

**The Evolution of Business Systems**

by

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## Summary

It is proposed here that differences between business systems are related to their evolutionary histories. Specifically this means differences in determinants at two levels of analysis: firstly that of the political, social, and economic circumstances which fostered a distinct institutional fabric for each society; secondly differences in cultural values and norms which influenced the emergence of the institutions.

The evolution of six competitive systems to date is proposed, and some introductory comments made about how they might be analysed.

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## **The evolution of business systems**

As individuals we are all products of our upbringing, despite there being a debate about how much influence is carried by nurture and how much by nature, in other words how much is due to surrounding circumstances to which we have adapted ourselves, and how much to traits we inherited from our parents. The usual underlying assumption is that people are shaped by their personal histories and display those influences in their present day behaviour. It is not a question of all nature or all nurture but simply how much of each in a total mixture with both playing parts. The analogy can be applied to systems of business. Why is Japanese management different from American in fundamental ways? The answer is twofold: (a) they evolved in different economic and political circumstances, and (b) they were shaped by differences in heritage. This paper is devoted to providing a framework for explaining how that happens, and to providing a set of categories in which the parts of the process might be looked at in more detail, piece by piece. The matter is complex, and the approach to it is essentially historical.

### **The idea of industrial pluralism**

We have considered separately how the question of convergence or divergence is answered. (Redding 2001). When considering the apparent movement of ways of organizing business towards one common formula for all, it is necessary to bear in mind the historical evidence that convergence is not to a single point. The result of what has happened so far is 'industrial pluralism'. The way that one country arranges its economic behaviour is only superficially the same as that of another. On the surface they may look remarkably similar. Below the surface there remains much to keep them distinct. If you make a visit to a large German engineering works and then to a similar factory in the United States, you will be struck by the surface similarities: the same kind of machine tools, the same kind of products, offices looking alike, probably many of the same customers, and workers appearing to do the same kind of work. But look further into the two companies and you are likely to find, for instance, very different patterns of ownership, or very different practices in the employment of staff. In Germany most large firms are majority owned by other industrial firms. In the United States they are likely to be owned by a widespread public, and this makes a difference to decisions on what to do with profits, as well as much else. Industrial relations in Germany are

very different from those in the US and this affects the way in which people are employed, trained, rewarded, hired and fired, and generally looked after within the economy. These differences do not show on the surface but they are significant in shaping the nature of organizations.

This is not to say that some convergence is not visible. It is. It is instead to say that variety seems likely to remain in the end and especially in attitudes and the setting of priorities, where it is not visible but where arguably it has a strong influence. Systems may borrow and lend to each other, and may mix together more, and there may be more hybrids on the scene. But in the home bases, in the societies where people find their identities, the particular societal rules of conduct will still penetrate the world of business and give it a distinct flavour.

The phrase 'industrial pluralism' raises a question. Is what has just been said relevant to the industrial era now coming to an end and not necessarily to the age of information now beginning? Will the Internet and the ubiquitous pc bring in a new age of universal sameness? Work on the question of information space suggests not. (Boisot 1995). The way information is handled varies a great deal from society to society and those ways are likely to resist the push to sameness at other than the technical level. Even at that level the ability of societies to handle the technology is clearly distributed in ways which reflect certain features of the mind and the organizing of the mind's use, which give some places advantage. The software industry of Bangalore, and the hardware industry of Taiwan are the results of rare skills being available in combination with other factors, but those skills and attitudes do not appear to be universally distributed. The apparently formidable skills of Japan in hardware have not recently been fully matched by skills in software and entrepreneurship of the kind which keep Silicon Valley dominant.

The evolution of business systems historically can be best perceived in the light of three important conditions of understanding.

### 1. Complex interactions

The systems themselves are configurations of parts and are complex wholes in which no single part can explain the total. The parts are in constant interaction with other parts internally and with other influences externally. As an example, the way in which a son of Li Ka Shing in Hong Kong has very quickly built a global company in telecommunications has

much to do with the speed with which deals are put together, itself a result of his 54% ownership, and his total control of strategy, a feature which in turn is a reflection of local cultural traditions affecting control and paternalism, and all influenced further back in time by specific factors like nepotism, technical education, societal insecurity as a stimulus to entrepreneurship, personalistic trust, and networking. These combine with the opportunities given by the new information age, a pro-business government, and the liberal business environment of Hong Kong. All aspects, plus more external features such as the current state of the telecommunications industry, make a contribution to the explanation. But patterns nevertheless appear in which certain features keep affecting all the firms in a particular society and that combination may then stabilize and replicate itself through time. Other firms will copy a winning formula and a 'type' or 'species' or 'recipe' shapes itself, but it is a combination of many ingredients.

