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Abstract

We present a sketch of the existing Chinese business system and discuss what we see as the main challenges in its future evolution. We argue that China will probably retain its own unique form of capitalism rather than converge on any presently existing model. Though the future shape of this form is difficult to predict, the available theory and evidence suggest that the present South Korean business system is probably the closest equivalent among the existing major forms of capitalism to what the Chinese business system may look like in the next ten or twenty years. We lay out implications of our arguments for future research, especially in the area of institutional comparative advantage.

Keywords
China, varieties of capitalism, comparative business systems, development, innovation, efficiency, convergence, hybridization

1. Introduction

Current research on varieties of capitalism, a field also known as comparative business systems, owes much of its vitality to the seminal volume on the topic edited by Peter Hall and David Soskice (Hall & Soskice, 2001). Though not the first work to explore this topic (earlier works include, among others, Albert, 1993; Berger & Dore, 1996; Dore, 2000; Orrù, Biggart, & Hamilton, 1997; Redding, 1990; Whitley, 1992, 1999), no other recent contribution has had similar impact on the progression of the field. At the time of this writing, Google Scholar lists about 1,300 citations to the entire edited volume, another about 1,000 citations to the introductory chapter by Hall and Soskice, and several hundred more citations to the remaining individual chapters in the book. Increasingly, other areas of the social sciences have come to draw on the theory and evidence presented in the book, including business and management research in the context of topics such as corporate governance (Aguilera, Filatotchev, Gospel, & Jackson, forthcoming; Aguilera & Jackson, 2003; Jackson, 2005) and international business (Jackson & Deeg, 2008; Redding, 2005; Witt & Lewin, 2007; Witt & Redding, forthcoming).

A casual review of publications suggests that most of the research in the field has focused on advanced industrialized nations in the West and, to a lesser extent, Japan. This relative de-emphasis of much of Asia is not without irony, as many of the early works on comparative business systems grew out of empirical studies in the Asian context (e.g., Berger & Dore, 1996; Orrù et al., 1997; Redding, 1990; Whitley, 1992). At the same time, it implies that many questions remain fully or partially unanswered, and the field, wide open for further exploration. To name just a few of these questions: What is the precise shape of East Asian forms of capitalism? What challenges do they face as they evolve? Are these forms of capitalism transient and bound to converge on Western models, or viable in the long term? And what are their likely evolutionary trajectories?

Our objective in this article is to propose answers to these questions for one specific national context, that of the People's Republic of China. It hardly needs arguing that what is happening in China today has significance for world business. It is a major source of products or components, a major competitor for raw materials, an increasingly significant source of capital, a major market in its own right, a dominant source of low cost labor, and a society with a growing sense of confidence and purpose. Its adventurous experimentation through its recent age of reform has yielded forms of integrating economic action that are both new and successful. And although they may take in certain components from the outside world, when seen as complete organizations they are by no means copies of other models. They are of great interest not just in practice but for theory-building, especially that version of it that deals with comparison.

We begin with a brief sketch of the existing Chinese business system as it presents itself today. We identify three challenges any mature, successful business system needs to meet: adaptability, innovation, and efficiency. It seems to us that while China has shown plenty of adaptability, innovation and efficiency are likely challenges in the future evolution of the business system. We proceed to propose that China will probably retain a unique form of capitalism. Though the shape of this form is difficult to predict, it seems likely that the present South Korean business system is the closest equivalent among the existing major forms of capitalism to what the Chinese business system may look like ten or twenty years from now. We conclude with a brief discussion of the implications of our arguments for future research, especially in our understanding of the institutional foundations of comparative advantage in general and that of China in particular.

2. Present State and Challenges Ahead

The pattern of the Chinese economy, in terms of the modes of coordination and control of economic action that have emerged to date, seems to have settled so far into three main formulae within what is bound to be an extremely complex and disparate economy. Each is a configuration of different features; in other words, a form of equilibrium that—although still inevitably evolving—is nevertheless showing signs of stable self-replication. Summarized in nutshell (for a detailed analysis, see Redding & Witt, 2007), these three formulae are:

