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Business groups and competition in post-Soviet transition economies: The case of Russian "agroholdings"

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Abstract The paper questions from an Austrian perspective the hypotheses that enjoy widespread support in mainstream economics that business groups are a symptom of imperfect competition and a threat to competition with negative impacts on social welfare. For this, an Austrian theoretical framework is developed and then applied to analyze the interaction of competition and business groups regarding the case of "agroholdings" in Russia. It is maintained that the orthodox literature does not adequately account for the characteristic features of competition in the real world, and therefore may lead to wrong normative conclusions on the relation between business groups and competition. It is argued that also in transition economies for competition to function as an entrepreneurial discovery process, no perfect markets are needed but only freedom to entry and property rights security. Then there is no pattern of action, which in and of itself is inconsistent with competition. Therefore, unless there is evidence for government support, business groups must principally be seen as the result of competitive entrepreneurial discoveries. It is further argued that the only real danger of business groups for competition does not come from their ability to raise non-legal barriers to entry, but from government protection. This may either result from successful lobbying of business groups or from the preference of government officials for this particular form of business organization. Case studies evidence from business groups in Russia's agro-food sector illustrates these arguments.

Keywords Business groups · Competition · Transition economies · Russia

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1 Introduction

A microeconomic response to the significant institutional change brought about by the collapse of the centrally planned economic system in Central and Eastern Europe and the newly independent States of the former Soviet Union was the creation of business groups, in particular in Russia, Kazakhstan, and the Ukraine (see e.g. Aslund 2007a: 258; Guriev and Rachinsky 2005: 132ff.). Business groups in this paper are understood as a collection of legally independent firms, who may operate in horizontally and/or vertically related stages of the value-added chain and/or in totally unrelated industries, and which are bound together by formal (e.g., equity) and/or informal (e.g., family) ties. This definition excludes a set of firms bound merely by short-term strategic alliances as well as a set of firms legally consolidated into a single entity. It includes explicitly holding company groups, where an apex firm controls via equity ownership other firms, because the constituent firms maintain their legal independence.[1]

In mainstream economics, the emergence and persistence of business groups in emerging economies usually raises concern with regard to competition. They are seen as a symptom of imperfect competition and market failure (e.g., Khanna 2000: 752; Khanna and Palepu 1999: 275) as well as a source of market power and thus a threat to competition and the welfare optimum of a society (Ghatak and Kali 2000: 28; Khanna and Yafeh 2007: 361f). The theoretical reasons for relating business groups to imperfect competition, market power, and negative welfare effects are based on insights of neoclassical welfare economics with its benchmark model of perfect competition. Austrian economists have been pioneering and trenchant to emphasize that the purposes and the advantages of competition do not lie in it being "perfect", but being an entrepreneurial driven dynamic market process with the function of a discovery procedure. This view on the nature and purpose of competition must lead to a different assessment of the interplay between business groups and competition. So far there have been no attempts to appraise the relation between business groups and competition from an "Austrian" perspective in general and for transition economies in particular. In fact, while there are Austrian contributions to the topic of firm size and scope, Jeon and Kim (2004) is, as so far known, the only "Austrian" analysis that explicitly deals with business groups (see also Section 3.6).

The aim of the paper is to apply the insights of the Austrian School of Economics on the nature and purpose of competition to assess the interplay of business groups and competition in post-Soviet transition economies. It questions the above-mentioned hypotheses that enjoy widespread support in mainstream economics that (1) business groups are the result of imperfect competition and (2) that they may reinforce imperfect competition because of considerable market power they are likely to wield. Rather than to provide exhaustive explanations of *why* business groups emerge, the focus of the paper is to develop and apply an Austrian theoretical

[1] Since "business groups come in a wide variety of types" (Granovetter 1995: 108), there is no universal definition. Granovetter (1995) therefore considers holding companies as a marginal case of a business group because their might be cases where the constituent firms have become de facto nothing more than units of the parent company, so that the character of a federation is lost.

framework to determine (1) *if* their emergence in transition economies is consistent with the Austrian view of competition as an entrepreneurial discovery process and (2) *under which conditions* business groups can become a danger to competition in the "Austrian" understanding.

Transition economies are an interesting case because the institutional change from a centrally planned to a market economy triggered by the unanticipated collapse of the communist system turned out to be a long-winded process due to political resistance and conflicts of formal institutions with slow-changing informal institutions. This is in particular said to be true for the newly independent states of the former Soviet Union (Aslund 2007a: 305; Havrylyshyn 2006: 47ff.). Therefore, it could even be assumed that competition might work "imperfectly" not only in the neoclassical sense but also in its function as a discovery procedure. This raises the following questions that shall be discussed in the paper: (1) What are the crucial requirements to unleash and maintain competition as a discovery procedure in transition economies? (2) To what degree can against this background business groups in transition economies be regarded as the result of competition in the Austrian understanding? (3) What impact can be expected from business groups on competition as transition progresses? Will they foster or impede competition as an entrepreneurial discovery procedure? (4) What are the policy implications?

The theoretical framework developed in the following to answer these questions will then be applied in a tentative empirical effort to analyze the interplay between business groups and competition regarding the case study of Russia's agricultural sector. Russia is the largest transition economy and time and again linked to failed or delayed transition because of a long-lasting output decline and crises like the default of August 1998 (e.g., Stiglitz 2000). It is also associated with oligarchic capitalism where a few businessmen control large parts of the economy, often via holding company business groups, who are alleged to capture the state (e.g., Havrylyshyn 2006: 177ff). According to Avdasheva (2007a: 98ff), by 2004 holding company business groups produced approximately 40% of Russia's total industrial output and employed 64% of industry's total work force. Business groups emerged even in the country's agricultural sector, in Soviet time a constant black hole and during the first 10 years of transition suffering from output decline and soaring farm debts (see also Section 4.1). In the Russian literature, these business groups are commonly called "agroholdings" (e.g., Rylko and Jolly 2005: 116). Since in agriculture of advanced market economies such vertically integrated business groups are in general unknown, their emergence in Russia was quickly linked to imperfect competition and market failure, too (e.g., Khramova 2003: 10; Koester 2005: 111ff.).

The paper's contribution to the literature is thus twofold: First, it enhances the understanding of business groups by focusing on an aspect that according to Khanna and Yafeh (2007: 361) is yet not well examined—the interplay of business groups and competition. Second, it provides insights to the microeconomic responses in post-Soviet transition economies both by applying an alternative, largely ignored theoretical perspective and by presenting a case study of an important sector of the largest post-soviet transition economy.

The remainder of the article is organized as follows: Section 2 summarizes the mainstream view on the emergence of business groups and their interplay with competition and to what degree it is reflected in public policy. Next, Section 3 develops an Austrian theoretical framework for assessing the relation between business groups and competition in transition countries. It explains the "Austrian" understanding of the nature and purpose of competition and works out the crucial prerequisites to unleash and maintain it in transition economies, the threat business groups can pose to competition and the consequences for the "Austrian" empirical analysis of business groups and their relation to competition. Section 4 applies this theoretical framework to assess the interplay of business groups in Russia's agro-food sector and competition. The paper ends with concluding remarks on the policy implications (Section 5).

2 The mainstream view on business groups and competition: A short review

In the literature, broadly three streams of explanations of the emergence of business groups can be found (Khanna and Palepu 2000a: 268f; Yiu et al. 2007: 1554): sociology, political economy, and market imperfections. The sociological perspective of business groups (e.g., Granovetter 1994; Keister 1998) views them as the result of preferences of the economic agents shaped by the culture and social norms of a society for a certain form of business organization (Guillén 2000: 363; Yiu et al. 2007: 1556). It is suggested that a social order characterized by vertical relationships and based on a patrimonial concept of authority particularly favors groupings of firms under the guidance of a single entrepreneur (Guillén 2000: 364).[2] The problem with that view is that the scope of contextual factors is quite broad rendering it difficult to make concrete prediction of the phenomenon (Yiu et al. 2007: 1556; Hamilton and Biggart 1988: S 53).

The political economy stream explains the emergence of business groups as a device of rent-seeking of economic agents and/or as a tool of the state to achieve political and economic policy objectives. A widespread objective in particular in emerging markets is to advance industrial development usually through mercantilist policies (Khanna and Yafeh 2007: 352; Yiu et al. 2007: 1557). In this case, the state either invests directly in the establishment of business groups in industries that are regarded as strategic to a nation's economy or provides credits, subsidies, or business licenses. The limit of the political economy perspective is that it is unable to explain why business groups are prevalent in countries where government interventions in business activities are minimal (Yiu et al. 2007: 1555).

The most widespread explanation of business group formation views them as "second-best responses" (Ghatak and Kali 2000: 28) or "substitutes" (Khanna 2000: 752; Khanna and Palepu 1999: 275) for market imperfections or market failure for the benefit of group members. With the terms *market* imperfections or *market* failures are actually meant two things: (1) Missing or only rudimentary developed markets, in particular capital markets (e.g. Guillén 2000: 363), but also product markets (Khanna and Palepu 2000a: 269) or the market for entrepreneurial talent (Leff 1976, 1978). (2) Missing or poorly functioning market-supporting *institutions*

[2] For example, studies on Korean business groups sometimes emphasize the importance of the family in the Korean society and resulting from this the preference to do business with family members (e.g., Orru' et al 1991: 387f).

such as court enforcement of contracts, accounting and disclosure rules, or intermediaries like investment bankers that help to reduce transaction costs and information asymmetry (Ghatak and Kali 2000: 23; Ghemawat and Khanna 1998: 38; Khanna and Palepu 2000b: 868). The importance of the institutional environment for the organizational choice of economic agents cannot be denied. Nevertheless, from an Austrian perspective, as will be explained in more detail in Section 3, setting *market* imperfections or *market* failure equal to ill-functioning or missing formal institutions is problematic because it implies that if the formal institutional environment of the market system worked properly, we would have perfect markets in the neoclassical sense and no business groups, but only a large number of powerless independent firms. If this were so, it would be difficult to explain why we observe business groups not only in emerging and transition economies but also in most advanced market economies (see also Granovetter 1995: 106).[3] Thus, while each of the three streams makes important contributions to understanding, neither alone is able to provide fully convincing explanations of the raison d'être of business groups.

Similar difficulties exist in explaining the *direction* of integration within business groups. This is in particular true for conglomerate and vertical rather than horizontal integration. The latter is usually seen as a practice to realize economies of scale and gain market power. Diversification and vertical integration is often related to market imperfections resulting from institutional voids (Khanna and Yafeh 2007: 336, 341). Under such circumstances, diversification of investment across industries and intragroup trade may lower risk and transaction costs. Yet, as Khanna and Yafeh (2007: 341) show, empirical evidence does not unambiguously support this theoretical explanation.[4] The costs of transacting as the crucial determinant for vertical integration are also emphasized by the transaction cost approach developed and expanded by Williamson (1975, 1985, 1996), Klein et al. (1978), and Grossman and Hart (1986). However, in contrast to the abovementioned market imperfection perspective, the focus of this transaction approach is not primarily on the formal rule of the games but on particular characteristics of transactions that make classical spot markets a more costly mode of exchange than alternative hierarchical institutional arrangements like vertical integration. These characteristics are the amount of uncertainty about the future and about trading partners' actions, the complexity of the trading arrangement, the frequency with which the transaction occurs, and the degree to which relationship-specific assets are involved. "Asset specificity" is held to be particularly important because more than the other characteristics it creates the potential for what is called the "hold-up" problem. Asset specificity means that assets have a value in alternative uses that is less than the value in the use originally intended to support a specific trading relationship. This creates a potential hold-up

[3] For broad discussions of the phenomenon of business groups in different countries, see e.g. Leff (1976, 1978), Granovetter (1994), Ghemawat and Khanna (1998), Khanna (2000), Morck et al. (2005), Morck (2007), and Khanna and Yafeh (2007). Many references to country-specific studies of business groups can be found in these papers.

[4] Diversified and vertically integrated business groups are ubiquitous (and often fairly successful) in many countries with quite market friendly institutional frameworks. Such an example is Chile where the extent of vertical integration was found to be higher than in countries with poorer formal institutions like Indonesia (Khanna and Yafeh 2007: 341).

situation if the parties can bargain over the appropriate quasi rents (the difference in asset values between the intended and next best use) created by specific investments. This hold-up problem can be mitigated by moving transactions inside the firm. Further popular explanations of vertical integration are technological reasons (exploitation of economies of scale and scope, technological interrelationships)[5] (Chandler 1977; Stigler 1951[6]), uncertainty in the supply of upstream goods or marketing of downstream goods due to information asymmetries (Arrow 1975; Barzel 1982; Holmström 1982; Hart 1983; Grossman and Hart 1986), tax reasons (Stigler 1951),[7] the avoidance of factor distortions in monopolized markets (Warren-Boulton 1974), and efforts to gain market power through creating entry barriers (Perry 1989; Hart and Tirole 1990; Ordover et al. 1990).