## 2. Evolution and change

The evolution of societal business systems is a long process of change and this continues. The ability to adapt is a necessity for healthy survival, and so change is more or less constant in systems which have achieved some success. When Japan opened up in the last quarter of the nineteenth century it quite deliberately sought new ideas and methods for the restructuring of its society, and it adapted itself to the evolving world circumstances of the time well enough to become a major power for the twentieth century. It is perhaps now adapting again, but we await the outcome.

## 3. Internal variety

Evolutionary theory in biology suggests that a proliferating variety is normal in species which adapt and survive. Some of the most successfully adapted creatures display the most remarkable variety, as Charles Darwin once remarked of the domesticated dog. The lesson of evolution in nature is that convergence is unnatural and inhibits survival.

It is not appropriate to stretch the analogy of natural selection too far as what applies in biology does not necessarily transfer to the world of societies, but two points from Darwinian theory are worth considering here. The first is that once an organism has achieved a balanced and stable relationship with its environment then it may last a very long time in that form. The second is that if the environment changes and adaptation becomes necessary then there has to be variety available within the organism to allow for the new selection of the better

adapted options. Pushing the metaphor to its limits no doubt, but acknowledging in doing so that one is simply playing with an interesting idea, it is possible to speculate that:

- (a) natural selection of business systems up to the end of the twentieth century has seen the emergence of six stable and self-replicating forms
- (b) these six are well adapted to their own different environments
- (c) if those environments change then the systems will come up with variations from within their stock of component units to act as examples of the new formula which others within the set will adopt and copy. If they cannot find the new formula within themselves then they will fade away.
- (d) the key environmental change affecting all of them at present is a set of forces pushing for them to standardize certain aspects of what they do and how they do it. At the same time these forces bring them together more.

Taking, by way of illustration, the example of Korea as a society involved in this challenge for adaptation and survival, its *chaebol* have been found to be weak in the changed conditions of different sourcing of capital and new rules for its use. Previously they could rely on government funding: now they must move to the finance market. They will now need to re-shape themselves against the criteria of new tests for survival capacity, which in practice means the continuing ability to perform in world markets. In this process the alternative types of organization available in the variety contained within the Korean economy will be examined and some will float to the top in the competition for influence. This process may also include the re-forming of the original *chaebol* into new structures also, so as not to lose leadership. It is too early to know the outcome but it is reasonable to suppose that a new form of Korean capitalism will emerge, represented by organizations, successors to the *chaebol*, which will meet the challenge of the global marketplace. The changes may be dramatic and obvious or they may be subtle and hard to see, but making them is a condition for the system's survival. The changes will be widespread and will affect not just the organizations but the whole set of components of the Korean business system. A similar thing happened in Japan after World War 2 when the zaibatsu were disbanded and replaced by their postwar equivalents. These latter were professionally managed and publicly owned, unlike their family-dominated predecessors, but they were equally 'Japanese'. The point here is to raise the issue of whether the end product will be no longer Korean. It is the main contention here that it will still be Korean, but that it may well be a different sort of Korean. It may show signs of

incorporated borrowings, as did Japan for most of the last 150 years, but that will not be a betrayal of its origins and the core characteristics of the society.

How then do such systems of social and economic behaviour evolve and stabilize, and how, to begin with, do we define more clearly what they are?

### The main business systems today

Any classification of something as complex as a system of capitalism will require compromise and acceptance of some simplification, even perhaps of exaggeration. We will be dealing with 'ideal types' which are inventions to represent a general tendency for patterns to form. It is possible to look at these classifications in more detail, and to open up their contents to more subdivision. For the moment however I will argue that there are six more or less equally competitive systems of capitalism in the arena of world business, This is not to say that they are competitive in the same industries, or with the same kinds of organization. In fact they will be seen to operate in business in different ways, choosing often to concentrate on certain fields they are good at handling, or with certain styles of organizing which come to typify them. This in a sense is the point of the analysis. They are not just straightforwardly different to look at. They also do different things, and they do them in different ways.

