EMNEs. First, Brazil is an example of a nation that embraced late market reforms (only in the late 1980s and early 1990s) and that followed the old Import Substitution Industrialization (ISI) policy (Bulmer-Thomas, 2003). As natural to the ISI and export-oriented growth, there was a wave of privatization that began to erode state assets and transfer them to private agents, particularly after the Real plan succeeded in controlling inflation in 1994. This rosy picture may give the appearance that market reforms in Brazil have already been largely implemented. However, the implementation of an open-economy agenda in Brazil is not tied to any ideology, and is closely associated with the future reelection prospects of the ruling party (Weyland, 2002), hampering further reforms in healthcare, social security, politics and the judiciary. This institutional setting facilitates the intervention of the government in business life, especially as a shareholder.

Second, the largest indirect government shareholders are key institutional investors. BNDES, Brazil largest development bank, is responsible for 15 percent of all investment in Brazil. The largest pension fund in the country, PREVI, is the county's largest institutional investor. This makes BNDES and PREVI the most important institutional shareholders in Brazil (Lazzarini, 2011).

Third, several characteristics of the Brazilian policy promote a one-to-one relationship between firms and government officials, or politicians that open avenues for the interest of governments to play into the control of firms. To begin with, Brazilian political institutions, such as large district size, undisclosed contributions and open list electoral systems, favor low accountability and particularistic relationships between businesses and the state. In fact, these political institutions attract entrepreneurial candidates, i.e., candidates with individualistic campaign styles seeking personal votes in exchange for group or individual rewards, and those who are responsible for their own political careers (Samuels, 2008). Finally, business politics in Brazil does not give incentives for collective action. The lack of encompassing peak associations, capable of controlling free riding and their use for personal favors, pushes firms to act by themselves (Schneider, 2004; Maxfield & Schneider, 1997).

Analytical Approach

Our objective was to analyze the effect of direct and indirect state ownership on EMNEs outward FDI. These relationships are complex as they involve data that points to different levels of internationalization developing overtime as well as different types of government participation as previously explained. In order to analyze such phenomena we selected studying a large group of internationalized publically traded Brazilian Multinationals. The limited information pertaining to the phenomenon of state ownership and its effect on the internationalization of the firm, accompanied with empirical evidence, as well as a number of cases that went beyond any trustworthy capacity for an individual narrative comparison, set place for us to use Qualitative Comparative Analysis as methodology (Stokke, 2007).

QCA provides key advantages for analyzing our study. First, with it we can “simplify complex data structures in a logistical and holistic matter” (Ragin, 1987 pg. viii). The relationships between ownership and internationalization have little been studied in environments outside of the Chinese context, where a large dataset is available and self-explained by China’s unique mode of government. Second, in QCA we can locate patterns of multiple-causation in small to medium data sets as ours. Third, Boolean algebra allows us to reduce variables as we remove causal conditions whose presence does not alter the outcome. Finally, our knowledge of Brazil and the existence of empirical cases that point to our suspicion on the effect of state ownership modes on internationalization fits the inductive nature of QCA and the fact that it provides a type of counterfactual analysis substantiated in case-oriented research practices (Ragin, 2007).

Given the nature of our study we were interested in finding variables in whose presence or absence our outcome exists. Therefore, we search causal conditions that are insufficient but necessary to produce the fast internationalization of the firm. This is known as a SUIN condition; sufficient but unnecessary part of a configuration that is insufficient but necessary for an outcome (Bol & Luppy, 2013). This rationality differs from traditional quantitative social methods and their conceptualization of causality (Goertz & Starr, 2003). As illustrated by Hume and interpreted by Goertz & Starr, our relationships can be understood as "if the first object had not been, the second would never have existed" (2003 pg. 57).

Sampling Design

We first determined what we considered to be a modified result of internationalization. As proposed, we expect that different types of state ownership will have either a negative or neutral effect on the internationalization of the firm. The effect can be accounted for as an "above-average" performance of firms unaffected by specific types of state ownership and "below-average" for firms affected by certain forms of state ownership.

In order to compute our pace of internationalization variable we collected information on publically traded Brazilian EMNEs between the years of 2004-2012. This list resulted from the combination of all EMNEs as reported by Fundação Getúlio Vargas' (FGV) *International Business Research Forum*, the SOBBEET-Valor Internationalization ranking, as well as the *Observatorio de Multinacioanis Brasileiras* from the Escola Superior de Propaganda e Marketing (ESPM). The combination of these sources resulted in a total of 110 Brazilian Multinationals. All of these sources define as a Multinational any firm with Foreign Direct Investment (FDI) in a foreign country, with presence of at least one subsidiary abroad. We then selected publicly traded firms in order to alleviate some of the reliability and trustworthiness concerns frequently found in other sources of data from emerging economies (Hoskisson et al., 2000), leading us to a total of 44. We believe these firms to provide an inclusive picture of internationalized Brazilian Multinationals.

The authors then collected information on each firm's establishment of new subsidiaries, capturing all FDI modes (greenfield, acquisition, etc.). Foreign subsidiaries were measured yearly and represented by the physical foreign presence of international activity (Vermeulen & Barkema, 2002). Finally, following Vermeulen & Barkema, the pace was computed by dividing the total number of subsidiaries in the period of study over the total number of years (2002). We use subsidiaries as a proxy for internationalization because the number of subsidiaries as per Sullivan, is positively correlated to many of the traditional scores of internationalization such as number of employees, assets abroad and profits abroad (Sullivan (2003) showed correlation scores of 0.87 between foreign subsidiaries and foreign assets and 0.91 between foreign subsidiaries and foreign profits). Also, while it is possible to collect reliable information on the presence of subsidiaries abroad, information on profits and assets abroad, whenever reported, is left at the firm's discretion, and is likely to cause divergences in terms of the standards used for their measurement.

Information on minority state ownership was collected by individually analyzing all stock holdings over 0.01% as reported by Economatica. In Brazil there are two types of shares, common and preferred. Since common shares benefit from voting rights, we only consider these to depict the nature of minority state ownership impact in the internationalization of the firm. We collected ownership information for the years 2003-2011 as we recognize that the effects of ownership should both take time to take effect and because they only exist in companies where the state has a long-term investment strategy. All incidences of state ownership that lasted for less than three financial years were therefore disregarded.

Measurement

We catalogued state ownership into two different modes (direct vs. indirect) and in four different types; state-run institution (STA), via state-owned firms (STO), development banks (DEV) and pension funds (PEN). We did this sub-categorization of our independent variables as a way to verify that our suspicions on the effect of state ownership modes held through even when enacted by different types of ownership. All variants of ownership were given a value of "1" (present) if at least present for a continuous period of time superior to 3 years (this would explain that governments were actually interested in achieving control in the firm and that their actions had a sufficient time frame for the succession of events that resulted in decreased internationalization pace) and "0" for absent.

As for a firm's pace of internationalization, we determined an above-average performance based on the average of international performance of the dataset (ABO AVE). Rihoux & De Meur established that the use of the average is appropriate, especially if the distribution does not locate many cases near the threshold (2009). The average is also suitable since out dataset, inside the QCA methodology, can be understood, as a wide case study, where the information available on all 44 cases collected, is enough to derive an estimation of the behavior of these firms. We then differentiate cases of fast pace of internationalization (above average) with "1" and slow pace (below average) with "0". Additionally, we confirm our results with the use of the median (ABO MED), as an equivalent control for the potential skew of the information and verify if any counterfactual evidence is available on any specific cases (none were reported).

Our causal relationships will then arrive from the presence or absence of state ownership modes and the presence of above-average pace of internationalization. As established, we foresee that the lack of state ownership and direct ownership will be necessary to achieving a faster subsidiary growth abroad. We used QCA software to fit our model.[6]

Results

As established, we are interested in understanding the effects of certain state ownership modes in the internationalization pace of the firm. Therefore we utilize the theoretic-set features of QCA to conduct such an analysis. The analysis of necessary conditions and, more specifically, the analysis of relationships between them (necessary relations) is, as suggested by Bol & Luppy, an additional tool inside QCA that allows us to determine conditions that, as combined, can constitute useful answers as part of the overall case assessment (2013). In order to arrive at necessary conditions, it is necessary to analyze all possible combinatorial possibilities of our variables of interest for which we use a threshold of 0.94 (Bol & Luppy, 2013). All results are shown in Table 1.