The question why transactions are carried out in a group of legally independent firms rather than within a single, consolidated firm is scarcely explicitly addressed in the existing literature on business groups. If business groups are seen, as Encaoua and Jacquemin (1982: 32) do, as "approximations of the American multidivisional form" (M-form), then the insights developed by Chandler (1977) and Williamson (1985) on the advantage of this firm structure relative to the unitary firm structure can be applied to assess business groups, too. More decentralized organizational forms like the M-form structure are expected to economize on the bounded rationality of the management and safeguard the internal resource allocation process against the hazards of opportunism through the assignment of operational decisions to a lower level in the organizational hierarchy while retaining strategic decision-making and monitoring divisional performance in a central office at the upper level of the hierarchy. Goto (1982) is the only known study that applied this view to analyze business groups. He (1982: 61f) argues that "by forming or joining a group, it [the firm] can economize on the transaction costs that it would have incurred if the transaction had been done through the market, and at the same time, it can avoid the scale diseconomies or control loss which would have occurred if it had expanded internally and performed that transaction within the firm".

Market power is not only a major motive for horizontal, vertical, and conglomerate integration in mainstream neoclassical economics; it is at the same time the major concern associated with business groups. These concerns are based on insights of neoclassical industrial organization theory on the competitive effects of horizontal, vertical, and diversified integration (see also Encaoua and Jacquemin 1982: 25). Unless for economies of scale, horizontal integration is considered anticompetitive because it provides the potential to restrict output and raise consumer prices above the firms' marginal costs, which is regarded as harmful for optimal allocation. Except for technological interdependencies and economies of

[5] A typical example is the integration of iron and steel making which is said to be motivated by energy savings from not having to reheat steel in the production of steel sheet (Williamson 1985: 86f).

[6] Stigler (1951) advances a dynamic theory of vertical integration and argues that vertical integration increases when an industry is young because the demand for specialized inputs would be too small to support independent firms supplying intermediate goods. As the industry grows, vertical integration declines because intermediate good suppliers whose production is characterized by increasing returns would be spun off as independent firms supplying inputs to multiple competing downstream suppliers and when the industry contracts vertical integration should increase.

[7] For example, to circumvent sales taxes by replacing taxable market transactions with internal transactions.

scale and scope, vertical (and also conglomerate) integration is suspected to foreclose markets and thus raise barriers to entry (e.g., Bain 1956; Carlton and Perloff 1994: 535f). In the 1970s, this foreclosure theory has been criticized by economists, especially from the Chicago School. They pointed to efficiency and consumer welfare gains from vertical integration, e.g., through the elimination of successive monopoly markups, the internalization of service and quality externalities, and the improvement of product quality (Bork 1978; Posner 1976). Williamson's trade-off model (Williamson 1968) underlines the efficiency enhancing effects of vertical (and conglomerate) integration emphasizing the reduction of transaction costs. However, at the same time, he does not exclude that it can also increase market power, so that in every single case the relative importance of the various effects needs to be assessed. This positive view of vertical (and conglomerate) integration was challenged again at the beginning of the 1990s by economists like Ordover et al. (1990), Hart and Tirole (1990), or Bolton and Whinston (1991). They developed theoretical models showing how vertical integration changes the nature of competition in upstream and downstream markets and identified conditions under which integration leads to market foreclosure and negative welfare effects. Referring to these insights, Bhuyan (2005: 264f) concluded with regard to vertical integration in the US agro-food sector that "there is evidence that vertical ownership integration not only enhances oligopolistic coordination but is often a prerequisite to the successful exercise of market power under oligopoly". Likewise, it is assumed that business groups may drive their rivals out of markets and prevent entry due to their "deep pockets" and "first mover advantage". Moreover, "'multimarket contact' (Bernheim and Whinston 1990) between diversified business groups competing with each other repeatedly in many sectors may facilitate collusion. And business groups may bundle together different group products in order to extract more rents from distributors and ultimate buyers" (Khanna and Yafeh 2007: 361).

In practical competition policy, the view that business groups harm competition has especially found strong support in the USA, besides the UK actually the only developed economy, where business groups are for the most part missing (La Porta et al. 1999; Morck 2005: 143; Morck et al. 2005: 659f). This was, however, not always the case. Since the end of the Civil War until the mid-1930s, integrated business groups, which were controlled by a few wealthy family-entrepreneurs, were widespread in the USA, too (see e.g. Aslund 2007a: 260; Roe 1994; Steele Gordon 2004: 241ff.). As Morck (2005) shows, changes in tax policy under President Roosevelt—the introduction of a tax on intercorporate dividends—supported by other legal acts like the Public Utilities Holding Company Act of 1935 made business groups in the USA disappear. In the UK, business groups were also eliminated by government regulation.[8] These regulations were motivated not only by anti-monopoly reasonings rooted in the theoretical benchmark model of perfect competition but also by political fears. As Roe (1994), Morck (2005), and Becht and

[8] Morck (2005: 147f) explains: "The nemesis they set against British business groups was the London Stock Exchange Takeover Rule, applied in 1968, which mandates that any acquisition of 30 percent or more of a listed company be an acquisition of 100 percent. This effectively eliminates business groups by forcing parents either to own their subsidiaries fully or to attempt to control them with stakes below the 30 percent threshold".

DeLong (2007) show in the USA, there was and still is a deeply rooted discomfort with the concentration of private economic power. It is feared it could be used to gain political power and capture the government.[9]

There are similar indications that the dominance of the standalone family farm in American agriculture is also the result of a discriminatory government policy against bigness and not solely the result of unhampered market forces as western scholars with regard to the emergence of agroholdings in Russia's agro-food sector at least implicitly pretend.[10] During the 1970s and 1980s, nine Midwestern states (Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, Oklahoma, South Dakota, and Wisconsin) have passed anti-corporate farming laws that restrict non-agricultural corporate involvement in agricultural production. Minnesota's anti-corporate farming law specifically states that it is in the interests of the state to promote and protect "the family farm as a basic economic unit, to insure it as the most socially desirable mode of agricultural production, and to enhance and promote the stability and well-being of rural society in Minnesota and the nuclear family" (cited in Welsh et al. 2001: 544). Further fears were that up- and downstream conglomerates might control prices and boost their profits at the expense of the farmers and corporate farm operators might harm the land and destroy American ideals of independence, self-reliance, and enterprise (Schroeter et al. 2006: 1000; Welsh et al. 2001: 543f). Similar arguments back the government support for small family farms in European countries, e.g., Germany (see e.g. Kible-Kaup 1996: 23ff.).

The existence of this legislation against a certain form of business organization does of course not rule out that other reasons might have also or even more so been responsible for the dominance of dispersed ownership in the US economy and of family farms in its agriculture.[11] Nevertheless, empirical studies show that the restrictive legal environment did have some influence on business organization (e.g., Schroeter et al. 2006; Welsh et al. 2001). Against this background, the industry

[9] Becht and DeLong (2007) explain why: "Americans love the market because it makes them free and gives them the power to say no... But suppose that there is only one monopolist? Then you are not free but controlled." Morck (2005: 156) cites Roosevelt with the following statement that reveals his hostile attitude to holding companies on similar grounds: "Close financial controls, through interlocking spheres of influence over channels of investment, and through the use of financial devices like holding companies and strategic minority interests, creates close control of the business policies of enterprises which masquerade as independent units. That heavy hand of integrated financial and management control lies upon large and strategic areas of American industry. The small-business man is unfortunately being driven into a less and less independent position in American life. You and I must admit that. Private enterprise is ceasing to be free enterprise and is becoming a cluster of private collectivisms; masking itself as a system of free enterprise after the American model, it is in fact becoming a concealed cartel system after the European model."

[10] For example, Koester (2005: 111ff.) holds that in Russia "under *working* market conditions family farms might be superior to large-scale farms" and "that the creation of new large holdings is not a reflection of market forces but of the specific institutional environment".

[11] For example, Becht and DeLong (2007: 620) point to spontaneous developments in the market, in particular the desire for diversification as major force to enhance dispersed ownership in American business. La Porta et al. (1998) argue that laws protecting the rights of small shareholders (e.g., one share–one vote rules) have also contributed to the absence of business groups and concentrated ownership in the USA. With regard to agriculture monitoring, costs associated with hired labor are seen as a major reason for the prevalence of the family farms. Allen and Lueck (1998: 379) argue that "[p]roduction stages in farming tend to be short, infrequent, and require few distinct tasks, thus limiting the benefits of specialization and making wage labor especially costly to monitor".

structures of advanced western market economies like the USA or the European Union cannot be used as an appropriate empirical counterfactual against which the occurrence and persistence of business groups in transition countries can be evaluated since many of the western countries' markets do not function unhampered from government regulations. This holds in particular for agriculture.

3 An Austrian theoretical framework

3.1 The nature and purpose of competition

Austrian economists understand competition as a dynamic process of interacting decisions of market participants in succeeding periods of time. Competition is regarded as inherently rivalrous because each market participant must not only pay careful heed to the prospective decisions of the actors on the other side of the market but also to the prospective decisions of actual and potential competitors (Mises 1949: 274; Kirzner 1973: 12). If the economic agents fail to outdo their rivals, they will suffer losses and might be driven out of the market. From this dynamic and rivalrous view of competition follows that the so-called data like qualities, prices, production technologies, or preferences cannot be regarded as given. Rather, competition as a process involves a continuous change in exactly these data, brought about by the economic agents themselves (Kirzner 1997: 70). Therefore, competition can never be "perfect" and when these changes are assumed away "perfect" competition means "indeed the absence of all competitive activities" (Hayek 1948: 96). This is a first argument why the perfect market model is inappropriate to appraise the interplay of business groups and competition.

Central to the Austrian understanding of the purpose of competition is the problem of knowledge. Hayek has emphasized that the knowledge of human beings in and about complex phenomena like a modern market economy based on labor division is limited. The reason is the insuperable limited cognitive abilities of human beings to capture and process all relevant information of place and time for economic decision-making. In fact, this information is dispersed among the many people of the society; it is never given to anyone in its totality, neither to any one of the economic agents acting on the markets nor to observing scientists or any omniscient dictator (Hayek 1945: 77f). The crucial question, which Hayek (1937, 1945) considers to be the essential economic problem faced by complex societies, is then how these societies can make use of this dispersed knowledge to ensure a high level of economic development and prosperity. For this, a mechanism is needed that mobilizes the available bits of scattered knowledge of separate individuals. According to Hayek (1945: 85f.), in market economies this mechanism is market competition that generates and transmits information about which goods and services best satisfy the needs of the people in the form of changes in relative prices. It is this capacity to cope with the inescapable decentralization of knowledge to satisfy the individuals' needs of a society, in which Austrian economists see the key contribution of competition to social well-being. This is why Hayek (1978: 179) called competition a "discovery procedure". It reveals not only preferences, profitable products, and productions technologies but also the size and scope of individual firms and other organizational and institutional arrangements (Hayek 1990: 77f).

Competition understood as a discovery procedure also contributes to an efficient allocation of resources and to a high level of social welfare because it will bring about a situation "where more of the potentially useful objective facts will be taken into account than would be done in any other procedure we know" (Hayek 1990: 68). However, Austrian economists neither claim that the allocation is "optimal" nor that its efficiency could be improved with alternative allocation mechanisms like government interventions.

3.2 The entrepreneur as the driving force of competition

Kirzner (1973, 1982, 1997) has emphasized that the driving force in competition as a discovery procedure is the entrepreneur. That's why he (1982) calls competition an "entrepreneurial discovery process". The notion "entrepreneur" describes any alert economic agent, individuals as well large, complex business organizations. Alertness is understood as the discovering of good ideas, inspired by the drive to grasp profit opportunities, i.e., as "noticing the potential for profitable venture" (Kirzner and Sautet 2006: 22). This alert "noticing" may not only consist of perceiving a price differential (arbitrage) but also of "alertly noticing how physical resources can be assembled to generate (physically different) products—for example by the invention of a new technique, in an innovative, profitable manner" (Kirzner and Sautet 2006: 3). This includes organizational arrangements set up to exploit discovered opportunities like, e.g., integrated business groups (Kirzner and Sautet 2006: 9).

Besides alertness, other functions or traits of entrepreneurship have been emphasized in the literature like uncertainty bearing (Knight 1921; Mises 1949; Rothbard 2009), innovativeness (Schumpeter 1943), creative imagination (Shackle 1979), or judgmental decision-making (Casson 2003). They, however, do not exclude one another, but are rather complementary (see also Casson 2003: 215). What is important for the purpose of this analysis is that entrepreneurial activity, irrespective of what characteristic one accentuates, does not require perfect competition. On the contrary, in perfectly competitive markets there is neither scope nor any need for entrepreneurial initiative because there is no uncertainty, so that "there is nothing left for the entrepreneur to do. He cannot find any opportunities to buy from sellers who underestimate the buying demand of their potential purchasers, in order to sell himself to these purchase-hungry buyers" (Kirzner 1973: 26f; similarly Leff 1979: 60). From this should follow that in transition countries there is lots of scope for entrepreneurial discoveries since markets are said to have many "imperfections" like information asymmetry due to underdeveloped transparency-enhancing disclosure rules, but also uncertainty because of poor contract enforcement and rapid structural change. In addition, there are missing or poorly developed factor and product markets, and especially early in the process of transition, lots of scope for entrepreneurial discoveries existed simply because the centrally planned economy left unsatisfied demands (see also McMillan and Woodruff 2002: 154). Insofar as entrepreneurial activity does not presuppose perfect markets, business groups could indeed be considered as a response to market "imperfections", but so are stand-alone firms and all other forms of business organization. And it cannot be claimed that one form of business organization is second-best and another first-best because the outcome of the entrepreneurial discovery process is unpredictable.[12] This is a further argument why the perfect competition model is inappropriate to assess both the emergence of business groups and their impact on competition.