1. The state-owned enterprises left over from the state planning era, and now under severe scrutiny over their performance. Simply put, they are now required to perform at global standards or to be privatized (Ralston, Terpstra, Wang, & Egri, 2006). Some will be retained on grounds of their strategic significance for the state. They tend to be large, to be both capital and labor intensive, and to have been run until recently at low standards of capital and productive efficiency. They also contributed heavily to the accumulation of major over-capacity in industry. Under new management in many cases they are now changing radically towards professionalism and market sensitivity (Guthrie, 2005; Tan & Tan, 2005). The state sector probably accounts now for about 15 percent of the economy.
2. The local corporates emerged mainly during the 1990s as access by local entrepreneurs to the assets of what had earlier been the "collective" enterprises became an important side effect of the reforms initiated under Deng Xiaoping. Such assets were generally available at bargain prices and often brought with them access to soft loans available via local branches of the state banking system. Access was not possible without the co-opting of political support, and this became feasible as economic decision power in China moved incrementally from Beijing into the provinces, cities and local administrations over the past two decades. State control was not given away in this process, as the Party kept its grip on local appointments (Keister, 2000). But the shift in ideology away from Communism towards economic growth has resulted in such officials acting in ways very

different from those within earlier dogma. Such organizations can be large in scale, although usually local or regional in reach. Many of them absorb external technology through alliances and shared ownership. Their productivity is increasing at a high rate and they account for something like 20 percent of the economy.

3. The private sector consists of very large numbers of small and medium enterprises, serving either local markets with services, or engaged in the network capitalism of the "workshop of the world." In this latter configuration they normally become components in a production system of connected highly specialized enterprises. These are the instruments of entrepreneurship let loose in a space full of opportunities (Tan, 2005). They depend on intermediaries to connect with external sources of design, technology, brand, and marketing logistics, and their distinct competences are flexibility, quality production, and low cost. This form of organization accounts now for about 65 percent of the economy. It gives full expression to the restored ideology of seeking private wealth, as the foundation for restored family status. Significant stimulus from Hong Kong and Taiwan is traceable in this sector, especially in Guangdong, Fujian, and Zhejiang provinces, where most export manufacturing is located.

These formulae have proved highly successful in propelling China forward in its economic development. There is no doubt that China's leading firms have made considerable advancements in a fairly short timeframe, and that at least some of them are beginning to leave their mark on the international scene.

As the Chinese economy evolves from here, these formulae are subject to at least three demands that any economic system, be it a functioning societal economy or a business unit, needs to meet for survival and growth. These are (1) efficiency in the use of resources—financial, technical, and human—(2) innovation, and (3) adaptability (Redding & Witt, 2007). The coordination of resources in the shape of managed organizations is the

arena in which these challenges are met. If China succeeds in creating its own viable form of modern business system, it will have done so by finding ways of meeting these demands, which are universal across all successfully evolved socio-economic systems.

In the light of these criteria we note perhaps the most significant of China's recent advances as being the decentralization of economic decision-making into the hands of local officials in the provinces and cities (OECD, 2005). Stimulated also by the encouragement to experiment locally from the mid-1980s onward, this has yielded a great variety of new combinations of the main inputs, the sponsoring of variety being a crucial feature of successful evolution in both the natural and social worlds (Beinhocker 2005). New forms of organization have come to dominate the economy, notably the "boundary-less firms" identified by Meyer and Liu (2005), the "local corporates" identified by Oi (1999), the vastly proliferating private sector, the new market-driven state firms, and the cascading networks of state involvement through shareholding reported by Guthrie (2006a). The injection of managerial standards and practices attached to the WTO initiatives is also a catalyst for much change, as market-driven logics show themselves connected with performance.

China's economy as it entered the new millennium was characterized by three forms of slack: trainable labor was available in seemingly endless supply at then low cost; reserves of capital were growing very large but were being used at high rates of inefficiency – both allocational and productive; and industrial capacity in the late 1990s had reached about double what the economy needed. There were counterbalancing shortages in, for instance infrastructure and education, but in broad terms the running of organizations could proceed with certain advantages relative to international competition. A further advantage of a different kind – not slack but speed in turning policy into action – is regularly remarked on as the government continues to demonstrate its ability to make things happen quickly, and at a scale, that other societies cannot emulate.

Looking ahead to a period where there is less slack to take up, however, we identify two challenges still to be faced, each with complex ramifications across the whole system. The first is the sponsorship of *indigenous industrial and scientific innovation* so that the value eventually released by this in corporate processes is captured by the Chinese rather than by outsiders. The second is the *building of large complex organizations able to compete at world standards of efficiency* but formed in a society where the architecture of trust and cooperation remains essentially personalistic. These issues are interdependent and deeply embedded in societal structures and especially in the maturing of the fabric of institutions such as law, property rights, participation and empowerment.

To begin with innovation, despite the very advanced forms of early scientific knowledge available in the Sung and early Ming periods, the momentum was not maintained, innovation gave way to conservatism, and China has for the past several hundred years had a poor indigenous record in science. The reasons for this slow-down (known as the Needham question) have occupied scholars for decades, and are in any case inevitably complex, but three are worth noting for the possibility of their continuing effects.

