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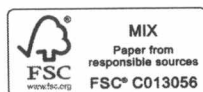
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HRM

Introduction to *Information, Incentives, and Bargaining in the Japanese Economy*: A Microtheory of the Japanese Economy

Masahiko Aoki

By the time the Pacific War ended with the unconditional surrender of Japan in August 1945, about one-quarter of Japan's national assets (excluding weaponry) existing at the beginning of the year had been destroyed.¹ In the ensuing years, soldiers returning from the battlefields and immigrants from former colonial lands, as well as those released from war materials production, joined the ranks of the job seekers. The number of job seekers during the first few years of the postwar period was about one-quarter of the total labor force.² The level of production in 1946 dropped to about 40 percent of the prewar level of 1934–6. For most Japanese, the 1940s were nothing but a series of daily struggles for survival. The entire nation was swept up in great social turmoil and drastic institutional changes.

Upon the new ground of the institutions shaped in the turmoil, however, the engine of growth started to run in the 1950s. An unprecedented growth rate of more than 10 percent per annum was realized throughout the 1960s, and the gains from this growth were widely distributed among diverse social groups. Even so, Japan was still considered a “fragile flower” because of its meager natural resources. Then in the 1970s Japan was hit by a series of shocks – environmental pollution, escalating oil prices, the shift to a flexible exchange system, and new waves of technological innovation. But each time it managed to steer itself out of the ordeal and in the process demonstrated that its economy was remarkably robust.

Source: *Information, Incentives, and Bargaining in the Japanese Economy: A Microtheory of the Japanese Economy* (Cambridge, UK: Cambridge University Press, 1988), pp. 1–6.

By the mid-1980s Japan's national product had surpassed 10 percent of the Gross World's Product and it had become the world's largest net credit holder abroad in history. Once considered a shrewd technological follower, Japan now seems to be gathering its industrial strength and is on its way to becoming a formidable technological leader in a number of global markets. Today Japanese companies are visible all over the world, although they have been greeted with some ambivalence since they are seen as both unwelcome invaders and as gratifying job creators. Considering the devastation existing immediately after the Pacific war, these are, approved or not, amazing achievements indeed.

What is the key to the developmental capability and adaptability of the Japanese economy? Is there a specific Japanese way of managing the competitive industry? If so, is it culturally unique, or can it be emulated in the Western context when desirable? Or do some Japanese economic institutions act as subtle barriers insulating domestic economic interests from foreign competition while allowing them to freeride on the international liberal economic order? Should Japan therefore try to make its economic structure conform more with the Western norm to make global competition fair? If so, is the Japanese polity capable of doing so? The social scientists' views on these questions are diverse and inconclusive.

The neoclassical economists see nothing mystical about the Japanese economy. In spite of its apparent cultural uniqueness, the Japanese economy is sufficiently competitive for the usual neoclassical paradigm (built on the postulate of maximizing behaviors of economic agents mediated by the market mechanism) to explain and predict Japan's economic performance reasonably well. Behavioral equations of economic agents in the market for Japan and any neoclassical homeland should reflect structural isomorphism. The only difference would be in the values for parameters representing the saving propensity of households, their willingness to supply effort, the government's tax rates, and so on. According to this view, any international imbalances may be corrected by realigning foreign exchange rates and appropriate internationally coordinated public policies affecting the maximizing behavior of economic agents.

Another important school of thought – the culturalist – regards the Japanese economy as a coherent system consistent with the Japanese cultural tradition. Cultural factors such as emphasis on the small group, the gift exchange of employee loyalty and employer paternalism, and the penetration of the workplace into what seem to Western eyes to be the personal and private affairs of the employee are the driving forces of the system. Thus the Japanese system is regarded as distinct from the individual-oriented Western system. If that is the case, the implication may be a dismal one: The current trade conflict may be impossible to resolve unless the Japanese change their culture or protectionist walls are erected to insulate the Western and the Japanese economies from each other.