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[6] Ragin, Charles C. 2006. *User's Guide to Fuzzy-Set/Qualitative Comparative Analysis 2.0*. Tucson, Arizona: Department of Sociology, University of Arizona

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Insert Table 1 around here

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The results obtained through the use of the systematic necessity assessment show that different levels of the group containing the lack of state-run institution and SOE ownership (~STA+~STO) lead to an above-average pace of both the average internationalization of the EMNE. This subgroup holds a consistency of 1.0 showing the variable necessary for the outcome of above average pace of internationalization, covering 38% of all cases. We can interpret our results to mean that not having direct ownership is required in order for firms to have an above-average pace of internationalization (Bol & Luppy, 2013). Furthermore, since the combinatorial assessment of all variables only leads to one set of combined characteristics (not having any mode of direct state ownership), we can acknowledge that only one necessary condition exists in our study, posing no contradictions as for the types of variables involved.

Discussion

We used 44 cases of Brazilian EMNEs to explore how minority direct and indirect state ownership affects the global expansion of EMNEs. Our study makes several unique contributions. First, we bring a new perspective to our understanding of state ownership modes and their effect on the internationalization of the Emerging Multinational. In using the Principal-Principal agency theory we are able to better describe the unique governance features of EMNEs (Young et al., 2008) and the way in which state ownership can gain the characteristics of controlling shareholders based on its national influence. We also bring a new set of features to the definition of state ownership modes (Musacchio & Lazzarini, 2010; Bremmer, 2009) and we provide empirical evidence for the behavior of a set of Emerging Multinationals. Finally, in utilizing Qualitative Comparative Analysis (QCA) we fill a gap in the use of QCA for the evaluation of the necessary character of individual conditions (Bol & Luppy, 2013) and provide a good example of instances where the identification of SUIN conditions responds to the design of an empirical phenomenon.

Our findings indicate that different minority state ownership modes have an influence on the internationalization of the firm. In emerging economies ownership and control mechanisms are not separated (Jensen & Meckling, 1976) and therefore principal-principal conflicts come as one major concern of corporate governance (Young et al., 2008). To add to the original proposition of Young et al., we show that minority state ownership, in addition to families and business groups, can become a powerful influence in the strategic outcomes of EMNEs. As principal-principal theory suggests, goal incongruence between controlling and majority shareholders can lead to the expropriation of the value of minority shareholders and poor performance (Filatotchev, Kapelyushnikov, Dyomina & Aukutsionek, 2001).

We also focused on understanding how different types of ownership could mark a difference in one key strategic decision of the EMNE: internationalization. By pointing to internationalization, our findings set a specific boundary for the ownership configurations that are more likely to arise conflict. This contributes to a specific concern of agency theory proponents, as to the specific structures and conditions that will result in principal-principal issues (Young et al., 2008; Hoskisson et al., 2007).

As predicted, we point to the confirmation that the two direct state ownership types can undermine internationalization of a firm. We explain this outcome by illustrating the inconsistencies between the realization of a political agenda, the approval of constituents and the decision to internationalize. Following the logic of industrial policy and economic policy theories, we show how the internationalization of large firms can go against the government's ambitions to maintain a large local workforce and increase tax revenues (Wells, 1971). We also suggest that state-owned firms and ministries can use ownership to ensure active participation in the firm's decision-making, leaving room for the possibility to exercise voting rights at their discretion (Bortolotti & Faccio, 2007). Governments are aware that their ability to influence the decision-making process inside of a largely known multinational is likely to gain or influence a large number of constituents (Poynter, 1985).

As anticipated, firms with indirect ownership will have no effect on the internationalization of their assets. We propose that indirect ownership can work as a governance structure balancing economic and political rents resulting in a net gain for the firm. Indirect ownership through government-controlled development banks and pension funds insulates firms against purely political and electoral pressures, and balances political and economic objectives. As it has been shown with other studies of institutional investors, these tend to not only affect governance mechanisms but to favor the achievement of strategic firm outcomes (Bushee, Carter & Gerakos, 2007; Aggarwal, Erel, Ferreira & Matos, 2011). From a governance perspective, we find that the importance of allowing and devising the right structures to control beneficial rent-seeking can lead to economic development (Evans, 1979; Wade, 1992).

Finally we show that the assessment of SUIN conditions can help test specific research configurations. Necessary conditions have often been described as deceptively simple, and therefore are usually not properly addressed in quantitative analysis (Goertz & Starr, 2003). A pointed by Goertz & Starr, “a necessary condition by definition is something without which the effect cannot occur” (2003 pg. 48). Our empirical example provides another application for this form of QCA analysis as it shows that the lack of direct state ownership is a SUIN condition in order to achieve a faster pace of internationalization (Bol & Luppy, 2013).

We acknowledge that our paper has some limitations as to the validity of our findings to other emerging market firms and the inductive nature of the QCA methodology. We assume that our findings help propose a new setting for the evaluation of different capitalist modes and the effects of state ownership. The novelty of our research is in incorporating a new empirical context (in this case Brazil) to show that, in countries other than China, state stock-ownership can have both, different modes and different outcomes as to the internationalization of the firm. We assume our findings to hold promising avenues for further research as for exploring the elements that may cause different outcomes when governments decide to invest.

From a managerial standpoint, our results bring enlightening information. EMNEs are subject to principal-principal conflicts that can lead to the inappropriate accomplishment of strategic goals. When the firm becomes partially owned by the state, it should focus on implementing better governance structures, align the interests of the state with its decision to internationalize and work on accessing the appropriate institutional and legal channels to reduce levels of control expropriation. Furthermore, since there is the possibility of either receiving direct or indirect ownership, managers should focus on enacting capabilities that serve bargain indirect over direct ownership.

Although it was not explored, we also question if state could cause additional principal-principal clashes by the presence of some former public servers in the boards of these firms. Sitting former politicians in EMNEs is a practice conceived as a way to gain political connectivity. However, as our results indicate, in the case of internationalization, we could suspect this to create further costs and disputes. We also find that future avenues of research can include the analysis of the specific costs that having governments as shareholders produce, such as the need to pay for higher dividends (Lins, 2003).

Conclusion

State ownership has been a recurring issue in the historical development of the firm. The type of ownership that the government exercises, either direct, via SOEs or indirect, will determine the extent to which it can influence the strategic choices of the EMNE, more specifically, the decision to internationalize. We find that SOE ownership is more likely to be detrimental to internationalization. Our particular findings suggest that firms should be aware of the potential outcomes of state ownership. The specific agenda of a government can lead to principal-principal clashes that go against a firm’s strategic attempts.

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Table 1 – Necessary Relations Analysis

Conditions Tested ABO AVE	Consistency	Coverage
~DIR+~STO+DEV+PEN	1.00	0.38
~DIR+~STO+DEV-PEN	1.00	0.38
~DIR+~STO+DEV	1.00	0.38
~DIR+~STO+PEN	1.00	0.38
~DIR+~STO	1.00	0.38

Frequency threshold: 1; Consistency threshold = 0.94; only the configurations of conditions that pass the consistency threshold are disclosed.

Conditions Tested ABO MED	Consistency	Coverage
~DIR+~STO+DEV+PEN	1.00	0.59
~DIR+~STO+DEV-PEN	1.00	0.59
~DIR+~STO+DEV	1.00	0.59
~DIR+~STO+PEN	1.00	0.59
~DIR+~STO	1.00	0.59

Frequency threshold: 1; Consistency threshold = 0.94; only the configurations of conditions that pass the consistency threshold are disclosed.

Mechanisms of influence of minority state-ownership in the governance and internationalization of privately held Emerging Multinationals

Maria Fernanda Arreola

Abstract

The resurgence of state ownership in the private sector increases the urgency to understand its effects on the emerging country multinational (EMNE). As suggested by principal-principal agency theory, specific groups of owners, in this case States, have a particular position to influence the firm. By using an in-depth case study of a Brazilian EMNE we observe some of the mechanisms through which states gain access to the decision-making of the firm and exemplify some effects of their participation on the internationalization of EMNEs. We contribute to principal-principal agency theory by pointing to states as another set of controlling shareholders that are responsible for creating principal-principal conflicts (PPCs). In addition we expose the use of corporate governance as a mean of intervention in the firm. We also evidence, in terms of the internationalization of the EMNE a level of PPCs affected by the intervention of states in favor of their own interests this strategic level of EMNE management.

Keywords

Internationalization, Ownership/Control Structures, Emerging-Market MNEs, State, Non-market Strategies

Introduction

The last 20 years have witnessed the accelerated development of Emerging Multinationals (EMNEs). Their appearance has defied many of the core ideas of doing business, as they have brought a new set of capabilities, values and trajectories, challenging key concepts attached to management theory (Ramamurti & Singh, 2009 pg. 140-146). In the case of corporate governance, their entrance has put into question the extent to which the traditional paradigms of analysis, namely the principal-agent theory, responds to their own idiosyncrasies (Young et al, 2008).