Elvin's (1972) argument for the "high-level equilibrium trap" is that with abundant labor at low cost there is little incentive to invent new means of raising labor productivity. Although his argument was made in the context of farming, the low-cost labor model that has underpinned the "workshop of the world" formula since 1980 is a modern reflection in manufacturing industry of that same logic. As labor costs rise, so too may inventiveness over productivity.

A second hindrance historically to science-based innovation was the risk attendant on weak property rights, and more generally the absence of reliable legal protection (Fairbank, Reischauer, & Craig, 1965; Jones, 1981). An outcome of this was arguably the encouraging of "deal-making" with a "mercantile" project-based mentality, whereby risk can be contained

(Faure, 2006). The industrial capitalist by contrast to this mercantile cousin, is more likely to be interested in the efficient use of invested capital in the long term, and so in the scientific raising of productivity, but can only invest in assets and their use if there is security of ownership as well as fairness and predictability in regulation and taxation. To the extent that these features are appearing, such new attitudes to the use of resources are likely to grow.

A third hindrance to innovation in China historically was the conservatism and conformity encouraged by government as a means of securing order in the society (Pye, 1985). A key instrument in this was the system of education. Whatever the content – Confucianism, Legalism, Maoism – it was learned by rote, and only rarely questioned.

The extent to which China has now changed in this regard is immeasurable, but the tendency for increased creativity and self-expression is clear. So too is the attention paid to scientific education, and this is beginning to bear fruit. China's gross expenditure on R&D is now the world's third-largest, after the United States and Japan (OECD, 2008b). Innovation clusters have developed around some universities, such as around Peking University and Tsinghua University in the northwest of Beijing and around Zhejiang University in Hangzhou. China is now said to be the world's second-largest VC market, with considerable IPO and M&A activity. R&D may also benefit from the push of the Chinese military to upgrade its technological capabilities, and financial market regulations as well as the legal system are undergoing continuous improvement.

On the other hand, analysis of the output side suggests that much remains to be done. Of the patents registered by Chinese firms in 2006, only 11 percent were inventive, as compared with 74 percent of patents registered by foreign firms in China (OECD, 2008b). Foreign firms are holders of about 50 percent of Chinese patents (Wilsdon & Keeley, 2007); the remainder includes also large numbers of patents taken out on knowledge produced by foreign firms who failed to register a Chinese patent for their intellectual property. The

number of triadic patents for China (433 in 2005) presently falls between those of Australia (414) and Sweden (652). It lags far behind that of the United States (16,368), Japan (15,239), Germany (6,266), and other larger members of the OECD, including South Korea as an example of a relatively newly industrialized nation (3,158) (OECD, 2008a).

Evidence from studies of exports allows a view to be taken of whether Chinese manufacturing industry meets the challenge of technological innovation. A number of studies suggest continued dependence of Chinese manufacturing industry on innovation stimulated by outsiders. The OECD (2008b) finds that the share of high-technology exports by foreign-owned companies, including joint ventures and firms controlled from Hong Kong, Macao, and Taiwan, account for a growing share of total high-technology exports, rising from 73 percent in 1998 to 88 percent in 2005, with the trend continuing in 2006.

Amiti and Freund (forthcoming) report that despite a shift into more sophisticated products for export, the skill content between 1997 and 2005 in China remained constant. The extra product sophistication was being achieved by assembly in China of duty-free imported components. This "processing trade" accounted for 47 percent of exports in 1992, rising to 55 percent by 2005. The imported inputs accounted for between 52 and 76 percent of export value depending on product category. Instead of growing by diversification into newly designed products, the growth rested on specialization and the narrowing of focus in established products.

Blonigen and Ma (forthcoming) analyze the relative performance of Chinese and foreign owned firms in Chinese exports, also between 1997 and 2005, and conclude that new product variety in the foreign firms was double that for the local firms. There is, moreover, no catch-up. Spillovers of productivity from the foreign to the local only occur in the most technically advanced Chinese firms, and then mainly via the hiring of executives trained in

the foreign firms. The proportion of exports by foreign firms is increasing, relative to the local.

Most Chinese start-ups, too, have so far not distinguished themselves as innovators, but are reported to copy business models of foreign firms, operate at the low end of the semiconductor design and manufacturing market, or are based on China-specific business models rather than technology (Kenney, Haemmig, & Goe, 2008). Even on the military side, much progress seems to be owed to collaboration with Russia. There is also general agreement that market regulations and the legal system remain very much work in progress, offering small firms limited access to money and aggrieved parties little chance of obtaining justice (Batjargal & Liu, 2004; Duckett, 2004; Greeven, 2007; Krug & Polos, 2004).

