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PERSPECTIVES

The many futures of Asian business groups

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Abstract What does the future hold for Asian business groups? This paper discusses three rival hypotheses whose predictions for the future of Asian business groups differ from the predictions of the prevailing institutional voids hypothesis. The latter is a two stage model that posits that business groups first emerge to solve market failures for affiliated firms. Subsequently government initiates the construction of a "soft market infrastructure" that plug institutional voids and so weakens the rationale for group affiliation. Groups should then unravel and dissolve. Yet, business groups remain important in Asian countries that have attained high levels of market development, which casts doubt on the institutional voids hypothesis. In this paper I review three alternative hypotheses of business group development—life cycle, state-led industrialization, and crony capitalism perspectives. A synthesis of these rival hypotheses suggests that Asian business groups are likely to persist in many possible future scenarios.

Keywords Business groups · Emerging markets · Institutional voids

Business groups are "collections of firms bound together in some formal and informal ways" (Granovetter, 1994: 454). The scope of their activities is very broad (Peng & Delios, 2006) and there is typically a high degree of ownership concentration in the hands of a family, the state, or financial institution sufficient to effect control and ordination over the affiliated firms (Cuervo-Cazurra, 2006). Business groups play a key role in Asia's governance landscape but there are significant differences between them and they are known under a variety of designations: the keiretsu of Japan, chaebol of Korea, business houses of India, the hongs of Hong Kong, government-linked groups of Singapore and Taiwan, ethnic Chinese business groups in Thailand, Malaysia, Indonesia and the Philippines, and

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the bumiputera Groups of Malaysia and Indonesia. Business groups are also particularly prevalent in transitional market economies. For example, in Russia oligarchic financial–industrial groups recently appeared and in China the state has fostered the emergence of large business groups known as qiye jituan or national team and since 1994 Vietnam has been establishing general corporations.

What does the future hold for business groups in Asia? In a recent special issue of the *Asia Pacific Journal of Management* on Conglomerates and Business Groups in Asia-Pacific, a leading scholar on business groups warned researchers that they should be careful “not to approach business groups as a special entity specific to East Asian country” (Chang, 2006: 414). Instead, Chang suggests that business groups can be better understood as a general form of diversified corporation that is common throughout the world. While business groups do indeed share similarities across national boundaries it is important to recognize the impact of contextual factors on the origins, structure, functioning, and development of business groups in different national settings. Indeed, the prevailing hypothesis about their purpose is based on the idea of institutional voids that suggest business groups arise to internalize a variety of transactions arising response to a particular set of market failures (Khanna & Palepu, 1997). This hypothesis implies business groups will gradually whither away when market institutions or soft market infrastructure is constructed that allows for the appearance of more focused enterprises (Peng, Lee, & Wang, 2005). This implied assumption in this hypothesis is that market institutions will operate in a similar manner in all national contexts. But this view overlooks the possibility that market institutions may undergo significant translation and transformation as they are enacted and implemented in different national contexts. If there is variation in the way market institutions operate then the pressure of market forces on business groups to restructure and refocus may also vary.

In this paper I examine the institutional voids hypothesis in the context of Asia Pacific. I first survey their hypothesized purposes. Secondly, I review the literature about their origins in several countries. Third, I outline three alternative hypotheses of group development and performance—life cycle, state-led industrialization, and crony capitalism perspectives. Each of these rival hypotheses makes very different predictions about the future of business groups. I pay particular attention to the role of the state in cultivating an environment where business groups have flourished and their subsequent attempts to develop market institutions and curb their power. The line of argument suggests that Asia’s business groups are evolving toward different futures within different national contexts. I conclude with research implications.

What do business groups do? The bright and dark sides

There are both costs and benefits of group affiliation but there is a deep division among analysts about their aggregate social and economic benefits. This division is reflected in recent survey that characterize business groups as either “heroes or villains” (Claessens, Djankov, & Lang, 2000a), “paragons or parasites” (Khanna & Yafeh, 2007), “red barons” or “robbers barons” (Perotti & Gelfer, 2001), and “anachronisms or avatars” (Granovetter, 2005). The positive view rests upon the argument that affiliation with a business group will enhance a firm’s performance

where markets are imperfect and legal, regulatory, and financial institutions are of poor quality. In these circumstances business groups may act as "safe havens" for internalizing and reducing transactions costs among member firms (Khanna & Palepu, 1997).

However, just how and what transaction costs are reduced is open to debate. Much of the economics and finance literature views business groups as a quasi-internal capital market that mimics the qualities of external capital markets. Some groups possess a core firm that makes and receives loans and offers credit to affiliated firms thus performing a role resembling that of a main bank or venture capitalist (Almeida & Wolfenzon, 2006). Other scholars propose that groups provide an important source of scarce human capital. (Leff, 1978) argues that business groups efficiently allocate scarce entrepreneurship capacity suggesting that, "the group constitutes a pattern of industrial organization which permits structure rather than gifted individuals to perform the key interactivity function of entrepreneurship" (Leff, 1978: 669).