In the end, EMNEs operate in a context of competition where they have to cope with the political, economic and social disruptions that are natural to their home markets. In these environments, all players are constrained by their local institutions, which influence their experience from different perspectives: from their access to capital to the availability of human resources (Meyer, Estrin, Bhaumik & Peng, 2009). For one, we are aware that the growth of these firms has been possible thanks to the creation and execution of industrial policies and government incentives (Katz & Stumpo, 2001). The state has been continuously signaled as one of the main actors in the business environment with its influence ranging from instituting "national champions", to pursuing industrial and economic objectives (Stal & Cuervo-Cazurra, 2011), to granting access to exclusive resources (Sauvant, 2005).

In this paper we review a special case of state participation in the business arena, as shareholder of previously privately held corporations. Although state ownership has been extensively studied in the literature (La Porta, Lopez-de-Silanes, Shleifer & Vishny, 2002; Sapienza 2004, Dinç, 2005), the phenomenon of state ownership in the privately operated firm with no previous attachments to the state apparatus is yet to be further explained (Musacchio & Lazzarini, 2012). This new phenomenon is determined by a state's decision to acquire a minority position in a firm with no prior connections to the state and take a participation standpoint that we argue, causes an impact in the organization.

We find that the existence of this new form of ownership is particularly interesting for a number of reasons. First, because it does not respond to the need to salvage an industry or respond to a punctual crisis as it is the case with developed economies (as it has happened with firms in the U.S. vehicle industry or Japan's nuclear sector). Second, because these state investments are not as transparently communicated in emerging economies as they are by many of their developed countries counterparts (an example is the case of France that publishes a state of affairs of all public shareholdings[7]). Third, because recent research has seen a spike in the interventionist behavior of many emerging nations' governments, and state shareholding falls within this category of increased state presence in the business life (Economist, 2012). And finally, because we suppose, that the decision of states to invest in a firm derives from a political economy reasoning, where politicians are better off when holding control rights as this gives them political benefits and bargaining power (Shleifer and Vishny, 1994)

Moreover, states seek in ownership a least costly and more efficient way of participating of the key decision-making of the emerging multinational. The importance of holding the aforementioned participation is enrooted in what has been devised as a new form of capitalism, for which many emerging economies' states have secured an increased participation in the business arena, in means to attaining their own developmental goals (Rodrik pg. 99-152, 2007). State's devise in ownership, an alternative to establishing industrial policies that works as a complement to market forces (Rodrik, 2007). Meanwhile, firms find in ownership, a response to their intents to increase their closeness to governments, and to secure, through this, their consideration in the policy arena (Hillman, 2005).

We suggest that the entrance of states as new shareholders posses a trait of new governance challenges that can be understood under the scope of the principal-principal agency theory. The difference in principals' preferences can lead to situations that are not accounted for in principal-agent governance literature (Arthurs, Hoskisson, Busenitz & Johnson, 2008). Corporate governance is dependent on the ownership structure of the firm (Imam & Malik, 2007) and although many studies exist on frameworks for effective governance (at least more than forty counting all those published by the World Bank (OECD 2004)), these have neglected to consider the effects of the presence of new forms of state ownership, and the effects that inappropriate governance structures can carry as for the implantation of strategic choices, namely the internationalization of the EMNE.

We seek to understand these corporate governance changes by researching a firm where the state recently became a minority investor. In our analysis we seek to help respond to which extent does minority investments by the state can affect the corporate governance of

[7] For more visit http://www.economie.gouv.fr/agence-participations-etat/portefeuille-letat-actionnaire-par-secteur

the firm? As it will be depicted in our study, we suggest that private firms that become targets of states ownership are made alter their internal governance, thus creating spaces for states, to take a part in the decision-making beyond their voting rights. As states achieve such changes they are capable of gaining leverage and influencing the firm to the point of creating divergences in the implementation of a company's strategy.

Our research consists of an in-depth case study of an Emerging Multinational; a large sugar cane and ethanol producer in Brazil that became the target of state ownership in 2010. By using a 6-month recollection of interviews, company data and secondary information, we are able to trace the before and after state of the internal governance mechanisms. Our findings contribute to establishing the pattern of changes that can occur in a firm that is recipient of state ownership as well as exposing some of the levels of principal conflicts that can emerge (adding for example, to what has been proposed by Peng & Sauerwald 2013).

Corporate Governance in the Emerging Multinational Enterprise

The ownership structure of a firm is largely recognized as a key component of firm performance (Margaritis & Psillaki, 2010). The distinct development of developed and emerging economies around the world has led to parametrical differences in the composition of their firms either favoring the existence of diffuse ownership or the presence of powerful controlling groups (La Porta et al., 2002; Dharwadkar, George & Brandes, 2000). These differences not only account for changes in the management of the firm, but also represent substantial variances in terms of the governance structure and the mechanisms that exist to protect shareholders, incentivize efficiency and avoid minority shareholder expropriation (Dharwadkar et al., 2000; Young et al., 2008).

EMNEs have attempted to adopt many of the governance standards of developed market firms (Young et al., 2008) but have also experienced their own set of throwbacks to respond to their market's particularities (Hoskisson et al, 2010). As governance literature suggests, much less is known about corporate governance practices and challenges outside Europe and North America (Hamilton, 1996; Peng, Au & Wang, 2001). Externally, these firms face the risk of inappropriate enforcement of governance bylaws and regulations (Gadajlovic and Shapiro, 1998). Internally, they are challenged by the higher incidence of ownership concentration, performance issues and managerial entrenchment from employees with large equity holdings (Young et al. 2008; Faccio et al. 2001; Lins 2003).

These differentiated environmental conditions and governance mechanisms of EMNEs, were source to the conception of principal-principal agency theory which proposes that conflicts amongst controlling stakeholders arise in economies where weak institutions are unable to prevent principal's intentions to extract private benefits of control (Peng & Sauerwald, 2013). In traditional agency theory terms, the firm is responsible for setting up the mechanisms necessary to coordinate the motivations and desires of agents and owners (in order to guarantee the accomplishment of the latter's financial objectives) (Jensen & Meckling, 1976; Berle & Means, 1932). The principal-principal variant recognizes that the particularities of many emerging economies, where sets of powerful groups have their own set of agents operating inside of the firm, can create goal incongruences that tend to cause minority shareholder expropriation and affect firm performance (Morck et al., 2005; Young et al., 2002; La Porta et al, 2002; North, 1996).

State ownership entrance in privately held firms

The presence of states as shareholders has been widely attested in management and governance literature (La Porta et al., 2002; Sapienza 2004, Dinç, 2005). The participation of states has been explained as an intentional institutional design aimed at balancing market forms and political authority (Perry & Rainey, 1988). The traditional form of state ownership, the state-owned enterprise is however, not the only mode through which the state can achieve a shareholding stance. An alternative phenomenon, driven by the presence of minority state-stockownership in firms with no prior connections to the state is taking place in many emerging market firms (Inoue, Lazzarini, Musacchio, 2013).

Studies of state-owned firms have shown them to pay less importance to governance standards (Allen & Galle, 2000). Issues like lack of transparency, lack of institutional investors, poor monitoring and auditing practices are more predominant in these firms and have been proved to improve when privatization is performed under appropriate conditions (Andrews & Dowling, 1998). A number of authors have also exposed the influence of state vs. private ownership in issues like strategic decision-making, (Papadakis, Lioukas, and Chambers, 1998) and performance (Parker and Hartley, 1991).

Nevertheless, less attention has been paid to state ownership when it occurs in firms that are privately held either when publically traded or not. When it comes to these firms, the question remains as to the extent to which some governance characteristics typical of SOEs such as increased monitoring costs associated with state-set managers, lack of transparent reporting or dual managerial orientation, exist. Privately held firms are on their side used to operating in open financial markets, use non state-owned banks as creditors and recruit managers with no political affiliation. The entrance of SOEs in privately held firms could therefore cause discrepancies in the way in which the firm is expected to be managed, the targets that it aims to achieve and the stakeholders that it responds to.

The governance characteristics of SOEs are also in their own a reflection of the reason for their existence, as they have been devised as conduits of political agendas, many times accounting for inefficient capital markets (Pargendler, 2012). Recent studies show that residual ownership after privatization is directly related with the achievement of political and economic objectives (Biais & Perrotti, 2001; Jones et al., 1999). State ownership is therefore explained by political-economy game, as politicians are aware that they are in a better bargaining position when they control the rights of important firms through which they can create conditions that favor their popularity or create rents such as employment or bribes (Shleifer & Vishny, 1994). The control-divestment decision only comes when the politicians perceive that the net gains from control are less than the negative impact that the imposition of their own agenda has in the perception of its constituents (Scheilfer & Vishny, 1004). When ownership occurs in less transparent ways or in firms that are not associated with the government, the risks of having to divest such investments are actually lower.