A somewhat surprising feature of this scene is the high significance of the "China Circle" relative to the US as a source of influence on innovation, although it may well be that the US influence reaches China second hand via the intermediation of Hong Kong and Taiwan, and during this intermediation it may well be that much is added to the core knowledge sourced eventually in places such as Silicon Valley. Branstetter and Foley (forthcoming) report that US investment in Chinese industry is relatively small. Despite the visibility of Chinese-made products in US daily life, and fears over jobs moving from the US to China, US business in China accounts for only 4.5 percent of US total affiliate employment globally, and 2 percent of global net income. Sales from that investment were directed mainly at the China market, and of the $40 billion sales by US affiliates in China, only 3.7 billion went to the US. The innovative activities of US MNEs in China were relatively modest, costing in 2004 US$622 million, or 0.3 percent of their global total. An inevitable outcome is a poor record in patent registration, with China-based patents registered in the US between 2000 and 2006 being 3447, in contrast with 241,000 for Japan, and 39,000 for Taiwan. The China Circle consists of the China-centric countries around the rim of the

South China Sea, with strong reciprocal business connections. Hong Kong, Taiwan and Singapore are the key members, and the main sources of China investment by the outside world.

The influence of this China Circle is unclear in the detail because international trade data do not permit the necessary disaggregation, but it would be reasonable to propose that the main channels of influence are three:

1. Out of Taiwan flows a large amount of technical knowledge built on the strong and long-established ties between the US and Taiwan in the field of technology. This is likely to flow into China via the ownership (whole or partial) of industry.
2. Out of Hong Kong flows a large volume of industrial investment by local industry expanding especially in the Pearl River delta. So too, in a different mode travels much influence in intermediation, as Hong Kong acts as a crucial linking point in the logistical systems connecting the world's workshop with the world's markets. As Blonigen and Ma (forthcoming) point out, the prominent role of Hong Kong investors as intermediaries in China's trade with the world stems from their "significant informational advantages over traders and investors from elsewhere" (p. 7 of the chapter manuscript). They also gain about 25% margin on re-exports.
3. Many MNEs, and the banks that serve them, base their Asian operations in these rim countries and invest in China from its border, taking with them a great deal of managerial and production technology and system.

A conclusion about innovation is that dependence on outside science and invention remains high, and that China's record in catching up is weak so far.

This weakness is in part the result of limited legal protection and personalistic societal trust, which are linked. Combined they influence the sharing of knowledge and the ability of manage complexity, which reduces the capacity for innovation in general and in the

commercial context in particular. Despite impressive investment in facilities, without a conducive set of surrounding institutions and values, the indigenous commercialization of new science is handicapped, as the numbers related earlier suggest.

Research on societal integration and on knowledge-sharing in China is limited but a handful of studies support the conclusion. Huang, Davison and Gu (2008) present data and an argument for the clear effect of cultural factors on the sharing of knowledge in China and find that (a) the retention of knowledge is perceived as preserving individual influence, the cultural instinct being to hoard knowledge rather than share it, and (b) knowledge sharing is conditioned by *guanxi* and by sensitivity to "face." This suggests that knowledge in China is a long way from being a "public good."

Taking this psychological feature upscale to the organizational and societal levels, Gilboy (2004) has defined China's innovation problem in terms of weak connections and poor integration between the key units of the societal system – research labs, funding sources, firms, government bodies, and markets. So too have Lieberthal and Lieberthal (2003) criticized Chinese firms for their weak integration and their tendency to be structured in silos each with top down control, and lacking in managers able to exercise integrating roles and with vision of entire value-chains. An autocratic tendency is evident in a recent study of 618 managers across all sectors of China's economy, confirming that human resource management is not being strategically devolved to line managers (Zhu, Cooper, De Cieri, Thomson, & Zhao, 2008). The same hierarchical sense pervades the managerial ideology (Cheng, Chou, & Farh, 2006; Kong, 2006). Ideals of discipline, control and paternalism are found to be the key organizational norms (Kong 2006), and managers tend to be reluctant to delegate to anyone who is not personally trusted (cf. Chen, Peng, & Saparito, 2002). Even though change is now happening as the Chinese meaning of employment moves through the long transition from welfare to rationality (Guthrie, 2006b; Tsui, Wang, & Zhang, 2002) the

economic system in a wider context, including its own history, does not provide the freedom for change towards worker empowerment, even though there is much dynamism on the surface.

