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HOW POLITICAL ENVIRONMENTS AFFECT THE GROWTH OF FIRMS: EVIDENCE FROM SMALL AND LARGE ENTERPRISES IN LATIN AMERICA

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ABSTRACT

This paper used data from firms operating in twenty Latin American countries to evaluate whether firms' perceptions about the nature and predictability of governments' regulatory policies, the prevalence of intervention in the domestic economy, and the degree to which corruption served as an obstacle to business activity influenced firms' growth. The paper also tested whether firms' size or multinationality influenced managers' perceptions concerning whether the political environment posed serious obstacles to their business strategies and performance.

Our empirical analysis showed that the presence of major regulatory obstacles, government market intervention, and extensive corruption were associated with lower sales growth among firms operating in a country. In addition, the predictability of a government's policy agenda appeared to be as important to firm performance as the specific regulatory policies that were in place at a given point in time.

Moreover, countries' political environments had a differential effect on small firms and larger firms. Both business regulations and extensive market intervention appeared to pose greater obstacles for larger firms than smaller ones. In contrast, small firms reported more substantial obstacles stemming from political corruption than their larger rivals. Finally, a country's political environment appeared to have a differential impact on foreign and domestic firms. Foreign firms perceived government policies as more predictable, and perceived fewer obstacles related to domestic political corruption than did domestic firms.

At 2001's Summit of the Americas, U.S. President George W. Bush proclaimed, "We have a great vision before us, a fully democratic hemisphere bound together by goodwill and free trade" (Bush, 2001). However, despite a decade of regular pronouncements of the emergence of democracy and economic reforms in all but one country in the western hemisphere, it is clear that the implementation of these political and economic reforms have met varying levels of success in the countries of Latin America.

"We also understand that democracy is a journey, not a destination," acknowledged Bush. "Each nation here, including the United States, must work to make freedom succeed. Elections are the foundation of democracy, but nations need to build on this foundation with other building blocks, such as a strong judiciary, freedom to speak and write as you wish, efficient banking and social services, quality schools, secure ownership of land, the ability to start and own a business. We must strengthen this architecture of democracy for the benefit of all our people" (Bush, 2001).

It is clear that the political environment present in the developing countries of Latin America sometimes erects obstacles to the expansion and success of business enterprises. These obstacles include extensive business regulation and government market intervention, unexpected shifts in government policies, differential levels of access of firms and individuals to policy makers, and varying levels of political corruption. This paper examines the effect of countries' political environments on the growth of firms operating domestically, and explores whether political environments have more detrimental effects on some firms than on others.

The paper uses data from firms operating in twenty Latin American countries to evaluate whether firms' perceptions about the nature and predictability of governments' regulatory

policies, the prevalence of intervention in the domestic economy, and the degree to which corruption serves as an obstacle to business activity influence firms' growth. The paper also tests whether firms' size influences managers' perceptions concerning whether the political environment poses serious obstacles to their business strategies and performance. Finally, the paper explores whether managers' perceptions of obstacles in the political environment vary based on whether the firm is headquartered in the country or abroad.

The next section outlines hypotheses based on the implications of governments' business regulations and levels of intervention in their domestic economy for firms' sales growth. The following section focuses on how government policy predictability and the degree of access businesses have to government policy makers affects sales growth. The next section discusses the implications of political corruption on firms' sales growth. Finally, the methodology is summarized, and regression and ANOVA results are presented.

