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A case of the tortoise versus the hare? Deregulation process, timing, and firm performance in emerging markets

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Abstract

The objective of this paper is to examine the relationships between the pace of insurance industry deregulation, the time since the process of deregulation began, and insurance firm performance in emerging markets. Also examined are performance differences between foreign and local insurers. These relationships are examined across different country and regional contexts using a time-series cross-section data set including 383 companies in 31 emerging market countries between the years 1998 and 2003. Results of the analysis suggest that regional differences in the pace of deregulation are significantly related to firm performance. Specifically, firms located in countries that took a rapid approach to insurance deregulation had significantly lower performance than firms in countries where the process was slower and more deliberate. Further, the longer the time since insurance sector deregulation began, the lower the financial performance for all firms. Foreign firms did not have significantly higher performance than local insurers indicating that, at least in this sample and time period, foreign firms do not seem to have a competitive advantage over local firms post-deregulation.

Keywords: Deregulation; Emerging markets; Foreign versus local firm performance; Insurance industry; Subsidiary performance

1. Introduction

Researchers in international business are understandably concerned with identifying the factors and conditions that enhance firm performance in multinational business ventures. A large part of the research in this area has focused on foreign direct investment (FDI) performance, specifically whether foreign firms are at a competitive disadvantage vis-à-vis local firms and when and whether foreign firms outperform locals when competing abroad (Dunning, 1988; Zaheer, 1995; Zaheer & Mosakowski, 1997). Numerous studies have focused on the experiences of manufacturing and service firms operating in the 'Triad' markets, the United States (US), Western Europe, and Japan (Daniels & Bracker, 1989; Li & Guisinger, 1991, 1992; Michel & Shaked, 1986; Mitchell, Shaver, & Yeung, 1993, 1994; Rugman & Verbeke, 2004; Wolf, 1975; Zaheer, 1995; Zaheer & Mosakowski, 1997) but until recently there have been fewer studies examining performance

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differences between foreign subsidiaries and local firms competing in emerging markets, particularly in insurance services (Whalley, 2004).

The relatively nascent state of the empirical research in this area is particularly notable given the profound changes in economic development strategy that have taken place throughout emerging economies (Buckley & Ghauri, 2004; Wells, 1998). During this period, governments began privatizing state monopolies, deregulating industries, and liberalizing their markets by bringing down barriers to foreign entry. Throughout much of the 1980s, efforts to deregulate and open domestic markets to cross-border trade and entry by foreign firms were initially concentrated on the trade in goods. Since the mid-1990s, the World Trade Organization (WTO) has been pressing member nations—both developed and developing nations—to open their markets to foreign competition in financial and insurance services. These efforts culminated in the Financial Services Agreement (FSA)—completed on December 13, 1997 and effective in early 1999—which included market-opening commitments by 102 WTO members.

Given this background, our paper addresses three research questions: (1) what is the relationship between the pace of deregulation and insurance firm performance in emerging markets, (2) what is the relationship between the time since the process of deregulation began and insurance firm performance in emerging markets, and (3) are there significant differences in firm performance between foreign and locally owned insurance firms located in emerging markets that have begun to deregulate their insurance sectors? Research on deregulation from economics is used to address the first two questions. There is a substantial amount of debate in economic research regarding the benefits of deregulation. Neoclassical economists tend to support deregulation, and often argue that countries should rapidly deregulate industries and liberalize markets (Becker, 1983; Caves, 1962; Stigler, 1971). In contrast, a growing number of economists are questioning the benefits of deregulation, particularly policies that have come to be known as "shock therapy" because of the rapid pace of market reform. To address the third question—the relative differences in performance between foreign and locally owned insurers—we integrate the deregulation research from economics with insights from the liability of foreignness research in international business to understand how deregulation may impact foreign and local firms.

There are at least three important reasons that we have chosen to focus on insurers located in emerging markets. First, prior research on deregulation indicates that there are more significant differences in deregulation policy and country context across emerging markets rather than across developed nations (Drury, 2000; OECD, 2001). Thus, the outcomes of deregulation policy may differ from those seen in developed countries that are relatively more similar. Second, and perhaps more important, is that most of the significant regulatory reforms over the last decade or so occurred in the insurance sector in developing countries while developed nations made few additional commitments to opening their markets beyond maintaining the status quo (Dobson & Jacquet, 1998). And third, large insurance firms from developed nations have been lobbying hard for deregulation and liberalization of the insurance sector in emerging markets (Drury, 2000). Since their domestic markets are generally saturated, US, European, and Japanese firms see emerging markets as critical areas for increased growth. Although it is widely perceived that these markets hold great opportunity for foreign firms, no studies, to our knowledge, have empirically examined in a multi-country study how deregulation pace and timing affects market attractiveness or how foreign insurers are performing in deregulating emerging markets.

In addition to our focus on emerging markets, our study extends the research in this area in several respects. First, while we include time since deregulation, we also attempt to determine how the pace of deregulation and the degree of liberalization affects firm performance. Second, most of the research to date has focused on the policy effects of deregulation on US manufacturing firms during the 1980s and early 1990s (Delmas & Tokat, 2005; Reger, Duhaime, & Stimpert, 1992). Although several studies have looked at deregulation in financial services, these studies focused almost exclusively on developed country contexts. And third, existing studies of financial services have largely overlooked the insurance sector.

With regard to the research methodology, we examine the research questions using a time-series cross-section data set with a sample of 383 companies located in 31 emerging market countries in Asia, Latin America, Central and Eastern Europe, and Africa over the time period 1998–2003 (resulting in a total of 1840 observations). Sample firms include locally owned, foreign owned and foreign-local joint venture firms for the time period 1998–2003. Results of the analysis suggest that regional differences in countries' deregulation pace