The entrance of the state as investor in privately held firms, with no prior attachments to the state-structure, is thus a reflection of the expectation of attaining political objectives that are expected to permeate inside of the firm (Dewenter & Malatesta, 1997) In the case of EMNEs, their standing as representatives of national sovereignty and progress makes them greater targets for intervention. These large firms, not only provide direct and indirect jobs to thousands of constituents, invest heavily in the local economy, and represent large pools of tax-income, they are also some of the largest donors to political campaigns, and their support can be key in the political game. Further, as states are in their own a unique set of owners that can attain control even beyond their cash-flow rights (Boubakri et al., 2009) they can choose to take minority positions that grant them the ability to interfere in the decision-making. For example, state-ownership can promote the location of new production facilities in regions where it is politically attractive against economically logical (Boubakri eta l., 2000).

This “political economy of corporate governance” (Boubakri et al., pg. 2924) of the

SOE, has effect on the overall governance of the firm where it invests, specially if this is unable to respond through governance, to a new ownership configuration to minimize agency costs (Berger et al., 2005). The governance consequences of the entrance of the state as shareholder can be better understood under the optic of the principal-principal agency theory, which assumes that controlling, or important shareholders including family members and business group affiliates often have “motive and means to exploit their positions” (Young et al., 2008 page 12). Proponents of this theory suggest that controlling groups act as informal institutions as they exercise their virtual power in the organization, through virtue of their formal or informal associations (family members working in the organization, contractual links to other business group members), to influence decision making in their own favor (Young et al, 2008). The same are able to extract benefits for themselves in environments where external governance is weak due to institutional conditions and internal governance mechanisms are not sufficient to compensate for them (Young et al., 2008; Dharwadkar et al., 2000; Peng, Wang & Jiang, 2008; Gilson, 2006). Some examples of these internal mechanisms include being publicly traded, having independent members in their board of directors, establishing systems for avoiding the entrance of shareholder appointed managers and avoiding the issuance of contracts with large (Young et al., 2008; Dharwadkar et al., 2000; Peng, Wang & Jiang, 2008; Gilson, 2006).

In the case of state ownership, the same poses itself in a similar manner as groups of controlling shareholders. As political science literature suggests the state holds an unequivocal condition of power as the operator of industrial and regulatory processes (World Bank, 1995; Fogel, 2006). The state is a respected stakeholder that serves other key roles as customer and regulator. Its importance can be observed in the study of other recently privatized firms, where CEOs may continue to maintain a close relationship with the state, promoting for instance hiring of bureaucrats, and generating thus effects on the firm’s performance (Chen, Fan Wuo, 2004). Other studies of state-stockownership show it to have an inverted U-shape negative effect on firm performance (Sun, Tong & Tong, 2002), revealing the extent to which a minority position can have as powerful of an effect of performance as larger holdings. We argue that such discoveries are an indication of the extent to which minority state ownership can take a role of importance equivalent to that of other controlling shareholders.

Therefore as a powerful stockholder the state is likely to use its awareness of its influence, in the regulatory environment and marketplace, as way to find the appropriate governance configurations to enforce its own interests in the firm. This will lead it to establish patterns through which its own agenda can be accounted for and its own expectations considered. We expect the state to exercise its influence beyond its own voting or shareholder rights, as a way to obtain results that are parallel to its inclination of satisfying constituents, increasing tax income, avoiding currency devaluations or winning elections (Wells, 1971; Shleifer, 1998). Meanwhile the firm is likely to defer to such efforts of intervention given the size of the state as a customer, the acknowledgement of the state's alternative modes of intervention (Meggingson & Netter, 2001), and the value of the state's presence at times of financial distress (Kornai, 1988; 1993). In order to attain such influence, the internal governance mechanisms of the firm, will have to be overcome, to provide for an un-proportionate participation of states in the decision-making of EMNEs.

Methodology

We employed a qualitative, case study research methodology. We chose this methodology as we study an empirical example of the phenomenon of state-stockownership that could be exemplar of the different conducts partaken by the firm and the state (Sigglkow, 2007). We chose this methodological approach since we are studying a phenomenon where established frameworks or patterns of behavior (in this case the effective intervention of the state through minority ownership) do not exist (Yin, 2009). The case describes the decision of State-Owned Enterprise Petrobras to become a minority investor in a firm hereafter referred to as Sugarcane Co. The case is an illustration and contextualization of the governance variables that are affected by the entrance of the state as well as the principal-principal levels of conflict that arise.

We chose the ethanol market and the Sugarcane Co. for our analysis after thorough consideration of potential candidates that would provide information on the following: 1) Emerging Multinationals, 2) privately owned firms with no prior state ownership, 3) a competitive landscape with many equivalent prospects for state investment, 4) an industry where the state would have a particular interest in.

In terms of the relevance of the industry, sugar cane production in Brazil was historically quintessential to the development of the country. After the Portuguese brought the crop in the sixteen century, the country became a leading provider to the European Market.

To this date, Brazil is ranked as the number one producer of sugar cane in the world and is recognized as the only country that has enacted substantial programs favoring the use of ethanol-fueled cars (UN Energy, 2011). In addition, the use of ethanol as a gasoline substitute also provides producers with a natural risk diversification strategy, by deciding the percentage to use for each product depending on market prices and demand. In the last 20 years the sector has seen tremendous change as efficiency production programs have been implemented and the state has lost control over the functioning of the industry (Alves, 2011).

Data Collection

This research was built upon primary and secondary information gathered around Sugarcane Co. and Petrobras, showing the before and after state of Petrobras' entrance as investor. All primary and secondary sources were gathered between September 2013 and June 2014. All interviews were designed as a mean to conceptualize specific events and detect meaningful occurrences amongst them (Langley, 1999). The interviews followed a semi-structured format with a basic set of questions defined to all interviewees. A total of five interviews with different employees representing Petrobras, Sugarcane Co. & sugar trade association UNICA were conducted (see Table 1 for a summary of all interviews and interviewee's positions). All the information thee contained is protected by a confidentiality agreement signed between the author's research institution and the Sugarcane Co.

In addition to primary information, more than one hundred instances of secondary information were collected including journal clippings, investor's announcements, industrial reports, economic indicators and other studies in the area (see Table 2 for categorization of all data). This information was organized with the use of HyperRESEARCH, a software designed to facilitate coding and analysis of data. 2011. Due to the sensitivity of political issues, the secondary data was an important source for understanding the phenomena studied and for making triangulations.

The data was analyzed and all findings (relevant changes that appeared as a result of the investment of Petrobras in Sugarcane Co.) were examined by using simple categorical qualitative analysis. The construction of the final conceptual framework was devised as a functional model with data and extant literature integration. Secondary data was used to compliment all interview findings and complete any missing piece of information.

Finally, we based our assessment of the changes to the governance of the EMNE on a compound categorization of observed internal governance changes that were borrowed from Young et al., 2008, Dharwadkar et al., 2000, Peng, Wang & Jian, 2008, Gilson, 2006, Ho & Wo, 2001 and Hu, Tam & Tan, 2009 (see table 3). We use all information gathered to describe changes in each category and to further assess the impact they carry in the incipient appearance of conflicts of interest. The use of this basis for analysis allows us to attach all findings to propositions grounded in governance theory of the EMNE.

Next, we take an opportunity to describe the governance structure of Sugarcane Co. before and after the state's investment decision. We use the storyline to point to relevant facts that were part of the state's consideration and selection. Afterwards, in the discussion, we examine the changes that took place in the firm's governance and conflicts that emerged.

Sugarcane Co.

The Sugarcane Co. was created in 1967 as a small factory of alcohol. The company quickly grew into a leader in the use of the most modern processing features available in the sugarcane market, and throughout the next 20 years established two new refineries and consolidated its position as a seller of liquid and processed sugar for the internal food processing industry as well as for export. The firm quickly became a household name and was the first in the sector to solely acquire an international refinery. In the year 2001 an international group (named as Foreign Mother Company, see Figure 1) with large assets and operation in Europe, Africa, Asia and West Indies, acquired the firm. The acquisition pushed further its consolidation in the sector and provided capital to pursue the purchase of other refineries in the São Paulo region. By 2007 the company successfully launched and IPO into the Brazilian stock exchange.