In analyses of Western societies going through the transition to their "modern" form, it is common to fix upon the emergence of "civil society" as an answer to the challenge of sponsoring societal integration and order while at the same time devolving political decision power. In particular the emergence of free-standing professions contributes much to the reduction of uncertainty in the field of economic exchange, providing as they do more reliable information, and the standardizing of systems, and finding their legitimacy in the maintaining of order. Analysts of China's evolution have regularly reported a Chinese form of civil society, but it clearly does not replicate that of the Western experience (nor would the more respected analysts expect it to). In particular the emergence of such independent professions is not reported or anticipated. Gold (1998) withdrew from his earlier (1990) position where he argued for the re-emergence of a pre-existing civil society in China, saying instead that Chinese people do not share the core value of individual autonomy so crucial to the Western design. Instead it is more likely that people in China will opt for community and stability in preference to freedom, and so seek alliance and incorporation with the state in the hope of protection, not independence. In the economy this might be achieved via the corporatist system itself, a tendency also reported by Guthrie (2006a) in his analysis of government penetration through nested shareholdings. In Gold's view (1998:182):

> Leaders and rank and file supportive of civil society might have more room to maneuver and crack the system from within than poorly organized challengers from without. This might evolve into civil society and the mediating institutions of a public sphere for discussing issues, without bringing about a pluralistic political system. The line between state and society would not be as clearly drawn as it is in the West.

In Gold's more recent description of China (2008), reviewing survey scores (out of 7) of 1.17 for accountability and public voice, 2.14 for civil liberties, 2.23 for rule of law, and 2.49 for anti-corruption and transparency, he points clearly to the restrictions and controls that remain attached to the remarkable reforms also achieved. Weller's (1994; 2008) studies of Chinese society have led him to similar conclusions, and his descriptions of how local ties exist in a kind of vacuum – i.e. in the absence of strong institutional ties across the broader society in both spiritual and social capital – reinforces the image of a highly diffracted social structure.

If the sharing of knowledge is a pre-requisite for the advanced commercialization of science, and if that sharing depends upon the notion of a society in which all can participate - and rely upon - equally, then the movement of China towards such a state raises the issue of the "dual ethic." Weber (cf. Collins, 1980) made this a core component of his theory of development with his acknowledgement of the key contributions of citizenship and the bureaucratic state (as opposed to the non-bureaucratic state identified as such in China by Boisot and Child (1996)). So too have others placed high emphasis on individual duty to the total community, or "virtue," as a contributor to progress (Himmelfarb, 2004), in a set of "bourgeois virtues" (McCloskey, 2006), Adam Smith's "moral sentiments" of course preceding by centuries. Current emphases by the Chinese government on social harmony may well be pointing in this direction, and government reforms may well produce a genuine bureaucracy, but the copying of the Western model is not feasible, given the contrast in underlying systems of meaning. The instinctive loyalties and dependencies of Chinese people are shaped by their entire long cultural history, and they are essentially particularistic. This fact is not negotiable, so change will mean working with it to build new equilibria containing it.

3. Hybridization, Not Convergence

Convergence theory (Kerr, Dunlop, Harbison, & Myers, 1960) was written at a time when the ascendance of Western-style, and especially US, applied rationality in finance, organizing, production and marketing seemed assured. It seemed set to have the rest of the world emulate it or fall under its influence, and viewed from its perspective, it would seem a foregone conclusion that competitive pressures will force China over time to converge on a US-style liberal market system.

But Kerr (1983) later published a highly significant revision to the core idea, in which he concluded that evidence since 1960 had convinced him that although convergence appeared to be quite widespread in matters of routines and practices, such as factory layouts, accounting routines, etc., there was an underlying realm of beliefs, attitudes and meanings where convergence appeared not to be happening. Convergence in this amended view moved so far and then no further, and systems from then on appeared to follow parallel non-converging trajectories based on differing collective mental frameworks. This revision came about because the earlier theory had misjudged the significance of the culturally different structures of meaning lying below economic behavior. As Kerr explains,

> Convergence, overall, slows down as the imprint of industrialism brings substantial uniformity in the areas where it has dominant influence; as convergence in the areas subject to bipolar solutions develops slowly; and as the limits of conduct dominated by beliefs, not subject to convergence, at least in the short run, are reached… The most impenetrable barriers to convergence are the power and tenacity of the elites that lead the process, the inevitable eternal conflict over the highest economic and political goals, and the ingrained beliefs of the people. The second of these is probably the most persistent among, but also within, nations. (Kerr, 1983: 87)

At the time of writing Kerr was pointing to the deep ideological divide between the communist and capitalist worlds. That divide disappeared in large measure as the Berlin

Wall came down, bringing with it widespread acceptance of capitalism as economic system and thus arguably, on a fundamental level, some degree of convergence.

