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The Foreign Expansion of Services by Business Group Affiliates: The Case of Ayala Group's Manila Water Company (MWC)

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Abstract:
This paper presents a case of internationalization of services by a business group affiliate from a developing economy. It applies the existing theories in the service internationalization and business group literature by focusing on the exploitation of the business group advantages. The research conducted a secondary data analysis to investigate the influence of business group advantages on the successful international expansion and operations of the services of a business group affiliate. The analysis shows that the combination of the group and firm-level resources, capabilities and experience have provided the strong backing in the internationalization of the business affiliate. This study contributes to the existing literature on business groups and internationalization especially on its contextualization of service firm internationalization and business group advantages.

Keywords*: developing economy firms, competitive advantages, Business Group advantages, affiliate-level advantages, internationalization*

1. Introduction

The study on the international expansion of developing and emerging economy firms has recently been invigorated in the international business literature (von Tulder et al., 2016). Most of these studies are pooled under the research theme of emerging economies. One important area in these studies is the issue on the increasing number of emerging economy firms that pursued international expansion in recent years. As a result, numerous studies have tried to provide an explanation of this phenomenon (Ramamurti & Singh, 2009). The explanations though run a number of theoretical misperceptions such as the comparison of the emerging economy firm to the advance economy firms, the discernment of the supporting resources and capabilities of the emerging economies, and the application of traditional theories in the analyses. All those contribute to the escalating research questions and agenda which continue to clutch a number of scholars in the field. One of the reasons for this is the nature of the research objective of the researchers which is much on generalization as opposed to being specific and focused (Meyer, 2013). Hence, more in-depth studies are needed to provide concrete explanations as well as supplement the limitations of the previous studies. This is the goal of this study, that is to provide a focused analysis on the explanation of the international expansion of an emerging economy firm.

On top of the main objective, this study selects a type of emerging economy firm as its research subject in order to contextualize its research analysis and contribution. This is by analyzing the case of business groups. A business group (abbreviated as BG or BGs) is defined as a hierarchy of independent firms, conceived to collaborate in domestic and international markets under a common administrative control; the affiliate firms are linked by various social and economic exchanges of resources, interpersonal trust, and mutual adjustment (Bugador, 2015; Leff, 1978). The Business group firm is a unique form of organizational enterprise in emerging economies. This unique nature of business group is one that is imperiled by the issue of the generalization in the emerging economy literature. This is by viewing the competitive advantages of business groups to be identical with other emerging economy firms. Apparently, the data say otherwise (UNCTAD, 2016). The business groups in emerging market display a different pattern compared to other emerging economy firms with regard to their international growth and expansion (Elango & Pattnaik, 2007; Tan & Meyer, 2013). They remain to be the most active in internationalization because of their distinctive routines and competitive advantages.

By focusing on the exploitation of the competitive advantage of business groups, this study hopes to contribute to the clarification of the resources and capabilities of emerging economy firms which has been one of the issues in the literature. Also, since the explanations of the internationalization of emerging economy firms are yet to be synthesized, an in-depth study such as this can provide an important foundation, also following the suggestions of Meyer (2013). Specifically, this research asks: how does a business group affiliate exploit the competitive advantages of its business group when expanding abroad? This research question is explored here in the context of a developing economy business group which is the AYALA business group, and its affiliate firm the Manila Water Corporation (MWC). The succeeding sections are organized as follows. Firstly, the study presents the theoretical foundation of the paper as the analytical framework of the investigation. Secondly, it describes the methodology and the context of the case. And lastly, it provides the findings, discussions and conclusions.

2. Analytical Framework

The internationalization and overseas operations of any firm, regardless of its home country and organizational characteristics, can be contextualized at two levels; the country and firm levels (Rugman, 1981; Dunning, 1980). These two levels also require a strategic alignment of the Country-specific advantages (CSAs) and firm-specific advantages (FSAs). The country-level or macro-level dimensions such as market size, government policies and economic development (both positive and negative), play significant influences toward the firm's decision to internationalize. For example, a growing population in foreign markets, trade agreements and increasing middle-class income can motivate different firms to expand their operational borders. On the other hand, the firm-level dimension in internationalization is captured by the internal strengths of the firm or its resources and capabilities (Teece, 2014). These resources and capabilities determine the decision of the firm particularly on how it can overcome the risks that are associated by operating beyond its national borders. These risks are the liability of the firm being foreign to international markets. One example of this risk is the lack of installed based in a foreign country, which results to a weaker competitive position of the firm compared to local rivals. However, if the firm has a superior product and marketing skills over its local rivals then this risk is easily overcome. The following paragraphs discuss these two contexts further by integrating them with the literature on the emerging business groups and internationalizations of services.