3.3 Institutional prerequisites to unleash and maintain the entrepreneurial discovery process

The scope for entrepreneurial discoveries and the existence of economic agents with the ability and the desire to make and exploit discoveries[13] are of course not sufficient for the discovery process to take place. The economic agents must have the possibility to make and exploit them. This leads to the question whether there are certain institutional conditions that are imperative to unleash and maintain competition as an entrepreneurial discovery process. According to Kirzner (2000: 228), competition is always present, except in a situation where market exchange is explicitly prohibited "as in the centrally planned economy". Therefore, with Colombatto (2002: 65f), it can be argued that in transition economies alone the downfall of the Communist regime and with that the institutional prohibition of market exchange as well as state control of the acquisition and exchange of information was enough to unleash the discovery process. People now became free to pursue their own goals and to access all kinds of sources of information (e.g., foreign press) and means of communication hitherto forbidden and thus to develop, reveal, and transmit preferences. Competition then develops naturally and necessarily since the pursuit of one's personal objective puts one inevitably in rivalry with all who share the same objective (Petro 2009). Referring to insights of Mancur Olson (2000), it can even be claimed that the entrepreneurial discovery process has never ceded to exist but has always been there. Olson (2000: 180) has shown that in the centrally planned economy of the Soviet Union, where private trade was officially illegal and private property rights were de jure absent, there was always trade on bazaars, gray or black markets and thus scope for entrepreneurial discovery and activity. Olson (2000: 176) speaks in this context of "spontaneous" and "irrepressible" markets. They appear always and everywhere, even in the complete absence of market-supporting formal institutions, when (1) the gains from making trades are significant and (2) the trades are self-enforcing. Trades are made self-enforcing by the partners to transactions themselves because each of them is anxious to take precautions against the danger that the other will not reciprocate. This danger can be avoided by making both parts of the transaction simultaneously or by trading only within families or other close social groups where the aggrieved individual can bring social sanctions to bear or by restricting trades to those who

[12] This does not mean that man is not able to make any predictions at all based on the knowledge he acquired through learning and past experience. However, this allows only for very general predictions of the *kind* of events which one must expect in a given situation, not of particular individual events. Hayek (1989: 4) calls this kind of predictions "pattern predictions".

[13] Entrepreneurship in terms of being alert to profit opportunities is nowhere scarce but universal and omnipresent in any society, i.e., not only in advanced but also transition and emerging economies (Boettke and Butkevich 2001: 97).

have invested too much to obtain a reputation for honoring deals to profit from failing to do so. Yet, Olson also shows that entrepreneurial discovery and exploitation that is restricted to self-enforcing or on-the-spot trades is not able to provide for a high level of prosperity. This can only be generated from what Olson calls “rights-intensive production” on “socially contrived markets”. “Rights-intensive productions” are productions that are based on long-term investments which require the cooperation of many people over an extended period of time, e.g., the construction of a factory that shall work for 30 years. “Socially contrived markets” are made up of transactions that are based on the reliable compliance with contracts, like for example in the capital market to pay out money whenever a check is written. The reliable compliance with contracts and thus the development of “socially contrived markets” can be fostered by adequate formal institutions. These institutions must not only give the individuals in a society “the freedom to trade, but also the right to establish secure title to property”. This includes “guaranteed access to impartial courts that will enforce contracts they make, as well as the right to create new forms of extended cooperation and organization” (Olson 2000: 185f). Similar insights provides de Soto (2001), who has shown for developing countries that markets exist although property rights are not well protected, yet the great prosperity of western market economies relies on leveraging capital which requires in turn strong property rights and contract enforcement. Leeson (2008) and Leeson and Williamson (2009) demonstrate that exchange exists even without any rule of law.

Hayek (2008: 195) points to additional institutional arrangements that the state *can* provide, which are, however, *not* absolutely necessary for the discovery process to take place but yet desirable to extent its productive power, for they “facilitate the acquisition of reliable knowledge about facts of general significance” and “provide a favorable framework for individual decisions”. These are the provision of standards and norms, the construction and maintenance of roads or basic school education.[14] With regard to agriculture, Hayek (2008: 315) even favors the provision of public services in the form of information; however, only in a certain stage of economic development where the access of the rural population to information that might be useful for entrepreneurial decisions is limited and its dissemination cannot easily provided in another manner. The information he has in mind is mainly about latest technological developments.[15]

To sum up, with Olson an entrepreneurial discovery process can be assumed to exist everywhere even absent appropriate formal institutions. However, in such an environment, it is unlikely that it will unfold its productive power to the fullest extent possible. For this, individuals and firms must indeed have a set of secure

[14] Hayek (2008: 196) relativizes this statement when he holds that the government must not always be best qualified to take the lead in the provision of such services and that it should therefore not be given exclusive responsibility. Moreover, he claims that in most instances “it is by no means necessary that government engage in the actual management of such activities; the services in question can generally be provided, and more effectively provided, by the governments’ assuming some or all of the financial responsibility but leaving the conduct of the affairs to independent and in some measure competitive agencies”.

[15] Hayek (2008: 316f) is well aware of the danger that in such a situation the government could easily decide what the individuals must know and what not. This is why he favors as first-best solution to encourage the formation of farmer-driven private information and extension services and that state-owned organization should be exposed to competition without any exemption as any other private actor.

individual rights. Now the transition in Russia and other post-Soviet countries has shown that the introduction and in particular the enforcement of many formal institutions is much more difficult than initially expected because of conflicts between the new formal and persisting informal institution and political resistance of interest groups (see also Colombatto 2002: 68). This raises the question whether some institutions are more crucial than others to unfold and maintain competition as an entrepreneurial discovery process in a transition economy that allows for more than self-enforcing trades? Kirzner (1982) argues that it is crucial that the economic agent have the freedom to act upon their discoveries because the dynamic of competition comes from the implementation of entrepreneurial discoveries. Freedom to act includes therefore freedom to contract and "requires that no entrepreneur be blocked from entry into any line of market endeavor", i.e., freedom of entry. Freedom of entry is at the same time the most effective tool to protect competition as an entrepreneurial discovery process because "so long as others are free to offer the most attractive opportunities they are aware of, no one is free from both the urge and the need to compete" (Kirzner 1973: 97f). Therefore, Kirzner (1973: 99; 1982; 1997: 74) considers freedom of entry the only crucial ("necessary and sufficient") institutional prerequisite to induce and maintain competition as a discovery procedure. This conclusion evokes the impression as if the existence of individual property rights were not equally important, as e.g. Havrylyshyn (2006: 34f) and Boudreaux (2005: 11) hold. Individual property rights give individuals the power to decide how to use and allocate resources, goods, and services. If someone else holds these rights (e.g., an authoritarian government), the individual cannot trade with others since this right rests with the person or institution holding the property rights. In fact, Kirzner (1973: 49) and Kirzner and Sautet (2006: 18) do not deny the necessity of property rights to resources to *exploit* discovered profit opportunities. However, they hold that the *discovery* of profit opportunities, which Kirzner (1973: 40f, 99) calls *purely* entrepreneurial activities, does not require the ownership of resources because discoveries understood as generating good ideas cannot be bought and therefore are not a resource.[16]

Yet, creating individual property rights is time consuming and costly. People must devote time and effort to define what a right consists of, to identify who may and may not hold such rights and, importantly, to enforce and defend rights. The more specific the right, the more expensive it is to create and enforce (Boudreaux 2005: 8). While the broad definition of property rights such as the right to use property, the right to keep the profits that flow from its use, and the right to transfer property can be done relatively quickly, their detailed specification and enforcement will take time. For example, in Russia, private property of

[16] Kirzner (1973: 100) illustrates this argument with the following example: "To produce orange juice one needs oranges...But it is not necessary to have access to oranges in order to discover, as an alert entrepreneur comes to discover, how unexploited opportunities for profit exist in orange-juice production". The role of ownership for entrepreneurial discoveries is yet a controversial issue within the Austrian School. In contrast to Kirzner Ludwig von Mises and Austrian economists, his tradition like Rothbard (1974), Greaves (1974), or Hazlitt (1974) conceives the ownership of property inevitable for entrepreneurial discovery. For a more detailed discussion of the relation of ownership and entrepreneurship, see also e.g. Salerno (2008) or Ricketts (2002: 125ff.).

agricultural land was recognized in the early 1990s, but because of political resistance its transfer via purchase and sale only in 2002 (see Section 4). Also time consuming is the reform of the judicial system as well as the creation of supporting institutions like cadasters. As a result in the early stage of transition, property rights will to a certain degree inevitably be insecure which hence raises transaction costs. Nevertheless, they enable individuals to make and implement discoveries unless for a situation of lawless Hobbesian anarchy where there is no restraint at all on the individual's incentives to take things from one another and hence transaction costs become prohibitively high. Therefore, we can conclude with regard to transition economies that:

- To *unleash* competition as a discovery process in the early transition stage, freedom to entry and a minimal degree of private property rights security are needed.
- To *maintain* competition as a discovery process as transition progresses, freedom to entry is in fact the only necessary and sufficient institutional prerequisite.
- To *unfold the productive power* of competition as a discovery process *to the fullest extent possible*, well-defined and secure property rights and an effective rule of law is necessary because it increases transactional trust.

It cannot be claimed that these institutional requirements for inducing and maintaining competition are really something specific for transition economies. They are also valid for advanced market economies, in particular the two last mentioned requirements—free entry and a high degree of property rights security and rule of law enforcement. In fact, in a dynamic world, any economy is always in transition since institutions change continuously under the pressure of interest groups (Colombatto 2002). However, post-Soviet economies differ inasmuch as an abrupt significant change in the constitutional system led quite rapidly to the introduction of new formal rules of the game, which might get in conflict with persisting informal rules. As Hedlund (2005) has demonstrated for Russia, the most important prevailing informal rules, which stretch back to old Moscovy and then have been reproduced over time in the pre-Soviet, Soviet, and post-Soviet era, are the trust in the reliability of personal relations to solve problems rather than into the validity of formal rules of law and the belief of the rulers to stand above the law which results in a rule *by* law or rule of *men* rather than a rule *of* law.

Insofar as one of the basic Austrian institutional requirements for competition are missing or ill-working and therefore society is kept from using more of its productive potential than it currently does, competition in its function as an entrepreneurial discovery procedure could also be labeled as being "imperfect". Nevertheless, although we can think to improve competition's productive power with better working or yet not existing institutions, in a dynamic world with incurable imperfect knowledge it is impossible to determine what results in detail competition will bring about. It is also not possible to determine which institutions in particular are suited to reach an improvement the discovery and productive performance of competition, not to mention something like an optimal degree of discoveries that leads to a maximum of productive power, because these institutions are as much the unknowns to be uncovered in the market process as prices, qualities, or forms of business organization.

3.4 Freedom and barriers to entry

For the appraisal of the effects of business groups on competition as an entrepreneurial discovery process, it is important to explain what “freedom” to entry exactly means. In particular, it has to be clarified if it is identical to the “barriers to entry” mainstream economists usually relate to business groups. For Austrian economists, freedom to entry means exclusively the complete absence of legal or, as Kirzner (1982) also calls them, “extra-market” barriers to entry like import tariffs, subsidies, tax breaks, license requirements, or other legal restrictions. Since these barriers provide privileges to a few economic agents, they do not fulfill a basic Hayekian requirement for rules in a free market economy, namely that they must apply without exemptions to an unknown and indefinite number of persons and cases (Hayek 1973: 122; Hayek 2008: 130ff.). Non-legal barriers to entry that neoclassical inspired studies usually relate to business groups like price discrimination, predatory pricing, advertising, and other modes of product differentiation, tying agreements, refusal to supply or purchase, or advantages due to size are considered to be legitimate and appropriate “entrepreneurial” business practices in the competitive struggle to forestall entry of newcomers since they make up the dynamic competitive process (Kirzner 1973: 170, Kirzner 1997: 75). All these non-legal barriers undeniably make it more difficult for newcomers to enter the market and constitute for them a *barrier*, but they can be overcome by superior performance and do in no way limit the *freedom* of entry. The freedom of entry would only be violated, if, for example in the case the entry into a market required from a newcomer a large amount of capital, he had raised the necessary capital and met all other requirements of being able to compete, such as having had assembled the necessary management and workers with the required skills, and then would have been forcibly prevented from entering the market by the government or other private economic subjects. The *freedom* to enter is, thus, not equal to the *ability* to enter an industry and therefore not the same as the barriers of entry of mainstream economics (Reisman 2002). For “Austrians”, extra-market obstacles against entry constitute the only real harmful obstacles to competition as an entrepreneurial discovery process because without them competition is, at least potentially, always present (Kirzner 1973: 98). That is why for Austrian economists even the existence of one single supplier or a group of colluding firms in a market is no economic problem, as long as the reason for the monopolistic or oligopolistic position is superior skills and not government protection (see also Kirzner 1973: 101ff.). Open markets will put a single producer under pressure to provide good products and services that meet consumer demands and ensure that market “power“ is never permanent (Hayek 1990: 79). If under the conditions of complete freedom to entry monopolies nevertheless prevail for a long time, this only signals that other would-be producers are in fact not able to meet the demand at prices and qualities that this single producer does. Otherwise, they would have entered the market.