Countries' Political Environments and Firm Sales Growth

Business Regulations and Intervention

It is well established that a country's political environment can influence the strategies and performance of firms operating within its borders (North, 1990; Lodge, 1990). While a comprehensive legal infrastructure is necessary to reduce uncertainty in business operations (Bergara, Henisz & Spiller, 1998) and facilitate the smooth functioning of a domestic economy, excessive business regulations and government market intervention can impose obstacles to firms' success. Extensive regulation and market intervention limit firms' strategic options and force them to adapt their activities to satisfy bureaucratic requirements. Business regulations also add to firms' costs not only due to the resources they must expend to satisfy regulatory requirements, but also because of bureaucratic hurdles they must overcome to demonstrate their

regulatory adherence to government officials. The magnitude of obstacle posed by these business regulations and acts of government intervention clearly varies across countries (Henisz, 2000) and industrial sectors (Brahm, 1995). Therefore, we concur with observations by Adam Smith, and more recently by Farr, Lord & Wolfenbarger (1998), Dawson (1998), and others, that market intervention diminishes economic performance and prosperity in both industrialized and developing countries, and suggest that firms that perceive extensive government regulation and market intervention will achieve lower performance than firms that encounter no such political environment.

More interestingly, we suggest that these regulatory requirements and interventions have a differential impact on firms throughout an economy. The same regulation or act of intervention will act as a more severe obstacle to some firms than others due to differences in its applicability to the firm's specific strategy, or because of differences in the likelihood of enforcement against a particular firm. In particular, smaller firms are less likely to participate in activities that are most often targets of extensive government regulation. For instance, smaller firms are less likely than their larger counterparts to engage in direct product imports or exports, deal in foreign currencies, or install large-scale manufacturing facilities (Miesenbock, 1988; Thurik, 1993). In addition, larger firms are more likely to be treated as public examples by government regulatory enforcers who lack the budgets to monitor every firm. Large firms' infractions may be easier to identify, and enforcement with larger firms is more likely to set an example for all firms throughout the country. With fewer occasions to interact directly with the government bureaucracy, small firms are less likely to report severe obstacles from government regulation.

Similarly, firms headquartered outside of the country are more likely to engage in the types of activities, such as importing, exporting, and currency conversion, that are most exposed to government intervention, and are likely to face greater scrutiny in the enforcement of a country's business regulations. In addition, regulations often grow from the lobbying efforts of host-country competitors who wish to place foreign firms at a disadvantage in the local market (Henisz, 2001). For these reasons, it is likely that business regulations and interventionist government policies will pose more substantial constraints on foreign firms than firms headquartered in the country.

Hypotheses 1-2: Overall impact of political environment on firms' sales growth

H1: Firms that report the presence of extensive business regulations will achieve slower sales growth than firms that perceive fewer business regulations.

H2: Firms that report frequent government market intervention will achieve slower sales growth than firms that perceive less intervention.

Hypotheses 3-4: Differential impact based on firms' characteristics

H3: Larger firms will report greater obstacles due to regulatory policies and more government intervention than small firms.

H4: Foreign firms will report greater obstacles due to regulatory policies and more government intervention than domestic firms.

Government Policy Predictability

Potentially more important than the presence of extensive business regulations or market intervention is the stability and predictability of such government policies over time. For example, in a study of the energy sector, Levy and Spiller (1994) found a wide range of government policies to be consistent with industrial success, as long as constraints were in place to ensure that those policies did not change arbitrarily over time. Such government policy

predictability allows private firms to base their investment decisions on economic considerations rather than speculation about the future political environment.

Given managers' preferences for avoiding uncertainty (Cyert & March, 1963), it is not surprising that instability in government policies concerning business regulations, tax policies, or market intervention would reduce firms' likelihood of developing long-term growth strategies (Pindyck & Solimano, 1993). In a study of the electricity sector, Bergara, Henisz & Spiller (1998) found that clear and credible political institutions were positively and significantly correlated with increased private investment in generation facilities. And of particular concern in this study of Latin American countries, Murtha (1993) found that government policy inconsistency may have a stronger negative effect on firms' strategic decisions in developing countries than in industrialized countries, perhaps due to greater overall confidence in industrialized countries' political systems and economic policies.