But what they ultimately do is to compete with each other in world markets and survive. They are in some undefinable sense as good as each other when it comes to reaching customers, keeping their organizations functioning, employing people, and adapting. As economic systems they are not all equal in total size. Three are massive, and two are relatively small in total weight of economic action. But it is not the total weight of the system which counts in the market place. It is : which firm does the customer buy from ? You buy your clothing, let us say, from The Gap, but The Gap gets 45% of its supplies eventually from Chinese family businesses throughout Asia.

The six main types of capitalism at the beginning of the millennium are:

1. The Anglo-Saxon individualist form, dominant in North America and the UK, and containing firms whose purpose is primarily to provide return to shareholders, or shareholder value.
2. The European large-scale form, more communitarian in nature, containing firms with a more complex set of purposes, included in which are more explicit

commitments to societal duties and obligations, as via forms of 'social contract'. There is great variety within this type.

3. The European industrial district form of networked enterprises based on family ownership but containing also important key skilled employees committed to the firm. Parts of Italy and Scandinavia display this form.

4. The Japanese form, represented in their great integrated and complex organizations, but also with attendant connections and networks. Their primary reason for existence is the stable employment of people.

5. The Korean form, represented until now by the *chaebol*, and subject to an evolutionary period of adjustment and adaptation as a result of the Asian crisis of 1997. Such firms have served for most of their historically short existence to fulfill their allocated part of the national plan for economic development, and that has been their core purpose.

6. The Chinese capitalist form, represented by family business throughout the Asian *diaspora*, with main bases in Taiwan, Hong Kong, and Singapore, and existing primarily to serve the needs and ambitions for wealth of particular families. Extensions of this form in China are now becoming significant in world commerce.

The different priorities seen here as being dominant in each case are not the only reasons for the behaviour of firms in these divergent systems. There is always a complex of reasons why firms do one thing rather than another. There are bound to be debates in boardrooms all over the world about what should take precedence. There are also arguments in the public arena about what constraints to apply legally to the behaviour of enterprises. There will also inevitably be a mixture of responses in a set of firms from one society: they will not all fit the type. But having said all that there is still a clear tendency for clusters of similar ideals to form, for certain things to work and to be worth copying. It is what the jargon of economic sociology calls 'mimetic isomorphism' - what works for one will be copied by many others. An extension of that is that people will tend to copy things which are

understandable to them and thus fairly close by and visible, and known to be subject to the same surrounding conditions.

So what does it mean to say something 'works' in this context. All societies have the right to influence the conditions they contain and the more open the society the more this influence shapes events and organizations. Firms exist, in the open conditions needed and fostered by capitalism, by the permission of the members of the society. If people did not buy from a firm, work for it, lend to it, supply it, then it would go out of business. So it has to 'behave' in ways which guarantee the continuation of those processes. It has to be a good corporate citizen. What is meant by 'good' in this respect is not set by any global definition, although there may be elements such as competitiveness which have to be factored in, as it were from outside. What is meant by 'good' is a mixture of local and global meanings. In America it is good to look after shareholders first. In Japan it is good to look after employees first. The contention here is that the local definitions of what is good have been predominant so far and are likely to remain so. They are also inevitably divergent from each other. It would be an amazing accident if societies evolving thousands of miles (and in some ways hundreds of years) from each other were to come up with identical mechanisms and rationales. They might well have the same challenges, but no logic dictates the same responses.

#### A framework of explanation

In the late eighteenth century when the Western industrial revolution began, the countries of the world which one might have called prosperous for the time were very close to each other in terms of wealth per capita. There then began a race to industrialize and to learn the skills which lead to gains in productivity. Two centuries later this race has seen the emergence of a cluster of varied leaders, and the gap between the haves and the have-nots has become very wide indeed. The principal runners in this race are the ones just identified. How have they got to where they are today? Why are they not all identical in the mechanisms they use to move forward, and their styles of conduct?