The importance of free market entry and its disciplining effect on monopolists has also been recognized by non-Austrian economists like Clark (1961: 112ff.) and in particular by proponents of the Contestable Market Theory. Yet, there is a substantial difference between Contestable Market Theory and Austrian Economics in what is considered an entry barrier. According to Baumol et al. (1982): 3f), perfect contestability of markets requires not only absolute freedom to entry but also that *exit* is absolutely *costless*. Freedom to entry is not only understood as the absence of legal restrictions to entry but also that “there be no cost discrimination against entrants”. Likewise, freedom to exit is not only meant as the absence of government interventions to resist the closing down of unprofitable firms or industries but also the ability of prospective entrants to recoup all or nearly all entry costs upon later exit (Baumol 1982: 4). In this context, Baumol and his colleagues do not even rule out a rationale for government intervention to achieve perfect contestability. Government intervention is considered legitimate to prevent predatory acts by incumbents (Baumol et al. 1982: 466), to regulate monopolies if the respective markets have substantial entry costs, and to take action to reduce sunk costs. These proposed actions shall encourage technical changes that replace technologies involving large sunk costs with technologies that offer more opportunity for mobility or shared use, e.g., through tax incentives for rapid depreciation, retooling of a plant, or the reuse of an old plant in new activities (Baumol et al. 1982: 483). From an Austrian perspective, this is problematic because, as Brätland (2004: 6) puts it, “[t]he extent to which entry and exit can be profitably accomplished must, in reality, be a totally speculative conjecture on the part of the entrepreneur and not a matter that can be discerned by a regulating authority assessing objective data. There is no empirical content that would provide a framework for the ambitious regulatory agenda envisioned by Baumol and his cohorts”.[17]

Besides government-imposed barriers to entry, freedom to entry can also be harmed by private economic agents in ways that are illegitimate from an Austrian perspective. One way is to influence political decision-makers to get protection and the other to threaten, intimidate, or extort competitors. In the transition context, the question may arise if the private provision of protection of individuals’ property right by organized groups, such as the mafia, could be held a legitimate competitive behavior and part of entrepreneurial discovery in an environment where the government does not effectively protect private property rights against private predation. From an Austrian point of view, the private provision of protection of property rights is in fact a double-edged sword. As Leeson and Boettke (2009: 256) argue, on the one hand this may be considered what they call “institutional or protective-tier entrepreneurship” in that these groups protect individuals’ property where the state does not and thus enable the exploitation of perceived profit opportunities through investment in productivity enhancing technologies. The authors call these commercial activities “productive-tier entrepreneurship”. On the other hand, these groups may become a danger to competition as a discovery procedure when turn their protection function into an expropriative one, extorting private businessmen under the threat of force and thus inhibit entry and productive-tier entrepreneurship. This possibility that institutional entrepreneurs may not engage in true protection of private property rights but in racketeering also constitutes the

[17] As to the impact of Contestable Market Theory on mainstream competition theory, Kirzner (2000: 21) concludes that “despite the substantive theoretical improvements introduced to our understanding of competition by the theory of contestable markets, it remains the case that standard microeconomic sees the ideal degree of competition as represented by the perfectly competitive model”.

relative disadvantages of private, as opposed to well-functioning public, protection technologies (see also Block 2005: 77).[18]

Apart from lobbying for protection and extorting competitors under the threat of violence, Hayek (1990: 83ff.; 2008: 230ff.) and also Petro (2009) do not exclude that some non-violent business practices by powerful private economic agents might constitute harmful entry barriers, in particular price discriminations and boycotts against suppliers or buyers. Hayek holds price discrimination undesirable if it is used to coerce particular individuals or firms to deter or otherwise influence potential competitors. An incumbent can, for example, use his power "to keep out a potential competitor by offering specially favorable terms to customers only in that limited region in which a newcomer at first will be able to compete" (Hayek 1990: 84). Yet, Hayek fails explain (1) what the harmful effect of such a business policy for consumer well-being will be, (2) how and under which conditions harmful coercion could be exercised, and (3) more importantly how they can unequivocally be identified. Price discrimination can only be successfully carried out when a supplier is able to separate a market along different price elasticities of demand and to prevent arbitrage between the market segments. Both the noticing of different price elasticities of demand and the commercially successful use of this knowledge through setting different prices for different groups of consumers are nothing but entrepreneurial alertness. In the case that an incumbent offers favorable conditions only to customers in a certain region in order to keep newcomers out, these customers are nevertheless better served as before.

In the discussion about non-legal barriers to entry, economic arguments are easily mixed with moral arguments. This is certainly unavoidable because it is not possible to exclude personal value judgments in normative statements about the good or bad of an economic action. Therefore, it must be conceded that people consider certain business practices also as a restriction of the *freedom* to action for other economic agents. In spite of Hayek's less permissive view on discrimination practices, most modern Austrian economists tend to hold only legal barriers to entry and the intimidation of competitors under the threat of force as a violation of the freedom to entry and thus harmful for the entrepreneurial discovery process. The criteria applied to judge whether a business practice violates freedom to entry or not is whether it constitutes a violation of someone else's property rights or not. Applied to boycotts, Armentano (1999: 100f) argues: "A consumer boycott of a manufacturer's product, for example, does not violate the property rights of the manufacturer; the manufacturer has no right to the consumer's income in the first place. Likewise, a restriction of production on the part of a manufacturer—a producer boycott—cannot violate the rights of consumers, since consumers, absent any contractual arrangement, have no property rights to the manufacturer's product". Therefore, we can conclude for our analysis that from an Austrian perspective there is no pattern of actions, neither certain organizational forms like business groups nor certain business practices, which, in and of itself, is necessarily inconsistent with competition as an entrepreneurial discovery process, if there are no government restrictions upon entry and private businessmen do not threaten competitors with violence.

[18] For more details on the discussion to what extent the state monopoly on the use of violence in property rights protection is justified, see e.g. Rothbard (1978) and (Rothbard 1982) or Osterfeld (1989).

3.5 The danger of economic entrenchment

Since the corporate control over a group of firms provides resources and power that can be used to influence politics, business groups are often associated with political lobbying to obtain favorable treatment from the government (Morck et al. 2005: 693). Rajan and Zingales (2003) showed that the ability to influence politicians for the sake of rent-seeking is nothing specific neither for business groups nor for transition economies but for powerful business incumbents in general. Yet, as Morck et al. (2005: 695) argue, entrepreneurs that control business groups might be more effective political lobbyers than stand-alone firms because the command over vast resources lowers political lobbying costs.

Privileges granted and protected by the government not only preserve and expand the economic power of business groups so that it can reach a point where they are considered "too big to fail" in times of distress. They also pose direct barriers to the operation of competition as a discovery procedure. As Morck et al. (2005: 711f) assume in transition economies like Russia, this might be the result of a feedback loop where weak formal institutions in the initial stage of transition provided opportunities for a few entrepreneurs to gain control over huge slices of a country's corporate sector, who then lobby for weak institutions to preserve their concentrated control. Morck et al (2005: 657, 694) call this situation "economic entrenchment".[19] This is, however, only one side of the story. Political lobbying of big economic actors in transition countries might be a rational defense mechanism to secure property rights and profits from the grabbing hand of the government. For this in a transition economy like Russia, where government authorities view the law as an instrument that does not apply to them but that can arbitrarily be used to ensure power and access to economic resources (see also Hedlund 2005), and therefore property and other rights are insecure, as the Khodorkovsky case has demonstrated, good relations with central and regional governments are vital (Aslund 2007a: 262; Gorodnichenko and Grygorenko 2008: 26). Protection of business groups from competition might also result from the desire of ruling politicians which might prefer large integrated business units over small-scale firms because of deemed economic superiority. Or they want to secure something like a "civilized" competition, a market economy "with a human face" or, in the case of agriculture, a high level of self-sufficiency and therefore support certain business structures and industries.

3.6 Is there an "Austrian" explanation of business groups?

The previous sections developed theoretical arguments from an Austrian perspective why it is untenable to view business groups per se as a symptom and result of market failure and under which circumstances they can be regarded as a threat to

[19] Another form of entrenchment, highlighted by Shleifer and Vishny (1989), is "management entrenchment". Managers can counter disciplinary forces by entrenching themselves by making manager-specific investments that make it costly for shareholders to replace them and thus can extract higher wages and larger perquisites from shareholders and obtain more latitude in determining corporate strategy. Hence, management entrenchment addresses a principal-agent problem at the firm level between managers and shareholders which at least directly has not much to do with the relation between business and politics.

competition understood as an entrepreneurial discovery process. Before moving on to what this means for the empirical analysis, this section takes up briefly the question whether Austrian economics provides any additional or contrasting explanations for *why* economic agents choose to organize the exploitation of profit opportunities in the form of integrated business groups and not of a stand alone single firm. A complete and careful discussion of this issue is beyond the scope of this paper whose focus is the interplay of business groups and competition rather than the explanation of their raison d'être. Nonetheless, it seems appropriate to spend a few words on this question which arises almost inevitably when studying business groups.

As has been mentioned in the introduction, there are "Austrian" contributions to the theory of the firm and at least one to the explanations of conglomerates. Yet, they provide no really other insights why business groups are formed than those mentioned in Section 2. For example, Rothbard (2009: 609ff.) applied Mises's analysis of the problem of resource allocation under socialism to the context of vertical integration. However, he does not explain why an entrepreneur chooses to integrate successive stages but only why there is an upper bound of integration is. He (2009: 613) argues that the size of the firm is constrained by the necessity for *markets* to exist in every factor, in order to make it possible for the firm to calculate profit and loss of each stage and thus to allocate resources correctly between the stages. Consequently, a firm cannot become so large that it is both the unique producer and user of a product. Jeon and Kim (2004) also refer to the calculation problem in their attempt of an Austrian explanation for the emergence of conglomerates in emerging economies. They (p. 59) argue that integration either as a division of a diversified single firm or as a subsidiary in a diversified business group occurs in order to solve the problem of economic calculation in a situation where markets are non-existent or underdeveloped and therefore cannot provide reliable information for accurate economic calculation of profit and loss. The divisions or subsidiaries then act as if they are external markets to one another and generate the missing market information for economic calculation. However, this argumentation leaves questions open. If external markets are held inevitable to exist in order to decide whether the integration of an additional stage of the value added chain into one organizational form is profitable or not how then can this decision be made if external markets are assumed to be non-existent or underdeveloped. In this context, the authors fail to explain what they mean with "underdeveloped" markets, what are the relevant markets for entrepreneurs in emerging countries—only the local or the world market—and overlooked that according to Rothbard (2009: 612f) "thin" markets, i.e., at least one other producer or seller of the intermediate good, are sufficient for meaningful calculation (see also Klein 2010: 14 n. 11).

Likewise, the attempts of Austrian economists to link the theory of the firm and entrepreneurship (e.g., Foss and Klein 2010; Foss et al. 2007a, 2007b; Sautet 2000; Klein 2010: 67ff.; Langlois 2002) provide no specific Austrian explanation for business groups. The argument put forward by Foss et al. (2007b: 1167) and Klein (2010: 70) that exercising judgment how heterogeneous assets may be combined to meet future consumer wants requires an entrepreneur to start a firm to carry out commercial experimentation for there is no market for judgment does not explain why an entrepreneur may need to have a *group* of firms for experimentation. One possible answer could give the insights of Sautet (2000) on the relative advantage of more decentralized hierarchical firm arrangements like the multidivisional structure. Sautet (2000: 116ff.) argues that decentralized hierarchical modes of governance are means to mobilize and utilize the local, social, and tacit knowledge necessary for the development of the firm that the central manager does not possess in its entirety. Yet, rather than a totally new explanation, this argument can be seen as a completion to the informational and computational complexity-reducing Chandler–Williamson view of the M-form.

In sum, all the mentioned Austrian contributions are completions of existing approaches to the broad topic of the theory of the firm rather than a rejection. In fact, the traditional explanations of business group formation easily fit into the Austrian market process view.[20] The experimenting entrepreneur may of course take into account transaction costs, information asymmetries, government regulations, cultural values, or technological aspects. Yet, as has been mentioned in Section 2 none of these reasons could so far unambiguously be confirmed by empirical evidence, so that Khanna and Yafeh (2007: 339) conclude that "the formation of business groups remains largely unexplained". It can be doubted whether economics will ever be able to derive unambiguous theoretical predictions of the sorts if A then follows B. First, there are a host of conflicting and overlapping determinants of business group formation which are empirically difficult to disentangle. Second, as Rothbard (2009: 598) pointed out, which of the many potential determinants an entrepreneur takes into consideration is highly subjective and cannot be objectively determined by observing economists.

3.7 Conclusions for the empirical analysis

Competition in the Austrian sense "works" if there is an institutional environment that allows for entrepreneurial discoveries and their exploitation. The fundamental institutions necessary to unleash and maintain the discovery procedure is complete freedom of market entry understood as the absence of *legal* barriers and individual property rights. From this follows that the assessment of the interplay of Russian agroholdings and competition as a dynamic entrepreneurial discovery procedure must focus on the institutions that provide for economic freedom and on government-created barriers to entry. Since the Austrian approach sees competition as an activity where entrepreneurs try to outbid rivals (Sautet 2010: 92), the empirical analysis also has to focus on the activities of the entrepreneurs, i.e., on what they do to enter and stay in business. The business activities that are compatible with the Austrian view of competition encompass price discrimination, advertising, and other forms of product differentiation as well as various degrees of interfirm cooperation, such as joint ventures or mergers. As Armentano (1999: 34f) explains: "Interfirm cooperation and rivalry are not opposing paradigms from a

[20] See also (Rothbard 1976: 76) and Sautet (2000: 7 and 44) who both see their contributions as a completion of the transaction cost approach. Likewise, Klein (2010: 19) states that "one can adopt an essentially Coasian perspective without abandoning the Knightian or Austrian view of the entrepreneur as an uncertainty-bearing, innovating decision-maker". Langlois (2002) and (Langlois 2005) also refers in the context of vertical integration to common arguments like transaction costs, uncertainty, thin markets, or weak market-supporting institutions.

market-process perspective. Cooperation and rivalry are voluntary alternative institutional arrangements by which entrepreneurs, under conditions of uncertainty, strive to discover opportunities and coordinate plans in a continuous search for profits".