2.1. The International Expansion of Emerging Economy Business Groups

The international expansion of developing and emerging economy business groups had been explored in the past. Most of these studies have focused on the industry pioneers and mitigators of market failures in their respective economies (Lall, 1983; Leff, 1978). These industry pioneers have now become global players in different markets around the world. Recently, some next generation BGs such as those from China, Latin America and India, which have begun with their international expansion. With the changes of the global economy, both protectionism and globalization forces, the business groups pursue different patterns of internationalization.

On the context of country–level dimension, the emerging economy business group internationalization has been coincidental with the development of their home economies. This is because the greater the development of the developing economies, the higher the support and incentives they provide to their domestic champion firms. The support and incentives range from technical, political and financial means. These push mechanisms which are incorporated in the country policy agenda encourage more exports and overseas expansion of different firms in various industries. This has been the case of the business groups from the newly industrialized economies such as Korea and in some countries, such as the BRIC (Brazil, Russia, India and China). However, not all country-level dimensions are positive. Most the developing economies have weak institutions that distort the provision of the incentives to capable firms. For most of the firms, these result to their slow maturity; for stronger firms, their escape from such country condition and choose to operate in better environment in other countries (Ramamurti & Singh, 2009).

As regards the firm-level dimensions, such as organizational resources and capabilities, they are necessary for the firm to function successfully in both domestic and overseas markets, especially in the long-run. This is amplified when the home country has little to offer for support and incentives to domestic firms. In the case of emerging economy firms, their firm-specific advantages are understood to be different from that of the typical multinational enterprises (Contractor, 2013; Ramamurti, 2012). The traditional MNEs have knowledge-based advantages, while the emerging economy firms, including the business groups, have transaction and network-based advantages. Hence, the emerging economy firms exhibit a different pattern of internationalization and operations compared to the traditional MNEs. For emerging economy business groups, a different kind of advantages is also highlighted. Bugador (2015) argues that business groups display a different routine of exploration and exploitation of resources and capabilities. He termed these resources and capabilities as the business group advantages (BGAs) and the affiliate-level advantages (ALAs). The BGAs are the accumulated the accumulated knowledge and resources that has been captured, owned and controlled by the business group over time while the ALAs are the unique resources, capabilities and strengths that are specific to an affiliate firm. These two types of advantages are stored at the two organizational levels of the business group namely at the group and affiliate-levels. Specifically, the core ingredients of the overall group competitive advantages are the transactional and network-based capabilities besides the typical tangible group assets such as pooled capital and broad scope of products and services (Elango & Pattnaik, 2007; Gonenc et al., 2007; Tan & Meyer, 2013). This is evident in their dynamic and collective management of group resources which are done at both levels. Therefore, as the emerging business groups pursue overseas expansions and operations, they would rely on their internalized group advantages for them to grow as a multinational firm or when they compete with other multinationals.

2.2. The Internationalization of Service Firms

Since this paper investigates the case of an international expansion and operations of a service firm, some literature on service internationalization are also presented as follows. The internationalization of service firms is expected to show a different pattern compared to manufacturing firms (Buckley et al., 1991). The differences lie on the characteristics of the value offering of the service firm which has at least five distinctive features according to Cowell (1986). These features are intangibility, inseparability, heterogeneity, perishability and ownership. Intangibility means that the service offering is rather an experience which cannot be assessed visually as compared to a product offering. Inseparability refers to the fact that services are produced and consumed at the same time; hence the outright experience of buying, selling and consuming simultaneously. Heterogeneity means that the delivery and the quality of the service vary a lot depending on various conditions such as the skills of the service provider and the direct environmental context. Perishability refers to the idea that a service may not be stored due to its experiential in nature, which is also related to the feature of ownership because a service offering would not usually transfer the ownership of the service by the provider to the consumer but rather on a limited time only.

Given all those features, the mode of international operations of service firms require a complex managerial capability. This was evident in the study conducted by Coviello and Martin (1999). They found out that at least 3 out of the 4 case service firms that they have studied have possessed internal resources in the form of personnel with significant offshore experience prior to their internationalization. They also highlighted that all four cases have strong experience in building contacts and made the firms developed an extensive social and technical network with partners, including client involvement. In addition, their results also show that service firms can still pursue international expansion with relatively low capital intensity and can-do project-based (either short or long term) business; both are not common in the internationalization cases of manufacturing firms. Thus, they have concluded that the explanation of the international expansion of service firms cannot be explained fully by the existing models in the international business literature.