Societies are large groups of individuals who sometimes act collectively to change their circumstances, but who mostly pursue their individual interests. What people have done in the main is to try to earn a living, to improve the conditions of their lives, and in some cases try to get rich. In doing so they have shaped their circumstances to make aims such as these

reachable. Where workers were getting a bad deal in terms of their rewards they have often resorted to unions to help them. Where owners could not get capital easily they have found bankers willing to try new ways of releasing money into the system. Where trustworthy transactions between strangers became increasingly crucial as commerce expanded, new ways of sponsoring trust were invented, such as the accounting profession, reliable press reporting, banking regulation, commercial law. In some cases governments took the lead in the fostering of these new responses, in other cases, government took a back seat believing that business could help itself in such matters. The French state was hands-on. The English state was hands-off.

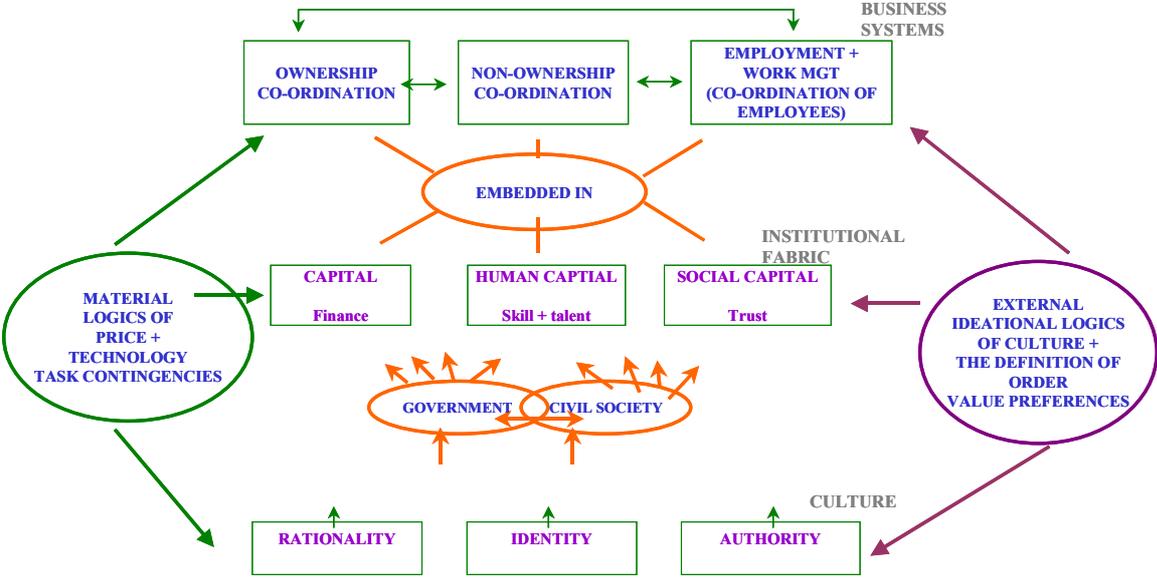
As well as shaping the environment in which business was conducted, members of a society would experiment with the kinds of organization comfortable to them. This process would be a long and continuing negotiation between owners, managers, and workers over what was acceptable, and the process would reflect the bargaining power of the parties at different times. At one point when workers were highly dependent on employers, as in the US in the 1930's, or Korea in the 1980's, then laws would not protect workers, management systems would be autocratic, and pay systems fairly primitive. At another point, as now in the information technology industry in Silicon Valley or along Boston's Route 128, you can only get good key staff if they share in the equity of the firm, a very different form of relationship. Where capital comes from in a society has a profound effect. If it comes from government, as historically in Japan, and more recently in Korea, then that brings with it a whole structure of mechanisms and controls to ensure its safe use. If it comes from the open market in finance, the controls and accompanying mechanisms are very different; Wall St does not behave like a ministry. If it comes from your friends, as it often does in the Chinese case, then again the ways of its use are different.

The constant experimentation and interplay between the parties also takes place against a background of ideas about good and bad, right and wrong, preferable or not, acceptable or not, which shape the choices being made. These ideas lie deep in the society and provide ground rules for conduct. How do you deal with authority, either as a holder of it or as someone subject to it? Do you resent authority, as you might if you had been brought up Australian, or do you accept life in a hierarchy as normal, as you might in Malaysia? How do you establish your own identity? Are you psychologically an individualist, brought up to achieve, succeed, do your own thing, 'be your own man', have a vote, sing songs about doing

it your way. Or are you a collectivist, ready to sublimate your personal wishes within the group welfare of a family or other grouping, so that in return you get protection and a sense of belonging? These inclinations will shape relationships, and organizations are made of relationships. So too are societies shaped by such ideals. Full blown combative democracy which is a form of individualism writ large, is very rare in the collectivist societies of Asia.