Although appealing for they seem to provide so-called hard facts, traditional quantitative indicators of the status of competition like market shares, concentration ratios, the Lerner Index, or price developments are not only held by Austrian but also non-Austrian economists (e.g., Sutton 1991: 23ff.; Sutton 1998: 473ff.; Baumol 1982: 14; Baumol et al. 1982: 465: Avdasheva 2007a, 2007b: 18f) of doubtful use for the following reasons:

- Measures of market concentration require an acceptable definition of "relevant market". However, determining the relevant market is an insurmountable problem (Armentano 1999: 83f; Sautet 2007: 188ff.) because it is far from evident what the nearest reasonable substitute for a certain product is. In fact, Austrian economists hold that "every commodity competes with all other commodities" (Mises 1949: 278) because producers are after the same thing, namely money (Krawisz 2010; Sautet 2007).
- Even if relevant markets could be clearly defined, it is impossible to know which levels of market concentration generate market power. As Armentano (1999: 86) put it: "No one knows, or can know, whether monopoly power begins at a 36 percent market share or a 36.74-percent market share".
- It is difficult to relate unambiguously price and output developments to market power because there are many other possible reasons for price and output changes, e.g., increases in demand or input prices (as in the case of the hike of global food prices between 2007 and 2008), natural disasters (like the drought of 2010) in Russia, or government interventions. Decomposition of these effects in empirical studies is difficult if not impossible.
- The knowledge requirements to determine the deviation of the price from marginal cost as a measure of market power are underestimated. It is impossible to objectively determine the individual's cost curves because in the Austrian understanding cost is subjective,[21] and to know what the competitive price is supposed to be (see also Shostak 2000). Even if it could, it is again difficult to determine the reasons for a deviation.

Because of these theoretical fallacies, these quantitative measures are not used in the following "Austrian" empirical analysis of the interplay of business groups in Russia's agro-food sector and competition. Instead it will be analyzed:

- Are the basic institutional requirements to unleash competition as a discovery procedure, as laid down in Section 3.3, met in Russia's agro-food sector?
- Have the agroholdings been founded and evolved with or without government support?
- What activities do they undertake to stay in the market? Do they engage in profit-seeking or rent-seeking activities?

[21] As Buchanan (1969: 43) explains, cost "exits in the mind of the decision-maker and nowhere else" and therefore "cannot be measured by someone other than the decision-maker because there is no way that subjective experience can be directly observed".

- Have over time government regulations been introduced that block entry of potential competitors?

4 A tentative empirical analysis of the interplay of Russian agroholdings and competition

The analysis is named preliminary because information on agroholdings is scant. The reason is that agroholdings are no legal form and therefore have no legal existence. Consequently, the Russian Statistical Office (Rosstat) has so far not been required to collect and publish data on this phenomenon. Likewise, the business groups must not disclose their entire structure with all affiliates and make and publish consolidated financial statements. Instead, each legally independent subsidiary keeps separate accounts (Rylko and Jolly 2005: 119). However, as Granovetter (1995: 98f) shows, this situation is not unique for Russia. In other countries, too, business groups are often no own legal standing, they are reluctant to disclose sensitive financial information, and the arrangements that bind enterprises together "are so intricate that they can be uncovered only with great difficulty". As a result, data used in empirical analyses are often inevitably biased samples determined by considerations of accessibility and personal contact. The same holds for the case studies used in the following analysis.

Before analyzing the institutional preconditions for competition as a discovery procedure in Russia's agro-food sector, a few stylized facts about this industry will be presented.

4.1 Stylized facts about Russia's agro-food sector

In 2009, agriculture in Russia accounted for 5% of the country's GPD and employed about 9% of the total labor force. That's down from 16% and 13% in the pre-reform year 1990 (APK: ekonomika, upravlenie 2010: 47). The food industry, the bottleneck in the Soviet agro-food sector,[22] has maintained a share in total employment of all manufacturing industries of 10% and accounts for 11–12% of total manufacturing output (by 1990 14%) (Rosstat 2009a: 136). Following the collapse of communism, output in agriculture, as in other branches of the economy, significantly dropped (until 1998 by 60%) due to a sharp cost-price squeeze which occurred after price liberalization in 1992 as well as due to reduced agricultural producer and food consumption subsidies and decreased domestic demand caused by falling incomes. Livestock production was particularly hard hit with a decline by one half because demand for livestock products is relatively sensitive to changes in income (Liefert 2001: 257). As a consequence of the worsened terms of trade, the losses of farms grew steadily. They reached its nadir in 1998 when 88% of all large and medium farms were financially insolvent. The share of loss-making firms in the food industry also peaked in 1998 with 44% of all enterprises (Wegren 2005: 225). Agricultural production resurged after the 1998 Russian ruble crises with an average

[22] For more details, see OECD (1991); Serova (1998: 93).

grow rate of 3.5% per year until 2009 (Rosstat 2010a: 245). Russia's food industry was growing even quicker at an annual rate of 15–20% (Belaya and Hanf 2010: 55). Factors contributing to the turnaround were the strong depreciation of the Russian ruble by three quarters in 1998 that provided an import substitution effect and increased domestic demand resulting from rising real incomes by on average 11.3% annually. This in turn was caused by an impressive GDP growth averaging more than 7% per year between 1999 and 2008 (Guriev and Tsyvinski 2010: 10).[23] Improved economic conditions and restructuring efforts at the firm level as well as the partial write-off of debt decreased until 2009 the number of loss-making enterprises in agriculture to a share of 22% in all large and medium farms (APK ekonomi, upravlenie 2010: 47) and in the food industry to 24% in all enterprises (Rosstat 2010b: 291). Despite considerable progress in crop and in particular in wheat production, which in 2008 and 2009 made Russia the second largest wheat exporter after the USA, Russia remained a large agro-food importer. Agro-food imports took up almost 13% of total imports in 2008 and consisted mostly of meat, fruits, beverages, and bulk crop sugar (Rosstat 2009b: 148).

Contrary to the expectations of Western experts (e.g., World Bank 1992), family farms, the backbone of western agriculture, did not become the dominant form of business organization in Russia's agriculture. Instead, large- and medium-scale corporate farms, resulting from the privatization of the Soviet collective and state farms, still cultivate a large proportion of the agriculturally used land even though their share decreased from 82% in 1995 to 66% in 2008. At the same time, the share of individual forms of farming (peasant farms and household plots) rose to 26%. However, the number of peasant farms stagnates since 2006 at around 260,000 farms which control a share of 13% in total agricultural land (Rosstat 2007: 445).[24] Russia's food industry was almost completely privatized by 1996. In addition, new enterprises entered the industry as witnessed by the rising number of food processing enterprises from roughly 10,000 by 1990 (World Bank 1992: 235) to 56,000 in 2009 (Rosstat 2010b: 57). Despite bankruptcies and mergers, no other manufacturing industry has more enterprises and is more fragmented than the food industry as reflected in the lowest concentration ratios (CR) of all manufacturing industries. In 2005, the most recent year for which Rosstat had published such data, CR_4 was 6% and CR_8 10% (Rosstat 2005: 384).

Even more surprising than the prevalence of corporate farms was the creation of "agroholdings". Avdasheva (2007a: 98) found that in 2004 39% of all enterprises of the food industry and according to the All-Russian Institute for Agrarian Problems and Informatics (VIAPI) in 2006 21% of all mid- and large-scale agricultural

[23] This is to a large extent attributed to high oil and commodity world market prices but also to improved incentives resulting from economic reforms undertaken during President Putin's first term, in particular a radical tax reform, facilitated registration and licensing procedures and the legalization of the sale of agricultural land (Guriev and Tsyvinski 2010: 14).

[24] There is no detailed and exact information about the total number of farms in Russia and their distribution over particular agricultural farm types. Rosstat distinguishes three farm types: agricultural organizations (corporate farms), private peasant farms, and private household plots. Recorded are, however, only large and middle-sized corporate farms (with more than 60 employees). According to the results of the latest agricultural census from 2006 reported in Uzun et al. (2010: 91), there were approximately 60,000 corporate farms while in pre-reform Russia ca. 25,000 collective (kolkhozes) and state (sovkhozes) farms (OECD 1998: 76).

enterprises belonged to such holding companies.[25] It is estimated that in 2006 agroholdings employed 25% of the total work force in agriculture, earned 25% of agriculture's total profit, and controlled 9% of Russia's total arable land (Ėkonomika sel'skokhozyaystvennykh i pererabatyvayushchikh predpriyatiy 2008: 16).

4.2 The institutional preconditions for competition in Russia

Analyses of the Russian transformation process show that the basic formal institutional requirements to unleash the discovery process have been created in the late years of Gorbachev's Soviet Union and in the early years of Russia's independence (e.g., Aslund 2007b: 52ff.). Already in 1986, foreign trade was partially liberalized breaking the foreign trade state monopoly.[26] Also, in 1986, the Law on Individual Labor Activity legalized a multitude of microenterprises designed for craftsmen. In May 1988, the Law on Cooperatives officially allowed for private entrepreneurship permitting economic agents to set up private trading companies as well as private banks. [27] After Russia had become independent, it created further freedoms to act and entry with the liberalization of prices, domestic and external trade as well as the official recognition of private property rights and the transfer of state assets to private economic subjects. By 1997, the private sector contributed 70% of Russia's GDP (Aslund and Kuchins 2009: 44). In addition, freedom to travel abroad, and access to the foreign press and to electronic communication has enhanced the discovery process by individuals as interactions became more intense and preferences more easily revealed in the market place.

When Putin took office in 2000, the most radical measure undertaken was a profound tax reform. It decreased the number of taxes sharply, reduced tax rates, and introduced a flat personal income tax of only 13% (Rutland 2008: 1053). This limited state interferences with the profit and loss mechanism and further improved the incentives for entrepreneurial discovery. Other significant steps to increase the freedom to act and entry were the reduction of business activities requiring licenses, a comprehensive judicial reform, and the adoption of the land code. The judicial reform improved the quality and financing of the courts and made businessmen sue both one another and the government on an increasing scale. However, as Aslund and Kuchins (2009: 32) report, the courts were not depoliticized.[28] The new land code reaffirmed private ownership of agricultural land and legalized its sale and

[25] Most holding company affiliated enterprises can be found in communications (77% of all enterprises), fuel and energy (68%), and metallurgy (56%) (Avdasheva 2007a: 98).

[26] As Aslund (2007b: 54) reports, by 1988 more than 200 state corporations had been granted the right to foreign trade and by 1990 their number has increased to 20,000. This liberalization was very popular among the managers of the state enterprises because they obtained an opportunity to make money through arbitrage on the enormous differences between low domestic prices and many-times-higher world prices.

[27] Aslund (2007b: 56) characterizes the cooperatives as follows: "These cooperatives were truly self-managing, self-financing, and profit-oriented. They operated freely on the market without plans, centralized supplies, or price regulation. The law explicitly permitted cooperatives to engage in any kind of activity not forbidden by law...".

[28] Survey results show that court cases against state agencies are more likely to be unfair than cases against rival businesses although lower-court decisions are also not completely free from corruption and political pressure from local politicians. Nevertheless, this indicates that at a lower level the rule of law seems to work better than at higher state levels (Bertelsmann Stiftung 2009: 7).

purchase, though with restrictions such as the preferential purchase right of the regional and local governments (Wegren 2002b: 655).

In Putin's second term starting in 2004, the institutional conditions for entrepreneurial discovery became less friendly as economic policy shifted towards state corporatism (Aslund and Kuchins 2009: 115). Privatization stalled, new state or state-dominated corporations have been set up (e.g., the United Aircraft Corporation in 2006, the grain trading corporation OJSC United Grain Company in March 2009) and in the energy sector even renationalization happened (e.g., Rosneft in 2003). As a result, private sector's share of GDP dropped from 70% in 2004 to 65% in 2008 (Aslund and Kuchins 2009: 44). The crucial harmful effect of this policy on the productive power of competition as a discovery process is the increase of uncertainty about property rights and the rules of the game for business (Hanson and Teague 2007: 153). By 2006, Putin advocated more industrial policy, import substitution, and state control over "strategic" sectors of the economy, among them agriculture to ensure "food security". Agricultural policy's shift to import substitution[29] became manifested in two state programs: the National Priority Project "Development of the Agroindustrial Complex (AIC)" from September 2005 for the period 2006–2007 and "The State Program for Development of Agriculture during 2008–2012" from July 2007. The National Priority Project targeted state financial support to animal husbandry, small farming enterprises, and rural housing in order to retain young specialists in the countryside. The State Program of 2007 is a prolongation of the national priority project in the form of a 5-year program under a different name, but more strongly emphasizes the need to regulate agro-food markets (Wegren 2009: 465). Under Putin's presidency, regulatory actions have been undertaken in the grain, meat, and sugar market. Already in 2001, Russia has implemented grain market interventions. In 2003, import tariff rate quotas for meat products and an import tariff for rice have been introduced. The sugar market was already protected under Yeltsin by import quota. In 2003, they were replaced by variable import tariffs. In addition to import restriction, Russia introduced export restrictions. Oilseeds have been subject to export duties since 1992 to support oil crushers. Grain exports were restricted during the peak of food price inflation from the end-2007 to mid-2008 in an attempt to reduce pressure on domestic food prices (OECD 2009: 132f). Measured by OECD's Producer Support Estimate (PSE),[30] the value of policy transfers to producers slightly increased from 13% of gross farm receipts in 2000 to 16% in 2007. This is still way below the OECD average of 26% in 2007 (OECD database on PSE). The Medvedev administration has continued Putin's protectionist policies which culminated in the passing of an official doctrine on food security by presidential decree of February 1, 2010. The doctrine signals a trend

[29] For more details on the development of agricultural policy under Putin, see e.g. Wegren (2002a), (Wegren 2005), and (Wegren 2009).

