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Strategic Innovation and the Administrative Heritage of East Asian Family Business Groups

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Abstract. Using the case of Chinese Family Business Groups (FBGs) in East Asia, this paper examines the relationship between the strategic behaviour exhibited by an organisational form and it's administrative heritage. To do so, we trace the origins of the strategic behaviour that scholars commonly attribute to FBGs to the environmental conditions prevailing during their emergence in the turbulent post-Colonial era of East Asia. We explain how fundamental changes brought about by shifts in the post-Cold war environment of East Asia have confronted FBGs with new opportunities and organising imperatives which their administrative heritages have left them ill-equipped to deal with. In concluding, we explain how the lack of fit between a dominant organisational form and contemporaneous environmental conditions may have significant implications for the organisations themselves and the economies whose landscapes they dominate.

Keywords: path dependence, administrative heritage, Family Business Groups, East Asia, financial crisis, corporate governance

1. Introduction

As industrial '*latecomers*' most East and Southeast Asian businesses acquired the technological capability to break into international markets through strategies of alliances, joint ventures, licensing, OEM manufacture and subcontracting (Hobday, 1995). In this way Asian firms were able to 'catch-up' and sometimes 'leapfrog' (Hobday, 1994) competition in the production of high-quality low-cost goods (Gereffi, 1994). So efficient was the implementation of these strategies that Asian firms significantly depleted Western economies of much traditional manufacturing activity. In the process several Asian economies became affluent societies with per capita incomes that surpass those of many OECD countries such as Canada and the United Kingdom.

As Asian firms approached and reached the technological frontier many states have recognised the need to move beyond factor cost and investment based strategies that relied upon technological imitation toward an innovation-driven phase of economic development (Porter, 1990). To assist in this goal these states modified their industrial policies to improve their innovative capacity (Mathews, 1999, 1997; Carney and Gedajlovic, 2000; Hobday, Cawson and Kim, 2001). States also sought to strengthen the institutional environment for innovation by establishing special stock exchange markets for newer, smaller enterprises

patterned after the U.S. NASDAQ and by strengthening laws protecting intellectual property.

However, these responses have delivered uneven results. While there are several examples of successful state-led innovation in electronics and PC components (Mathews, 1997, 1999; Schein, 1996) there is growing evidence that many East and Southeast Asian firms have profound difficulties in developing the capacity for strategic innovation (e.g. Redding, 1990; Weidenbaum and Hughes, 1996). Firms that demonstrated excellence in mature product markets have encountered difficulties in creating many of the internal organizational capabilities needed to compete in the initiating phase of the product-life cycle (Glasmeir, 1994; Leung and Wu, 1995; Lui and Chui, 1994). Among the deficiencies identified are capabilities, assets and resources needed to discover, develop and commercialise complex technical systems, capital goods and innovative products (Hobday, 2000; Hobday, Cawson and Kim, 2001). Too few firms in the region spend significant sums on research and development. Few have developed or acquired the downstream distribution assets or brand capital to compete in international markets (Redding, 2000).

In this regard, there is growing evidence that the corporate structures and business practises of East and Southeast Asian Family Business Groups (FBGs) may impede industrial reform (Johnson et al., 2000; Khanna and Palepu, 1999; Maher and Anderson, 1999). BGs can be described as 'a corporate organization where a number of firms are linked through stock pyramids and cross-ownership' (Claessens, Fan and Lang, 2002:1). FBGs are similar structures that are controlled by either a single individual, family or coalition of families (Claessens, Djankov and Lang, 2000) and are prominent and in many cases dominant features of the economic landscapes of Hong Kong, Taiwan, Singapore, Indonesia, Malaysia and the Philippines.

In this article we adopt an historical perspective in order to identify and describe the environmental conditions and pre-conditions that led to the emergence of Chinese FBGs as an essential component in the economic development in much of East and Southeast Asia. In doing so, we illustrate how dominant organisational forms and the institutional arrangements that engender them evolve along path-dependent trajectories. Insights from organisation theory suggest that emergent firms adopt business practices and develop routines (Nelson and Winter, 1982) that strongly reflect their nascent institutional environments (Starbuck, 1965). As a consequence, a firm's administrative heritage may leave it ill-equipped to respond to the environmental challenges of a subsequent era (Bartlett and Ghoshal, 1989). At the same time, organisations (particularly dominant ones) interact with, and shape their institutional environments (Pfeffer and Salancik, 1978) in both active and passive ways. Consequently, institutional structures come to reflect the needs and demands of dominant organisations. The purpose of this paper is use this evolutionary perspective to shed light on some of the difficulties firms and economies presently confront in creating innovative capacity.

2. Path dependency in institutions and organizations

Most scholars today agree that institutional environments influence organizational behaviour. The more difficult questions revolve around how they matter, in what degree, and in what ways? Peng (2002) suggests that emerging and transitional economies are a

natural experiment for researching these questions due to their accelerated rate of change. Much of the debate focuses upon the extent of convergence upon market institutions and upon market orientated behaviour by firms (Gilson, 2000). While few scholars suggest absolute convergence upon a single institutional model many believe that the *direction of change* will reflect the imperatives of globalization. For example, Newman (2000) suggests that intermediate levels of institutional change in transitional economies will promote market-oriented transformations in incumbent organizations. Peng (2002) suggests gradual institutional change in emerging economies is likely to de-institutionalize the predominantly relational strategies of incumbent firms and institutionalise the resource and market oriented strategies of new entrants and foreign firms. Gilson (2000) argues that pressure to converge upon a particular institutional form is moderated where institutions are functionally flexible with regard to efficiency pressures.

On the other hand, much of the evidence from the recent economic history of East and Southeast Asia is suggestive of strategic and structural persistence (Whitley, 1999) rather than firm-level adaptation in the face of institutional, technological and market change (Prowse, 1998; Claessens, 1998). Many East Asian businesses remain wedded to the same array of industries and employ many of the same organising principles that characterised the initial stages of East Asian industrialisation (Boyer and Hollingsworth, 1997; Whitley, 1999; Wong, 2000).