Its participation as a publically traded firm encouraged the implementation of increased transparency and accountability. As a publically traded firm Sugarcane Co. was obliged to present, in addition to all financial statements, relevant information including audited quarterly financial reports, analysis of its competitive advantages, international operations, exports, risks factors (both market and operational), association with a group or holding, salaries to top executives, human resource management and extraordinary activities (BMF&Bovespa, 2014). While a company is publically traded, all information is stored in EmpresasNet accessible through BMF&Bovespa's site.

In addition the firm established a board of directors with the mandate of six to ten representatives out of which two were independent. The firm also set an office of investor relations to provide relevant details to interested stakeholders, publishing timely information on the firm's performance and releasing important news. In addition, the firm hired and external accounting firm to audit all reports as well as a communication's agency to manage all press releases. At the time of the IPO no direct representatives from the Foreign Mother Company were sitting in key Executive Positions inside of the firm, as the structure was intentionally set to pursue the consolidation of a professionally managed firm (Interviewee C).

Entrance of State Ownership

Between 2003 and 2008 the scenario for sugarcane production was very positive, as the production of flex cars (vehicles that can be operated by using gasoline, ethanol or a mix of both) increased and rules for the fixation of gasoline prices became more transparent. By 2008 Brazil's ethanol sector, had already undergone a consolidation phase as larger groups acquired small and medium sized refineries. The consolidation and quick expansion of many mills also signified steeper financial leverage, higher financial costs, higher expenditures on raw materials due to increased legislation on safety and working conditions and finally, smaller crops due to climate issues related to the effects of *"El Niño*" and "*La Niña*" in 2009, 2010 and 2011 (Cardozo & Sentelhas, 2013). In addition, the beginning of the financial crisis of 2008 also affected the profitability of the sector with a steep decline of return on investment of the 2006/2007 harvest of 14.4% going all the way to 0.6% in 2007/2008 (Especial Etanol, 2011). The new financial challenges eased the entrance of new players, namely traders and foreign investors. According to Interviewee E, one third of all assets changed hands between 2008 and 2013.

In the same period, Petrobras determined the need to acquire ethanol-producing assets in the country as part of it Biofuels' division strategy. The company made a reserve of US$ 1,94 billion to quadruplicate its ethanol production until 2015 (Folha, 2011). According to the Petrobras Biofuels president Miguel Rossetto, the idea was to participate in 15% of the market as of 2017. As Interviewee A stated, the decision to invest was led by three reasons; first by business motives, as they found in the sector an opportunity to participate in a healthy and profitable related activity; second by the possibility to participate in the export of ethanol; third given the enormous possibilities of development of the internal market.

The sector understood the state-run enterprise decision as twofold; first, the measurement (measure?) would give Petrobras some leverage over its dependence on gasoline imports, an activity that affects the company's bottom-line severally given the state's control over the establishment of gasoline prices (Exame, 2013); second, it would provide some funds to increase capacity in a sector that is perceived to be highly punished by the same low gasoline prices established by the government as an attempt to contend inflation (Folha, 2013b).

Petrobras attempted to invest first in a Greenfield project, announcing an ethanol-production plant in Itarumã in a JV with Mitsui. The plant would produce ethanol to be exported to Japan for the country's electric energy production. By 2009 the company had already abandoned the project (BNamericas, 2009). After the failed operation, Petrobras established publically a new set of directives for the selection of partners, for which they looked for national producers holding a large number of assets, giving preference to firms that had international investors (to give international visibility to the investment), were located in the São Paulo estate area (where the majority of all refining activities in the country are located and where more infrastructure exists) and where programs to avoid slavery were in place. According to Interviewee A, Petrobras' also acknowledged that it would prefer an ethanol-only producing facility (as opposed to a mixture of sugar/ethanol) but that the market conditions were unlikely to allow the establishment of such firm.

Since foreign firms had already acquired the two-largest producers, Petrobras was forced to look into other producers with less size and capacity. According to Interviewee A, more than ten firms were considered for investment, where Sugarcane Co. was selected as it was considered to be the one to best fit all previously stated conditions. According to Interviewee B, other elements, outside the commercial activities of the Sugarcane Co., were considered and behind closed doors, negotiations relied on the strength of Sugarcane Co.'s political connection. As for Sugarcane Co., its interest in becoming the target of investment was associated with the injection of new capital, but also to the understanding that Petrobras opened an opportunity of communication with the government

> "There is a hierarchy (inside of Petrobras) where at the highest levels the government intervenes in the decision making… Petrobras is a strategic partner in terms of government relations. Its partners seek Petrobras because they know that they gain an open window of communication with the government" (Interviewee B).

In early 2010 Petrobras, announced that it would acquire a gradual stake of up to 47.5% in Sugarcane Co. As announced, in the first stage, Petrobras would invest $393 million over five years, with the option to invest an additional $527 million, entitling it to a position of 26.3% that could, if investments were made, increase to up to 45.7% in five years (Material Fact, March 28, 2010).

Sugarcane Co.'s new governance and operation

At the time of the announcement of the partnership, the Foreign Mother Company informed that the Sugarcane Co. would be delisted from Brazil's Stock Exchange (Bovespa), to be incorporated into a new holding. The Foreign Mother Company would contribute international assets to this new holding, under which Sugarcane Co. would remain as a subsidiary (See Figure 1 for the ownership structure before and after Petrobras' investment).

The delisting of the Sugarcane Co. was one of the requirements from Petrobras. According to interviewee A, having a firm that was publicly traded, would simply make the operation more troublesome. The decision to invest in a subsidiary of a publicly traded firm was replicated in other of Petrobras' investments; evidence from other partnerships shows Petrobras requests all new capital to be invested into new, less visible, subsidiaries

As of the announcement of the new partnership, both parties released a statement detailing all conditions of the new investment. Petrobras was granted three seats in the new six-person Board of Directors where the Chairman was to be established by the Holding Company and no independent members were appointed. The new board was sought of, as an equal way to balance all relevant investment decisions and to guarantee that the money invested by Petrobras would be adequately used (Interviewee A).

In addition to the board, Petrobras was granted two key management positions inside of Sugarcane Co. these being the Industrial Officer and the Investment and Portfolio Director. In addition, the existing investor relations' team was given as new responsibility, to attend any information demands from Petrobras (Interviewee C.). The firms also signed a contract, where Petrobras committed to purchase a value worth of 2.2 billion liters of ethanol (approximately a 2.2 billion reias value) between 2010 and 2014.

Case Analysis and Discussion

In 2010 Petrobras decided to invest in an Emerging Multinational and become a minority shareholder with the possibility of increasing its participation to up to 46% of the firm. The decision to invest in this privately held firm had political and economical motivations. On one end, Petrobras wanted to invest in an alternative source of energy that could help alleviate its dependence on gasoline imports, same that were being exacerbated by the prohibition to allow a free-float of gasoline prices. On the other hand, its motivations also reflected political interests, supporting the idea that emerging governments participate in the business arena as a way to secure its own developmental goals (Rodrik, 2007). In this case, the state needed to develop the ethanol industry, often showcased as a key indicator of Brazil's modernization (Planalto, 2013).

> *" (The) government recognized the importance of the development of the sector…investing capital in specific firms was a way to support and induce the growth of the sector" (Interviewee E*)

As a minority investor, Petrobras required changes to the governance structure of the firm that facilitated its intermission in its decision-making. Sugarcane Co. was inclined to subdue to this new structure based on the perceived benefits of receiving a large direct investment and also having the state's presence as shareholder. The state, as an active participant of the management of state-owned firms is able to use them as vehicles for achieving an agenda (Shirley, 1983). Firms are aware that in this capacity the partnership with large SOEs represents an opportunity to interact directly with government officials (Xin & Pearce; 1996)

> "Petrobras has a hierarchy, where at the highest levels it is the government that directly intervenes in the decision-making… Petrobras is a strategic partner in terms of government relations. Its partners look after Petrobras because they know this opens a window of direct communication with the government" (Interviewee B).

In order to accommodate its new partner, Sugarcane Co. underwent significant governance changes. These changes are exemplary of an array of internal governance mechanisms of EMNEs, that when in place, can reduce conflicts between groups of controlling shareholders (Young et al., 2008; Dharwadkar et al., 2000; Peng, Wang & Jiang, 2008; Gilson, 2006). As Petrobras requested changes in these internal governance mechanisms, it set the ground to facilitate its participation in the decision-making, even as a minority shareholder. For instance, public listing tends to benefit the transparency of the firm and bring other helpful elements of internal governance such as independent board members, external auditing, and professional managers (Young et al, 2008; Monks & Minnow, 2001). In delisting the firm, Petrobras was required to provide less information to markets, and had less scrutiny over its interference with the firm's choices in the public eye.