The preceding discussion suggests that the explanation of the international expansion of service firms mainly revolves around the firm-level dimensions rather than the country-level dimensions. A perspective which echoes the transaction cost theory and resource-based view. Because of this, the strategic framework of the international expansion of service firms may present some unique challenges and perspectives (Grönroos, 1999). The study of Javalgi and Martin (2007) attempted to address this. They have suggested a conceptual framework for analyzing the internationalization of services. Their framework presents three groups of elements in order to understand service internationalization. The first group is the firm-level elements which are composed of firm level resources (market orientation and capabilities), management characteristics (global mindset and leadership) and firm characteristics (size and service dimensions/scope). The second group is about the mode of choice of international entry and involvement. Lastly, the host country factors that may determine the growth and success of the international service business. Among these elements, the firm-level elements postulate the strong foundation which would establish the second and third elements. Hence, they have maintained that the firm level elements can offer a good basis in analyzing the pre and post internationalization of a service business.

3. Case Illustration

Since the aim of this study is to provide an exploration and focused analysis on the internationalization of business groups, a case study approach is considered most appropriate. A case study approach is suitable when the aim is to understand the "why" and "how" of the phenomenon (Yin, 2003). In this case, *how* the advantages of business groups influence the international expansion of their business group affiliates. This research utilized various secondary data in constructing the necessary data for the analyses. The materials are taken from the latest financial statements, magazines, news articles, company websites and publications about the business group and the focal affiliate. The study analyzed the relevant data by conducting a social network analysis. These are organized here as follows. First, the information about the entire business group is presented. This is the AYALA Group and its affiliates, which also includes their experience related to international expansion. Next is the data on the focal business group affiliate that is the Manila Water Company (MWC). This study used the collected secondary data for both illustrations.

3.1. The AYALA Group

The AYALA group is one the oldest business groups in the Philippines. Their operations date back to the late 19th century. Similar to early enterprises in other developing economies, the group started with agribusiness operations. Today, it is one of the largest conglomerates in Asia with business interests in real estate, financial services, telecommunications, water infrastructure, electronics manufacturing, automotive distributorship and dealership, and business process outsourcing, and new investments in power generation, transport infrastructure, and education (A brief history, 2016). There are about 97 business affiliates under the business group (the group's prominent affiliates are shown in Figure 1). Although the majority of the businesses of the group are domestic in orientation some affiliates have had successful international operations in the past. These include exporting and international joint venture and FDI. One of the most significant international operations of the AYALA group is the establishment of Integrated Micro-Electronics Inc. (IMI) in 1980. This affiliate is under the Ayala Corporation International Finance Ltd., which is the majority owner of IMI. The affiliate has a global presence with 15 manufacturing sites and sales offices across Asia, Europe and the Americas. IMI is one of the leading global providers of electronics manufacturing services (EMS) and power semiconductor assembly and test services (SATS) in the world (About us, 2016). Its EMS operations is ranked 18th in the world. For 2016, IMI's operating income grew 4 percent to $28.8 million in the first nine-months of the year. Overall, the international operations of the business group have been minimal yet intensive. This is in line with the group's values of integrity and long-term vision which pertains to gradual growth while discerning its exposure to risks.

3.2. Manila Water Company (MWC)

The Manila Water Company, Inc. (MWC) is a water service affiliate company of the AYALA business group (see Figure 1 below). The company was incorporated on January 6, 1997 and started commercial operations on January 1, 2000. It became a publicly listed company via an initial public offering on March 18, 2005. The board of directors come from the AYALA business group while the operations and management has been entrusted to Chief Operating Officer - Vicente Rivera, a veteran in the operations of the business group. The international operational strategy was to take a small and manageable project, one at a time. The company holds the exclusive right to provide water and wastewater services to the eastern side of Metro Manila, Philippines, which covers 23 cities with an area of 1400 square kilometer and about six million customers. In addition, it has subsidiaries that operate in other cities through service consortiums with other local government units. All these domestic operations are under a Concession Agreement entered into between the company and the Philippine government through the Metropolitan Waterworks and Sewerage System (Our Company, 2016). Most of these domestic operations were taken over from the then state-owned Metropolitan Waterworks and Sewerage System when it took over the water and sewerage system operations in the eastern part of Metro Manila. The company has learned a lot from the take-over experience and turn around the whole business from the operational problems such as aging water distribution system, addressing human resources concerns, managing public perceptions, and servicing almost 2 million customers (Rivera, 2014). This was aside from the foreign debt that it has to pay off.