To explain such an emergence and persistence of firm strategy, institutional theories of organisations have identified a range of cognitive, bureaucratic and political processes that impede the smooth re-alignment of an organisation with its environment (Oliver, 1991; Hamilton and Biggart, 1988). While early versions of institutional theory emphasized the determinative effects of institutions on firm behaviour (Meyer, 1994) recent theorizing gives weight to the intendedly rational adaptive behaviours of actors (Greenwood and Hinings, 1996). These theories stress the interactive effects of the firm-institution relationship and characterize firm and institutional change as co-evolutionary (Baum and Singh, 1994). In its strongest form these arguments suggest that dominant firms can pro-actively influence their instititutional environments by political action and other means that impede the adoption of institutions that create competition for them. Consequently, institutional change becomes path-dependent (Bebchuk and Roe, 1999). In this paper we utilize what North (1990) calls the "*institutional matrix*", to describe the legal, cultural and normative foundations of a firm's environment.

The importance of the institutional matrix lays in the way in which it limits attempts at institutional reform by policy or regulatory action. Because elements in the institutional matrix are complementary attempts to change part of the matrix are often thwarted by supporting or complementary institutions elsewhere. North (1990) suggests that institutional matrices develop and change in a path-dependent manner. This means that once a particular developmental path has been selected (or even unintentionally adopted) forces are set in motion that reinforces momentum along it. The adaptive expectations of economic and political agents act to orient behaviour toward the opportunities and incentives presented by an initial path. Following a course of least resistance, values, attitudes, behaviours and practices that are consistent with the initial path come to be reinforced, legitimated and institutionalised. At the same time values, attitudes, behaviours and practices

that are inconsistent with a path will tend to wither or fail to develop. Practices, norms and beliefs that encounter high institutional resistance will not be widely diffused in society since energies can be more profitably directed toward more legitimate and institutionally sanctioned ends. Consequently business and regulatory institutions adapt to each other and produce strategic responses that strongly reflect their unique administrative heritages. Contemporary institutional matrices have been shaped by distant, sometimes seemingly inconsequential, events that 'lock-in' particular policy models and approaches to problems.

Path-dependent institutional change in institutional environments is echoed by similar path-dependent processes within organizations that similarly inhibit the adoption of new organizational elements. Since the effectiveness of a particular strategic response is largely a function of the firm's environment (Andrews, 1971; Hofer, 1975), a strategy that is effective under one set of environmental conditions may be much less effective under a later, changed set of conditions. For instance, Bartlett and Ghoshal (1989) describe how many European multinational enterprises that emerged in the first half of the 20th century adopted highly decentralised organisational structures as a means on managing their foreign operations. Such federated operating structures had many virtues in the context of a global business environment characterised by nationalist economic policies and highly fragmented and localised product, factor and capital markets. On the other hand, such a legacy has left many European multinationals with path dependencies ill suited for the increasingly integrated product, factor and capital markets of the modern global economy.

Finally, North (1990) points out that the path dependent character of an institutional matrix means that even well managed firms may have difficulty aligning themselves with new environmental conditions. North argues convincingly that changes to formal rules are often insufficient to bring about institutional change if they are inconsistent with the prevailing culture, beliefs, norms and interests in the institutional matrix.

In the sections below, we illustrate this phenomenon through the case of Asian FBGs in East and Southeast Asia. We first describe the origins of these FBGs and highlight the environmental conditions that led to their ascendancy in the wake of WWII. Next, we explain how FBGs and their institutional environments evolved on path dependent trajectories. Finally, we describe how these path dependencies pose difficulties for many firms and the economies they dominate with respect to the emerging market and technological conditions they face today in the global economy.

3. The emergence and ascendance of ASIA's FBGs

Since WWII, FBGs have become the dominant corporate form of large-scale enterprise in East and Southeast Asia and in many countries, a relatively small number of family firms have become very large (Claessens, Djankov and Lang, 2000; Mackie, 1992). The extent of this phenomenon is indicated in column 2 of Table 1, which gives the percentage total value of listed corporate assets controlled by the largest 15 family firms. Column 2 indicates the total number of publicly listed firms in which a family controls at least 20% of the voting rights. Table 1 also indicates the relative importance of other corporate forms such as state-owned and widely held corporations.

Table 1. Ownership of East and Southeast Asian corporations.

	Top 15 families (%)	Family (%)	State (%)	Widely held financials institutions (%)	Widely held corporations (%)	Widely held
Hong Kong	34.4	66.7	1.4	5.2	19.8	7
Indonesia	61.7	71.5	8.2	2	13.2	5.1
Malaysia	28.3	67.2	13.4	2.3	6.7	10.3
The Philipines	55.1	44.6	3.6	7.5	26.7	19.2
Singapore	29.9	55.4	23.6	4.1	11.5	5.4
Taiwan	20.1	48.2	3	10.4	18.1	2.9
Thailand	53.3	61.6	7.5	12.8	21.1	2.2
Japan	2.8	9.7	0.8	6.5	3.2	79.8

Source: Claessens et al. (2000).

Two key factors behind the emergence of FBGs were the continuing Chinese Diaspora in the region and the state-led industrial development strategies of Post-Colonial States. Emigrants from Mainland China founded a very large percentage of East and South Asia's FBGs (Mackie, 1992; Kao, 1993; Redding, 1990). Overseas Chinese merchants were an important non-Colonial capitalist class in East Asia since the pre-colonial and European colonial era where immigrants from South China were employed as tax collectors and commercial intermediaries or *compradors* (Twang, 1998; McVey, 1992). From these difficult origins Chinese entrepreneurs went on to found a variety of diversified business groups that became a central feature of East and Southeast Asia's organizational mosaic.