Khanna and Palepu (1997) further suggest that emerging markets lack institutions with the ability to supply high-quality executive talent. They propose that large business groups can efficiently develop a pool of specialized management that is available for dispatch to firms that might otherwise have difficulty finding executive talent. A noted feature of Japanese and Korean business groups is the dispatch of senior management to assist affiliates in specific projects such as business turnaround, new venture start-up, or foreign market entry (Gerlach, 1992; Guillen, 2000). Khanna and Palepu (1997) suggest that business groups allow firms with a visible and known reputation to enjoy a "reputation premium" when objective information is difficult to find and evaluate. Businesses with a reputation for fairness and good management practices may command a premium as business partners in such environments as resource providers prefer to trade with trustworthy partners. This reputation premium may facilitate the growth of member firms; for example, they may attain economies of scale and more easily enter new markets. The reputation premium arises because business groups operate in many sectors of the economy and are highly visible. Due to their visibility, it is difficult for the group's affiliates to engage in opportunistic acts without being detected and damaging their reputation. To uphold the group's collective reputation, the core firm in the group has an incentive to monitor the behavior of affiliates in the same manner as a franchisor monitors and audits the operation of franchisees who license the franchisors trade marks and businesses processes. As monitoring agents, business groups may fill "ownership voids" where property rights are not clearly defined and alternative governance devices are lacking (Ma, Yao, & Xi, 2006).

Business groups have also been viewed as risk sharing or mutual insurance device. Affiliation with a business group allows affiliates to share risk by smoothing income flows between firms and by coming to one another's aid in time of crisis and thus reducing the risk of bankruptcy (Khanna & Yafeh, 2005). Income smoothing is achieved by channeling resources from stronger and more profitable firms to underperforming firms or firms in financial distress. In so doing strong firms "prop up" their troubled affiliates (Friedman, Johnson, & Mitton, 2003). Business groups have been viewed as a technology "catch up" mechanism used by governments in late industrializing economies as a means of imitating and absorbing foreign

technologies to repeatedly enter new industries (Kock & Guillen, 2001). More generally, due to their broad scope, business groups can facilitate development by internalizing public infrastructure in regions where the provision of public goods is poor (Fisman & Khanna, 2004). For example, India's largest business groups have created self-contained industrial cities providing their own essential infrastructure such as roads, telecommunications, electrical power, schools and medical facilities. The strategy offers access to low cost factors of production (land, labor) and in turn catalyzes economic development in the surrounding area. In contrast, Fisman and Khanna (2004) note that multinationals and single industry firms typically locate in India's most developed cities.

This array of features, or some subset of them, should enhance the performance of firms that affiliate with groups. Yet, empirical evidence supporting the positive performance hypotheses is surprisingly scant. While some studies have found support for the hypothesis (Chang & Choi, 1988; Keister, 1998; Khanna & Rivkin, 2001), other studies offer only mixed support and many find a negative effect and see only a dark side (Scharfstein & Stein, 2000). Indeed, much recent business group research chronicles the high costs and negative performance outcomes of group affiliation (Bertrand, Mehta, & Mullainathan, 2002; Lu & Yao, 2006; Morck, Wolfenzon, & Yeung, 2005). The main critique is led by researchers who view groups as device for expropriating minority shareholders, and for tunneling, looting, and plundering the assets of their affiliates (Morck et al., 2005; Young, Peng, Ahlstrom, Bruton, & Jiang, 2008). Organized as pyramids, owners of peak firms can inflate their control over firms lower down the pyramid so causing several governance problems such as monopoly rent extraction, moral hazard, and inefficient investment. For example, with regard to reputation, business groups are often very large entities with complex structures and linkages between firms. The myriad of intra group transactions are opaque to outsiders and make it very difficult for an outside investor, equity analyst or credit rating agent to unravel and disentangle what is going on. In these circumstances, detecting opportunistic behavior is difficult (Dewenter, Novaes, & Pettway, 2001).

The quality of entrepreneurship in business groups has been questioned and is often characterized as rent-seeking (Morck & Yeung, 2004). Far from providing superior human resources business groups may entrench their top management. If poorly performing corporate leaders are not replaced society's most important businesses end up being run by corrupt and incompetent managers (Morck, Strangeland, & Yeung, 1998). Moreover with the notable exception of Korea and Japan, business groups have not been particularly effective at improving on existing technologies. Indeed, the administrative heritage of many business groups as imitators of foreign technology has created obstacles to the development of innovative and proprietary skills (Carney & Gedajlovic, 2003). Table 1 juxtaposes these positive and negative perspectives and indicates that for every value enhancing feature attributed to business groups there is an equal, countervailing, value-destroying potential.

Just whether affiliation has a positive or negative effect upon a firm's performance may depend crucially on the institutional setting. Under some circumstances the positive attributes of business group affiliation may outweigh the negative. However, if circumstances change in a significant way the negative attributes of affiliation may

Table 1 Business groups value creation and destruction attributes.