Societies find ways of putting together people, technology and capital to make organizations, and those societies themselves evolve to accommodate the new forces within them. If they are to grow wealthy they attempt to achieve a balance which fosters both progress and constant change. But there is no law of nature which says that the formulae they create have all to be the same. You can get to the same destination by different routes using different vehicles.

In order to explain how these different systems of conducting business have emerged through time it is proposed to adopt the framework given in Figure 1. This is a historical view and deals with the processes of influence at three levels. The present day system of business is at the top and is characterized by three related features. This is a living object, constantly buzzing with action, and evolving through changes to itself. These changes are usually slow but may occasionally be dramatic, as when a country in crisis goes through reforms.



**Figure 1: The Historical Emergence of Business Systems Within a Specific Society**

This complex system of business is part of a larger society, larger in the sense that it contains many more features and influences. The business system is embedded and cannot be analysed to a point of understanding unless it is seen in that context. The context which matters most for the shaping of organizations and their behaviour is the set of societal features designed to influence the business system. Examples here are the systems of influence established by the government, the legal system, the banking and capital market structures, the labour market structure including unions, the education system's supply of a certain set of skills and capacities, the society's ability to foster trusting exchange between strangers. This set of features of a society is known as its institutions, or its institutional fabric. It is that set of ways of organizing aspects of existence which, in total, produces societal order.

The institutions of a society are its skeleton framework, giving it shape and support and structure. They are sometimes visible in the form of organizations such as an accounting profession, or the legal profession, and the most obvious institutions are bodies of that kind. Less obvious, in that they are not so visible, but important in their influence, are the cultural understandings which guide behaviour in the way of definitions of the correct ways of doing things, or the accepted ways of seeing things. These are systems of accepted ways of thinking and examples are the Japanese commitment to not firing people, and the American contrary acceptance of the necessity of sometimes doing so. They in turn underpin the institutional fabric.

So, in simple terms

**THE BUSINESS SYSTEM**  
*is embedded in*  
**THE INSTITUTIONAL FABRIC**  
*and both are resting on*  
**THE SOCIETAL CULTURE**

In more complex terms, at each of these three levels, we shall observe separate parts which make them up. We shall also acknowledge influences from the world outside which affect all the interactions.

## How to describe a business system

The business system referred to here is the way of describing the most typical structures adopted in a particular society for handling economic behaviour. This is the top layer of the model: the end-result to date of the historical processes of influence represented in the middle (institutional) and lowest (cultural) layers. It is a description of how business is organized. Arguably the most advanced research on this question is that of Richard Whitley, and the set of components he uses to describe this phenomenon will be used here.

Three components are seen as connected together but analyzable separately. They are (a) ownership, (b) horizontal and vertical networks, and (c) management of people.

These are ways in which the assets needed to run a business are pulled together, or 'coordinated'. They vary from society to society but the most important point is that their combinations become quite distinct. The separate features may be found to look the same in a number of countries, but when seen in combination the total takes on a discrete character. The totals are dissimilar. The systems diverge from each other. Japanese business is organized very differently from Korean, Chinese capitalism is not the same as German.

Most economies contain great variety and the argument made here is not that the entire set of firms in a society follow a single pattern. It is rather that the firms seen as most representative do so. These will normally be most representative because they account for the major part of economic activity, thus in Japan the *keiretsu*, in Korea the *chaebol*, in Germany the large industrial firms, in the US the large divisionalized multinationals, in Chinese capitalism the family business. It is also necessary to make clear that within each of these types there is also great variety. No two firms are exactly alike. Their description here is in terms of an ideal type, in other words a notional representation of average tendencies, something into which the majority more or less fit, but it is more or less, and the range of behaviour in reality is inevitably wide. There will always be exceptions.