[30] PSE are estimated by the OECD since 1986. The PSE is the monetary value of transfers associated with agricultural policy which raise farmers' revenues or reduce their costs. The types of policy measures taken into account are budgetary transfers, market price support measures that maintain domestic prices for farm commodities at levels higher than those at the country's borders, and revenue forgone, i.e., policy measures that provide implicit transfers through tax concessions or fee reductions that lower farm input costs.

toward more protectionism, listing minimum percentages of food supply that domestic production is expected to fulfill.[31]

An indicator how well formal institutions de facto function is the level of corruption. Corruption means that politicians and civil servants selectively apply formal rules for private benefit rather than applying them without exemption to everyone. It then limits the entry of newcomers while incumbents that have learned how to handle it become entrenched. A common measure of corruption is Transparency International's Corruption Perceptions Index, which is based on an eclectic mix of third-party surveys. After improvements from rank 82 in 2000 to rank 71 in 2002, corruption in Russia has grown worse since then down to rank 154 out of 178 countries in 2010 (Transparency International 2010).[32] Frye (2010: 80) reports the result from two large surveys of Russian businesses in 2000 and 2008, which confirm this tendency. The worsening is attributed to president Putin's policy of recentralizing political power, curtailing democratic freedoms and increasing state regulation (Aslund 2007b: 263; Frye 2010: 83). Since this increases government officials' discretion about whether to grant a permit or subsidy or not, the incentive to bribe a person or to take a bribe rises. On the one hand, in a heavily regulated economy and in transparent political environment, the payment of bribes is a survival mechanism which can help mitigate the harmful effects of excessive government regulation and thus can be viewed as overcoming an entry barrier (see also Osterfeld 1992: 204ff.; Mkabu 1996). On the other hand, when a regulator takes a bribe to *prevent* a business from opening, it becomes an entry barrier and reduces competition in his function as a discovery procedure. Organized crime that can inhibit entry and entrepreneurial discovery (see Section 3.4) lasted in post-Soviet Russia only for a short period from 1991 to 1995 (Aslund 2007b: 148ff.) when new laws compatible with a liberal society were missing and the Russian state was weak. However, already by 1995 organized crime had been brought down by the legalization of private security companies in 1992, which the state then could increasingly supervise and regulate, by competition from security services set up by new big businessmen and the recognition of the dangers of organized crimes for society (Aslund 2007a: 243).

In sum, the basic institutional requirements that allow for entrepreneurial activities and thus competition in the Austrian understanding to unfold, as laid down in Section 3.3, are given in Russia. Yet, persisting problems in enforcing the

[31] Grain and potatoes (95%); sugar, vegetable oil, fish, and fish products (80%); meat and meat products (85%); milk and milk products (90%) (see the Doctrine on the website of the Russian Ministry of Agriculture, http://www.mcx.ru/documents/document/show/12214.19.htm).

[32] Because corruption is willfully hidden, it is impossible to measure it directly. Therefore, proxies are used, which in the case of the Corruption Index are surveys from third party like the Asian Development Bank, Freedom House, or the World Bank. Another commonly used measure of the quality of the rule of law is the World Bank's Doing Business Index, which uses de jure, i.e., formal, legal indicators, such as the number of procedures required to start a firm, rather than de facto assessments of the ease of doing business in a country (Frye 2010: 81). As with other indicators that attempt to measure and express the quality of institutions with a figure like EBRD's transition indicators or Fraser Institute's Economic Freedom of the World Index, these measures suffer in particular from the subjectivity of expert opinions because the experts (e.g., local entrepreneurs, foreigners working for international organisations or companies) usually know well only the country they were asked about, and therefore lack a comparative perspective. For more details on the critique of such indicators, see e.g. Ochel and Röhn (2008).

rule of law due to political interferences and corruption as well as increasing protectionism represent extra-market barriers to entry that shield incumbents from competitive pressure and prevent competition to expand its productive power.

4.3 The behavior of Russian agroholdings

The analysis of the behavior of Russian business groups within this institutional framework draws on twelve case studies of Russian agroholdings complemented by secondary sources on the topic.

4.3.1 How have agroholdings been founded and evolved?

Table 1, which presents an overview of the cases studied with some basic information, shows that the majority of agroholdings were founded by private, individual businessmen. Only a few—Alexander Orlov of BEZRK–Belgrankorm and Igor Babaev of Cherkisovo—had minor nomenklatura positions in Soviet times. Most of the other founders had started entrepreneurial activities in the late perestroika era and early transition years.

A typical example is the owner of GK[33] “Agroholding” Aleksandr V. Chetverikov. While still being a student at Moscow’s Lomonosov University in the late 1980s and early 1990s, he carried out various trading operations, among others with sugar and grain, when Gorbachev’s partial reforms led to the co-existence of regulated and quasi-market prices which created huge opportunities for arbitrage. After graduation in 1992, he founded with the wealth built during the late perestroika years together with 10 friends a trading company for mixed feed and feed concentrates which became the foundation of his later agroholding. Other agroholding founders have comparable backgrounds, for example A. Zlochevskiy of OGO, V. Moshkovich of Rusagro, I. Potapenko of Razgulyay, or P. Dudnikoviv of Wimm-Bill-Dann. Only the two agroholdings in the oblast[34] Orel were directly founded by the regional government and thus are a result of constructivism of political actors and not of experimentation of private entrepreneurs in the competitive market process. In Orel, the government created the two holding companies in order to regulate the region’s agro-food sector. It was intended that they shall restore what in Russia is called “price parity”, meaning that, as in Soviet times, input prices for farmers should not rise faster than farm-gate prices. This was at the same time seen as way to save insolvent agricultural enterprises from bankruptcy. In order to realize these purposes, the entire agro-food sector of the oblast Orel sector was structured hierarchically. At the rayon level so called “agrofirms” were founded through the merger of all entities of a certain vertical production chain into one single integrated enterprise. The majority of the shares of

33 The abbreviation GK stands for “Gruppa Kompaniy”, i.e., group of companies.

34 There are several types of federal subjects (administrative divisions) of the Russian Federation, which are comparable to the federal states in the USA or provinces in Canada. All have equal representation in the upper house of the Russian parliament, the Federation Council—two delegates each. The most common type are oblasts, followed by republics, autonomous okrugs, krais, one autonomous oblast, and two federal cities (Moscow and St. Petersburg). The subdivision of an “oblast” is called “rayon”, which can be translated into English as administrative district.

Table 1 Overview of the Agroholding Case Studies

Company	Year of foundation	Entry into primary agriculture	Controlled farm land (ha)	Founder	Main fields of operation	Region
OGO	1989	1999	120,000	A.L. Zlochevsky (trading operations)	Feed, flour and oilseed products, bread products, poultry, pork	Moscow and several other
GK “Agroholding”	1992	1996 (poultry) 2000 crops	30,000	A.V. Chetverikov (trade operations)	Feed, poultry, pork, wholesale and retail trade	Kursk and several other
Razgulyay	1992	2004	500,000	I.V. Potapenko (trade operations)	Grain trading, flour, cereals, sugar, poultry, and rice	Moscow and several other
OJSC Group “Cherkisovo”	1993	1997 2007 Outsourcing of crop production	200,000	Igor’ Babaev (meat processing)	Meat and meat products	Moscow and several other
OJSC “APK Orlovskaya Niva”	1994	1994	284,000	Oblast administration of Orel	Regulation of the regional agro-food sector	Orel
OJSC “Orlovskiy Agrokombinat”	1999	1999	400,000	Oblast administration of Orel	Regulation of the regional agro-food sector	Orel
Rusagro	1995	1998 2000 (at request of the oblast government)	188,000	V.N. Moshkovich (sugar trading)	Sugar, grain, oilseeds	Belgorod and several other
Agros	2001	No engagement	0	Interros (V.O. Potanin) (investment company with stakes in different non-food branches)	Grain trading, flour, pasta, poultry, and fast frozen food products	Moscow and Stavropol
Wimm-Bill-Dann Foods OJSC	1992	2004	15,200	Pavel Dudnikov (juice production)	Dairy, beverages (juice, mineral water), baby food	Moscow and several other
APK “Stoylenskaya Niva”	2000	2000–2010	110,361	OJSC “Stoylenskiy GOK” (ore mining and processing company) at request of the regional government	Grain production and trading, feed, flour, bakery products, livestock production	Belgorod and several other
OJSC “BEZRK–Belgrankorm”	1997	1998	67,000	Aleksandr Orlov (feed production)	Feed, poultry, pork, and milk production	Belgorod
Group “Efko” (Efirnoe)	1994	2000–2007	20,047	Valeriy Kustov (investment company)	Vegetable oils and fats	Belgorod and several other

Source: own compilation

these agrofirms are held by the rayon administration. The activities of the agrofirms are in turn controlled and coordinated by the holding companies "Orlovskaya Niva" and "Orlovskiy Agrokombinat" that are owned by the oblast government.

More difficult to disentangle is entrepreneurial discovery from constructivism in the case of agroholdings in the oblast Belgorod. There is considerable evidence that at least their entry into primary agriculture has been encouraged by the regional government, while their engagement in food processing and trading, which they had started long before the government promoted integration into agriculture (see Table 2), is the result of pure entrepreneurial discovery. In the oblast Belgorod, the governor advocated agroholdings as a device to reorganize insolvent agricultural enterprises. This goal was explicitly expressed in the regulation of the administration of the oblast Belgorod No. 710 of 14.12.1999 "On measures to restructure insolvent farms of the oblast". In order to avoid the bankruptcy of the many loss-making farms (see Section 4.1), which was feared to lead to the loss of regional self-sufficiency in food supply, the resolution "recommends" insolvent farms to join profitable enterprises from within and outside the agro-food sector. After the resolution was passed, agricultural enterprises in the Belgorod oblast were integrated into business groups in a great number (Ushachev 2002: 6). Officially, the decision of loss-making farms to join a business group is voluntary. In reality, however, the regional government frequently exercised pressure on insolvent farms to take this step. This was possible because many insolvent farms had outstanding tax payments to the regional or local budget. In addition, the regional government used its competences in the program of subsidized credits[35] to make the decision whether a farm is eligible for subsidized credits conditional on their willingness to join an agroholding. The profitable non-agricultural enterprises were encouraged to take over insolvent farms by privileges like tax breaks or easier access to subsidized credits (see also Sagdiev 2003). As Gataulina et al. (2006: 52) explain, for the non-agricultural enterprise the integration of over-indebted farms is something like the fulfillment of a social obligation. In exchange for the allowance to do their core business in the regional agro-food sector, e.g., food processing, private entrepreneurs have to accept the social obligation to rehabilitate insolvent agricultural enterprises.

The cheap purchase of assets from over-indebted enterprises is also the characteristic method of expansion for those agroholdings that appeared without any government support. Table 2 demonstrates that the expansion occurred evolutionary over a period of several years and was obviously guided by the profit opportunities in certain markets of Russia's agro-food sector. These profit opportunities existed at the beginning of transition almost exclusively in the crop sector because consumer demand had shifted from livestock to crop products. Later, when Russia's economic recovered and consumer incomes had increased the poultry and pork business offered new profit opportunities. Then, following the 1998 crisis, when the depreciation of the ruble provided opportunities for import substitution, the entry into agricultural raw production became attractive for many of those

[35] The system of subsidized credits was introduced in 2001. Commercial banks are to provide these credits to farms but the state compensates two thirds of the interest rate. The regional governments have a say in selecting which enterprises shall receive subsidized credits.