Government policy consistency varies from country to country (Murtha, 1991). Levy, Spiller, Mody & Sappington (1993) concluded that some governments are able to place restraints on policy makers to avoid arbitrary changes in policy while others are not. The predictability of government policies also likely varies from sector to sector. For instance, government policies may be relatively stable in traditional sectors of the economy, but volatile in newer industries or industries that have been targeted for growth by the national government.

We argue that firms are likely to vary in their assessments of the predictability of the domestic policy agenda based on their understanding of the country's political system and their level of interaction and influence with the government policy makers who control the regulatory agenda. Domestic firms may hold a greater understanding of the intricacies of their country's political system, making policy shifts more predictable. Domestic firms may also hold greater

access to government policy makers, which would give them an edge in predicting future policy shifts.

Given that government regulations can impose obstacles for firms' growth, firms can benefit from maintaining access to the policy makers that design and implement those policies. Firms with access to government officials can help shape public policies to favor their own company or industry. In addition, in countries in which government regulatory enforcement is uneven or inefficient, firms with greater political access may be able to effectively evade policy enforcement, or at least receive early notice that enforcement is likely to occur.

By and large, bigger firms are more likely to hold the political connections necessary to maintain access to government policy makers. In addition, because larger firms have a potentially greater impact on the country's economy, their managers are more likely to be consulted in the formulation of new government policies. Therefore, we suggest that small firms are likely to report that they hold less access to government policy makers than larger firms.

The relationship between a firm's nationality and access to government policy makers is a complex one. Many "developmental states" (Johnson, 1982) have the capability to discriminate either in favor of or against foreign firms in order to support their country's economic strategies (Lenway & Murtha, 1994). Domestic firms are a government's natural constituency, and some governments are widely seen to provide legislation that benefits domestic firms at the expense of foreign competitors. For example, Japan's MITI officially discriminated against foreign firms in the early postwar era in order to cultivate the country's economic development strategy (Lenway & Murtha, 1994).

At the same time, because foreign direct investment can serve as an important source of revenue for countries, some developmental states choose to offer preferential treatment or

incentives to foreign firms that help meet particular national goals by locating research and development facilities locally or procuring components from local suppliers (Lenway & Murtha, 1994; Murtha 1991, 1993). In many cases, these foreign firms come to interact with government officials in the natural course of making their investment decision, providing a conduit for firm access to policy makers.

Historically, Latin American countries have taken the former approach by protecting their markets and offering preferential treatment to domestic firms. For example, Guillen (2000) noted that many countries in Latin America, such as Venezuela, Brazil, and Argentina, have historically had a populist perspective towards outward flows of trade. These countries have focused on import substitution and local investment while often oscillating between a nationalist perspective that protecting local firms and a pragmatic policy allowing selective imports and inward foreign investment. Therefore, given the context of many Latin American countries, we suggest that domestic firms will report greater access to policy makers than foreign firms.

Hypotheses 5-6: Overall impact of political environment on firms' sales growth

H5: Firms reporting that government policies are more predictable will achieve higher sales growth than firms reporting less predictability in government policies.

H6: Firms reporting greater access to government policy makers will maintain faster sales growth than firms that lack such access.

Hypotheses 7-9: Differential impact based on firms' characteristics

H7: Domestic firms will report a greater predictability of government policies than foreign firms.

H8: Larger firms will report greater access to policy makers than smaller firms.

H9: Domestic firms will report greater access to policy makers than foreign firms.

Political Corruption

Economists have long argued that political corruption can diminish economic growth and discourage private investment in developing countries (Mauro, 1995; Shleifer & Vishny, 1993; Gupta, Davoodi & Alonso-Terne, 1998; Macleans & Mangum, 2000). For example, Wei (2000) and Wei & Shleifer (2000) found a significant negative relationship between the level of corruption in a country and foreign direct investment. Habib & Zurawicki (2002) extended this finding, showing that corrupt countries had a particularly difficult time attracting investment from firms whose home countries displayed very low levels of corruption, suggesting that some firms' investments decisions in part reflect an attempt to avoid engaging in corrupt business activities. In general, corruption can increase the cost of doing business in a country. And when that corruption allows inefficient producers to thrive and win business, it will crowd out productive investment, and reduce the quality of products—particularly those sold to the public sector (Macleans & Mangum, 2000).¹