Today the overseas Chinese are the dominant commercial class in many East Asian economies including Hong Kong, Taiwan, Singapore, Malaysia, Indonesia, Thailand, and The Philippines (Hodder, 1996; Lim, 1996; Mackie, 1992). In Malaysia, Indonesia, Thailand, and The Philippines ethnic Chinese are demographic minorities, yet account for a disproportionate magnitude of economic activity. The importance of overseas Chinese in Indonesia is a particularly striking example of this phenomenon. While they total only 3% of Indonesia's population, firms controlled by overseas Chinese account for more than half of the country's trade and three quarters of its private domestic capital (Hodder, 1996; Lim, 1996).

Not all family owned businesses are controlled by a single family, for example, in Taiwan *Tainanbang* Business Groups that are based upon alliances of close partners are common (Numazaki, 1993). Diversified government linked enterprises have emerged as important players in Taiwan and Singapore (Williamson, 1997; Zutshi and Gibbons, 1998). Nor are all business groups controlled by ethnic Chinese. For example, Indonesian and Malaysian governments have fostered the development of Bumiputera Groups that are owned and controlled by indigenous entrepreneurs (Mackie, 1992; Haggard, 1994). However, most estimates concur that ethnic Chinese families control a very large proportion of East and South Asia's leading businesses groups (East Asia Analytical Unit, 1995; Lim, 1996; Weidenbaum and Hughes, 1996).

East and Southeast Asian FBGs emerged during a period of extreme political turbulence (McVey, 1992). Colonial disengagement, communist insurgency and the establishment of nationalistic government characterised the post WWII period. In this environment, FBGs emerged as the region's major entrepreneurial force and their social status improved from that of '*pariah to paragon*' (McVey, 1992). Such a description reflects the fact that in the colonial era and at the beginning of the nationalist era, now pre-eminent Chinese entrepreneurs were a marginal social group subject to discrimination, arbitrary state confiscation of their private property and popular violence (Twang, 1998; Redding, 2000). The appearance of the FBG owes much to these unfavourable founding conditions.

Turbulent social conditions in Mainland China produced a large and continuing Diaspora. The overseas Chinese in Southeast Asia are a product of turmoil in their home country. Acute social instability and recurrent civil war including the Taiping Rebellion in 1851–1864, the Boxer rebellion, the Republican Revolution, Civil war, and the Cultural Revolution of 1966–1976 produced a steady migration from Mainland China (Fairbank, 1994). The Chinese state's disdain for commercial activity did little to advance the interests of domestic entrepreneurs who were forced to emigrate (Redding, 1990). As such, overseas Chinese entrepreneurs emanated from an unstable, warring society that placed little value on commercial activity and had no entrepreneurial tradition.

In the late 19th and early 20th centuries, migrant Chinese workers settled in predominantly agricultural colonial societies where alien Westerners occupied elite economic and political positions. Leading colonial industries of plantation agriculture, mining and oil extraction created a range of new intermediary economic roles in society, which recently landed Chinese immigrants, were encouraged to take up. Overseas Chinese who hitherto had no entrepreneurial experience filled new occupations such as tax collecting, retailing, and money-lending and other ancillary roles related to resource-based industrialisation (McVey, 1992). Within the colonial order, overseas Chinese *petit-entrepreneurs* developed contacts with domestic elites and learned commercial skills that later filled a vacuum left by departing colonial powers. First, as the *compradors* of colonial powers, Chinese entrepreneurs familiarised themselves with basic Japanese manufacturing techniques and Western business practices. Many subsequently established businesses based on Western models (Chan, 1982). For example, Singapore's Overseas Chinese Banks founded in the 1920s were modelled on US banks by former Chinese employees of the New York City Bank (Yoshihara, 1988).

The skills and contacts developed by Chinese entrepreneurs during the colonial era increased in value subsequent to the widespread colonial retreat that took place after WWII because indigenous entrepreneurial skills were in short supply.

Chinese migration was widespread in the region and entrepreneurs maintained personal contacts among entrepreneurs from the same family or language group in many East Asian countries. Close-knit, spatially dispersed networks offer channels for mobilising assets and for sharing information about business opportunities (Koa, 1993; Hodder, 1996). In this manner, the Diaspora produced an entrepreneurial class that was well placed to operate international networks and attuned to the behaviour of a diverse group of key actors.

The main concern for post WWII national governments was national security. There was a need to restore internal order or fend off external communist threats—a goal shared by US foreign policy. Consequently, many government officials in East Asia were drawn

from military ranks and had little knowledge of business and economics. During this time, national economic agendas were commonly limited to managing strategic industries and rebuilding basic infrastructure. Strategic industries were managed by establishing state owned enterprises and infrastructure was created with the assistance of US aid. Prior to the late 1980s, there was little Japanese investment in East Asia- a function of both Japan's own nationalist economic agenda and a legacy of Japanese assets being confiscated and turned over to indigenous governments at the close of WWII. Much capital for investment came from local savings (Singh, 1998). Observing the success of post WWII Japanese industrial policy, beginning with Korea and Taiwan and spreading sequentially through Southeast Asia, governments adopted export oriented development models. These policies focused upon the provision of tax incentives and low interests loans to spur production and the utilisation of low cost labour to compete in textile and consumer durables. Such export oriented development (EOD) models provided many opportunities to cosmopolitan Chinese entrepreneurs.

Of particular note were Chinese entrepreneurs who cultivated relations with Japanese manufacturers. Seeking to re-establish entry into East Asian markets Japanese producers needed local partners to surmount tariff walls. Western colonial firms operating in the region already had strong relations with European sources and at that time did not perceive much potential in Japanese manufacturers (Yoshihara, 1988). Chinese entrepreneurs were less established and willing to link up with Japanese partners. Whether due to a cultural affinity, social marginality or western hubris, circumstances put the Chinese into a series of minority joint-ventures as well as licensing and technology sharing agreements with Japanese partners in product-markets such as textiles, food processing and cement production. Through these relationships, many FBGs were able to develop and acquire basic process engineering competencies.