Yet another view of the Japanese economy emerging in recent years is that, although some aspects of Japanese institutions may have cultural origins, the institutional differences between the West and Japan are not absolute. Proponents of this view would argue that the problems facing researchers are related to economic, political, and technological phenomena integral to advanced levels of capitalism and industrialization rather than to specifically Western or Japanese traits, and therefore that propositions applicable to both the Japanese and Western cases should be sought. But, unlike the neoclassical economists, they would contend that this could only be done by enlarging and enriching the existing theoretical models developed primarily for explaining the Western phenomena. In practice, they leave open the possibility that some aspects of Japanese institutions may prove superior to some aspects of corresponding Western institutions and thus be potentially worthy of emulation in the Western context, and vice versa.

Such studies are taking shape in diverse disciplines, although they are at different stages of development. Industrial engineers, for example, are focusing on factory organization, labor economists and sociologists on industrial relations and incentive schemes, business economists on the management system, financial economists on corporate finance, industrial organizational economists on subcontracting and corporate grouping, technology specialists on the R&D process, and political scientists on the government bureaucracy. This work has already produced a stock of interesting results, but no earnest attempt has yet been made to relate them to each other. This situation is unsatisfactory from the social scientist's point of view, however, for we need a consistent and unified theory that covers the micro-micro structure of the business firm through the performance characteristics of markets to the political and economic role of the government bureaucracy. In this book I venture to present a simple, yet coherent account of the Japanese economy along such lines. In so doing I rely extensively on recent contributions in diverse disciplines, but try to reformulate and reinterpret these earlier results in accepted economic terms as much as possible. The analysis is descriptive and does not deal directly with policy issues, except to consider the functioning of the political process.

I open the discussion in Chapter 2 with a micro-micro analysis of the Japanese firm. I draw on the contributions of industrial engineers and labor specialists to illustrate that work organization and intershop coordination in the Japanese firm form one type of information structure, distinct from the conventional model of the functional hierarchy, and I compare the performance characteristics of the two. The central point here is that the internal information structure of the Japanese firm is more decentralized, as it relies on horizontal communication among functional units and autonomous problem solving at individual work units, made possible through the development of workers' integrative skills as opposed to segmented and specialized skills. Such decentralized structure is shown to be effective in adapting the work

process flexibly and swiftly to a continually changing market and technological environment.

Chapter 3 is about the types of incentives used to develop the skills (information-processing capacities) needed to operate the information structure studied in Chapter 2 efficiently. The nature and function of what are thought to be culturally unique organizational practices – such as “lifetime” employment, seniority pay, bonuses and retirement allowances, and enterprise unionism – are reexamined in the light of the growing incentive literature developed within the framework of neoclassical economics. In short, I argue that the essence of Japanese incentive structure is the *ranking hierarchy*, in which employees of the firm compete for faster promotion on the basis of their learning achievements. The centralized administration of the ranking hierarchy by the Japanese firm complements the decentralized approach to handling information and safeguards the integrity of the organization.

Chapter 4 turns to the financial aspect of the Japanese firm, specifically, the roles of different types of investors in corporate finance and the corporate governance structure: individual investors, banks, and other corporate firms. In this chapter I try to demystify Japanese corporate finance and refute the widely held view that the interests of stockholders are ignored in the Japanese firm and that the cost of capital is lower in Japan than in other developed economies.

The first four chapters pave the way for the hypothesis that the Japanese firm should be regarded as a *coalition* of the body of employees and the body of stockholders rather than the sole property of stockholders, as postulated in the neoclassical paradigm. In Chapter 5, I utilize the results of recent contributions to bargaining game theory to examine various aspects of management in the coalitional structure and analyze the behavior of the Japanese firm as an equilibrium outcome of a bargaining game between the constituent bodies. For example, the gift exchange of diligent work by the employee for a job guarantee by the employer, which is conventionally thought to be culturally conditioned, is seen as the efficient and equilibrium resolution of the partly conflicting, partly harmonizing interests of both parties.