Value creation: Business groups…	Value destruction: Business groups…
1. lower transactions costs for affiliated firms	1. are organized as pyramids designed to loot and plunder their affiliates
2. serve as a quasi-internal capital market for affiliates	2. concentrate corporate control in the hands of small elite
3. are a source of scarce entrepreneurship	3. entrepreneurship is rent seeking
4. are a source of management talent	4. entrench incompetent management
5. reputation signals quality and helps acquire scarce resources in factor markets	5. insiders use their complex and opaque corporate structures to exploit outside investors, outsiders demand risk premia
6. are a mutual insurance device	6. impose costs on weak firms
7. fill ownership voids, effectively monitor subordinates	7. inadequate monitoring facilitates moral hazard and inefficient investment
8. are a "catch up" mechanism	8. are stuck in the imitation phase
9. facilitate economic development in areas lacking public infrastructure	9. exercise monopoly power

prevail. For instance, chaebol business groups served as a technology catch-up mechanism for firms during Korea's rapid growth in the 1960s–1980s (Amsden, 1989) but by the 1990s when many Korean firms had approached the technological frontier business groups increasingly lapsed into expropriation devices for their family majority owners (Chang, 2006; Lee, Peng, & Lee, 2008). In this regard, much may depend upon when and how business groups were formed and what their founders intended for them.

Where do Asia's business groups come from?

The story of the origins of Asian business groups is generally well known. While the details differ, business groups are typically a product of administered capitalism. This is of some significance because the institutional voids hypothesis depicts business groups as spontaneously emerging to compensate for inefficient markets. However, the dominant pattern of group formation and growth is that a series of single party states and/or strongmen leaders with long, uninterrupted periods in power have directly constructed or encouraged the development of large diversified business groups to pursue nationalist political and economic agendas (Carney, 2008). Far from emerging to fill institutional voids business groups appeared and prospered because states actively and passively annulled, dismantled, and generally rescinded the operation of market institutions (Prowse, 1996).

Japan led the way in creating an administered economy. After WWII, the US occupying administration was determined to rebuild Japan's economy on a US blueprint complete with independent firms, competitive markets, and vigorous antitrust regulation. The prospect of aggressive American style markets horrified Japan's government officials and they did everything they could to resist their establishment (Morikawa, 1992). US policy priorities in the region shifted from economic reform toward security concerns during the Cold War and the US turned a blind eye as Japanese quietly encouraged the restoration of industrial groups in a

system that Lincoln and Gerlach (2004) describe as administered capitalism. Korean business groups were also deliberately constructed by a developmental state. Korean officials consistently suppressed the development of markets for three decades by systematically distorting market prices and monopolizing the supply of capital (Amsden, 1989). The state also picked the players. In 1960, President Park chose a "select group of progressive millionaires who would be allowed to enter the centre stage" to lead the developmental mission (Amsden, 1989: 14). These entrepreneurs were allowed to establish the large groups that remain dominant up to the present.

Perhaps the apogee of administered capitalism is to be found in post-independence India where the government adopted self reliance as a principal policy goal. Prime Minister Nehru's first industrial policy resolution in 1948 was to regulate foreign investment to assure that majority ownership should always remain in Indian hands (Encarnation, 1989). The state subsequently monopolized the provision of finance and underwrote domestic business houses as they acquired the assets of departing British businesses. Within a decade of independence the 20 largest Indian business houses controlled over one third of all corporate assets in India. The emergent policy regime, known as the "license–permit–quota raj," subjected nearly every decision an entrepreneur could make to the discretion of the state bureaucracy.

Japan, Korea and India are not exceptions to the pattern of constructing business groups through a regime of administered capitalism. Across post-war Asia, the prevalent ideology among newly established nationalist governments was a belief in the efficacy of state planning (Vogel, 1991). Taiwan's KMT government sought to control the commanding heights of the economy and allocated market entry rights to trusted elite entrepreneurs from prominent Taiwanese families who formed major business groups (Noble, 1998). Similarly, long serving Singapore Premier Lee Kwan Yew had little faith in the entrepreneurial and technological talents of native Singaporeans and under the aegis of the Economic Development Board he oversaw the creation of large government linked groupings to achieve developmental goals (Zutshi & Gibbons, 1998). In Indonesia, Suharto enlisted an elite group of about 20 Chinese entrepreneurs to build an industrial base (Dieleman & Sachs, 2006) and later helped several family members establish their own groups (Mursitama, 2006). Government leaders in Malaysia, Philippines, and Thailand each selected a small group of entrepreneurs to lead development efforts, provided them with credit, domestic monopolies, and protected them from foreign competition. More recently, China has experimented with an industrial policy based on large business groups and has assembled the qiye jituan or national team from existing state-owned enterprises (Keister, 2000; Nolan, 2001). Vietnam appears to be emulating China as the state is creating about 100 General Corporations to lead sector development strategies (Abegaz, 2005).

Where are business groups heading?