Despite the fact that FBGs embodied an entrepreneurial drive and possessed competencies well suited for export oriented development models, they were owned by a highly visible ethnic minority in many countries and did not always enjoy the full protection of the state. Chirot and Reid (1997) characterise Chinese entrepreneurs as '*essential outsiders*' *in this regard.* In Thailand, Indonesia and The Philippines political corruption and bureaucratic '*rent-seeking*' (McVey, 1992) produced wariness of the state. Despite their economic success, and indeed possibly because of it, Chinese entrepreneurs encountered discrimination and asset expropriation. Recent violence against Chinese property in Indonesia indicates that this hostility is both grave and enduring. Overseas Chinese entrepreneurs suffered official discrimination in Malaysia and Indonesia from nationalist policies intended to secure greater participation in the economy for ethnic nationals (Lim, 1996).

In States where Chinese were not ethnic minorities (i.e. Hong Kong, Taiwan, and Singapore) entrepreneurs remained wary of the state. Many entrepreneurs had migrated from Mainland China and had grown to distrust the state (Fukuyama, 1995; Redding 1990). In Hong Kong, the Colonial state was relatively indifferent to fate of entrepreneurs. Similarly, in Taiwan entrepreneurs deeply distrusted the state (Wade, 1990). Entrepreneurs cooperated with the state when it was in their interests but not otherwise (Chu, 1994). Moreover, fear of Mainland aggression in Taiwan and a return to Chinese sovereignty in Hong Kong did little to assuage age-old uncertainties about state expropriation.

Government connections offered the opportunity for many FBGs to use their personal network or *guanxi* to secure national production franchises and other licenses. However, the initial relationship between nationalist states and the entrepreneurial Chinese was at best one of indifference and mutual mistrust (Yoshihara, 1988). These relations have become more accommodating in recent times, but in the 1950s and 1960s governments did not particularly favour the overseas Chinese, but they did need entrepreneurs and the Chinese filled that gap (McVey, 1992).

4. The creation of an administrative heritage

The forces of Diaspora, national economic policy and hostile state bureaucracy described above created the conditions for the appearance of FBGs. This environment was simultaneously threatening and full of opportunity for FBGs. However, it was in this environment that FBGs forged a characteristic set of business routines and strategic behaviours that would best protect their economic interests and which would later become their hallmark. While culture, politics and historical events posed a number of constraints, FBGs responded to prevailing conditions in a manner that was fully consistent with the rationalities of a family business.

Regardless of context, the concentration of personal and family wealth in owner-managed firms normally creates a preference for income and for wealth preservation over other dimensions of enterprise performance such as growth (Dyers, 1986; Wong, 1985). As highlighted by agency theory, other key differences in strategic goals stem from the risk bearing attributes of owner-managed enterprise (Fama and Jensen, 1983). Owner managed enterprises are not well equipped to bear risk since the owners are likely to have a large proportion of their wealth and income tied to the performance of their enterprises. Such a concentration of undiversified risk increases the firm's effective cost of capital and may result in risk-averse strategic behaviour (Carney and Gedajlovic, 2002; Claessens et al., 1999).

While FBGs are motivated to accumulate wealth, family needs create pressures to extract capital from the business (Chandler, 1990). Such pressures reduce available capital for organisational growth. FBG ownership is ordinarily concentrated in the hands of a founding entrepreneur, the immediate family or ancestral trust depending upon the age of the firm (Wong, 1985). When the family firm's assets account for a significant proportion of that family's wealth significant risk can be reduced, and the preservation of wealth better assured by extracting capital from the business and allocating it to alternative sources. In the post war Southeast Asian political environment, the risk of expropriation reinforced the prudential avoidance of capital concentration.

Other forces promote a near term focus on immediate earnings. To provide income for an extended family and inheritances for male offspring who may wish to establish their own patrilineal businesses, there is additional pressure to extract income from the core business. Redding (1990:109) suggests the spirit of Chinese entrepreneurship is infused with values *that* '*facilitate the initiating phase of entrepreneurship but which place barriers to the higher levels of co-ordination necessary for growth.*' Under these conditions, goals related to patient capital and large scale or enterprise growth give way to a concern for near-term profitability and family wealth preservation (Carney and Gedajlovic, 2002). In theory, equity market prices reflect both imputed short and long term firm values, but unless

an owner plans to reduce their holdings in a firm, market returns will not be as important a goal as those related to cash flow and accounting income.

4.1. FBGs and the allocation of capital

Contemporary analyses of FBG suggest that their competitive advantage lies in their ability to fill institutional voids (Khanna and Palepu, 1997). One such void, namely the absence of liquid equity markets, has stimulated FBGs to develop internal capital markets. The stimulus to develop such a capacity is a response to an institutional environment that was in part deliberately designed to inhibit equity market development. Under state led industrialisation, non-bank sources of corporate financing in Asia were both actively and passively suppressed (Prowse, 1996). Active suppression is the degree to which government regulation, discriminatory taxation and cumbersome and restrictive issuance procedures hamper capital market development. Passive suppression refers to the neglect of regulations governing corporate disclosure, accounting standards and protection for minority stockholders (Prowse, 1996). The former restricts supplier and user access to markets. The second interferes with the ability of participants to get reliable data about risk and return.

Active and passive suppression of non-bank sources of finance was an integral part of governmental led industrialization as it concentrated control over the flow of credit and investment in the hands of the state, a factor that was especially important during a post-colonial period of capital scarcity and credit rationing.

Historically, overseas Chinese entrepreneurs had relied upon close-knit rotating credit associations for external funding (Hamilton, 2000), but the opportunities created by export oriented development demanded greater capital flows than those available from such personal networks. In the absence of capital markets, firms were restricted in the range of financing options. Funding for growth was limited to self-generated funds or lending from state controlled banks. The evidence from the period suggests that reliance on internal funds was more critical (Akyuz and Gore, 1996; Singh, 1998). However, to the extent that firms relied on external funding, then they were drawn into the state dominated system where sensitivity to state objectives was a pre-requisite for continuing financial support.