Table 2 Steps of Integration

Company	Steps of integration
OGO	1994 Purchase of elevators and a bakery
	1997 Purchase of two poultry plants
	1999 Entry into own grain and oilseeds production
	2000 Oilseed processing plants and extension of own agricultural production
	2005 Exit from oilseeds production
	2008 Purchase of additional farm land to expand grain production
GK "Agroholding"	1994 Production of mixed feed
	1996 Entry into poultry production
	1999 Entry into pork production
	2000–2003 Own feed grain production
	2002 Creation of a supermarket chain
	2004 IPO
Razgulyay	1995 Purchase of a sugar plant
	1999 Entry into grain trading business
	2001 Purchase of 3 poultry plants and 1 meat processing plant
	2004 Entry into rice production
	2005 Extension of own sugar beat production
	2006 IPO
	2007 Purchase of farmland
OJSC Group "Cherkisovo"	1995 Horizontal expansion of meat processing
	1996 Entry into wholesaling
	1997 Entry into poultry production
	1998 Entry into pork production, including hog breeding
	2006 IPO
	2007 Outsourcing of non-profile agricultural activities into a separate agroholding
OJSC "APK Orlovskaya Niva"	Since 1994 control over 20 agrofirms at the rayon level
OJSC "Orlovskiy Agrokombinat"	Since 1999 control over 19 agrofirms at the rayon level
Rusagro	1997 Purchase of a sugar plant
	1998 Entry into own sugar beat production
	1999 Entry into grain and oilseed trading
	2000 Purchase of oilseed processing plants and integration of 9 farms on request of the government of the Belgorod oblast
	2002 Integration of 4 farms
	2004 Entry into pig breeding
Agros	2001 Acquisition of the grain trading company "Roshkleboprodukt"

Table 2 (continued)

Company	Steps of integration
	2003 Concentration on pasta, poultry meat and fast frozen food production
	2005 Exit from grain trading
	2007 Specialization on poultry meat production
Wimm-Bill-Dann (WBD) Foods OJSC	1995 Acquisition of Lianovsky Dairy Plant
	1996 Acquisition of the Baby Food Plant in Moscow and of further dairy plants
	2001 Incorporation of the holding company "WBD Foods"
	2002 IPO
	2003 Entry into mineral water production
	2004/5 Acquisition of 4 farms
APK "Stoylenskaya Niva"	2000 Acquisition of 36 illiquide farms
	2001 Acquisition of bakeries
	2006 Acquisition of grain elevators, mills, and additional bakeries
	2010 Exit from agriculture
OJSC "BEZRK–Belgrankorm"	1997 Entry into mixed feed production
	1998 Entry into poultry production
	2000 Integration of illiquide farms
	2004 Entry into pork production
	2005 Expansion of poultry and pork production
Group "Efko" (Efirnoe)	1994 Entry into oilseeds
	2000 Entry into agriculture
	2007 Exit from agriculture

Source: own compilation

agroholdings that had emerged without government support. A further expansion of agricultural activities was induced in 2007 and 2008 when world market prices for major agricultural commodities, in particular oilseeds, grain, and also milk,[36] had reached a height. This signaled further profit opportunities and some agroholdings started to purchase an increasingly amount of farmland as a first step to exploit these profit opportunities (see Table 2).

In a number of cases, the integration into successive stages of the value-added chain was motivated by principal-agent problems with the buyers or suppliers. For example, in the case of GK "Agroholding", it had turned out that the poultry firms as the basic clients of the "Agroholding"'s mixed feed did not use it properly. As a

[36] Agricultural commodity prices rose sharply in 2006 and continued to rise in 2007. While the FAO food price index rose on average 9% in 2006 compared with the previous year, in 2007 it increased by 23% compared to 2006. The surge in prices has been led by dairy, which on average increased by nearly 80%, then by oils with nearly 50% and grains with 42%. The only exception was the price of sugar, which declined by 32% after having increased by over 20% over the 2005–2006 period (FAO 2008).

result, poultry meat quality was bad and hence sales declined since customers turned to other competitors. To counterbalance this development, the "Agroholding" decided to breed and feed chicken as well as process chicken meat itself. For similar reasons and because of growing consumer demand, the group entered in 1999 into pork production. In 2002, it bought agricultural enterprises to secure raw material supply for the mixed-feed business. Thus, the entry into own poultry and later also pork and agricultural production was a way of expanding the market for its concentrated feed and securing input supply. The same story is told by OGO. All this evidence indicates that except for the two state-owned agroholdings from Orel, all other agroholdings emerged and evolved to a large extent as the result of competitive entrepreneurial discovery.

4.3.2 What do agroholdings do to stay in business? Pro-competitive business practices

The Orel agroholdings have primarily a regulatory function rather than a pure commercial one. As Gataulina et al. (2006: 60) confirm, they largely perform the functions of centralized procuring and servicing organizations similar to those that existed in Soviet times. The two agroholdings receive budget funds, provide the subsidiaries (agrofirms) with credits and inputs like fuel, lubricants, seeds and fertilizers, and resell the produce received on account of the credits. The agrofirms are principally free to purchase necessary resources on the market and sell surplus produce, left after buying back credits. However, to do so, they need to have other financial resources or a better credit line than the one offered by the holding company. Only a few agrofirms are reported to have such options. The majority of agrofirms owe the holding companies large amounts of money for the inputs supplied to them (Gataulina et al., 2006: 68). The regional government, which is represented in the board of directors in the agroholding by the vice-governor, directly intervenes with the allocation of funds, specifying which enterprises are to receive loans and in what volume. Russian reports on these two agroholding suggest that they are a failure. Apparently they are plagued by heavy debts (Regnum 2004) and "Orlovskiy Agrokombinat" is said to have de facto, but not de jure ceased operating since 2006 (Ėkonomika sel'skokhozyaystvennykh i pererabatyvayush-chikh predpriyatiy 2008: 16). All other investigated agroholdings including those in the oblast Belgorod applied business practices that are pro-competitive from an Austrian perspective. They made considerable investments in the firms they have acquired in order to introduce modern technology (see also Rylko and Jolly 2005). An empirical analysis based on survey and farm-level accounting data for the period 1999 to 2003 by Hockmann et al. (2009: 30) confirms that investments in farms belonging to an agroholding were made primarily to modernize production technology rather than just maintain the existing capital stock. In addition, they show that investments in agroholding members were significantly higher and led to more capital intensive agricultural production than in independent farms.

Agroholdings also take great effort to restructure the management of the acquired enterprises to increase profit. Usually the number of managers and technical employees are reduced which is reflected in a lower manager-to-worker ratio than independent farms (Hockmann et al. 2009) and better trained and paid managers are hired by the holding company for the subsidiaries. At the same time, the holding companies often enforce strict corporate control on their subsidiaries. A typical example is the GK “Agroholding”. Its subsidiaries are required to fulfill production and profit targets set and controlled by the holding company. The subsidiaries may transact among themselves using transfer prices which are based on market prices and fixed for half a year. Then they are adapted to the new market prices. However, if they find that independent suppliers and purchasers offer better prices, then the subsidiaries are free to deal with these non-group members in order to achieve a higher profit. If the subsidiaries make continuous losses, they are either sold or the management is exchanged. Similar practices apply to Wimm-Bill-Dann, Razgulyay, OGO, and Agros.

Typically, the agroholdings centralize certain functions in the holding company, mostly the purchase of key farm inputs, key investment and financing decisions, and in some cases (e.g., Cherkisovo, Efko) also the marketing of output. In order to obtain necessary quantities of inputs at competitive rates, the holding company enters into large-scale purchase agreements with input suppliers. In order to promote the sale of the final products to retailers, most agroholdings run their own distribution networks. Only GK “Agroholdings” has also set up own retail networks. Furthermore, most of the examined agroholdings made minor investment into new trucks and Razgulyay and Rusagro invested into own port terminals to overcome infrastructure constraints[37] (Pinegin 2003). This was also a major motive behind Wimm-Bill-Dann’s horizontal expansion in milk processing into Russia’s regions nearer to raw milk producers (Wimm-Bill-Dann 2003: 3).[38] As to financing, agroholdings facilitate access of subsidiaries to bank credit at lower interest rates than independent enterprises by pooling collateral and providing guarantees from other profitable subsidiaries of the group. Moreover, they (e.g., Wimm-Bill-Dann, GK “Agroholding”, Cherkisovo) overcome domestic capital market constraints through the issue of shares on the international markets. In order to attract outside investors, they reorganize the group structure to increase transparency. For example, “Wimm-Bill-Dann” reorganized itself into a holding company group before its initial public offering at the New York Stock Exchange in 2002. OGO, GK “Agroholding”, and Razgulyay have created subholdings for different product divisions. This also serves to reduce the likelihood of entrepreneurial mistakes as more diversified activities are put together. In addition, some agroholding founders have invited outside managers into the board of directors and reduced their own shareholding when they had recognized that their own capacity to develop their businesses was

[37] Contraints in storage and transportation infrastructure remain a major problem in Russia’s agriculture. Viktor Zubkov, first deputy prime minister of Russia, admits that infrastructure development has not kept pace with dynamic production growth. In particular, the country's ageing rail infrastructure remains a challenge, with national railroad company predicting 57% of its grain transport fleet being defunct by 2015. Also, ports are close to choking point. A manager of the “Siberian Agrarian Group” told the journal “Agroinvestor” that transport cost to deliver grain 3,000–4,000 km from Siberia to the ports of Southern Russia make up 50% of the value of grain (Goncharov 2010a: 20).

[38] Quick and cheap transport is important in the dairy industry for two reasons. First, consumers usually do not demand raw milk but processed dairy products. As a result, the economic value of raw milk is low. Second, raw milk requires quick processing to keep it from spoiling and ensure high quality of the final dairy products.

limited. For example, Wimm-Bill-Dann has four foreign board members, and at the end of 2010 the company announced to sell 66% of its shares to PepsiCo (Interfax 2010: 16). Igor Potapenko of Razgulyay is about to sell 21.4% of his shares in the holding company to the investment company Avangrad Asset Management and Il'ya Karpov of OGO 49% to the Kremlin Bank in attempts to reduce the heavy debts incurred during the world financial crises (Agroinvestor 2010: 49; 2011a: 10). This also shows that agroholdings are exposed to competition on the market for corporate governance.

Another common pro-competitive behavior applied by many of the examined agroholdings (e.g., Wimm-Bill-Dann, OGO, Razgulyay, Agros, BEZRK–Belgrankorm, Efko, Cherkisovo) is product differentiation through quality improvements, advertising, and branding. In the context of quality improvements, many provide support to independent suppliers of agricultural raw material and thus promote development and competition in agriculture. A typical example is again Wimm-Bill-Dann. In order to ensure a high quality of raw milk, Wimm-Bill-Dann runs since 1999 a special program called "Milk Rivers". Under this program, the company provides dairy farmers with loans for the purchase of dairy cattle, feed, and leases modern combines, feed-chopping, milking, and refrigeration equipment. In selecting farms to participate in this program, Wimm-Bill-Dann chooses only those that seek to increase the quality of their products. The lease receivables are offset with milk supplies based on a predetermined schedule during the lease term.

Most agroholdings use a multitude of institutional arrangements to govern transactions with input suppliers and customers. For example, Razgulyay procures only about 25% and Wimm-Bill-Dann, Agros, and EFKO less than 10% of the raw material for their processing enterprises from the groups' own farms (Rylko et al. 2008: 97). The reason for the simultaneous use of various modes of governance is to counterbalance the disadvantages of each arrangement in terms of transaction cost and principal-agent problems and to react flexibly to changing market conditions. For example, when market prices for raw milk and sugar beet had increased, Razgulyay and Wimm-Bill-Dann announced to increase their own production in an attempt to secure agricultural raw material supply at lower costs. External observers suggest that not only increased demand for raw milk by competing dairy plants but also high overcapacities as a result of the strong horizontal expansion into milk processing made Wimm-Bill-Dann's processing firms vulnerable to the hold-up problem (Saraikin 2005). Igor Potapenko of Razgulyay confirms that overcapacities in sugar processing caused independent sugar beet farmers to demand higher prices, which resulted in higher input costs for the group's sugar plants. Through own sugar beet production with modern production technology, Razgulyay tries to keep raw material costs stable and increase capacity utilization (Borozdina 2005). This evidence also illustrates that agroholdings do not seem to be able to dictate market prices.

A final indication for the pro-competitive behavior of Russia's agribusiness groups and that competition as a discovery procedure in fact works is the fact that the examined agroholdings not only entered but also exited markets in response to changed profit opportunities. For example, in 2003, Razgulyay, which until then also had produced poultry products, specialized on sugar and grain production. In 2005, Rusgaro sold most of its grain business to the American grain trading company

Cargill. OGO withdrew in 2006 completely from egg production and Efko in 2007 from primary agricultural production. In 2010, Stoylenskaya Niva, an agroholding founded by the Stoylensk ore mining and processing company following the Belgorod government resolution No. 710, also sold its complete agricultural assets to Rusagro (Agroinvestor 2011b: 12). These last two incidences are interesting because they indicate that competition as a discovery procedure even works in the Belgorod oblast. Although both Efko and Stoylenskaya Niva have been "asked" by the regional government to enter agricultural production, after some time they were able to get rid of this obviously unprofitable "social obligation" and exit the market.

4.3.3 Rent-seeking and rising non-market entry barriers

Besides these practices that foster competition, there is also some evidence for rent-seeking activities aimed to raise extra-market barriers of entry which hamper competition as a discovery procedure in Russia's agro-food sector. Typically, the rent-seeking activities take the form of investment agreements between agroholdings and regional governments and of active lobbyism for more border protection and price regulation. For example, Rusagro and the oblast government of Belgorod signed an agreement in which the latter invited the agroholding to play a leading role in the implementation of the 2003 regional development program of the pork industry and offered tax breaks and subsidized credits. In June 2005, the Russian Federal Antimonopoly Committee has criticized this agreement as anti-competitive because these privileges have been selectively offered and granted only to Rusagro (Press-Sluzhba 2005). Similar investment agreements for the same industry have concluded the founder of the GK "Agroholding" and the governor of the oblast Kursk in July 2002 (Kulagina 2002) and in 2010 the group "Cherkisovo" and the oblast government of Lipeck and the federal ministry of agriculture (Sokhina 2010). On the one hand, the conclusion of such investment agreements might be a rational business practice for the entrepreneur to secure property rights in an environment where they are specified and enforced in an unsatisfactory manner. On the other hand, this practice is anti-competitive from an Austrian point of view because the privileges are not granted to every one and therefore constitute extra-market entry barriers.