Because business groups are instruments of state administered capitalism it is probable that their future is going to be sensitive to shifts in state policy. It is only in the 1990s that states have taken steps to liberalize their administered economies in a

move toward the neo-liberal ideology of free markets. For the most part, Asian states have avoided the worst excesses of the "shock therapy" liberalization strategies that were implemented in Latin American and Eastern Bloc countries in the 1970s and 1980s. Instead, emerging Asian economies and former communist states have implemented liberalization packages in an incremental and partial manner. The full policy package includes fiscal and macroeconomic liberalization of trade, capital outflows and foreign investment restrictions and the liberalization of the banking and financial sectors. In several industries such as electrical utilities and telecommunications, the policy package also includes factors such as privatization, the formal separation of regulation and service provision, the depoliticization of regulatory agencies, and deregulation, the opening of markets to multiple service providers (Henisz, Zelner, & Guillen, 2005). Although neo-liberalism is today the dominant economic policy paradigm, it has not emerged simultaneously in all states and nor has it been adopted to the same degree everywhere. For example, privatization frequently occurs without deregulation or the depoliticization of the bureaucracy. How does the incremental liberalization of administered capitalism impact upon business groups?

First and somewhat paradoxically, liberalization initially generates greater uncertainty for firms. Early-stage transitions toward market institutions occur in a context of imperfectly functioning and partially developed institutions. The transition period is marked by an increase in the scope of business group activity (Peng et al., 2005). These conditions often stimulate the emergence of a new cohort of business groups (Kedia, Mukherjee, & Lahiri, 2006; Luo & Chung, 2005). In China, the policy of gradual regulatory reform was instrumental in the formation of business groups (Keister, 2000). In Taiwan, sweeping liberalization and deregulation of the financial and several industrial sectors led to the strengthening of formerly weak and fragmented business groups (Chung, 2006; Luo & Chung, 2005). Initial reforms in Indonesia followed the oil price increases of the 1980s and saw the growth of a small group of extremely powerful business groups (Mursitama, 2006). Hence, in the early stages of market construction it seems that business groups become more important in the economy rather than less.

Second, the liberalization process creates opportunities for incumbent groups to further strengthen and consolidate their position. For example, incumbent groups typically benefit from privatization programs that provide opportunities for group to further diversify into sectors such as energy, communications and banking (Ramamurti, 2000). States may inadvertently expand the group scope when they pressure stronger groups to acquire the assets failing firms (Peng et al. 2005). Partial and incremental liberalization in Korea also led to a strengthening of the larger business groups (Amsden & Euh, 1993). Hence, the effect of incremental liberalization is a the emergence of large, cash rich, autonomous and more powerful corporate sector that is no longer dependent on state mediated credit. Importantly, these groups accumulate significant political power and possess a potent ability to influence the pace and shape of subsequent liberalization. Indeed, Claessens, Djankov, and Lang (2000b) argue that indicate "a relatively small number of families effectively control most East Asian economies (Claessens et al., 2000b: 109)".

What began in an earlier period as state led administered capitalism has evolved into a co-equal partnership between the state and a small number of powerful groups

(Granovetter, 2005). Just as groups did not spontaneously appear so will they not disappear, crumble, or uniformly restructure as market institutions are constructed, in large part because large groups are probably going to be important influences in shaping the emerging institutional environment (Carney, 2004). It is in light of this shifting balance of power that we consider the question of the possible futures of business groups.

Predicting the future development of business groups

The institutional voids hypotheses about business group development predicts that the logic for their existence will disappear as market institutions are established and groups will encounter pressures to restructure or dissolve away as more focused rivals enter the market. However, Granovetter (2005: 445) concludes "business groups have typically defied predictions of their imminent demise, surviving both conscious attempts by political authorities to break them up and the impact of financial crises." Morck, Wolfenzon, and Yeung (2005) believe business groups have amassed sufficient economic and political power to entrench their positions. Khanna and Yafeh ponder "can groups ever die peacefully? … Because business groups do not fully realize the full costs of their presence …presumably they will not dissolve on their own" (Morck et al., 2005: 57–58). A survey of Asia's business groups suggest substantially different developmental paths that do not fit comfortably into a two-stage rise and decline model implied by institutional voids. In fact several hypotheses about business groups have been advanced since scholars first began to research the phenomenon. Table 2 juxtaposes three rival hypotheses against the prevailing institutional voids hypothesis. Each hypothesis rests on different assumptions about the key actors, their motives, and capacities to achieve their objectives. Importantly, each specifies very different mechanisms about the relationship between group affiliation and firm performance.

Table 2 Four hypothesis of business group development.

Hypothesis	Key actors	Origins and growth	Decline	Performance
Institutional voids	Firms	Spontaneous emergence	When institutions appear, rationale for business groups disappears	Initially, affiliation improves profits. Later, costs exceed benefits
Lifecycle	Firms	Firms choose to affiliate	Inertia/decadence	Initially, profits are based on efficiency. Later, profits are based on power
State-led industrialization	State Firms MNEs	State creates business groups, firms learn	As firms approach the technology frontier, they restructure and focus	Initially, the state determines profits. Later, profits based on competitiveness
Crony capitalism	Politicians and entrepreneurs	Deals, reciprocity	Business groups persist	Non-transparent, firms hide profits

