Institutional voids come in many forms and play a defining role in shaping the capital, product, and labor markets in emerging economies. Absent or unreliable sources of market information, an uncertain regulatory environment, and inefficient judicial systems are three main sources of market failure, and they make foreign and domestic consumers, employers, and investors reluctant to do business in emerging markets. When businesses do operate in emerging markets, they often must perform these basic functions themselves.

Institutional voids, however, are not only roadblocks. They are also palpable opportunities for entrepreneurial foreign or domestic companies to build businesses based on filling these voids. To return to the example of the travel industry, Ctrip.com has emerged as China's leading travel booking Web site, offering services similar to those of Expedia, Orbitz, and Travelocity. Established in 1999, Ctrip.com fills voids by aggregating hotel reservation and airline ticket information, providing rates and schedules, and offering a platform for customers to complete transactions—a powerful proposition in a market without a well-developed network of alternative intermediaries, such as travel agents.[7] Ctrip.com registered $210.9 million in revenue in the year ending September 30, 2008, with a profit margin of 31.8 percent.[8] Listed on NASDAQ, the company had a market capitalization of $1.3 billion as of January 13, 2009.[9] The significant value that can be created by intermediary-based businesses illustrates the importance of such market institutions—and the cost of their absence. Transaction costs in markets, the role of market institutions in mitigating them, and the challenges of designing market institutions have been analyzed by several Nobel Prize–winning economists: Ronald Coase, Douglass North, George Akerlof, and Oliver Williamson. We draw on this vast literature in institutional economics in the following discussion.

Why Markets Fail and How to Make Them Work

Transactions vary in difficulty. It is generally easier to transact in developed than in developing markets. For example, renting a car in Boston is far easier than it is in Mumbai, São Paulo, or Ankara. Purchasing a home in London, although increasingly cost prohibitive, is a much easier feat than buying real estate in Moscow, with its infant mortgage market. Even in developed economies, however, there are degrees of transactional difficulty. For instance, U.S. consumers find it far more complex to buy health-care services than to buy groceries or consumer electronics.

Transaction costs, which offer one measure of how well a market works, include all the costs associated with conducting a purchase, sale, or other enterprise-related transaction. Well-functioning markets tend to have relatively low transaction costs and high liquidity, as well as greater degrees of transparency and shorter time periods to complete transactions.

The World Bank Group's World Development Indicators highlight the variance in market performance between countries. Brazil, China, and India required more than twice the number of start-up procedures to register a business in 2007 than the six procedures required in the United States; Australia required only two. Another transaction cost measure is the time required to build a warehouse. A warehouse could be completed in leading developed countries in fewer than 200 days in 2007—in some cases far fewer—whereas in major developing markets such as Brazil, China, India, and Russia, it took 411, 336, 224, and 704 days, respectively. Other indicators, such as time to enforce a contract, time to register property, and time to start a business, also suggest higher transaction costs in many developing regions (see table 1-1).

All markets, irrespective of development phase, are less than perfectly efficient. Compared with emerging markets, however, developed markets are more likely to approach consistent standards for efficient transactions. Conducting even simple transactions in developing economies can be a time- and resource-intensive process, posing hazards for those expecting the fluidity of developed markets.

The challenge of transacting in the absence of well-developed market infrastructure is best illustrated through the Nobel Prize–winning economist George Akerlof's example of a used car market. Akerlof's work showed the difficulty of creating a well-functioning market when the quality of goods and services being bought and sold is uncertain.[10] After