In 1996, twenty-one members of the Organization of American States (OAS) signed the Inter-American Corruption Convention "to hold corrupt persons accountable in order to combat corruption" (Zagaris, 1999). Even so, corruption remains a considerable problem across many Latin American countries. For instance Haiti, Bolivia, and Ecuador ranked among the lowest in the world on Transparency International's Corruption Perceptions Index.²

Corruption likely deters foreign direct investment not only because it poses a moral dilemma for managers, but also because it effectively acts as a tax on private firms, adding costs to their operating budgets. The expectation of bribery of government officials, and even the

¹ Even so, some economists have articulated conditions under which bribery, in particular, can lead to relatively efficient outcomes. See Bardhan (1997) for a review.

² Paraguay ranked 98 out of 102 countries considered, while Haiti, Bolivia and Ecuador tied for 89 of 102 countries (Transparency International, 2002b).

prevalence of informal “grease payments” has a direct financial impact on the firm’s cost structure, and can also cost the firm more indirectly by increasing market uncertainty and causing holdups of business operations. For these reasons, we would expect that firms that report obstacles stemming from the prevalence of corruption will achieve lower sales growth than firms that do not report such obstacles.

Levels of corruption clearly vary from country to country. For instance, Ades (1999) found that corruption tends to be higher in countries in which domestic firms are sheltered from foreign competition and in economies that are dominated by a few firms. Transparency International ranked the Latin American countries in this paper’s sample from a low score of 2.2 out of 10 (Haiti, Bolivia and Ecuador) to a high score of 7.5 out of 10 (Chile³) in terms of their worldwide corruption perception index. Corruption levels may also vary from one industry to another based on the particular activities and requirements of firms operating in a given industrial sector. For instance, Transparency International reported that construction and arms industries lead other sectors in the propensity to offer bribes to government officials (Transparency International, 2002a). Therefore, managers operating in the same country may hold different perceptions of the prevalence of local corruption.

We argue here that political corruption also has a differential impact on firms operating within a country. Specifically, large firms are likely to hold advantages over smaller firms when corruption runs rampant in a country. As we argued above, large firms are more likely to have access to public policy makers, and this access can facilitate special treatment. In addition, larger firms are more likely to have the financial resources to engage in bribery when their smaller competitors cannot, and are likely to have the capability to out-bribe their smaller rivals when bidding on a contract or attempting to influence a ministry’s regulatory agenda.

³ Chile was ranked 17 out 102 countries in the overall corruption perception index.

Therefore, while corruption is likely to diminish the sales growth of all firms operating in an economy, we argue that its impact on small firms is likely to be larger than its impact on larger firms.

In addition, foreign firms may hold advantages in avoiding corruption that are unavailable to firms operating in their home environment. Foreign firms are likely to be larger than domestic firms, which will give them the resources to engage in bribery and other forms of corruption. In addition, foreign firms may have a greater capacity to credibly resist pressures to offer bribes or otherwise engage in corruption.

The United States' Foreign Corrupt Practices Act imposes penalties at home for executives caught offering bribes to obtain business overseas. And other countries and international institutions are beginning to discourage corrupt practices in multinational enterprises, as well. For instance in 1996, The Organization for the Economic Cooperation and Development (OECD) members agreed to rewrite tax laws to avoid encouraging bribery overseas, and the International Chamber of Commerce has called for transparency in multinational enterprises' activities abroad. Corporate bribery is on the agenda at the negotiations of the World Trade Organization, and other international organizations such as Transparency International have sought to impose discipline on corrupt multinationals (Maclean & Mangum, 2000).