GK "Agroholding" has also actively lobbied for more border protection, in particular for poultry meat, through Chetverikov's membership in the Russian State Duma and its agricultural committee. Razgulyay lobbied for tariff quotas on the import of rice as a precondition to enter the rice market (Konkin 2005). As Table 3 shows, which confronts the time of market entry of the agroholdings with the time of the introduction of market protection, 1 year before Razgulyay entered the rice business tariffs on rice imports had been introduced. Apart from this case, Table 3 demonstrates that most other agroholdings entered certain markets, in particular the poultry and pork market, *before* the government protected them. This suggests that they at first tried to exploit perceived market profit opportunities, but then have lobbied to protect their positions and extract rents. On the other hand, there is also evidence that local and federal politicians are themselves interested in greater state support for agriculture because they are convinced that this sector is strategic for food security reasons and principally not viable without state protection (see e.g. the

Table 3 Time of Market Entry of Agroholdings and Implementation of Support Measures in Russia's Agro-food Sector

Business group	Market	Year of entry	Year of implementation of state support	Form of support
Wimm-Bill-Dann Foods OJSC	Juice	1992	No protection	
	Dairy products	1995	2005	National priority project
	Mineral water	2003	No protection	
GK "Agroholding"	Mixed feed	1994	No protection	
	Poultry	1996	2003; 2005	Import tariff rate quota; national priority project
	Pork	1999	2003; 2005	Import tariff rate quota; national priority project
OJSC APK "OGO"	Grain	1992	2001	Grain market intervention
	Oil seeds	1992–2005[a]	2001; 2005	Export duty on sunflowers, import quota on butter
	Poultry	2000	2003; 2005	Import tariff rate quota; national priority project
Razgulyay	Sugar	1995	1993	Import duty
	Grain	1999	2001	Grain market intervention
	Rice	2004	2003	Import duty
	Meat	2000–2004[a]	2003; 2005	Import tariff rate quota; national priority project
OJSC Group "Cherkisovo"	Meat processing	1989	2003; 2005	Import tariff rate quota; national priority project
	Poultry	1997	2003; 2005	Import tariff rate quota; national priority project
	Pork	1998	2003; 2005	Import tariff rate quota; national priority project
	Mixed feed	2000	No protection	
Agros	Grain	2001	2001	Grain market intervention
	Poultry	2003, 2007	2003; 2005	Import tariff rate quota; national priority project
	Pasta, deep frozen food products	2003–2006[a]	No protection	
OJSC "APK Orlovskaya Niva"	No specialization	1994	1994	State-owned company; regional price regulation
OJSC "Orlovskiy agrokombinat"	No specialization	2000	2000	State-owned company; regional price regulation
APK "Stoylenskaya Niva"	Grain	2000	2001	Grain market intervention

	Feed stuffs	2000	No protection	
	Livestock production	2000	2003	Import tariff rate quota
			2004	Regional support program in Belgorod
			2005	National priority project
OJSC “BEZRK–Belgrankorm”	Mixed feed	1997/98	No protection	
	Poultry	1998	2003	Import tariff rate quota
			2004	Regional support program in Belgorod
			2005	National priority project
	Pork	2004	2003	Import tariff rate quota
			2004	Regional support program in Belgorod
			2005	National priority project
Group “Efko” (Efirnoe)	Vegetable oils and fats	1994	2001	Export duty on sunflowers
			2005	Import duty on butter
Rusagro	Sugar	1995	1993	Import duty
	Vegetable oils	2000	2001	Export duty on sunflowers
	Grain	2000	2001	Grain market intervention
	Pork	2004, 2007	2003	Import tariff rate quota
			2004	Regional support program in Belgorod
			2005	National priority project
	Raw milk	2005	2005	National priority project

Quelle: own depiction. The information about the implementation of support measures are drawn predominantly from Vasil’ev (2007).

[a] Year of exit

governor of Belgorod oblast Savchenko 2001). However, with the information available, it is difficult to figure out who really initiated greater state protection. This requires far more empirical research, which is beyond the scope of this paper.

The latest selectively granted privilege to agroholdings that can become an extra-market barrier of entry for competitors resulted from a policy response of the federal government to the world financial and economic crisis that hit Russia in 2007. At the end of 2008, the Russian government issued a list of 295 corporations from different branches deemed to be "system relevant", among them eight of the 12 agroholdings covered by this case study analysis. [39] Since they are regarded as essential for the Russian economy, they are eligible for government support in case they get into economic trouble. Thus, the list is nothing but an official recognition of being "too big to fail". It has to be seen whether the promised support will really be granted. The fact that, as has been reported in the previous section, Razgulyay, an agroholding from the list, was forced to sell assets to ease its debt burden does not indicate much state support for now. But if it will be given, then this discriminates competitors that are not held to be important enough, aids to entrench powerful business actors, and creates for newcomers an extra-market barrier of entry, all which harms competition in its function as an entrepreneurial discovery procedure.

In spite of these tendencies of rent-seeking and rising entry barriers that undoubtedly hamper competition as a discovery process to unfold its productive power to the fullest extent possible, the actors in Russia's agro-food sector are still exposed to considerable competition. As has been shown in Section 4.1, government support to agriculture in Russia is still low compared to the OECD average and food imports, in particular of meat products, which account for one third of total meat consumption in Russia (Goncharov 2010b: 18) are still considerable. Likewise, analyses show that except for the temporary export restrictions on wheat between October 2007 and June 2008, price developments in Russian agro-food markets are not decoupled from world market developments, but adjust to changes in domestic and international demand and supply conditions (e.g., Glauben and Götz 2011: 3; Skrynnik 2010: 46; Kharitonova 2010: 43).

4.3.4 Is agroholding behavior exceptional?

Except for Fortescue (2006) who analyzes the oil and metal industry, there are no sector-specific studies on Russian business groups. However, both Fortescue's analysis and those on Russian business groups in general, often carried out under the heading of "oligarchs", show that the patterns of their formation and the business practices described above are anything but exceptional for the agro-food sector. Guriev and Rachinsky (2005), Fortescue (2006), and Aslund (2007a: 258) report similar life stories of the founders of business groups. Another feature common to all Russian business group is the expansion through the cheap purchase of assets from over-indebted enterprises but which still have the potential for quick restructuring (see e.g. Perotti and Gelfer 2001; Hoffman 2003; Shleifer and Treisman 2005;

[39] Wimm-Bill-Dann, Razgulyay, Cherkisovo, Rusagro, Efko, OGO, Stoylenskaya Niva, and Belgrankorm (Finans-Online 2008).

Guriev and Rachinsky 2005; Fortescue 2006; Aslund 2007a: 263f; Avdasheva 2007b: 213; Pappe and Galukhina 2009). These authors also confirm that Russian business groups usually invested in their affiliated enterprises with the objective of improving the affiliates' productivity, and enforced effective corporate governance and financial accounting needed to attract outsiders. Fortescue's (2006: 19) conclusion on "oil barons and metal magnates" fits very much to what has been shown for the agroholdings: "The concentration of corporate control they eventually won for themselves encouraged the oligarchs to adopt a long-term view of corporate development that was reflected in an increased willingness to invest. They even began to recognize that their own capacity to develop their businesses was limited, and so turned to outsiders, including foreign investors and managers. They undertook the reforms of corporate governance and financial accounting needed to attract such outsiders. … Rather than rapacious asset strippers, from the beginning they have been effective creators and reproducers of wealth. … Politically, while they might have at times misused the political system to protect their own interests …, nevertheless the oligarchs served a useful function in destroying the last remnants of Soviet socialist corporate control and management. They are needed to continue to serve as a counterweight to bureaucratic and authoritarian forces". All were true entrepreneurs and distinguished from other entrepreneurs by "their willingness to take risk" (p. 38). "After a decade of privatization and *peredel*[40] the 'Chubais reformers' had what they wanted—big, powerful private companies, with a considerable degree of vertical and horizontal integration" (p. 75). A similar conclusion reached Guriev and Rachinsky (2005: 139): "These entrepreneurs … converted Soviet manufacturing enterprises into successful modern capitalist firms". These authors (2005: 136f) also found no convincing evidence that the business groups hold excessive market power in the sectors they operate. Most do business in the tradable goods sectors that are subject to global competition because all these sectors sell to the global market. The only exception they found is the automotive sector, which they call "a classic example of interest groups politics as described in Grossman and Helpman (1994)". Russian cars are not internationally competitive, and the industry has always relied on protection. "Yet even with high import duties and support of domestic producers via both generous tax write-offs and subsidies, import penetration was 25 percent and rising" (Guriev and Rachinsky 2005: 136).

5 Concluding remarks

The paper developed a theoretical framework for the "Austrian" analysis of the interplay of business groups and competition in post-Soviet transition economies and applied it in a tentative empirical investigation of business groups in Russia's agro-food sector. It is has been argued that the Austrian understanding of competition as a rivalrous activity and dynamic process of entrepreneurial discovery does not require from markets to be "perfect" but to have free entry and a minimum degree of property rights security. Freedom to entry means absence of government regulations

[40] Peredel means redistribution of property (Fortescue 2006: 60).

and intimidations of private economic agents under the threat of force against competitors. If these institutional prerequisites are given and there is no government support, then there is no form of business organization that (1) is incompatible with competition in the Austrian understanding, and that (2) per se constitutes a threat to it because in a dynamic world without government protection dominant market position will never be permanent. If they nevertheless turn out to be so, then this is the result of superior entrepreneurial alertness. Therefore, business groups like any other form of business organization must be seen as the unpredictable outcome of competition as an entrepreneurial discovery procedure. They can only pose a danger for competition when they receive government support.

The results of the empirical analysis of the interplay of Russian agroholdings and competition show a mixed picture. On the one hand, there is evidence that agroholdings arose for the most part spontaneously by the initiatives of alert private entrepreneurs responding to profit opportunities. Likewise, the case studies provided much evidence that agroholdings employ fairly entrepreneurial and pro-competitive business practices to stay in business. The business groups invest heavily into modern productivity enhancing production technologies, introduce strict corporate control in the acquired firms, constantly adjust the organizational structure of the group to increase manageriability and transparency, enhance product quality and differentiate their products, open up new sources for outside finance, and enter and exit markets in response to changes in profit opportunities. These are all precisely the entrepreneurial activities which in the Austrian understanding make up the dynamic competitive process (Kirzner 2000: 22). On the other hand, there was also evidence that in some cases their emergence (in the oblast Orel) and in other cases their further expansion into certain markets (agricultural production in the oblast Belgorod) occurred with government support. Therefore, Russian agroholding development can only partially be seen as the result of competition as a discovery procedure.

Yet, this is no unique outcome for Russia or its agro-food sector. As Khanna and Yafeh (2007: 352) in their literature survey show in many other countries, “business groups emerged with at least some degree of government support, often in the context of development-oriented mercantilist policies”. In the further course of development, the relations between business groups and the state can vary considerably. They found evidence both for cases where groups have captured regulators and lobbied for more protection that stifles competition as a discovery procedure as well as for cases where they lobbied for and invested in market-supporting institutions and infrastructure that fosters competition. In this analysis, evidence was found for lobbying activities for more government protection. However, the information available does not allow figuring out whether the protection introduced in some agro-food markets really resulted from successful lobbying of powerful agroholdings or from the government’s own political preferences. Given that it could be found out that business groups did indeed successfully exercise pressure on politicians to raise barriers to entry the “Austrian” solution to this problem is not the prohibition or control of the creation of business groups. This would not only be “pretence of knowledge” (Hayek 1989) but also deter entrepreneurial activities and entry (Kirzner 2000: 22). Moreover, the danger of such a “big is bad” policy is to restrain the competitive performance of certain forms of business organization and to support or protect smaller, inert, and less efficient business organizations (Armentano 1999: 14). Since the root of the problem of raising non-market barriers to entry lies not only on the demand side for protection but also on the supply side, that is the politicians' vulnerability and inclination to grant government protection to certain companies or branches for what reason so ever, appropriate policy measures should focus on the polity rather than on the economy. Hayek (1990: 20ff., 104ff.) suggested to develop institutional arrangements that reduce the incentives for *politicians* to grant rents to powerful economic actors on whose support they believe to depend upon to stay in power. This inclination exists, however, not only in authoritarian transition economies like Russia where officials stand above the law but also in western democracies. Based on his diagnosis that it is the insufficient separation between legislative and governmental functions that creates the incentive for privilege granting, Hayek (1990: 119) suggested to strictly separate the genuine task of legislation from the task of directing the day-to-day operation of government, and to entrust the two tasks to two distinct assemblies—a legislative and a governmental assembly. Since in Russia these functions are even less separated than in western democracies, as state power is highly concentrated in the hands of the president, which under Putin has even increased, Hayek's suggestions can in principle be applied to authoritarian post-Soviet transition economies, too. Although they have nowhere in the world been realized and are much more unlikely to be so in today's Russia, because there are too many political and economic actors that benefit from the status quo and would lose their privileges through the implementation of general rules, they nevertheless point to the direction where improvements in the polity should go to in order to limit the scope for a policy of privilege granting that harms competition as an entrepreneurial discovery process.

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