How the East Asians Learned to Compete: Comparative Institutional Advantage of Firms in Japan, South Korea and Taiwan

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Research background

- The increasing trend, and the perils, of de-industrialisation in emerging economies has been highlighted, which calls for the need to think ambitiously about building productive capacity

- Yet, industrial development has been viewed narrowly in terms of trade and industrial policies, with strong emphasis on the management of FDI as a major source of technology and skills transfer

- And these discussions take the form of 'state vs. market' debate: neoliberal argue for the need for market-friendly policies for attracting FDI, on one hand, and state interventionists arguing for protection, subsidies, and selective approach to FDI....has the debate run its course?

- Let's bring in new theories and concepts to understand firm capabilities - that go beyond specific policies but to understand the structural conditions and shifts required for endogenous (long-term) firm growth and continuous upgrading

Institutional theory of the firm

- Amidst the rise of new institutional theory, the so-called "institutional theory of the firm" emerged at the intersections of "comparative political economy" (comparative capitalism) and "strategic management" to examine how national level institutions shape firm behaviour
- The focus is on institutions that shape financial capital (financial system) and labour (labour relations)
- Key concepts are institutional coordination and complementarity
- Key theses is that leading firms use and bundle (coordinate) these institutions in a complementary way to build core competencies
- Two dominant pathways: "liberal" (Anglo-Saxon economies) and "non-liberal"/ "organised"/ "coordinated" (Northern European economies, Germany, and Japan)
- The theory has emerged from, and has been repeatedly tested, in advanced economies with firms operating at a high-end of innovation...but what insights for emerging economies?

Institutional theory of the firm in a catch-up context

	Advanced economies	Emerging economies
View of institutions	Institutional coherence, coordination and complementarity	Institutional incoherence, coordination failure and incompatibility
Level of innovation	Research-based: radical or incremental innovation	Search-based: innovation by imitation
Types of learning	Exploratory and exploitative	Absorptive and adaptive
Dynamics of change	On-path incremental	Path-shifting radical

Comparative historical analysis of East Asia

- East Asia provides rich empirical site for investigation as region that has bed successful in building endogenous firm capabilities, but where "state vs. market" debate dominates as the battleground of two ideologies - there is room for different theoretical perspective!
- Process-tracing the developments of, and the changing dynamics between, financial system and labour relations in Japan (from 1945), South Korea (from 1953) and Taiwan (from 1949) through the use of secondary literature on the political economy of East Asia
- To derive a structural institutional interpretation of how endogenous firms capabilities were built, taking into consideration missing conditions and substituting strategies of catch up development
- To gain a better understanding of how firm capabilities can be upgraded, bearing in mind the problem "structural inertia" (and "middle-income trap")

Japan

- Japan is often compared with Germany for having comparative advantage in "incremental innovation" and exploitative learning firm capabilities (quality manufacturing)
- Transfer of institutions from Imperial Germany to Meiji Japan in the 19th century has made the institutional landscape similar: bank-based financial system ("patient capital") and micro-corporatist labour relations ("workers' commitment" to firm-specific skills)
- The two sets of institutions accorded the top mangers the temporal conditions to experiment with long-term strategies, and the social spatial condition for stakeholder learning, leading to social compromise that underpin co-evolution and complementary between the institutions
- Implications for change is that when there is a problem of structural inertia institutional complementarity makes it difficult to undertake path-shifting structural change.

South Korea

- Despite importing many of the Japanese institutions, Korea (until late 1980s) never quite attained comparative institutional advantage in incremental innovation, although it demonstrated impressive absorptive firm capabilities.
- Without strong banks nor moderate unions, the state controlled banks and governed labour relations engineering the temporal conditions for long-term strategies...but!
- State coordination left little social space of stakeholder learning, and therefore institutions did not co-evolve to complement, but remained compatible at best
- Implications for change is that without complementarity, once the state disengaged path-shifting structural change is feasible
- Since the late 1990s, Korea underwent a structural adjustment under IMF, and are now showing comparative institutional advantage in radical innovation and explorative firm capabilities

Taiwan

- Taiwan had with even smaller industrial base and weaker endogenous firm than Korea, but the Kuomintang (KMT) had stronger state capacity, and so the state focused on SOEs
- The private sector comprising mostly of SMEs (the "tugboats of growth") were marginalised from the financial system and labour relations, although it did benefit from SOE spillover and broad-based state investments in education and training esp., of engineers
- SMEs operated in largely laissez-faire environment, and networks emerged in the form of "multiple, volatile and short-term links" to flexibly deal with to market pressures, enabling adaptive capabilities (i.e., the capacity to adapt to external environment by changing internal structure)
- The state gradually begin with lend more support but by facilitating insertion into and upgrading within global production networks through investment industrial clusters, making on-path change towards comparative institutional advantage in radical innovation with limited success.

Pathways to dynamic firm capabilities

	UK and USA	Japan	South Korea (until late 1980s)	Taiwan
Conditions or substituting mechanisms	Liberal market	Neo-corporatist institutions	Developmental state	Networks of local SMEs
Financial system & labour relations	Stock market-based & flexible labour relations	Bank-based & micro-corporatist labour relations	State-controlled bank based & state governed labour relations	Small private banks & flexible labour relations
Institutional settlement	Complementary	Complementary	Compatibility maintained by the state	Compatibility
Firm capabilities	**Research-Based (Exploratory)**	**Research-based (Exploitative)**	**Search-based (Absorptive)**	**Search-based (Adaptive)**

Findings and implications

- Building endogenous firm capabilities require more than trade, industrial and technological policies. Institutional theory of the firm informs that there are structural institutional conditions that enable (or hinder) development of certain types of capabilities

- Japan's incremental innovation and exploitative firm capabilities stems from complementarity between bank-based financial system and micro-corporatist' labour relations. It also highlights the importance of social compromise as that which underpins institutional complementarity

- Korea shows how the state engineered similar conditions to enable absorptive capabilities. It also highlights the limits of bypassing social compromise (limited success with incremental innovation), and room for path-shifting change without complementarity

- Taiwan shows how, without the state willing to take on a similar coordinating role, networks have emerged to enable adaptive capabilities

"...Japan's 'unique' labor relations and innovative managerial techniques, stables of western journalism on the Japanese economy, may actually be insignificant and even counterproductive because they are missing from Korea and Taiwan with no noticeable effect on economic performance"

Chalmers Johnson (1987:138)