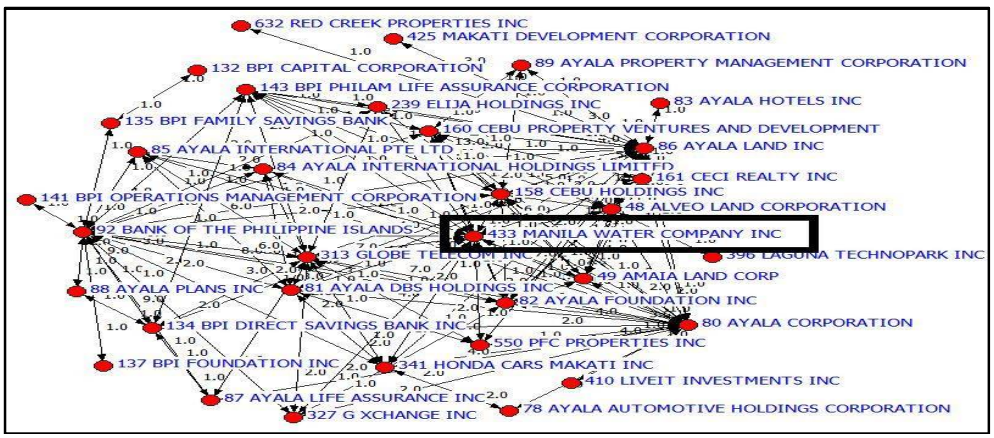

Figure 1: The AYALA business group network of companies

In November 2016, the company's total billed volume of services was up 4 percent to 538.1 million cubic meters. The billed volume in the Manila Concession grew 4 percent to 360.3 million cubic meters on increased water connections. The company maintained its operating efficiency in the Manila Concession as its non-revenue water ratio held steady at 11.7 percent. Collection efficiency remained strong at 99.9 percent (Ayala posts, 2016). On the other hand, the international expansion of MWC was officially inked in 2010 with the established of the Manila Water Asia Pacific Pte. Ltd. (MWAP) in Singapore. The decision to internationalize its services came from the initiative of the top executives of the AYALA business group. The business group saw the potential for the expansion of the capability of the group in the ASEAN which they identified as a high growth area for infrastructure investments (Basilio, 2015). The firm is 100% owned by Manila Water and functions as its ASEAN regional headquarters. MWAP, which by definition is a multinational enterprise, manages the overseas investments and projects of MWC in the region. It has established various Public – Private Partnerships (PPPs) and investments in the water industry of different host countries which include local and national governments. These investments are integrated in three other entities which are the South Asia Holdings Pte. Ltd. (MWSAH), Thu Duc Water Holdings Pte. Ltd. (TDWH) and Kenh Dong Water Holdings Pte. Ltd. (KDWH). MWAP operates in Vietnam, Indonesia and Myanmar. However, the bulk of the operation is in Vietnam, which contributes to around $3.5 million or about 6% to the MWC's annual net income. Although the international operation of MWC is less than ten years, it is already gaining a strong reputation in the ASEAN region. In 2015, the company gained recognition in several categories at the ASEAN Corporate Sustainability Summit and Awards (ACSSA) 2015 (Manila Water bags, 2015), while in 2016 it was the lone Philippine company and the only Southeast Asian company to make it to the top 100 elite list of awardees in the 2016 Corporate Information Technology (CIO) Awards USA, an awarding body which recognizes the capability of companies in creating business value through the innovative use of technology (Manila Water, 2016).

As to financial strength, the company has a stable pattern of recorded profitability. In the first nine months of 2016 its net income rose 6 percent, largely driven by strong growth of its domestic businesses, supported by the steady expansion (Ayala posts, 2016). The Figure 2 below shows the financial growth of the company. The revenue has been increasing since the beginning of its operations in 1997. In 2015, it amounts to $364 thousand, almost tripled in the last 10 years. This is the result of the increasing volume of operations and collection efficiency. With regard to the net income, the pattern is not very different. It has doubled in the last 10 years to $128 thousand with a towering EBITDA of 69 percent. In general, this consistent financial performance provides a very strong foundation into their future plans of more expansion in the ASEAN region. At the moment, the company plans to double its income in the next five years.