Life cycle hypothesis

The earliest studies of business groups (and direct antecedent of the institutional voids hypothesis) advanced a life cycle model of development. Both Strachan (1976) and Leff (1978) propose that business groups will be particularly important in emerging markets. In their view business groups appear when independent entrepreneurs choose to affiliate themselves with a particular group. Alternatively, a group may emerge as a single entrepreneur diversifies through partial acquisitions and/or spins out other firms as semi-autonomous entities. In the early phase of the lifecycle, a group forms voluntarily in order to provide several services to its members, especially financial services connected to securing credit and making investments. Strachan also suggests that the group insurance principal is an especially important motive for forming or joining groups in emerging markets because unpredictable changes in government policy create risks and uncertainty for the firm. However, the life cycle model is not optimistic about the expected behaviour of mature business groups or the consequences for economic development and welfare. Strachan provides a succinct summation of the developmental logic of the life cycle model:

> In the formative years, the group is climbing to a position of power. Its growth will almost always depend upon its being situated in the number of fast-growing, profitable industries. The groups … achieve an initial critical mass from firms who have successfully adapted new technology to old activities or who are leaders in developing new industries. Having reached a position of relatively great size the job of maintaining historic growth rates becomes increasingly difficult. About this time an alternative business strategy opens as the concentration of power within the group makes the elimination of competition and the use of political power an increasingly feasible road to profits.… I suspect that in their mature years business groups follow a strategy built more on power than on performance (Strachan, 1976: 98).

In this view, the hard-driving entrepreneur who establishes a large group begets “a decadent elite” (Strachan, 1976). The entrepreneur’s successors seek to entrench their power and resort to politics to protect their wealth. Entrepreneurs initially embody the bright side attributes of the business group form, which brings great success. Yet success is fleeting and self-limiting: to maintain their position, groups increasingly betray the dark side attributes of business groups. In contrast to the institutional void perspective, business groups do not disappear or fail in the second stage of development nor do their profits decline; instead business groups remain strong and frustrate continued economic development by inhibiting the entry of new firms into the economy.

State-led industrialization hypothesis

While the life cycle hypothesis puts the entrepreneur at the center of the analysis, there is little room for the state as an actor in the model. The state is mainly viewed as a potential threat and source of uncertainty that must be managed and proactively

kept at bay. Similarly, the institutional voids hypothesis largely confines the state to the sidelines. In the state-led industrialization hypothesis the state is cast as the most important character: the state is the entrepreneur (Evans, 1979; Haggard, 1990). The strong state can override vested interests, such as landowners, military, multinational enterprises organized labor, and direct economic resources toward establishing industrial capacity on its own terms. Because the state is viewed as having more information and more power than the private sector, it takes the lead in driving economic development. The state decides the timing and manner of entry into certain industries and selects particular firms to perform the market entry activity (Amsden, 1989; Keister, 2000).

The state-led industrialization thesis views domestic firms as "industrial latecomers," who lack the resources to catch-up with technological leaders from advanced economies. This introduces another actor into the state-led industrialization hypothesis, the foreign firm, which possesses the advanced technological and managerial capabilities that the latecomer state would like to acquire. Under a free-trade regime, foreign firms could enter and dominate a local economy because they have overpowering technological skills relative to domestic firms. To provide a space for domestic firms to imitate, learn, and catch up with firms from advanced economies, the state must deliberately manipulate property rights in favor of local players. Through a regime of licensing and permissions, the state establishes a protected trading environment that allows domestic firms sufficient time and protection to catch up with more advanced firms. Internally, the state manages domestic markets and determines the competitive "rules of the game," allocating opportunities to firms, setting prices for inputs, and determining the number of competitors and which foreign firms may participate. If a favored entrepreneur becomes complacent or is perceived as inefficient, the state may encourage new firms to enter a sector. In this manner, and in contrast with the institutional voids hypothesis, it is the state that directly and indirectly determines a firm's profitability through its control of resource levers.

Because industrial strategy is determined by the state, the role of the business group is to "implement" the industrial capacity building process (Amsden, 1989; Hobday, 1995). The task is to be a pupil and imitate technology and capabilities invented elsewhere. By doing technological learning, the late developing pupil catches-up assists the movement of a country's domestic economy towards the technological frontier. During the learning or catch-up phase, business groups compete for the allocation of state's resources and they must perfect their project management skills and demonstrate production efficiency (Kock & Guillén, 2001). Because firms in latecomer economies, at least initially, do not possess proprietary skills they become generalists whose skills enable them to operate in a variety of protected industrial sectors. This may also result in economies of scope, which provide a basis for firm growth.

A new phase of development begins once a country achieves a significant level of economic development. Recognizing the need to travel up the value-added chain, the state seeks to establish an institutional infrastructure that supports innovation, such as science parks, and provides tax incentives for research (Hobday, 1995; Mathews, 1999). Trade barriers that were initially erected to protect weak domestic firms may now be incrementally dismantled, which gradually introduces domestic firms to the

stimulus of international competition. As the selection environment gradually becomes more market-based firms prosper or fail based upon their ability to compete in the international marketplace not upon their relations with state actors.