Consequently, the region's financial systems developed a distinctly relational character distinguished by enduring interpersonal networks of policy makers, lenders, borrowers and intermediaries (Rajan and Zingales, 1998). Entrepreneurs that developed a facility for relational contracting were at an advantage under these conditions. Indeed, Wong (1996) suggests that by supporting certain connected entrepreneurs Banks acted as 'kingmakers'. In these circumstances, 'arms length' equity markets and a robust necessary regulatory infrastructure did not take root because FBGs developed alternative sources of capital and governments did not encourage equity market development. However, the absence of efficient markets for equity would later limit the development of innovative capacity.

A defining element of a firm's strategy is its capital allocation routines (Chandler, 1962). In Asian FBGs, capital allocation proved to be a pivotal influence on the establishment of their administrative heritage (Carney and Gedajlovic, 2002). We have noted the inefficient risk bearing properties of owner managed firms. One means of diversifying risk while maintaining family control is to diversify at the product-market level. FBGs are noted for the

fragmentation of their capital resources, a propensity that creates widely diversified product-market portfolios. A typical pattern is to establish a manufacturing business followed by diversification into trading activities followed by investments in property and financial services (Lassere and Schutte, 1995). The manufacturing opportunities offered by export oriented development policies provided the initial impetus for growth. However, FBGs do not possess a particular affinity for manufacturing activities. The propensity for capital dispersion weighs against success in capital-intensive manufacturing activity.

Many analysts have noted the overseas Chinese propensity for deal making, trading, and speculating (Chu and McMurray, 1993). Entrepreneurs favour, and excel, with opaque transactions based upon privileged information and personalised relations or *guanxi*: the practice of drawing on connections to secure favours in personal or business relations. Lasserre and Schutte (1995) see FBG success as stemming from *guanxi* and the related ability to exploit market imperfections arising from access to privileged contacts and non-publicly available information. Capitalising upon such opportunities does not require a competence-based rationale. Many of these opportunities are self-limiting or temporary and do not require a major capital commitment. Therefore at the level of the business group, the FBG tends to be widely diversified.

FBGs tend to disperse their assets into multiple separate public listings. Ultimate majority ownership is typically concentrated in a private enterprise registered in an offshore country of convenience. Breaking up large groups into smaller units reduces the enterprise's visibility, a basic defence mechanism for a firm in a hostile environment. However, fragmentation and the creation of multiple separately listed public units is a means of achieving monitoring and feedback on unit performance when subsidiary managers are not trusted, or when the organisation has inadequate capacity to perform a thorough internal auditing function (Carney, 1998). Daily market valuation of a business unit's performance is a valuable managerial decision tool, which is an advantage denied most diversified firms. Consequently, at the level of the firm, product market scope is narrowly focused.

Relational contracting, discrimination and local hostility encouraged FBGs to develop a highly liquid and generic asset regimes that could be rapidly deployed. Kao (1993) suggests the preference for liquid and tangible assets results from deeply held '*life-raft values*' stemming from generations of economic and political uncertainty. Liquid assets are mobile and moved under a perceived threat. Moreover, a *guanxi* driven diversification and the propensity to speculate also demands access to liquid assets if the firm is to profit from fleeting opportunities. Family wealth preservation goals and the capital allocation strategies that support those goals in turn influence the way FBGs compete in the market place.

4.2. FBG product-market strategies

Establishing large enterprises and creating brand capital requires patient capital and also increases the visibility of an enterprise, something foreign entrepreneurs may wish to avoid. Resource commitments in dedicated assets or lock-in investments reduce the flexibility that is central to FBGs adaptive-entrepreneurial capabilities. Instead, capital investment is directed to generic assets that are readily deployed to respond to shifts in fashion and volume (Redding, 1990). Moreover, because FBGs appropriate residual returns and tend to focus

upon accounting profits, they have a strong incentive to reduce operating costs (Carney, 1998). The ready availability of low cost labour along with these incentives combined to provide FBGs with a competitive advantage based upon cost leadership. Rather than seeking to build competitive advantage through innovation or the creation of proprietary assets, FBGs have typically focused upon the manufacture of products that were conceived and designed elsewhere (Hobday, 1995, 2000).

Relatedly, the international activities of the FBG are limited to labour seeking FDI and quasi-portfolio investment (Yoshihara, 1988). The success of the export led development policies in Southeast Asia eroded the labour cost advantages of local firms, especially in settings such as Taiwan, Singapore and Hong Kong. Faced with higher costs FBGs began to internationalise to seek cheaper labour (Lecraw, 1993). The first international investments by FBGs were manufacturing transplant activities, which were financed through internally generated funds. However, manufacturing investments are minor relative to a second wave of investments in service sectors, particularly in infrastructure, property development and financial services. A flood of foreign portfolio investments made second wave investments possible and commercial bank lending (OECD, 1999; Henderson, 1998) that enabled FBGs to make many ill-fated asset purchases. Many assets acquired in this way have proven to be overpriced and are now non-performing. FBG investments in services may be viewed as the exploitation of firm specific advantages in the management of labour intensive processes (for example, in construction and hotel management) and in trade and financing (Lecraw, 1993).

Eventually, decreasing investment yields cause exportation of capital. Indeed, Taiwan and Hong Kong have become net exporters of capital (UNCTAD, 1994; World Bank, 1996). While some have heralded capital exports as evidence of the emergence of FDI and the development of the Asian multinational (Yeung, 1994), an alternative characterization is that it is a form of disguised portfolio investment (IMF, 1998; OECD, 1999) and a case of capital flight (Yoshihara, 1988). In this view, a significant portion of Asian FDI may represent attempts by family principals to diversify their risk and protect their personal wealth rather than attempts to enhance their strategic assets and technical capabilities.

Alternatively, many of the international investments of FBGs may be driven by personal connections or *guanxi* and are project-specific investments aimed at generating fast returns (Williamson, 1997; Lasserre and Probert, 1998). Investments based upon *guanxi* may be a fundamental cause of capital misallocation. While *guanxi* provides market access, it does little to contribute to a firm's technical or managerial capabilities. Indeed, *guanxi* may do the opposite. Because investments stem from personal connections they escape internal bureaucratic and market scrutiny leading to widespread allocation to inefficient or low return projects (Rajan and Zingales, 1998).