These home country and international institutions may facilitate firms' efforts to avoid engaging in corrupt practices when operating in Latin America. Foreign firms may be less likely to be approached by local officials soliciting bribes, may be better able to resist the pressure to offer a bribe, and are likely to have the slack resources to ultimately pay a bribe when necessary. Anecdotal evidence suggests that worldwide reputation effects have deterred some multinational

firms from engaging in bribery, even within very corrupt environments. Habib & Zurawicki (2002) suggested that McDonalds' worldwide image helped them take a stand against corruption in Russia, and Gratchev (2001) reported a similar effect among 3M employees operating overseas. Therefore, we propose that a corrupt political environment is likely to impose greater obstacles on domestic firms than their foreign competitors.

Hypothesis 10: Impact of corruption on firms' sales growth

H10: Firms reporting that that corruption poses an obstacle to their firm will achieve lower sales growth than firms that report fewer obstacles stemming from corruption.

Hypotheses 11-12: Differential impact based on firms' characteristics

H11: Smaller firms will report greater challenges stemming from political corruption than larger firms.

H12: Domestic firms will report greater challenges stemming from political corruption than foreign firms.

Methodology

Each hypothesis was tested using survey data of approximately 2,000 respondents across twenty Latin American countries: Argentina, Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Panama, Peru, Trinidad & Tobago, Uruguay, and Venezuela. Data to test the hypotheses came from the World Bank's World Business Environment Survey (World Bank, 2000).⁴

Individual variables were aggregated into factors to test the hypotheses. Obstacles posed by *regulatory constraints* reflected 7 items in which respondents reported whether regulatory issues such as business regulations, customs regulations, environmental regulations, foreign

⁴ A copy of the World Bank's report on survey results, "Voices of the Firms," is available at <http://info.worldbank.org/governance/wbes/index1.html>.

exchange restrictions, high taxes, labor regulations, fire regulations, or tax administration regulations, posed obstacles to their business operations ($\alpha=.77$).

The extent of **government intervention** in the economy consisted of 7 items in which respondents reported the government's level of intervention in wage rates, corporate dividends, employment decisions, investment decisions, mergers and acquisitions, product pricing, and sales activities ($\alpha=.86$).

The **predictability** of government policies consisted of three items reflecting changes in laws, economic predictability, and the predictability of government regulations ($\alpha=.80$). This variable was coded 1=completely predictable to 7=completely unpredictable so that a high number indicates *unpredictability* of government policies.

Access to policy makers was measured via five items. Respondents reported the extent to which their firm holds influence over various branches of the national government (executive and legislative branches, government ministries and regulatory agencies), and the extent to which the government takes the enterprise's perspective into account in decision making ($\alpha=.68$).

The severity of obstacles stemming from **corruption** was measured by a survey item in which respondents reported the extent to which corruption posed an obstacle to their business operations. The paper also includes **control variables** using world-bank categories that reflect three size categories (small, medium, and large firms) and three categories reflecting the age of the firm (new, moderately aged, old).

The dependent variable in the regression analysis consisted of respondents' reports of the percentage **change in sales revenue** (positive or negative) in the previous year. All variables were standardized and centered at zero for the analysis. Table 1 reports means, standard deviations, and correlations among variables.

Table 1: Means, Standard Deviations, and Correlations

	Mean	Std. Dev.	1	2	3	4	5	6	7	8	9	10
Small firms	0.00	1.00	1.00									
Large firms	0.00	1.00	-0.41	1.00								
New firms	0.00	1.00	0.17	-0.10	1.00							
Old firms	0.00	1.00	-0.22	0.16	-0.46	1.00						
Reg. obstacles	0.00	1.00	-0.09	-0.03	-0.05	0.06	1.00					
Intervention	0.00	1.00	-0.11	0.01	-0.06	0.08	0.28	1.00				
Unpredictability	0.00	1.00	0.03	-0.06	0.04	-0.03	0.17	0.12	1.00			
Access	0.00	1.00	-0.05	0.12	0.03	0.01	0.03	0.11	0.01	1.00		
Corruption	0.00	1.00	0.04	-0.04	0.04	-0.05	0.27	0.12	0.14	0.06	1.00	
Change in sales	0.00	1.00	-0.09	0.08	0.11	-0.11	-0.08	-0.07	-0.07	0.00	-0.07	1.00

N=2085; Correlations above .04 are significant at $p < .05$.