The avoidance of supply transactions is also a way in which a firm reduces hidden interests and avoids giving preferential treatment to investors. The 2.1 billion-reais ($1.23 USD according to Reuters, 2010) contract signed with Petrobras created additional dependence of Petrobras as an investor and provided Petrobras with private benefits of control (Gilson, 2006). Finally, the participation of managers and executives affiliated to a concentrated owner also creates clashes amongst principals (Young et al., 2008) (See Table 4 for a summary of all internal governance changes).

By setting less effective governance mechanisms, the new corporate structure, as argued by Filatotchev et al., was likely to carry further effect in terms of principal-principal issues (2005). Principal-principal conflicts (PPC) manifest themselves when shareholders do not share the same goals and these are countered by appropriate internal or external control mechanisms (Wright et al., 2005; Young et al., 2008). These issues traditionally pertain to strategic categories, increasing transactions costs and affecting the performance of the firm (Peng & Sauerwald, 2013). In terms of Emerging Multinationals, one of key strategies is to achieve the internationalization of the firm. In reviewing the entrance of Petrobras as investor we are able to observe how a new principal-principal conflict appeared in terms of the internationalization strategy and pace of Sugarcane Co.

Internationalization of Sugar Cane Co.

Prior to the entrance of Petrobras, the sugarcane Co. was operating as an international Emerging Multinational, not only through exports but having been the first in the sector to establish international operations. Furthermore, after becoming an affiliate of a large international agricultural producer, Sugarcane Co., became further interested in the development of different internationalization goals that could help it take advantage of the positioning of its Foreign Mother Company as a large European player. As shown in internationalization literature, one of the most obvious trajectories for subsidiaries of developed economies is to take advantage of the prior know-how of their parent company as a way to improve its performance (Uhlenbruck, 2004; Birkinshaw & Hood, 1998).

In 2007 Sugarcane Co. acquired a sugarcane-crushing plant in Africa. The idea for the establishment of such plant was to take advantage of the sugar needs of the region, the local production and distribution plants of some of its large food-processing customers as well as the access to the European market and importing quotas as a subsidiary of a large European firm.

When Petrobras first joined the Sugarcane Co. it made clear that it too, had an interest in the international positioning of Brazilian ethanol and on its export. Building on diplomatic momentum, they soon suggested that the Mozambique plant would benefit from investment to increase its crushing capacity (Africatoday, 2011). Not only that, the Brazilian government began talks with the African country in order to establish an inexistent ethanol market, based on the example of the Brazilian experience. By 2011 Petrobras opened up about intentions to develop the international market and accelerated talks to produce ethanol in the Mozambique plant (Exame, 2011). The government of the African country promised to create legislation to force the inclusion of a small percentage of ethanol on all gasoline products (as it is the case with Brazil). This would represent the creation of a new market, outside the scope and opportunities that were envisioned by the Sugarcane Co., the sugar sector, thus suggesting the appearance of a conflict of interest.

In addition, although by 2014 the African country's government had set in the necessary legislation to mandate quotas of ethanol use in its gasoline derivatives (UNICA, 2011) the production of ethanol was postponed. With soaring gasoline prices and the risk of increased inflation, the interest of Petrobras had switched back to the internal market and reflected again on Sugarcane Co.'s international position. As stated by Interviewee A:

> *"Our objective when we began our search for new partners was to develop the market with an external focus… given the changes in the environment (by 2012) we had shifted our focus 100% to the internal market… currently we have no intention of investing in any other country…although many African countries have asked for it"*

The lack of strategic flexibility that results from the presence of Petrobras can carry further unexpected burdens if the firm decides to pursue further internationalization in the future (Ghoshal, 1987). Moreover, state ownership may not only hinder efforts to internationalize but favor modes of internationalization that are different from those that are more attractive EMNEs (Erakovic & Wilson, 2005). Table 5 shows a proof quotes and support from secondary data for the appearance of such conflict of Interest.

Implications

The case provides empirical evidence as to the internal governance changes that state ownership can promote. As state ownership occurs, governments may be inclined to use their power as investors to influence arrangements in the governance structure of the firm that will facilitate their involvement and control position in the decision-making. The case shows how minority state ownership is an additional variant of a type of principal that can expropriate the voice of other shareholders.

States use their SOEs as vehicles for pursuing issues that pertain to areas foreign to EMNEs such as attaining a political goals or achieving developmental goals (Boubakri, Coser, Guedhami & Saffar, 2008). In this case Petrobras' motivations influenced by objectives related to the development of a sector, industrial policy and political activism (Shleifer & Vishny, 2002), affected the attainment of an internationalization strategy set previously by the EMNE. The existence of weaker internal governance mechanisms, allows for such interference, even beyond Petrobras' control. If emerging economies are already affected by an ineffective corporate governance environment (Dharwadkar et al., 2000) setting inefficient governance structures, as argued by Filatotchev et al., is likely to carry further effect in terms of principal-principal issues (2005). Facilitating the emergence of such governance changes only permits further intromission of the state in business decisions.

The case also contributes to identifying, in internationalization, an additional case of principal-principal conflicts adding to the recent analysis made by Peng & Sauerwald (2013). We show that in addition to issues like executive compensation, mergers & acquisitions, managerial talent and self-dealing (Peng & Sauerwald, 2013), internationalization is another level of strategic concern where PPCs may appear. As depicted, the appearance of such PPC is aggravated by the changes to the internal governance mechanisms (Peng & Sauerwald, 2013).

Conclusion

Different from the previously analyzed case of SOEs going private (Grosse & Yanes, 1998; Megginson, Nash & VanRandenborgh, 1994) this case study sheds light over some of the traits that characterize state investment in privately held emerging multinationals. The study shows that states consider both market and non-market parameters when deciding to invest in a firm. This is in line with the acknowledgement that in Emerging Markets, the state plays a fundamental role in the development of businesses and that those with tighter political connections are more inclined to be under their scope (Inoue, Lazzarini & Musacchio, 2013). The discoveries that we unveil suggest that there are further opportunities to understand the extent to which other modes of governance can help alleviate the emergence of PPCs in the Emerging Multinational.

Finally, we also contribute to literature by showing some of the mechanisms through which minority investors realize the enactment of their own objectives and the types of principal-principal conflicts they create. Along with Peng & Sauerwald, we suggest that the understanding of PPCs can help managers and policymakers create better governance structures for variants of ownership that favor PPCs appearance (2008). Corporate governance policies for EMNEs need to take into consideration the institutional environment (Globerman et al., 2011) to fill "governance vacuums" that favor PPCs and affect the operation of firms (Peng & Sauerwald, 2013).

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Table 1 - Interviewees

Interviewee	Position	Job Description	Data/Duration
Interviewee A	Executive Director of Biofuels for Petrobras	Executive Director of Biofuels at Petrobras. More than 12 years working in management positions at Petrobras. Responsible for the development of the biofuels sector and the attainment of the objectives of production and efficiency set up by Petrobras.	May 9, 2014 Duration 53 min
Interviewee B	Former Managing Director of Internal Communications	Former Managing Director of Internal Communications at Sugarcane Co. at the time of Petrobras' investment	November 11, 2013 Duration: 45min
Interviewee C	Current Manager of Communications	Previously held a position as Communications Specialist for the Foreign Mother company at their headquarters in France, from which the interviewee witnessed the effects of the entrance of Petrobras as shareholder.	December 3, 2014 Duration: 1hr55min
Interviewee D	Fiscal and Project Field Supervisor at Petrobras	Current Employee of Petrobras with 7 years of experience in strategy and project management. Witnessed the entrance of Petrobras as partner of Ethanol producers	March, 25, 2014 Duration: 32min
Interviewee E	Executive Director at UNICA	Executive Manager of the UNICA, the largest Sugarcane Association in Brazil representing the interests of 50% of sugarcane producers and 60% of ethanol production in Brazil.	November 14, 2013 Duration: 55min

Table 2 - Secondary Data

Sources	Description of Information Contained
BOVESPA	Annual Reports, Clippings and Press Releases
Company Reports (Sugarcane Co. & Petrobras)	Financial and market Reports from 2008 until 2013
YouTube	Interviews with sugarcane's CEO, UNICA's President, Holding Company's director of investor relations and Petrobras' CEO
Associations	Reports from several associations including UNICA, sugarcane.org,
News	News in media outlets such as journals and sector reports.
In-depth analysis	Industry and firm's profiles collected form investor's sites, theses, dissertations and expert sites (ex. Novacana.com)
Presentations	Sugarcane and Petrobras' presentations at workshops, fairs and events (ex. Ethanol Summit 2013, 2014)