Nevertheless, skills with *guanxi* and relational contracting in weak institutional environments may constitute the basis of a competitive advantage. Khanna and Palepu (1997) suggest that business groups can add value in such institutional settings by imitating the functions of several institutions that are present only in advanced economies. For example, a conglomerate with a reputation for quality products can use its group name to enter new businesses even if those businesses are completely unrelated. As Khanna and Palepu put it: '*because the misdeeds of one company in a group will damage the prospects of the other,*

all the group companies have credibility when they promise to honor their agreements with any single partner. They (conglomerates) provide a haven where property rights are respected' (1997:17). For example, large Asian property groups have diversified into cellular telephony not on the basis of telecommunications competencies but due to a capacity as reliable business partners.

For Asian firms that have followed more focused product market strategies, the capacity for filling institutional voids has been the competence basis of growth. For example, Gereffi (1994) notes that Asian producers of athletic footwear, garments and fashion products have developed profound low cost-high quality manufacturing skills. However, despite their best efforts, such firms confronted difficulties in extending their activities down the value chain into textiles or up the value chain into distribution, retailing and branding.

In response to rising labour costs in home markets and under pressure from global retailers and marketers of branded products, Asia's contract manufacturers have developed geographically diversified production systems in countries where labour costs remain low. Skilled at operating in locations with weak institutional environments, these producers are adept at acquiring permission to access resources and export quotas from local bureaucrats. However, in industries dominated by contract manufacturing, the core capability is reputation for timely contract fulfilment under stringent price and quality specifications and not strategic innovation (Gereffi, 1994).

4.3. FBG organization structures

There is considerable research pertaining to the nature and origins of FBG organizational structure. Management is exercised through a senior owner-manager who typically assumes the presidency of the core firm and concurrently holds the post of chairman in the major affiliated firms whose presidential posts are occupied by kin or close trusted associates (Koike, 1993). The senior management team tends to be small, and the limited numbers of non-kin professional managers are often excluded from strategic decision making processes (Kao, 1993; Redding, 1990). Where professional managers are employed in senior positions, the roles are considered subordinate to entrepreneurial roles held by family members or trusted friends (Redding, 1990; Whitley, 1992). Non-kin professional managers from different group divisions rarely meet and the structural integration of group management is weak. On the whole, '*groups look more like a collection of independent firms than an integrated business group*' (Numazaki, 1993:502).

Redding notes the avoidance of organizational complexity and the tendency to subdivide business units to maintain financial simplicity. This solution allows entrepreneurs to '*carry the paper and pencil in the head*' (Redding, 1990:181). Ampalavanar-Brown (1995:2) says '*the financial structure, which might have held the structure together more firmly, did not play a large part in pulling the parts together into a cooperation. The purposes of the accounting system were to track sales and purchases and to prevent fraud*'

From an information processing perspective this kind of organizational structure commonly resembles the Holding Company or H-Form structure (Williamson, 1975). The informational attributes of the H-Form structure facilitate the undiluted control of a diverse range of assets while requiring limited coordination, planning and auditing capacity

(Carney, 1998). The H-form permits a small management team to oversee heterogeneous businesses by focusing upon financial performance metrics such as ROI (Chandler, 1997).

Managerial processes are infused with leadership values that Westwood (1997) describes as '*paternalistic headship.*' The structural consequences of paternalistic headship include high centralization, low or selective formalization, and non-complex structural processes. The human resource implications of such structures are significant. Immediate and extended family and trusted quasi-family employees (Westwood, 1997) may be expected to be highly committed and motivated members of the management team (Whitley, 1999). On the other hand, for employees without any special relationship to the patriarchy, commitment is likely to be weak. Consequently, employee turnover tends to be very high and exit decisions can be precipitated by marginal salary differences (Shieh, 1992). Non-trusted employees in the organization may be subject to a functional handicap because '*didactic leadership emasculates subordinates by depriving them of the information necessary to have a clear idea of what is going on in the organization*' (Westwood, 1997:469).

Organizational and management practises in Asian firms are often attributed to cultural (Westwood, 1997) institutional (Hamilton and Biggart, 1988) and national business system characteristics (Whitley, 1992). However it is also the case that the relatively simple organizational structures adopted by FBGs represent an efficient response to the structural imperatives associated with latecomer industrialization.

In the catch up phase of industrialization much technology was mature, characterized by low task complexity. Owner-managers had little need for large support staffs or elaborate technostructures (Mintzberg, 1979). With product market strategies focused upon prices and costs managers could rely upon centralized organization structures with low horizontal complexity and vertical co-ordination based upon rules or personalized authority. In commodity markets governed by rapid price movements and lacking the reach to influence distant markets managers did not develop extensive planning, control and marketing infrastructures. Moreover, even if they had wanted them skilled-middle managers were in short supply.

To sum up, post war Asian FBGs exhibited strategic behaviour aimed at wealth preservation and near term accounting profits. They pursued conglomerate diversification strategies and their balance sheets tended towards generic and liquid assets. International investments were first labour seeking, but later, fuelled by foreign portfolio inflows, investments were deal driven based upon a competence with relational contracting. Where product market strategies were more focused, such as contract manufacturing, relational skills proved decisive in dealing with distant buyers and local bureaucrats. FBG entrepreneurs created simple, lean, personally directed organizations structures as a cost-effective vehicle for implementing their strategies. Widely practised, such strategies provided the entrepreneurial drive behind the export-led era of East and Southeast Asian industrialisation. Indeed, it is the great success of these strategies that constitute the lasting administrative heritage of the FBG as an organisational form.

However, elements of this heritage are self-limiting over the long run. The currency devaluations that precipitated the 1997 financial crisis were based upon weak organisational fundamentals (Backman, 1999; Garran, 1998; Henderson, 1998). Nevertheless, broad

environmental changes are bringing about conditions that may support new strategic behaviours, which may contribute to improved productivity and firm competitiveness.