Greater demands are made upon entrepreneurs and managers at this more advanced stage of economic development. Instead of the generic skills of imitation, industry entry, and production efficiency, firms must transition from imitation towards a strategy of innovation, and from dependent pupil to active originator. However, there are significant path-dependencies in shifting from imitation to innovation (Carney & Gedajlovic, 2003). To be competitive firms must develop proprietary organizational and technological capabilities to enter either the initiating phase of the industry product life cycle or enter infant industries. The product market focus will shift from that of conglomeration and wide diversification toward a more focused, coherent strategy driven by core competences (Kock & Guillen, 2001). Changes in strategic emphasis lead to significant structural readjustments on the part of the business group, which evolves towards a formally integrated and centralized M-form organization. Improvements in firms' organizational and technological capabilities combined with enhancements in the quality of the innovation infrastructure may set the economy on a virtuous circle of incremental, continuous improvement. At this transitional stage of catch-up firm performance is increasingly dependent upon international competitiveness.

The crony capitalism hypothesis

The explicit assumption of state-led industrialization hypothesis is that the state is a strong actor capable of resisting demands from special interest groups. Politicians and officials exhibit a technocratic goal orientation intent on pursuing national development agendas. The crony capitalism hypothesis relaxes this assumption but retains the state at the centre of the analysis. In the crony capitalism hypothesis there is acknowledgment that Asian states have not always enjoyed enlightened and disinterested leadership and that some officials have sought to extract a personal stake from the opportunities provided by industrialization (Fisman, 2001; Kang, 2003). In a closed economy with significant state intervention, politicians and officials have reserved to themselves significant discretion to allocate resources. The discretionary authority of state officials creates opportunities for entrepreneurs who are skilled at exploiting their network connections, blat or guanxi, to cultivate reciprocity with resource gatekeepers. The practice of striking bargains with corrupt political leaders to gain access to state mediated credits and local monopolies is often characterized as rent-seeking and a form of opportunism (Morck & Yeung, 2004). However, "cronyism" may also be rooted in patrimonial, or protection seeking behaviour by entrepreneurs rather than by opportunism (Hutchcroft, 1991).

Cronyism often arises in "low trust societies" (Fukuyama, 1995) where conflict, strife and insecurity between social groups may be endemic. Where there is a history of social and ethnic conflict or state predation and hostility toward the business community or some sub-section of it, entrepreneurs confront a heightened risk of asset confiscation, rent expropriation, corruption, discrimination, regulatory restriction and other risks that engender defensive behavior. To mitigate the threat posed by

expropriation, entrepreneurs actively seek out the patronage of high-level officials. These patrimonial relationships typically place the entrepreneur in a subordinate position relative to the patron. Reciprocal exchange is an essential element in these relationships and this can be either the sharing of the spoils of patronage or as protection money. However, patrimonial relationships can be unstable, as their value will depreciate rapidly if the patron falls out power. Moreover, the entrepreneur must also keep the potentially unlimited demands of a patron in check while preserving the relationship. Entrepreneurs prudently understate their wealth by creating nontransparent and complex business structures, such as pyramids to disguise assets values. Such structures also provide for "capital flight" and shield resources in the event that patrimonial relations sour. In business groups that have cultivated patrimonial linkages with the state it is difficult to determine the true profitability of constituent firms since the wealth and assets values are deliberately distorted.

Moreover, due to their low trust in social institutions entrepreneurs protect their interests by constructing a thick social defensive perimeter to distinguish between reliable insiders from untrustworthy outsiders (Fukuyama, 1995). Closed networks are an understandable defense against potential predators but they may equally impede the development of the more open and universalistic values that are necessary for the diffusion of liberal market institutions. Where the state has not delivered collective goods, such as security and justice, then gangs, cliques, and criminal organizations may emerge to provide basic levels of security, but such organizations also retard institutional development.

Both crony and patrimonial linkages are sometimes characterized as guanxi or trust-based but more often the reality is much more precarious. Patrimonial links are calculative and based upon implied threats of sanction and power asymmetries, indeed such relationships are a defining feature of a low trust society. Crony capitalism may generate an inertial dynamic as entrepreneurs and state officials mistrust one another yet maintain a delicate mental calculus about preserving or defecting on their relationships. Because contextual threats remain latent, uncertainty and risk may be viewed as a long-term phenomenon and entrepreneurs may be unwilling to initiate trust building. If officials and politicians find it difficult to give up their interventionist the selection environment will remain politicized and competitive environments will stagnate at low levels of firm capability. Societies remain crisis-prone with the potential for political discontinuity, instability, and dramatic reversals in their development. In this perspective, there is nothing inevitable about the decline of business groups. In chronic low trust environments business groups whose capabilities are primarily relational may remain prominent.

The many futures of Asia's business groups

The institutional void hypothesis that suggests that business groups will fade away is suggestive of institutional convergence. Strategy scholars have argued that factors such as competition and technology will drive firms in international competition with one another to adopt similar corporate structures (Ohmae, 1985). Institutional theorists see convergence as driven by bureaucratic rationalizing forces or an "iron cage" that progressively spreads common standards, norms and beliefs (Meyer,

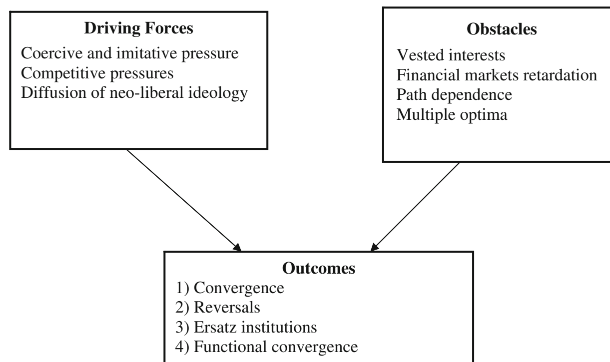
1994). Others see convergence in corporate governance stemming from the more diffuse forces of world society (Drori, Jang, & Meyer, 2006). Yet it is far from clear that a convergence fully explains the developmental trajectory of any Asian state.