Table 3 - Internal Corporate Governance instruments for EMNEs

Types	Reference
a. Public Listing	Young et al., 2008
b. Board Composition and Independence	Dharwadkar et al., 2000; Peng, Wang & Jiang, 2008
c. Reporting and Transparency reputation	Young et al., 2008
d. Avoidance of supply transactions	Gilson, 2006
e. Non-participation of managers affiliated with controlling shareholders	Young et al., 2008

Table 4. Corporate Governance changes

Type	**Description of Governance Change**
Public Listing	Delisted, no further reporting necessary other than a summary of all results as subsidiary of the "Holding Company"
Board Composition and Independence	A new board was formed with no external board members. Each party was granted equal seats on the board regardless of an unequal holding of shares (74% vs. 26%) Choice of CEO and CFO left at the discretion of the "Holding Company"
Reporting and Transparency reputation	Dedicated investor relations officers for Petrobras The majority of information generated by the office served for internal use only
Avoidance of supply transactions	Petrobras signed a 2billion contract with Guarani for the selling of Ethanol
Non-participation of managers affiliated with controlling shareholders	Petrobras negotiated having two directors working directly on site on management positions One was the industrial officer and the other the investment and portfolio Director

Figure 1 - Ownership structure before and after Petrobras' investment

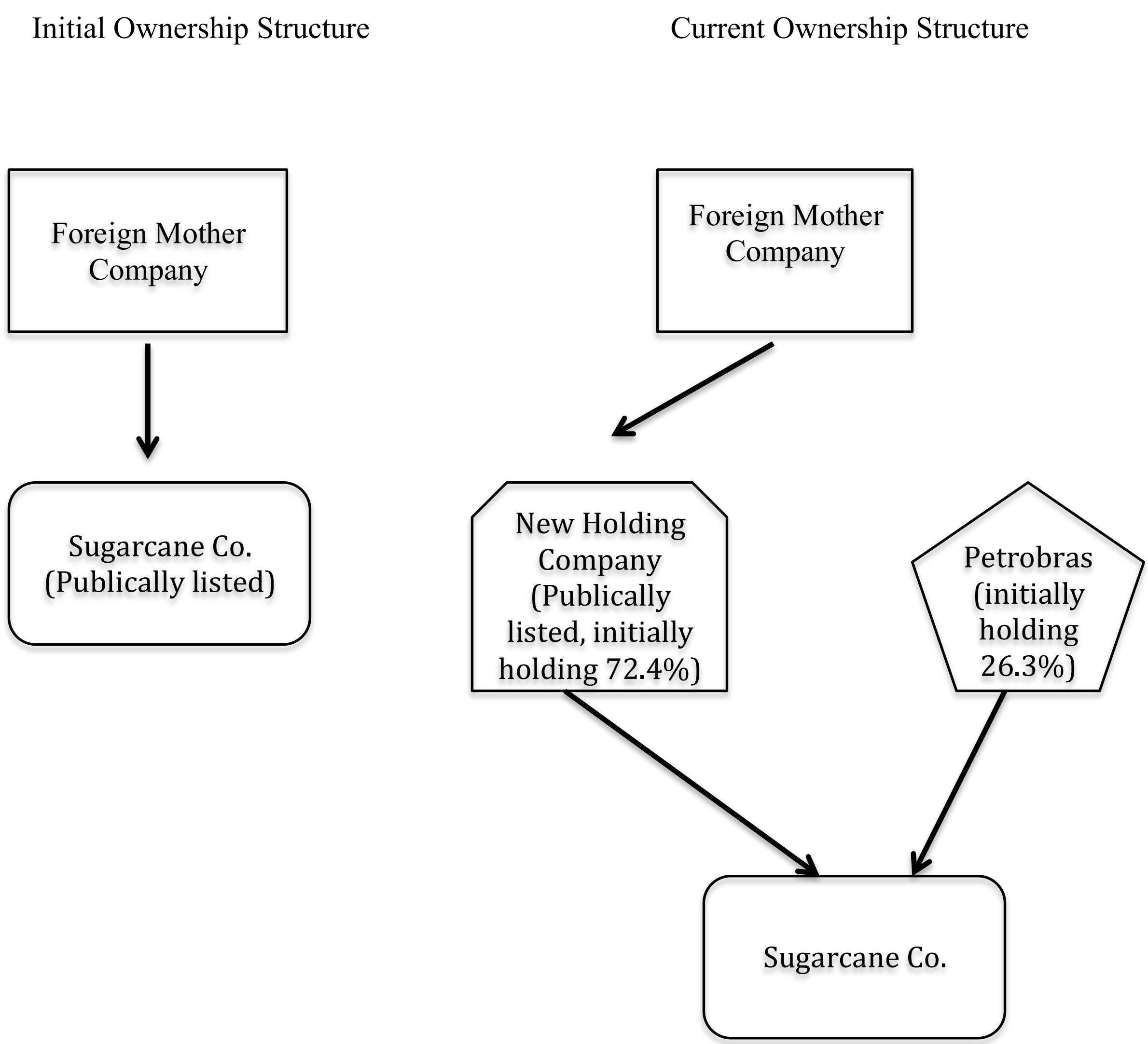
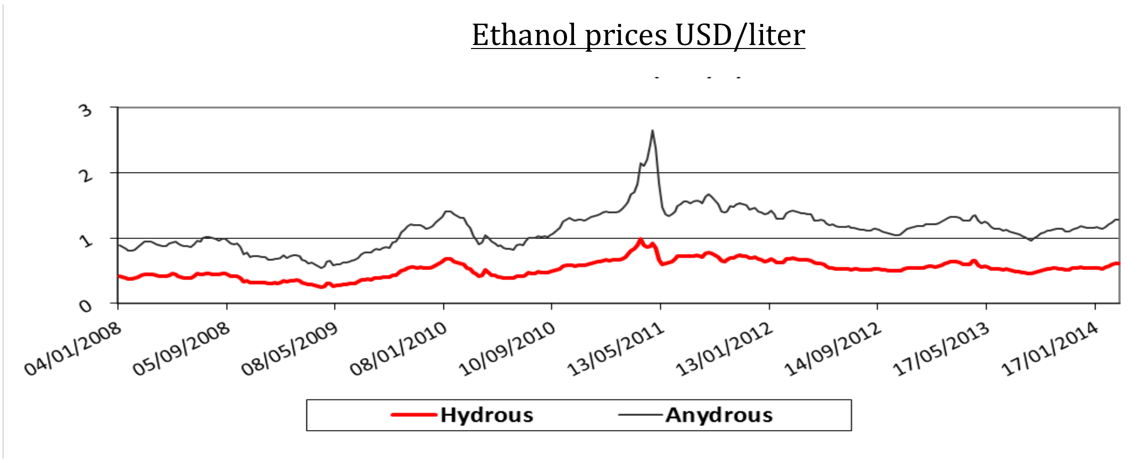
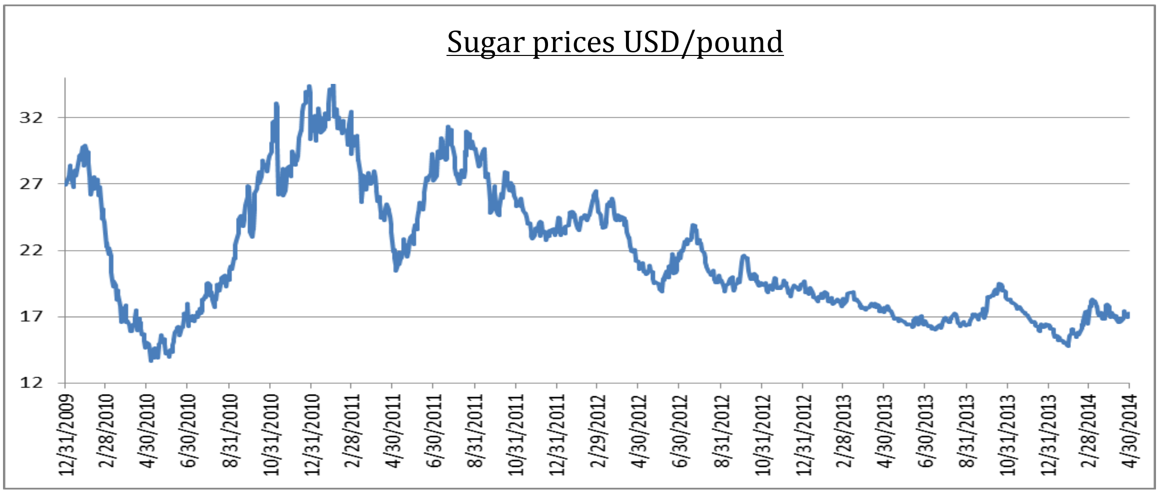