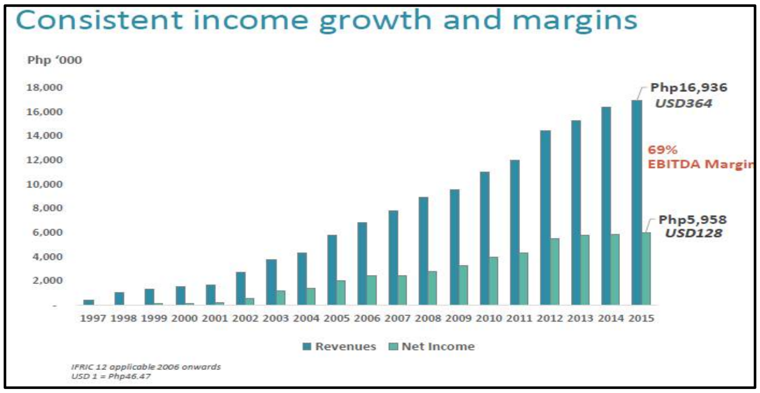

Figure 2: The MWC Revenue and Net Income (source: MWC)

4. Findings

In general, the foreign expansion case of MWC is an outcome that is based on firm-level dimensions rather than the country-level dimensions. While the MWC's home country, the Philippines, has been persistent in providing support to its firms, the support seemed insignificant from the perspective of big business groups such as the AYALA group. Most of the risks associated with their foreign expansion were mitigated either by their managerial experience or the business group advantages. Hence, the growth and expansion of the MWC were mainly supported by the AYALA group rather than its home country. Thus, belongingness to the business group and its advantages mattered. This point is expounded below following the analytical frameworks of Bugador (2015) and Javalgi & Martin (2007).

4.1. The Firm's Characteristics

The business group structure of the AYALA group has provided significant support to MWC. Starting from the opportunity recognition until actual operations. The support ranges from capital (50%), lending of group managerial skills (deploying Mr. Rivera) and negotiations with overseas local partners and governments, especially on the PPPs. Clearly, these supports are forms of BGA exploitation. In addition, the size and scope of the business group also mattered in accelerating the implementation of MWC projects. The absence of the business group component in the foreign expansion efforts of MWC would have rendered enormous challenges for a small firm such as MWC. But because the business group was behind the mission and has endowed the affiliate with the group advantages, MWC became a competitive regional (ASEAN) service multinational.

4.2. The Firm-Level Resources and Capabilities

In the case illustration, it was clear that MWC has established a strong experience out of their domestic operations for more than a decade. According to Mr. Rivera, the company has developed a set of competencies that can be leveraged geographically. These include some transactional and network capabilities, particularly in choosing partners, system losses management and efficient collection. Because of this, the company have been consistently profitable (Figure 2), aside from the service awards it received from national and international institutions. Also, their experience of turning around the previous debt-ridden company into a fully-functional and income generating business is a manifestation of their dynamic capabilities of exploiting the resources and capabilities that were available to them. Hence, the company has developed its ALAs that are unique within the business group and eventually these ALAs will be available for the other affiliates to exploit as well.

4.3. The Firm's Management Characteristics

The company has a strong leadership and global outlook. It focuses on how to leverage their overall resources and capabilities to the target host countries and any other foreign market opportunity. In fact, the company is beginning to negotiate with partners in India to replicate their success in the ASEAN. The company would like to address the institutional voids in India, particularly in the utilities sector, by applying what they have learned from their negotiations and transactions with other governments. Also, MWC is a dynamic company by showing their commitment to continuously explore and exploit the AYALA group's BGAs. This is through collaborations with other company within the business group that operates in other industries such as real estate, ICT and finance.

5. Discussions and Conclusions

The preceding sections outline some substantial answers to the research question posed by this paper. This was possible through the use of an integrated analytical framework which was derived from the literature on the internationalization of business groups and service firms. Particularly, the conceptual framework of Javalgi & Martin (2007) has facilitated the operationalization of the business group advantages (BGAs) which has been proposed by Bugador (2015). Both studies have provided a description of the three firm-level advantages, which contextualizes the affiliate-level advantages (ALAs) of the Manila Water Company (MWC). These ALAs become the unit of analysis when measuring the extent of BGA exploitation by a business group affiliate; that is, by MWC on the BGA of the AYALA Group. The MWC as a business group affiliate has exploited the BGA of the AYALA group as early as the conception of the foreign expansion strategy all the way through the final decision making, partner negotiations, market entry and implementation. This is an affirmative result on the proposition by Bugador (2015) which states that the initial international expansion growth of business group affiliates from emerging economies is significantly influenced by their reliance on BGAs. In addition, the combination of the previous service experience of MWC, which is their distinctive ALA, and the international network of the AYALA group has accelerated their internationalization. This is consistent with the study of Coviello & Martin (1999). In sum, without the total support and initiative of the AYALA business group, MWC would not have utilized their core competence in their foreign expansion. The exploitation and leveraging of the BGAs were not only necessary but also an efficient routine in the overseas growth and success of a business group affiliate.

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