Implicit in the idea of convergence view is the concept of diffusion to explain the spread of market institutions. What is sometimes missing from the concept of diffusion is an understanding of what happens when an institution arrives on the scene to be adopted in a particular country or organization (Campbell, 2004). In this regard, each of the four hypotheses described above highlight different actors, motives, and causal mechanisms. Each sheds light but empirically the posited relationships may resonate with greater or lesser relevance in different national settings at different times. Campbell (2004) suggests that as market institutions diffuse they undergo significant translation and transformation as actors modify, integrate, and try to make them fit their particular context. Moreover, actors may not all be working toward the same ends. In particular there are both driving and inhibiting forces that impact the way institutions are enacted, imported, and implemented in a particular society and culture.

Forces driving institutional convergence interact with resistant obstacles and produce divergent change trajectories. This collision of powerful structural forces generates micro-interactions in which a succession and combination of incremental trickle-up and trickle down processes may culminate in one of several outcomes. Just how the balance of these forces play out is likely to be a context specific co-evolutionary processes that is can produce a range of outcomes. Peng (2003) suggests that national systems react incrementally and as a result, incumbents and new entrants adopt elements from one another in a manner that produces hybrid institutions consisting of international and locally constructed elements, a phenomenon Campbell (2004) describes as bricolage. Figure 1 specifies several potential future institutional scenarios, each of which points to different futures for business groups.

On the one hand are coercive and normative pressures driving institutional development toward the adoption of "global best practice" standards of political and corporate governance. Coercion influence stems from the ability of powerful states and international organizations to shape the rules of the international game and enforce compliance by weaker states. Coercive influences are particularly strong during periodic financial and currency when states become dependent upon foreign

Figure 1 Driving forces and obstacles to institutional development



debt. The IMF, the World Bank and other multilateral developmental agencies impose conditionality clauses that commit states to carrying out extensive constitutional reforms according to the principle of liberal market economics in exchange for financial support. Normative forces arise from the transmission of ideas, ideologies, and beliefs as actors imitate what they perceive to be desirable institutions. New ideas and beliefs diffuse through processes of voluntary adoption and imitation in receiver societies.

Competitive pressures stem from the receiver society's need for resources or from changes in the aspirations of local actors. If states determine that they wish to develop industry sectors or improve their trade position they begin to compete to attract resources from external entities. Asian states have long recognized that technological and management know-how is embedded in the proprietary processes the multinational enterprises. Hence, states are in direct competition with one another to attract foreign direct investment. Countries competing in the same market have selected to adopt similar policies in order to maintain competitive parity. For example, states such as Hong Kong, Singapore, and Malaysia have each attempt to attain the status of "regional financial center" and have proposed a raft of policies to attract foreign capital. These forces promote an escalating pattern of imitation among states as each seek to match another's institutional imitations, for example, several states have sought to establish NASDAQ style equity markets to promote the growth of local high technology firms.

On the other hand are set numerous obstacles that inhibit the development of market institutions. The most visible of which are the vested interests of newly powerful business groups who may be expected to resist reform efforts because they threaten their rents. Incumbent business groups have sunk costs and investments into relational assets that are well adapted to existing environments that will lose their value in more transparent environments, which motivates incumbents to capture and derail institutional innovations (Haggard, 2001). The coordination of influence is eased because the business elite are few and dominant firms may continue to set the rules and agendas for potential new entrants and challenger firms. The development of large liquid external capital markets is considered central to institutional reform yet the prevalence of internal capital markets within business groups also retards their development. Because business groups have become very large relative to the economy they may inadvertently suffocate the emergence of alternatives (Almeida & Wolfenzon, 2006). There may also be multiple optima, which suggests that differences in the efficiency of alternative institutional modes may be small. New institutions are costly to establish and if their benefits are difficult to quantify actors may be unwilling to incur the costs. Literature on the varieties of capitalism suggests that, at least among advanced economies, liberal market economies and coordinated market economies, although their institutional environments are characterized by important differences, each may be equally effective in terms of generating income and productive efficiencies for the members (Hall & Soskice, 2001).

The interaction of driving and inhibiting forces may lead to outcomes other than convergence including, reversals, symbolic or ersatz institutional change, and functional convergence. "Reversals" in the direction of institutional development are a snapback to intensive state administration of the economy and the re-imposition of restrictions on markets (Rajan & Zingales, 2003). Reversals may stem

from the perception of excessive coercive pressure to adopt market institutions by outsiders. Re-current crises and uncertainty attributed to market institutions that result in many stakeholders losing valued positions can generate a backlash. For example, after years of seeking to establish Malaysia as an international financial center, Prime Minister Mahathir's handling of foreign capital and his resistance to IMF restructuring procedures during the 1997 Asian Financial crisis was indicative of a reversal in the direction of institutional development. Institutional reversals will typically reinforce the position of business groups in the economy.