Figure 2: Comparison of Sugar and Ethanol Prices 2009-2014



Source: UNICA



Source: UNICA

Table 5 – Categorization of PPCs

Principal-Principal Conflicts (PPCs) Categorization	Description	Evidenced By	Proof quotes and data
Internationalization	Petrobras supported two things; first the internationalization of the firm on the Ethanol production side and second re-focusing on the internal market to meet internal demands.	In 2007 Sugarcane Co., acquired a crushing facility in Africa that was dedicated to meet sugar demands in the region and the European market. In 2011, and after a diplomatic visit, Petrobras and Sugarcane Co., announced themselves as leaders in the introduction of ethanol in the country committing to opening a plant before 2014. Due to the internal market demands, Petrobras re-focused its strategy locally, and required Sugarcane Co., to drop immediate plans for international expansion.	*"Our objective when we began our search for new partners was to develop the market with an external focus… given the changes in the environment (by 2011) we had shifted our focus 100% to the internal market… currently we have no intention of investing in any other country… many African countries have asked for it" (Interviewee A).*

Chapter 3

3.1 Conclusions

As a whole this thesis navigates through the phenomenon of minority state ownership through different phases. The first work suggests that the very presence of minority state ownership happens to be a previously unforeseen outcome of non-market strategies, enacted through corporate political action. In this study, we are able to observe how states are inclined to participate in the ownership structure of a firm as a way to reciprocate the support provided by EMNEs in the form of donations. The interest of states in repaying the firm by taking an equity position is also related to the interest states in emerging economies hold over the control of the actions and decisions of its key corporations. These corporations are capable of creating conditions and changes that have enormous repercussions on the achievement of developmental policies and industrial objectives and therefore cause an increased interest of governments to become involved in the firm management.

The second study analyzes a the role of state ownership in an outcome that is of extreme importance for the emerging multinational, this being the internationalization of the firm. This research acknowledges that different types of state ownership, namely direct and indirect, will have a different effect on the internationalization of the firm. The variation arrives from the fact that from an institutional perspective, while direct ownership is a better conduit of the state's desires, indirect ownership has its own set of stakeholders and governance mechanisms that make more difficult the intrusion of government set objectives and their passing into the invested firm's own management. As suggested, we show that the state has an interest in diverting the focus of EMNEs on their internationalization as this goes against the main developmental objectives of many emerging governments. Issues like tax management, capital expatriation and layouts, are found within many of the steps of the internationalization process and cause states to be inclined to reduce this activity and foster national growth. Therefore, while direct state ownership is likely to have negative results in the firm's efforts to internationalize, indirect ownership will have no effects, given the decreased transferability of the desires of the state into the management of these institutional investors.

The final paper presents a review of many of the governance changes, mechanisms and strategy areas through which the state is able to generate changes. Based on the principal-

principal agency theory, the author is able to summarize some of these conditions. To begin with, once ownership occurs, governments may be inclined to use their power as investors to influence arrangements in the governance structure of the firm that will facilitate its involvement and control position in the decision-making of the firm. Once this new structure is in place, the state will attempt to enforce changes in different areas of strategic concern included, but not limited to, corporate communication, investment decisions, the internationalization pace and the use of funds. The deviation from the strategic plans of the firm are likely to represent increased transaction costs, and as a result, the structure necessary to alleviate the government's concerns as to the appropriate use of the injected capital as well as to deal with the clashes between the firm's principals (owners or other shareholder) and the state, as for the appropriate course of action of the EMNE.

3.2 Contribution

The contributions of this thesis are manifold and they are grounded upon the international business literature, the study of the ownership structure of the firm, the principal-principal agency theory, the outcomes of non-market strategies as well as the characteristics that distinguish emerging-market firms from their developed market counterparts. Furthermore, in utilizing the QCA Crisp-set methodology, we bring a new set of empirical uses to this methodology.

To begin with, we are able to show a previously unforeseen feature of non-market strategies that is ownership as an outcome of political activity. Through this, we are able to contribute to a body of literature that has called for further attention into describing not only the components of CPA but also the unanticipated consequences of its use amongst firms. Second, we are also able to develop our understanding of the specific ownership properties of EMNEs for which concentrated ownership and powerful controlling groups have been already recognized as a contradistinctive property (Young et al., 2008).

In conclusion, we show states to be an additional, previously unaccounted for set of powerful owners for which more focus is necessary in the ownership literature. The recognition of states as powerful owners comes hand in hand with the appearance of ownership as a new phenomenon that has recently focused the interest of many multi-disciplinary scholars (or you could say focused the attention of the academic community) eager to unveil the reasons why states are increasing their ownership stakes, even in firms with no prior linkages to the SOE structure (Musacchio & Lazzarini, 2014).

We are also able to explain the existence of new empirical ground, which as suggested in Figure 1, is the materialization from the configuration of many emerging market firms in an environment between large state-intervention and coordinated economies. Our suggestion opens grounds for further discussion as to the appropriateness of the use of China as an equivalent to emerging economies with stronger open-market system experience.

Finally, we are able to show the effects of ownership on many issues other than those previously pointed out by Peng & Sauerwald (2013). We find new areas of principal's conflicts arising in areas such as communication, investment decisions and the internationalization of the firm. This last situation, one that we can name as critical for the development of the EMNE, was further explored in a final study, through which we point to the effects of the direct ownership. Our results contradict prior results evaluating the power direct investment in the internationalization of Chinese firms (Sun et al., 2002; Wan et al, 2012). We suggest that, as per Buckley et al, 2007 the very policy objectives that the more powerful and controlling standing of the Chinese government produce these deviations, further supporting our case as for the existence of an additional environment for the study of state-stockownership.

3.2.1 Practical Implications

We find many practical implications as a result of our findings. To begin with, the fact that ownership is a by-product of non-market activities sets a new important area of consideration of firm managers and government relations' directors as for their use of such strategies. Furthermore, as we suggest that direct ownership can create an increased number of principal-principal issues, managers should review how their organization might be inclined to favor the existence of one vs. the other type of state ownership (indirect).

We also reveal how governance changes, as suggested by the state as investor, may be detrimental as to the firm effort's to manage the organization and reduce transaction costs. Firms should be aware that as previously pointed, in emerging economies, the increased vulnerability of external governance mechanisms, accounting for weaker institutions, regulations and law enforcement, should be alleviated through the increased use of internal governance mechanisms (Young et. al 2008; North 1990). If firms act in a contradictory matter, they may be fostering and even incentivizing the appearance of principal conflicts, and therefore, creating systemic issues as for the scoring of their own goals.

In terms of government policies, the author firmly believes that, even when the institutions in emerging markets may not be fully consolidated, their development needs to be accompanied by the proactive effort of states to contribute to and respect the enactment of existing governance objectives. The state as owner should be treated not only under the same consideration as other investors, but also make additional efforts to maintain a more transparent position. For instance, as posited in one of the essays, the state of France fully discloses all investments in private firms and has a set strategy for the types of industries that it will support through equity positions. The same should be considered by governments in emerging economies.

As also suggested, direct ownership should be an issue of consideration by states as it has been shown to have a stronger effect on the management of the firm. Separating direct and indirect investments and incentivizing if necessary the latter, may facilitate the growth and development of the firms that have been set to receive investments as part of an industrial policy. Furthermore, investments should be a matter of public policy as opposed to a response to donations and firm contributions. However, this is an issue that calls fur further exploration under fields that pertain to other areas and domains, and that perhaps can only be attained through vehicles that are far from the control of the author of this thesis.

3.3 Future work

While our focus was on using the principal-principal agency theory as a ground for our exploration and to use the specific case of Brazil as an example of the caracterization of emerging multinationals, there are many other opportunities to extend research on the matter. To begin with, our focus on the internationalization of the firm is just one variant of the strategies that can be imapcted by the entrance of the state as an investor. We suggest further research can investigate the impact of state ownership on other factors and aspects of firm performance.

We also suggest that further attention should be given to positive examples of governance mechanisms for which principal-principal conflicts can be diminished. In line with this idea, further research could examine if other types of investors (institutional, foreign) play any type of regulating role in the management of the firm with state-stockownership.

Future researchers may also wish to address PP conflicts in emerging multinationals when compared against developed multinationals. This would allow the opportunity to test the proposition of the different types of conflicts that arise (agent-principals vs. principal-principal) in firms that are controlled under the German-Japanese or Anglo-Saxon governance models. This could also lead to understanding which governance model more effectively accommodates state-stockownership.

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