Yet differences remain salient, even among advanced industrialized countries, both at the cultural and the institutional levels. At the cultural level, fundamental views of the desirable shape of the economy remain radically different even in countries whose business systems are often seen as similar, such as Germany and Japan (Witt & Redding, forthcoming). Where indigenous and foreign cultures come together, a common empirical finding has been the occurrence not of convergence, but of crossvergence (Ralston, Gustafson, Cheung, & Terpstra, 1993; Ralston, Holt, Terpstra, & Yu, 1997), which takes place

> when an individual incorporates both national culture influences and economic ideology influences synergistically to form a unique value system that is different from the value set supported by either national culture or economic ideology. (Ralston et al., 1997: 183)

To the extent aspects of outside cultures are imported, the process is often selective, as the example of German learning from US management methods illustrates: while German management thinking was highly receptive to the US scientific management and organizational design schools, it almost completely ignored the US human relations school (Guillén, 1994). In the Asian context, the industrialization of Japan was realized with extensive borrowing of ideas, such as quality management brought in from the United States.

Similarly, empirical studies on institutional convergence have identified a general pattern of "hybridization," in which institutions transferred from other contexts are adapted and reconfigured in the process of fitting them into the existing institutional structure (Aguilera & Jackson, 2003; Djelic, 1998; Pieterse, 1994; Vogel, 2003). This tends to be true even where the intention is to copy a perceived "best practice" as closely as possible. For example, Streeck (1996) documents how German carmakers were unable to adopt Japanese

production methods without considerable changes necessitated by the characteristics of the German institutional environment. A key element in the inability of business systems to effect one-to-one transfers of structural components of other business systems is path dependency (North, 2005; Pierson, 2004).

Though definitional inaccuracies lead to a tendency in the literature to overestimate the occurrence of crossvergence (Witt, 2008) and possibly also of hybridization, the available evidence suggests that a high degree of variety both in culture and institutions remains manifest and, in terms of economic outcomes, competitive with each other in world markets. In simple terms, literature suggests that this variety is the result of either (a) different philosophies about the purposes and methods of economic action (e.g., Biggart & Delbridge, 2004; Estevez-Abe, Iversen, & Soskice, 2001; Fligstein, 2001; Guillén, 2001; Sorge, 2005; Witt & Redding, forthcoming), and/or (b) different equilibria in the combining of institutions (e.g., Amable, 2003; Crouch & Streeck, 1997; Greif, 2006; Streeck & Thelen, 2005).

As China moves forward, it is thus likely to do as all the other business systems have been doing, namely, to selectively adopt, and adapt to its existing conditions, practices from other business systems. The result will be a distinct, Chinese variety of capitalism, not convergence on any existing variety.

4. Conjectures about the Future Shape of Chinese Capitalism

It is impossible to say with confidence precisely what shape this future Chinese capitalism will have, or how the sub-unit variations within it will eventually stabilize. However, it is likely that the future shape of Chinese capitalism will be more similar to some of the existing major non-Chinese types of capitalism than to others. Whitley (1999) identifies six major

configurations, but for our purposes here, the most relevant comparisons are exemplified by the United States, Germany, Japan, and South Korea .[1]

To develop this point, it is necessary to introduce the notion of the business system as a complex adaptive system. Building on Whitley (1999), Redding (2005) proposes that the business system of a society be conceptualized as a complex adaptive system of coordination and control exercised in three domains: (i) the integrating of action into business units that become the key interactive survival units in the environment, usually firms, but at least held together—i.e., coordinated—under a form of ownership; (ii) networks of connection between such units across the economy; and (iii) managerial systems inside units that coordinate human skills, technology and capital. These three interlocked features rest on a bed of institutions designed to provide order in the sourcing and allocation of three forms of capital: financial, human, and social. These in turn rest on a bed of cultural features providing the meanings that permit the constructing of reality, specifically in terms of (a) rationale, or espoused intentions, and the values and beliefs underlying the ordering principles of (b) authority and (c) identity. All relationships of determinacy are reciprocal and complex. In successful economic action certain equilibrium states emerge in which forms of coordination lock together with certain forms of institution, legitimized by certain values in the cultural sphere.

A number of actors and forces shape the evolution of business systems. The state and, where it exists, civil society are major players in the shaping of the system (Redding, 2005). Deviant action by individuals or firms may induce institutional change even without the intention of doing so (Witt & Lewin, 2007; Zhou, 1996). In addition, external ideational

[1] One of the six configurations corresponds to Chinese capitalism and is thus not useful for our discussion. A second describes small European business, which we will subsume in the German case. A detailed exposition of the four systems used here is beyond the scope of this paper but can be found in Redding and Witt (2007).

and material forces condition the evolutionary trajectory of the business system (Redding, 2005), often indirectly through their impact on individuals and organizations within the business system.