Ersatz Institutional Reform occurs when regulatory and supervisory agencies are established but are under-resourced or vested with little executive authority, or when legislation is put on the books but not enforced (White, 2004). Ersatz reform is symbolic. Governments may either fail to understand what is required to make market institutions work or they fail to invest in the institutional capacity needed to breathe life into the formal rules. For example, there is robust evidence of some convergence on de jure similar systems of corporate governance systems but there is much less evidence of de facto similarity. In other words, "best practice" institutional rules are widely diffused across many societies but these rules are not implemented (Khanna, Kogan, & Palepu, 2006).

Formal convergence occurs when states adopt similar formal institutions. Legal scholars such as Gilson (2000) distinguish between formal and functional convergence. Functional convergence suggests that different institutional arrangements are equally capable of performing the same governance task and producing similar outcomes. For example, in North America the market for corporate control can terminate weak top management but in Japan, the market for corporate control is much weaker due to the system of cross shareholdings. However, Kaplan (1994) finds that Japanese firms achieve executive turnover in underperforming firms through other means. Advocates of functional convergence argue that improvements in corporate governance are more likely if reformers work within the traditions of existing institutions rather than attempting to fashion completely new institutions. Phenomenon such as reversals, ersatz reform, and functional convergence suggests that the diffusion of markets will not occur homogenously across Asian states. Rather actors in receiver societies will enact, interpret and pragmatically adjust market institutions to fit their aspirations and circumstances. In so doing they translate and transform those institutions in a manner that will alter their local impact.

Research implications

Business groups remain important across Asia despite considerable institutional reform. Yet, the dynamic interaction between institutional context and firm behavior is too often ignored or overly simplified. We are unlikely to gain insight into the causal mechanisms governing business group structure and performance unless we take seriously the impact of institutional context. Some of the key reference works in the field are monograph length works that provide extensive insight into context and the behavior of key actors (Amsden, 1989; Encarnation, 1989; Gerlach, 1992; Keister, 2000; Strachan, 1976). However, much empirical work on business groups is anchored in a structure–conduct–performance hypothesis testing tradition that was

developed by scholars to examine the performance of freestanding firms in a North American context. The tendency to adopt this paradigm to a networked and group enterprise system without regard to context is questionable (Biggart & Hamilton, 1992). Nevertheless, the tendency to utilize this paradigm in management research is reinforced by academic career incentives that increasingly provides for the "three essay" PhD thesis aimed at expediting publication in top journals—a tendency that surely puts the publication cart in front of the research horse.

There is a need to address the radical disjuncture between business group theory and existing approaches to empirical work. Theories of business groups universally emphasize their complexity and the multidimensionality of the relationship between the group and affiliate in terms of the importance of equity, debt, personnel, trade, and operational linkages. Whereas group affiliation is a complex and multidimensional relationship the vast majority of studies use indictor (dummy) variables to denote firm affiliation. Much research relies upon directories such Dodwell's Industrial Groupings in Japan and Business Groups in Taiwan and those published by the Center for Monitoring the Indian Economy that classify firms as either group affiliates or freestanding firms. Some scholars believe that there is significant hierarchical variation in the degree to which a firm is connected to the group suggesting that group membership will bestow benefits on core and tightly linked firms while costs are borne by peripheral firms. The prevalent use of indicator variables in the empirical literature may account for the contradictory and mixed evidence on the effect of affiliation because the benefits and costs of affiliation may not be shared equally among affiliates (Kim, Hoskisson, & Wan, 2004).

Moreover, there are severe problems with both financial market and accounting measures of performance due to capital market inefficiencies and accounting data distortions. Some owners have powerful incentives to extract revenues and manipulate performance data. The possibility of cross subsidization, tunneling, propping and mutual insurance further complicates the relationship. The lack of transparency in intra group transactions strongly suggests the possibility of endogeneity, the reverse causality between firms' affiliation and performance. Moreover, there is little research exploring the impact of ownership differences among business groups. For example, many emerging markets contain a blend of state and family owned enterprises but few studies distinguish between them. Yet there are important differences between family and state-owned groups' governance, incentive structures and risk bearing capacities that will effect their potential to realize positive (and negative) performance outcomes.

Conclusion

The transformation and translation that occurs when market institutions are constructed in Asian economies produces divergent patterns of institutional development. While the general trend is (currently) toward the construction of market based institutions there are significant differences among states and a variety of hybridized state coordinated and liberal market forms of capitalism is emerging. For example, both India and China are liberalizing but each is generating its own version of capitalism. These variations will differ in the degree to which they exert

pressures on groups to refocus and restructure. The population of business groups is also heterogeneous especially with regard to ownership structure and identity, affiliation patterns, and the kinds of performances they can attain. As this heterogeneous population adapts to pressures in their divergent institutional settings they are likely to persist with different structures and performance outcomes in many future scenarios.

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