Results

To test hypotheses 1, 2, 5, 6, and 10, we regressed the reported change in sales revenue over the past year on the various independent variables. Firms' size and age (new, moderately aged, old) were included as control variables. Specifically, we included two of the three dummy coded variables for firm size (small and large) and two of the three age variables (new and old). Table 2 reports regression results. As one might expect, new firms tended to experience faster percentage sales growth than older firms, and smaller firms tended to experience slower sales growth than larger firms.

Table 2: Regression Results

	Change in Sales
Small firms	-.12 (.02)***
Large firms	.06 (.02)**
New firms	.08(.03)***
Old firms	-.11(.03)***
Regulatory obstacles	-.05(.02)*
Market intervention	-.05(.02)*
Unpredictability of policies	-.04(.02)*
Access to policy makers	.00(.02)
Corruption as obstacle	-.05(.02)*
F	11.98***
Adj. R-Square	.05

Beta (Std Error)

***p<.001; ** p<.01; * p<.05

H1 that predicted a negative relationship between sales growth and regulatory obstacles was supported. As can be seen in Table 2. The presence of regulatory obstacles was a significant negative predictor of changes in sales revenue, lending support to H1 ($p<.05$). Similarly, the level of reported government intervention in the economy negatively predicted change in sales revenue, offering support for H2 ($p<.05$). Unpredictability of government policies was negatively associated with the change in sales revenue, providing support for H5 ($p<.05$). Contrary to expectations in H6, the level of access a firm had to policy makers did not predict sales growth. Finally, firms that reported that corruption posed an obstacle to their business activities experienced lower sales growth ($p<.05$), lending support to H10.

Table 3 provides results from ANOVAs designed to test for significant differences between small and larger firms in respondents' perceptions of the obstacles posed by regulatory policies and government intervention, the predictability of government policies, managers' access to policy makers, and the degree to which corruption acts as an obstacle to business operations. ANOVA results contrast responses from small firms with responses from medium

and large firms. Table 4 provides similar results assessing differences in the responses of firms headquartered domestically and abroad.

Table 3: Analysis of Variance: Small Versus Large Firms

	Group	Means^a	F-Value
Regulatory Obstacles	Larger Firms	0.06	15.25***
	Small Firms	-0.13	
Market Intervention	Larger Firms	0.07	23.88***
	Small Firms	-0.16	
Policies are Unpredictable	Larger Firms	-0.02	2.31
	Small Firms	0.05	
Access to Policy Makers	Larger Firms	0.03	5.09*
	Small Firms	-0.07	
Corruption is an Obstacle	Larger Firms	-0.03	3.91*
	Small Firms	0.07	

^ameans were standardized and centered.

***p<.001; ** p<.01; * p<.05

Table 4: Analysis of Variance: Foreign Versus Domestic Firms

	Group	Means^a	F-Value
Regulatory Obstacles	Domestic Firms	0.02	3.24(+)
	Foreign Firms	-0.07	
Market Intervention	Domestic Firms	-0.01	0.05
	Foreign Firms	0.01	
Policies are Unpredictable	Domestic Firms	0.04	7.84**
	Foreign Firms	-0.11	
Access to Policy Makers	Domestic Firms	-0.03	7.65**
	Foreign Firms	0.11	
Corruption is an Obstacle	Domestic Firms	0.03	4.34*
	Foreign Firms	-0.08	

^ameans were standardized and centered.