5. Developments in the modern era

The end of the cold war and the rise of Japan as a global economic power represent two epochal developments that fundamentally changed East and Southeast Asia's political and economic environment. China's adoption in 1978 of Deng Xiao Ping's four modernisations resulted in the gradual opening of China to foreign investment (Fairbank, 1994). This major policy shift signalled a reduction in cold war tensions and allowed states in the region to focus upon the economic agenda. Another crucial event was the Plaza Accord signed by the G5 countries in 1985, which led to a rapid appreciation of the Japanese Yen against other major currencies. The Plaza Accord signalled the beginning of the end of Japanese export oriented development and led to large outward Japanese investments into other East Asian economies (Stubbs, 1999). These two events accelerated the movement of capital into and within the region. In response to these capital movements many states initiated partial liberalisations in their capital markets and eased restrictions on the foreign ownership of domestic firms (World Bank, 1996). In turn, more liberal financial policies stimulated the flow of portfolio capital into local equity markets (Henderson, 1998).

Concerned with national security and internal stability, state bureaucracies of the nationalist era new little of business and did little to promote business interests except when it concerned personal gain (McVey, 1992; Macintyre, 1994). Governments of Indonesia, Malaysia and Taiwan were preoccupied with the threat posed by internal or external communist parties. The colonial governments' of Singapore and Hong Kong were relatively indifferent to indigenous enterprise. With the subsidence of external threats and the ending of colonial rule, state bureaucracies have recognised the importance of economic development to their political legitimacy and national prosperity. In addition, rents secured by bureaucrats from office holding and cronyism are relatively fleeting and insecure. To assure a more secure revenue stream officials needed to acquire a greater knowledge of business, to enable the official to oversee the handling of his money, and effective legal guarantees for private property to ensure it could not be confiscated once out of office. In circumstances of perceived mutual interest and more balanced-power relations, state officials and entrepreneurs began to develop a measure of trust and mutual accommodation. A consequence of economic growth has been to convert state bureaucrats from '*parasites to promoters*' of business (McVey, 1992:26).

Rapid post war growth and the colonial withdrawal created a managerial vacuum in the region that was left unfilled for a generation. In the past two decades several new sources of managers have emerged. First, is a new generation of university educated managers that are the product of recently established universities. New Asian managers are more likely than their parents to have received a university education. Secondly, in the post-war years, large numbers of students received graduate engineering and business education in Western universities. Importantly, after graduation many students remained in the west to work for several years before going home. Returning with technical qualifications and first hand experience many promoted professional management practices and the absorption of new

technology in their firms (Vogel, 1991). Third, an increasing number of young managers are gaining experience in the local subsidiaries of the region's MNEs. The transfer of management techniques, especially at the plant level, accompanied extensive Japanese investment (Thong, 1991). Finally, following de-colonialization many governments paid careful attention to managerial development programs in state and para-state organisations that are now coming to fruition (Schein, 1996). While many point to the continuing acute shortages, a pool of trained managers has been assembled that did not exist in the nationalist era. Moreover, these new managers have been exposed to educational and organisational influences different from their parents of a prior generation and do not necessarily embody parental values.

From several perspectives, many East and Southeast Asian business environments have become increasingly munificent in the modern era. Risk and equity capital has become more freely available. A managerial cadre is coming into being that could provide the co-ordinating and organising capacity needed for technologically complex businesses. State officials now more readily facilitate new business projects. Indeed, across the region state officials now actively promote technological upgrading through a variety of industrial policies (Wade, 1990; Yeh and Ng, 1994; Noble, 1998; Hobday, 2000). However, despite an environment that is in many respects hospitable to the development of new industries and technological upgrading, powerful path dependencies have resulted in organisational and institutional inertia.

6. Path dependence in institutions and organisations

The set of capabilities developed by Asian FBGs profoundly reflects their history. In the Post-Colonial era war-damaged Asian economies faced the challenge of reconstruction in context of cold war politics. Entrepreneurial responses to this challenging environment were remarkably adroit and have attracted wide admiration. As industrial latecomers located in economies with undeveloped national systems of innovation firms were dependent on others for the core capabilities needed to enter into international markets. FBGs first perfected competencies in relational contracting and coping with institutional voids. Relational contracting reflects skills in navigating a hostile political environment but was also the key to acquiring technological, financial and commercial resources.

Such competencies were well adapted to the exigencies of the post war institutional environment and the factor-cost and investment driven (Porter, 1990) phases of industrialization. The capabilities developed by entrepreneurs in navigating hostile operating environments proved to be transferable to other emerging markets in the region. Transferable relational skills also facilitate firms to transfer their technological capabilities to new and institutionally undeveloped environments (Hu, 1995). However, these competencies are unlikely to furnish the basis of a competitive advantage in an innovation-driven phase of development.

Notwithstanding state encouragement, many FBGs have typically failed to move into high technology areas or create proprietary innovative competencies (Hobday, 2000). High growth markets are concentrated in new-technology based industries such as software or new media. The intellectual property requirements, capital and risk-profiles and internationalism of these new industries pose a variety problems to the family-centric character of the FBG

(McVey, 1992). Capital-intensive ventures in the region have normally been the domain of public enterprises (Wade, 1992) but state-owned enterprises have not been dynamic in seizing opportunities in the new industries (Vogel, 1991; Zutshi and Gibbons, 1998).

In closing this paper, we show how elements of the FBG administrative heritage interact with the institutional matrix producing path dependent processes that impede the accumulation of innovative capabilities. Both organizational and institutional path dependencies illustrate the constraints upon actors, such as a government or regulator, that endeavour to change their institutional environments, for example by introducing a particular regulation or economic mechanism. Path dependencies highlight the fact that institutional change agents have little control over the way a change may function within a particular context, partly because firms or other constituents may actively resist institutional processes (Oliver, 1991; Bebchuk and Roe, 1999) or passively disregard elements in the environment such that desired adaptations do not take root (Prowse, 1996). Such path dependencies draw attention to passive processes that limit the extent to which states can effectively imitate and recreate institutional models that are successful in other contexts (Gilson, 2000).

