So You Think You Understand Asian Business?

By Peter Dollé, Berlin Correspondent

We may talk about "Asia" as a block, but the businessman or woman looking to be successful in the region had better start differentiating between Asian countries – politically, socially, and economically. Here's a review of 13 countries to get you started.

Westerners seem hitherto stymied by the task of learning Asian languages and script so different from the Western Indo-European linguistic framework. It all seems much too "foreign" and inscrutable. INSEAD Affiliate Professor of Asian Business and Comparative Management **Michael Witt** and co-author Gordon Redding in a working paper entitled "Asian Business Systems" take the mystery out of the ways business is done across Asia.

Each economy has its own rules of the game, which collectively are known as a "business system". Some economies, such as China's, even have multiple business systems. Understanding how these business systems work is critical for managers wanting to be successful in Asia, Witt says.

"The number one killer in international business is what is called 'liability of foreignness'," Witt explains. "That means you don't know how the place works. And as more and more businesses are moving into Asia and trying to take advantage of the fact that the 21st century is Asia - at least economically - if these businesses want to be successful, they have to overcome this ‘liability of foreignness’.”

In a bid to help firms understand how Asia works, Witt and Redding explore and compare these business systems for all major economies from India eastward to Japan. Sorting these systems by similarity, they conclude that there are five major clusters in Asia: post-socialist economies (China, India, Laos and Vietnam), advanced city economies (Singapore and Hong Kong), emerging Southeast Asian economies (Indonesia, Malaysia, the Philippines and Thailand), advanced Northeast Asian economies (Korea and Taiwan), and, standing on its own, Japan.

From there, Witt and Redding compare education and skills, the role of the state, investment and cultural influence unique to each country.

Many differences are obvious and would impact any investment or marketing plan. Literacy rates differ widely in Asian countries, with 61 percent of adults in India able to read and write, compared to 99 percent in Japan. Skill training is left up to the individual in most countries with the exception of Japan, where companies provide extensive on the job training. State-owned enterprises in China, India, Laos and Vietnam have the means to offer job training but are reportedly falling short of expectations.

It’s “Who” you know

The role of government varies throughout Asia and partially reflects the country’s stage in economic development.   Many major companies in the region are controlled by governments or prominent families. Governments play a major role especially in the post-socialist economies, but also in economies such as Malaysia and Singapore. A high degree of family influence is evident everywhere, with the notable exception of Japan.

One of the more striking revelations in this working paper is the influence of “social capital” in business relationships. Here, the word “trust” plays a key role. Party officials in China and elsewhere in the region are more inclined to extend control of companies and financing to members of the party as well as immediate family members whom they trust. One result of low trust in strangers is the proliferation of business groups in the region. According to

Witt: “The leading theory of why business groups exist is that it’s because it’s not possible to enforce contracts well.” The mistrust leading to the formation of business groups also discourages Asian managers from entering into deals with outsiders.

Witt and Redding also suggest parallels in Asian institutionalised trust with the economies of Southern Europe. “In many places (in Asia), personal connections actually supersede the importance of rules,” says Witt. “And this is something that takes some getting used to, particularly if you’re from Anglo-Saxon European countries. Funnily enough, if you're from Southern Europe, you may feel pretty much at home.”

Who holds the reigns?

Decision-making in firms usually remains in the hands of the owner and flows mostly from the top downwards. “Most Asian economies have a top-down management, highly centralised type of management and in some cases the chairman - somebody who has a very large stake in the company - will be driving the decisions,” Witt says. “The key deviation from this would be Japan, where decision-making is collective. It’s not just top-down, but many parts of the company will be involved in the decision-making.”

Many Asian governments adopt specific industrial policies and grant state-owned and private companies licences and loans to conduct business. Banks are still the main source of financing for most companies but a parallel network of informal lending institutions has grown out of relationships, especially in the poorer economies of the region. Many conglomerates and business groups have their own banks. In Korea, for example, leading corporations finance investment partially through their own non-bank lenders such as insurance companies.

The Rule of Law

Of particular relevance to foreign managers in Asia is the extent to which the rule of the law applies. Witt and Redding include in their report an index by the World Bank that reflects the degree to which countries abide by the rule of law in practice and indicates the trust Asians would have in their institutions. The mean score among the 13 Asian countries studied is 0.30, with Laos at -0.63 and Singapore 1.69 (higher is better). (Incidentally, the mean score in a sample of 19 Western countries is 1.62, with Italy scoring

0.38, which is at the low end of the index.)   "It tells you whether you can rely on contracts, whether you can rely on law and this ultimately has something to do with the amount of transaction costs you have to deal with. There's a tendency among Anglo Saxon people when they go somewhere and they have concluded a contract, they actually believe that people will stick to that."

The authors warn against grouping Asian economies into one. Witt strongly suggests managers learn the differences between cultures and institutions in the region. "Quite often companies form regional strategies," Witt describes. "To the extent that you try to apply a one-size fits all approach to something which underneath is very varied, you run into this problem of "liability of foreignness" and the company doesn't run as well as it should."

Witt says the economic influence of China is felt everywhere in the region. "You actually have multinational companies using it as a production base. And more specifically - at least historically - as an assembly base where machines and equipment would be provided by Western nations - by the Japanese, by the Koreans - where subassemblies and components would come mostly from the newly-industrialised economies. So the more advanced economies in the region and then China would be the place where you put it all together."

China and India were the biggest economies on earth in the two millennia leading up to the Industrial Revolution, according to the World Bank. Asia will continue to drive global economic growth well into the future. And Westerners are compelled to go there if they want to survive at all. Their degree of knowledge in the region is sure to affect their success.

Michael Witt is Affiliate Professor of Asian Business and Comparative Management at INSEAD.

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