In the original formulation of convergence theory discussed earlier in this paper (Kerr et al., 1960), it is these external forces, specifically economic pressures, that will force business systems to become ever more similar until, at some point, they will be structurally identical. In reality, as Kerr (1983) himself recognized, it is especially the cultural layer—the differing collective mental frameworks—that prevents business systems from converging beyond a certain point. North (2005: 49) makes the same point when he asserts that

> The institutional structure reflects the accumulated *beliefs* of the society over time, and change in the institutional framework is usually an incremental process reflecting the constraints that the past imposes on the present and the future. [italics added]

Similarly, Hall and Soskice (2001:13) note that although much published analysis proceeds from formal institutions onwards,

> something else is needed to lead the actors to coordinate on a specific equilibrium and … what leads the actors to a specific equilibrium is a set of shared understandings about what other actors are likely to do, often rooted in a sense of what it is appropriate to do in such circumstances.

Their conception of culture is of "a set of shared understandings and available 'strategies for action'" (Hall & Soskice, 2001:13) accumulating from experience in a particular environment. In a rare empirical contribution to this debate, Witt and Redding (forthcoming) provide evidence that executives in different countries hold distinct conceptions of the ideal institutional shape of the economy, with recent institutional reforms having been broadly consistent with these views.

The picture that emerges from this discussion is that the Chinese business system is unlikely to evolve similar structural characteristics to business systems with fundamentally

different cultural layers. To the extent this is true, we are unlikely to see much structural similarity between the future Chinese business system and those we presently see in the West. Especially the Anglo-Saxon variety of capitalism, but also the most common forms of capitalism in Continental Europe, rest on considerably different cultural foundations than those present in China: individualism vs. collectivism as identity, relatively low vs. high power distance in authority, and fundamental variations in accepted ends and means of economic activity (Redding & Witt, 2007).

Greater similarity exists at the cultural level between China and Japan, with both cultures being relatively collectivist and showing relatively high levels of power distance. A closer look, however, shows important dissimilarities. For instance, while Chinese collectivism tends to be organized around the family, that of Japan is centered on the firm, at least in economic life. Similarly, views of accepted ends and means differ markedly. For instance, while firm economic activity in China is typically seen to be a vehicle for accumulating private wealth and contributing to the development of the Chinese economy, the key function of the firm in Japan is the provision of benefits to its employees (Redding & Witt, 2007).

By contrast, the cultural layer of the South Korean business system shows a relatively higher level of similarity with that of China. Both societies are collectivist, with the family as the reference group. Both societies have relatively high power distance, with authority relations structured around Confucian criteria such as education and age. In terms of rationale, both nations accept family wealth and economic development as legitimate objectives, and family business as a key form of working toward them (Redding & Witt, 2007). Further similarities are already evident at the institutional and business system layers. For instance, family ownership is common in both systems for smaller, private firms; decision-making inside the firm tends to be top-down and with a strong role for individual

leaders even at large firms; indirect finance through banks and non-bank institutions represent the key source of external funds of firms; public vocational training is weak; and employment tends to be for the short term, which hinders in-depth in-house vocational training of the kind present, for instance, in Japan (Redding & Witt, 2007).

Of course, salient differences are present and may well remain. Most notably, institutionalized trust in the South Korean context is much more strongly developed than in the Chinese context, though still relatively low compared with Japan and many Western business systems. It is likely that the relative predictability of government action since the 1960s—at least in the economy, with hard enforcement of clear rules—has contributed to building institutionalized trust in South Korea. Democratization and the attendant limits on the reach of government in South Korea are likewise likely to have contributed to this development. The result is that cooperation among strangers is relatively easier in the South Korean context, with concomitant implications for the ability of firms to delegate and handle complex tasks.

As already pointed out earlier in this paper, China by contrast lacks institutionalized trust, with neither professional codes nor the legal system providing sufficient assurance that outcomes will be fair. Societies with high levels of institutionalized trust, such as the United States, parts of Europe, and Japan, took centuries to develop it. It seems doubtful that China will be able to shortcut this process to less than a couple of decades. Complicating the development of institutionalized trust is the absence of checks and balances on the Communist Party; even with the best of intentions, the Party can not make a credible commitment that it will let justice run its course even if it contravenes its own interests.