Path dependent processes have created a managerial capacity constraint in many East Asian economies that militates against the cultivation of innovative capacity. Latecomer industrialization created a heritage of simple organizational structures that were well adapted to the purpose of technological catch-up. In this phase managers did not need the organizational models used in innovation intensive sectors, such as strategic business units, matrix organizations, and professional bureaucracies. Business partners performed functions such as R&D, logistics, distribution, and marketing so information-processing requirements were relatively low and managers did not perceive the need for complex lateral coordination mechanisms or an extensive middle management to implement such systems.

Although a pool of trained managers has emerged in the region in recent years that might now staff more complex organizational structures, the deployment of that cadre to very senior levels of organisation has been limited by an FBG tradition for selecting top management on the basis of family ties, rather than on the basis of professional expertise. Many researchers have described and documented this tendency among FBGs in particular (Wong, 1985; Fukuyama, 1995; Weidenbaum and Hughes, 1996). Redding (1990) notes that while mangers are hired for their technical proficiency, they are typically excluded from strategic decisions. Consequently, experienced professional managers are relatively rare in the region since FBGs have not make extensive use of them.

While there was no efficiency penalty for managerial capacity constraints in the catch-up phase of development it seems probable that there will be increased costs with FBG practises in an innovation phase of development. One consequence of selecting top management from a narrow circle of kin or close business associates is that the top management team is often quite homogenous and lacking in the diversity of skills needed to grow the organisation to international scale. Other manifestations of this self-imposed managerial capacity constraint are evident when one considers the conspicuous difficulty East Asian FBGs have encountered in entering overseas and especially Western markets (Pangarkar, 1998), and acquiring and managing high-technology firms in political and social conditions different from their domestic markets (Hu, 1995). Consequently, the Asian Multinational organisation tends to be focused within the Asian region (Lecraw, 1993; Yeung, 1994).

A second illustration of the modern day consequences of path dependence in FBGs and their institutional environments relates to financial system development. In the wake of the Asian financial crisis, a number of analyses have pointed to systematic problems in East Asian financial systems (Claessens, 1998; Goldstein, 1998). At the centre of many analyses are problems stemming from the dominance of bank financing (Prowse, 1996; Huang and Xu, 1999) and the comparative underdevelopment of public and private equity markets.

The dominant role of banks in many East Asian economies can be seen as a path dependency stemming from the region's rapid industrialisation. In the early phases of the region's post WWII growth period, infrastructure building and support for export led manufacturing were fuelled by capital from state owned banks (Singh, 1998). As these economies grew rapidly, banks consolidated their dominant position as the major form of financial intermediary. Moreover, states that attempted to influence industrial policy and direct investment to government priorities could better accomplish their goals through a tightly regulated banking sector (Noble, 1998; Rajan and Zingales, 1998) than through diffuse actors in equity markets. To better control the allocation of capital, governments in the region actively and passively suppressed non-bank sources of financing (Prowse, 1996, 1998). For several reasons FBGs to finance their growth through internally generated cash flows (Akyuz and Gore, 1996; Singh, 1998) so as to retain control in the hands of a single family. Government policy and firm financing preferences combined to leave public equity markets relatively underdeveloped.

While banks are structured to provide long-term debt and working capital to manufacturing firms or to firms who can back their loans with liquid or marketable assets as collateral (Miller, 1998; Rajan and Zingales, 1998) they less are not well structured to provide risk capital or to lend to businesses whose uncollateralised assets. For example, bank debt is rarely used to support R&D projects that have risky cash flow outcomes and little residual value in the event of failure. Therefore, in bank dominated financial systems that have underdeveloped equity markets, firms with innovative but risky projects and firms whose key assets are intellectual property or intangibles can face risk capital constraints (Prowse, 1996; UNCTAD, 1998).

Policy makers in the region are quite aware of the innovation limits of bank-dominated financial systems and they have attempted to solve the problem by addressing the capital market void problem directly: by supplying 'risk capital' through venture capital divisions of state banks, by supplying incentives to cash-rich incumbent firms to provide venture capital and by establishing special stock exchange markets for newer, smaller enterprises. In this regard, policy makers recognize the complementariness of institutional environments: specifically for venture capital markets to work efficiently investors must have a means to capitalize their investment. Path dependency shed light on the difficulties of these solutions.

First, these solutions suffer from the fact that yet other complementary institutions are still absent from the institutional matrix, including 'venture capital organizations, the limited partner investment vehicle, and investment bankers experienced in taking early-stage companies public' (Gilson, 2000:20). Secondly, there are limits on the functional flexibility of existing Institutions. In particular, state banks are imperfect substitutes and lack some of the essential incentive features of venture capital companies found in technology intensive economies. Third, relying on incumbent firms to supply venture capital serves only to

entrench their positions. Since incumbent firms possess an incentive to oppose institutional changes that increase competition for their established positions (Bebchuk and Roe, 2000) it is unlikely that FBGs will be willing to nurture a generation of new firms that will marginalize them. Perhaps more importantly it seems unlikely that FBGs will be able to alter their functioning in a way that emulates venture capital markets. Recent evidence suggests that while BGs in East Asian, excluding Japan, add value to older and large businesses they appear to reduce value in small and young businesses (Claessens, Fan and Lang, 2002).

As latecomer industrialisers (Hobday, 1995), Asian FBGs began a path dependent development pattern that initially focused their activities as imitators at the mature stage of various product-market life cycles. Surrounding elements in the institutional environment, including, capital markets, and internal elements including organizing patterns and managerial recruitment practises became adapted to imperatives of cost-based competition in mature commodity markets. Asian FBGs have pushed this strategy to the limit and now confront competition from ever lower cost rivals located in Mainland China and elsewhere. As such, FBGs face pressures to upgrade their competencies, engage in strategic innovation and to enter higher valued added product market segments. However, in meeting these pressures, FBGs must seek to re-orient business routines that were perfected for the conditions and challenges of a very different historical era. Moreover, they must accomplish this re-orientation from an institutional base that they played a major role in creating and sustaining, but which now impedes, rather than supports the requisite corporate restructuring and renewal.

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