*.p<.05; **. p<.01; ***. p<.001

As can be seen in Table 3, H3 is supported since large firms perceive obstacles stemming from regulatory policies and government intervention to be more salient. From Table 4, we can see that H4 is not supported. That is, there is no difference between foreign and domestic firms

in how they view regulatory policies and government intervention. Contrary to expectations in H7, foreign firms reported greater predictability in government policies than did domestic firms. As shown in Table 3, H8 was supported in that larger firms hold greater access to policy makers than small firms ($p < .05$). Contrary to our expectations in H9, foreign firms report greater access to policy makers than domestic firms. To better understand these results we looked at the differences in means for small versus larger domestic and foreign firms. The means are shown in Table 5 and suggest that this result is driven primarily by the lack of access enjoyed by small, domestic firms. Among domestic firms, larger firms held significantly greater access to government policy makers than their smaller counterparts ($p < .05$). However, foreign firms displayed no significant differences between small and larger firms' access to government policy makers. Among larger firms, no significant differences arose between the access enjoyed by domestic versus foreign firms. However, among smaller firms, foreign firms enjoyed greater access than domestic firms ($p < .05$).

Table 5: Access to Government Policy Makers

	Foreign Firms	Domestic Firms	
Small Firms	.16	-.11	Foreign>Domestic*
Larger Firms	.10	.01	No difference
	No difference	Larger>Small*	

Finally, hypotheses 11 and 12 were supported. Specifically, as predicted by H11, corruption appears to stand as a larger obstacle to smaller firms than to larger firms ($p < .05$). In relation to H12, corruption appears to be larger problem for domestic firms than for foreign firms ($p < .05$).

Table 7 offers a summary of the results from each hypothesis test.

Table 7: Summary of Hypotheses

H1	Firms that report the presence of extensive business regulations will achieve slower sales growth than firms that perceive fewer business regulations.	Support
H2	Firms that report frequent government market intervention will achieve slower sales growth than firms that perceive less intervention.	Support
H3	Larger firms will report greater obstacles due to regulatory policies and more government intervention than small firms.	Support
H4	Foreign firms will report greater obstacles due to regulatory policies and more government intervention than domestic firms.	No support
H5	Firms reporting that government policies are more predictable will achieve higher sales growth than firms reporting less predictability in government policies.	Support
H6	Firms reporting greater access to government policy makers will maintain faster sales growth than firms that lack such access.	No support
H7	Domestic firms will report a greater predictability of government policies than foreign firms.	No support
H8	Larger firms will report greater access to policy makers than smaller firms.	Support
H9	Domestic firms will report greater access to policy makers than foreign firms.	No support
H10	Firms reporting that that corruption poses an obstacle to their firm will achieve lower sales growth than firms that report fewer obstacles stemming from corruption.	Support
H11	Smaller firms will report greater challenges stemming from political corruption than larger firms.	Support
H12	Domestic firms will report greater challenges stemming from political corruption than foreign firms.	Support

Discussion

Three particularly interesting findings arose from the empirical analysis. First, firms' the degree of business regulation, market intervention, predictability of government policies and level of corruption have significant effects on the level of sales growth achieved by firms. Second, this political environment has a differential effect on small firms and larger firms.

Finally, a country's political environment appeared to have a differential impact on foreign and domestic firms.

The relationship between the regulatory environment and firms' sales growth has important implications for Latin American policy makers. In this study, the presence of major regulatory obstacles, government market intervention, and extensive corruption were associated with lower sales growth among firms operating in the country. Latin American countries vary considerably in their levels of economic freedom. At one extreme, Chile was ranked 9th in economic freedom the world by the Heritage Foundation and the Wall Street Journal in 2002. At the other extreme, Haiti ranked 136th of 155 countries in this measure of overall government intervention, regulation, and trade policy. Researchers have shown a relationship between the level of economic freedom and overall prosperity across countries (Farr, Lord & Wolfenbarger, 1998). This study extends that finding to show that government regulation and intervention have direct impacts on the sales growth of individual firms. Therefore, government officials need to realize that their regulations and acts of intervention have a negative effect on firms' sales growth, potentially resulting in fewer businesses locating in their country.

