Labor Markets

In the labor market, educational institutions not only help develop human capital but also certify its quality through graduation requirements. Placement agencies and headhunters help employers find talent. Employment contracts and numerous regulations allow both the employers and the employees to protect their interests. Unions act as intermediaries between rank-and-file labor and big corporations that have substantially more power and resources. Unemployment insurance gives companies the flexibility to hire and fire based on their needs and yet provides employees with a safety net.

In developed economies such as the United States, Canada, Western Europe, Japan, and Australia, dozens of market institutions facilitate the smooth functioning of capital, product, and labor markets. In emerging markets, by contrast, many of these intermediary institutions are either underdeveloped or absent. Chapter 2 describes a framework to help spot these institutional voids in emerging markets. Chapter 3 examines the institutional anatomy of markets in more detail as we consider opportunities for businesses to serve as intermediaries in emerging markets.

Structural Definition of Emerging Markets

This chapter highlights the myriad institutions required in product, labor, and capital markets to support simple or complex transactions between buyers and sellers of goods and services. We define emerging markets as those where these specialized intermediaries are absent or poorly functioning. That is, these markets are emerging as market participants work to find ways to bring buyers and sellers of all sorts together for productive exchange. This structural definition arrays markets along a continuum, from entirely dysfunctional—with a plethora of institutional voids—to highly developed (see figure 1-1).

This definition implies that every market, including those of the United States and other developed economies, has some degree of "emergingness" built in. For example, the subprime mortgage market in

FIGURE 1-1

Continuum of institutional voids and market definitions

the United States, a key contributor to the financial crisis of 2008–2009, was an emerging market. Although the subprime lending market was serviced by a range of intermediaries—mortgage brokers, credit scorers, rating agencies, investment bankers, credit insurers, and regulators—these intermediaries did not effectively mitigate the information and contracting problems of a market in which the origination and financing of loans were so separated and incentives—such as credit-rating agencies being compensated by the entities whose securities they rated—were misaligned. The fast growth and increasing sophistication of transactions—the bundling and selling of mortgages in complex derivatives—outpaced the capacity of market intermediaries to handle them. More than the absolute growth or potential of a market, it is this gap in market infrastructure that defines an emerging market. The resulting financial crisis—the worst since the Great Depression—shows that institutional weaknesses can lead a market completely astray.

Working with this structural definition, chapter 2 focuses on how to evaluate emerging markets to spot these voids and introduces a general approach for companies to use in responding to institutional voids. Markets do not emerge overnight. Product, labor, and capital markets that are missing critical intermediaries tend to be imperfect for long periods. Even when governments of developing countries establish new intermediaries to fill these voids, they do not immediately function along the same lines as those in developed economies. The existence of intermediaries does not guarantee that they will execute their roles effectively, efficiently, or even-handedly, as the U.S. subprime mortgage market example illustrates.