Other salient dissimilarities exist. Among others, these can be seen in (cf. Redding & Witt, 2007):

- the finer details of the rationale part of culture;

- the structure of government, with democratic and centralized leadership in South Korea and authoritarian but decentralized leadership in China;
- the structure of the financial sector, with South Korean banks being privately owned and subject to market discipline while most Chinese banks are state-owned enterprises whose business is at least in part to executive government industrial policy;
- the quality of human capital, with South Korea's education system, at least through secondary level, confirmed to be world-class in international comparisons, a level China has yet to attain;
- the organization of labor, with South Korea featuring independent unions, while union work in China occurs under the auspices of the state-sponsored All-China Federation of Trade Unions; and
- ownership and control of the major enterprises, most of which in South Korea are privately held and controlled while the Chinese state continues to play a major role in terms of both ownership and control.

Some of these differences are likely to diminish or disappear over time; there is little doubt, for instance, that educational levels in China will continue to improve. Other dissimilarities are likely to be stickier, notably the area of political governance structures. Important in this context is the recognition that both countries have also faced different external material and ideational forces, which condition their paths forward. One important such factor, with impact on matters such as political governance, is territorial size, with China being about one hundred times the size of South Korea.

In sum, on the basis of the available theory and empirical data, we would expect China to evolve its own form of capitalism. It is impossible to say with certainty how this form will look like in ten or twenty years. However, it seems to us that its structural

characteristics will be more similar to—not identical with!—those of present-day South Korea than to those of the other existing major forms of capitalism today.

5. Conclusion

We began this paper with a brief sketch of the existing Chinese business system as it presents itself today. We have pointed to the three challenges any mature, successful business system needs to meet: adaptability, innovation, and efficiency. We have argued that while China has shown plenty of adaptability, innovation and efficiency are likely challenges in the future evolution of the business system. We have further proposed that it is probable that China will retain a unique form of capitalism. The shape of this form is difficult to predict, but it seems likely that the present South Korean business system is the closest equivalent among the existing major forms of capitalism to what the Chinese business system may look like ten or twenty years from now.

Our argument suggests that further success in China's economic development is entirely possible, but not a foregone conclusion. The hard part may well still lie ahead, and we believe social science stands to gain much from observing how China masters, or fails to master, the challenges ahead of it. In this context, micro-level studies will provide invaluable insights, but as Perry (2005) has observed, the proliferation of micro-level research on China in recent decades may have come at the expense of our ability to see the forest for the trees. In our analyses of China's forward trajectory, and despite the great value of specific studies, it will not be enough for us to know about individual firms, about temple societies in remote villages, about informal finance, and about the obstacles to civil society. We will need work that puts together all these various bits and pieces to present a holistic picture of the shape and evolutionary path of the entire country.

This holistic picture should help us explore the implications of the continued existence of a distinct Chinese business system for both foreign and Chinese business. For instance, there has been keen interest in the relationship between institutional variations across countries and the activities of multi-national enterprises (MNEs) (Jackson & Deeg, 2008) in three broad areas of international business research: the role of host country institutions in affecting MNE entry (e.g., Brouthers, 2002; Henisz, 2002; Meyer, 2001); the availability of resources for MNEs in host countries (e.g., Wan, 2005); and institutional distance between host and home countries as a potential source of friction (e.g., Eden & Miller, 2004; Kostova, 1999). China may provide a useful context of broadening our knowledge in these areas.

A second example pertains to what may well be the holy grail of research in varieties of capitalism today, namely, the quest for an understanding of how the shape of the business system relates to comparative advantage and what this implies for the future areas of strength of Chinese business. Hall and Soskice (2001:36) introduce the notion that certain institutional configurations may form the foundation of "institutional comparative advantage" by predisposing firms toward certain kinds of productive activities and pulling them away from others. They propose that the institutions and complementarities present in coordinated market economies, such as Germany and Japan, favor industries featuring incremental innovation, while those in liberal market economies, such as the United States, support industries requiring radical innovation. While the empirical evidence on this specific proposition is mixed (Boyer, 2004; Hall & Soskice, 2001; Lehrer, 2000; O'Sullivan, 2000; Redding & Witt, 2007; Streeck, 1991; Taylor, 2004; Vitols, 2002; Witt, 2006), the construct of institutional comparative advantage as such has taken hold.

The question for China in this context is what institutional comparative advantages it may be able to build given the shape and future evolution of its business system. Giving an

answer to it would have profound ramifications, for instance, in providing guidance to investors as to where to invest and to government as to which industries to promote through industrial policy. Before we can do so, however, we first need to gain a better understanding of what kinds of institutional configurations bestow what kinds of comparative institutional advantages. Redding and Witt (2007) identify a number of such institutional patterns and their apparent effects in various business systems. We firmly believe that further research in this vein, paired with an enhanced understanding of the Chinese business system and the institutional patterns it already features or could in the future support, will have great impact on research on both, China and varieties of capitalism.

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