The findings in this study also suggest that the predictability of a government's policy agenda is as important as the specific policies that are in place at a given point in time. A relatively unstable institutional environment increases the uncertainty inherent in any long-term investment decision. Shifts in government policy may also place a multinational firm's worldwide strategy at risk by disrupting the production of one component or reducing the market for imported products. Political shifts may also mandate actions on the part of firms that cause them to renege on commitments to their own suppliers, partners, or customers (Murtha, 1991). For these reasons, instability or unpredictability of government policies over time may diminish

managers' interest in developing long-term growth strategies in the country (Tan, 1996).

Guillén (2000) noted that historically many Latin American countries have oscillated between contradictory policies. This tradition continues to this day. Given recent dramatic events in Latin America, affecting countries from Argentina to Venezuela, policy stability becomes all the more important. Policy makers should make every effort to maintain continuity in their policies toward business, despite changing economic and political circumstances.

Although the political environment, and the predictability of that environment is critical to all firms in a country, different types of companies experience the environment differently. Large and small companies appear to differ in their perceptions of the political environment. Both business regulations and extensive market intervention appeared to pose greater obstacles for larger firms than smaller ones. As mentioned earlier, such a difference was expected due to the types of activities that larger firms are involved in as well as the fact that larger companies are more likely to be treated as public examples. Still, small enterprises need to be made aware of how their reality may change as they grow in size. In contrast, small firms reported more substantial obstacles stemming from political corruption than their larger rivals. Smaller firms may have fewer resources with which to deal with corruption issues such as bribery. In addition, smaller firms also reported that they enjoyed less access to government policy makers than their larger competitors.

Policy makers have identified entrepreneurship as a critical source of jobs and economic growth in Latin America in the coming decades. Indeed, small and medium-sized enterprises employ more than half of the working populations in many Latin American countries (Gomez & Spencer, 2002), and several countries have established policies specifically targeting the development of the entrepreneurial sector (Gomez & Spencer, 2002). Policy makers targeting

the entrepreneurial sector should recognize that while strategies to decrease regulation and government intervention will likely contribute to economic development as a whole, they will do less to promote the advancement of small businesses. Instead, policies to reduce domestic political corruption and to take small enterprise's specific needs into account in policy development are likely to have a greater impact. In addition to eliminating obstacles related to corruption, governments focused on increasing entrepreneurship must focus on reducing other liabilities of smallness by enacting policies that cut street crime, organized crime, and other forms of small-scale disruptive activity that make it more difficult for smaller firms to compete against their larger rivals (Schiffer & Weder, 2002).

The differential impact of the political environment on foreign and domestic firms has important implications for both multinational and local enterprises. Foreign firms appear to perceive government policies as more predictable and perceive fewer obstacles related to domestic political corruption than do domestic firms. Future research should explore this result directly by assessing whether foreign firms gain this advantage due to the fact that they maintain greater access to local politicians and hold slack resources that can be used to pay any bribes that may be required, or because they are able to avoid corruption more effectively than domestic firms. In either case, policy makers should be aware of the fact that policy unpredictability and corruption in their domestic political environment appear to pose greater obstacles to the growth of their own domestic firms than to foreign rivals, and may actually provide an advantage to foreign entrants.

The coming decades are likely to be a period of substantial change in the countries of Latin America. This research emphasizes the importance of a political environment that maintains consistent policies, low levels of corruption, and little market intervention. All

firms—small and large, domestic and foreign-- will benefit from such an environment. But policy makers can also develop specific policies to help particular types of companies overcome the problems that are inherent to their situation. We hope that the empirical results presented here will facilitate the efforts of governments and international organizations attempting to reform and foster growth in these economies.

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