### **Ownership**

The first feature of the business system is how ownership works to determine a certain kind of firm. If ownership is widely spread among the public, either directly or through investment funds, then the firm will be under pressure to satisfy the shareholders' demands for return on their investment. It will tend to have professional directors and managers, whose jobs depend on their achieving the results to pay such returns. A critical business press is likely to put executives under notice that they are being closely watched. There is a hard edge

to such a management system and the rationality which drives it is about economic performance first and foremost. This characteristic stems essentially from the pattern of ownership.

If, on the other hand, the ownership is kept within a family, then the motives and behaviour patterns are different. The owning group can take a more paternalistic view of their staff, partly perhaps in the interests of keeping their skills because that reduces uncertainty. They can also take a longer view of investment yield because they are the recipients of the yield. They may also behave with more entrepreneurial adaptiveness if they are accountable essentially to themselves. Information about what they are doing is not publicly available in any detail.

Between these two extreme types are others. Some systems evolve with ownership shared across an industry, as in Japan and Germany, and this produces higher levels of collaboration than elsewhere. Others may have a tradition of strong bank involvement in ownership, as in Japan, where banks may commonly send executives in to a firm to monitor the use of the assets.

Each system has disadvantages as well as advantages. The shareholder value driven system produces a hard and insensitive social context, according to some. The family based system can lead to conservatism and corporate decline if talent is not injected when family reserves of it run out. The reliance on banks and often eventually on government can lead to a drift away from the hard business discipline brought by market competition.

There is clearly no perfect solution, but instead a set of choices and trade-offs.

## **Networks**

Some economies have dense networks of connections which are stable and long-lasting, as if there were ties between firms which are part of the firms' structures. These might be regular suppliers, regular customers, regular sub-contractors, bankers, sources of trained staff etc. But the structures of such ties, and also their stability, vary between societies. In some cases they are essentially horizontal in the economy, as in Germany, where ownership links and interlocking directorships form a dense web across industry. In other cases such as Japan there is this same feature plus an additional feature of marked vertical networks. These latter are seen in ties with subcontractors which are unusually binding. In Korea neither of these features occurs to a strong degree and integration tends to be handled within the large conglomerate structures of the individual *chaebol* themselves and not outside into other firms.

In the US there are laws to prevent what might be seen there as too much collaboration and firms tend to act more independently, or at least have ties which are less binding, less stable, and shorter in duration, leaving the market to set the rules of what connections will pay off when, and the government to police the arena and prevent conspiracy against the market's logics.

### **Managing people**

The three features described here as the prime components of the business system are essentially ways of coordinating economic behaviour. That means that there are needs for stable and reliable means of guaranteeing the necessary cooperation of people and combinations of assets. *Ownership* pulls together the necessary total of resources: people, capital, technology, market demand, management control. *Networks* serve to pull together the necessary connections into sources of assistance beyond the firm itself: information, key supplies, customers, extra capital, commercial cooperation. There is one final component to be brought into the mixture and that is the cooperation of the firm's employees. In the best conditions this cooperation is voluntary, and brings with it creativity and commitment for the use of the enterprise, and it is the job of *management* to secure this contribution. At the core of all management work lies the need to provide the rationale within which people will work, to formulate and define the purposes for which people spend their time in companies. In effectively managed contexts these purposes will be motivating and will generate both willing cooperation and creative contribution.

Management is exercised in many ways and is heavily influenced by what a society sees as legitimate authority. In Korea the expectation is of an autocratic, top-down, disciplined approach. In Japan the opposite is the case and much consultation and massaging of worker egos is involved in achieving the creativity so widely dispersed there; nor are managers a separate caste. In the US the worker / manager relationship is more legal, more rationally calculable in its workings, and often looser in terms of expected commitment both ways. A key feature of these variations is the way in which labour relations have come to be structured, and whether they are based on cooperative processes, as in Germany and Japan, or more combative traditions as was the case in the UK or Korea. These influences are also shaped in their workings by whether union membership is drawn from the firm or from a craft or skill across society more generally. In some cases also unions are of little account in most of the economy, as is the case in Chinese capitalism.

The business system is then the particular combination of ownership, networks and management which has given rise in a society to a distinct pattern for the putting together of business behaviour. These distinct patterns, as indicated earlier, are not fixed for ever. They evolve over time and are capable of adjustment as societies themselves evolve, as ideas move across borders, and as innovation brings with it new techniques for making, distributing, and communicating about the products of human ingenuity.

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