Chapter 6 deals with various aspects of industrial organization. Section 6.1 analyzes the transactional mode of the subcontracting group in the manufacturing industry from the viewpoint of the growing economic theory of contracts and relates its prevalence to the informational structural characteristics of the Japanese firm outlined in Chapter 2. Section 6.2 takes up the phenomenon of corporate grouping brought about by mutual stockholding among major firms. Here I argue that one of its major roles, besides takeover insulation, is to share business risk. The need for risk sharing (group insurance), although on the decline at present, arose from the long-term association of employees with the firm under the incentive scheme discussed in Chapter 3, which cannot be met through the financial markets. In Section 6.3 I discuss the R&D process of the Japanese firm and show how the type

of information produced is related to and conditioned by the way it is utilized. I also call into question the conventional wisdom that the Japanese are technological followers and not innovators and attempt to explain why intercorporate linkages for multidisciplinary research and development are emerging. In Section 6.4 I discuss the role of social reputational ranking as an incentive for top managers, which may be considered unique to Japan.

Chapter 7 deals with the political-economic process and the role of the government bureaucracy in it. By breaking open the black box of the bureaucracy, as I do for the Japanese firm, and examining its internal information and incentive characteristics, I endeavor to clarify the dual role of the ministry, which is to represent constituent interests and to delineate the national interest. By using the theoretic framework of the n -person bargaining game, I show that the politically stable outcome of the bureaucratic process ought to be a democratic aggregation of constituents' utilities in a specified sense and that the converse is also true. From this perspective, I then describe the evolution of pluralistic politics mediated by the bureaucracy, which I call *bureaupluralism*, and its current dilemma.

Chapter 8 focuses on the mutual lessons to be learned from the experiences of Japan and the West. Most cultural and business anthropologists consider small-group orientation to be an essential element of Japanese organizations, the implication being that Japanese organizational practices, however efficient they may be, cannot be transplanted to individual-oriented firms. Although the recurrence of the decentralized information structure and the centralized incentive-ranking hierarchy at various levels of Japanese social organizations suggests that these characteristics have cultural origins, I contend that emphasis on the small group is neither a necessary nor sufficient condition for the future viability of a Japanese-like system in an environment where individual integrative skills and communication technology are highly developed.

A sincere effort at mutual learning by the West and Japan may well lead to some form of hybrid, but it will not be easy to find a path toward it. This book is not intended to guide readers along that path, but only to foster a theoretical understanding of some fundamental issues that may arise as the two sides move in this direction.

Notes

1. Economic Planning Agency, *Sengo Keizaishi – Soukan* (The post war economic history – A Survey), 1957.
2. Mataji Umemura, *Sengo Nihon no Roudouryoku* (Labor force in post war Japan), Iwanami Shoten, 1964, pp. 63–5.

Organizational and HRM Strategies in Korea: Impact on Firm Performance in an Emerging Economy

Johngseok Bae and John J. Lawler

Gaining competitive advantage through strategic action has become an important focus of research and analysis in the human resource management (HRM) field (Cappelli & Singh, 1992; Pfeffer, 1994; Ulrich, 1991; Wright & McMahan, 1992). Work in this area has gained more impetus as the management strategy literature focuses increasingly on internal resources and competencies (Barney, 1991; Collis & Montgomery, 1995; Teece, Pisano, & Shuen, 1997; Wernerfelt, 1984). Drawing on an extensive body of past research on strategic human resource management (SHRM), we examine the links between various aspects of organizational strategy, HRM strategy, and firm performance. Our research emphasizes two different aspects. First, in contrast to most SHRM research, which has occurred largely within the context of industrialized Western economies, the present study focuses on these issues in one of the leading economies of East Asia – Korea. Hence, we consider the impact of non-Western cultural influences on the conventional SHRM framework and provide empirical evidence for the model we construct. The second feature of the present research is in line with international HRM studies. Studying both multinational corporation (MNC) subsidiaries and local firms operating in Korea, we were in a position to examine between-firm variations in HRM strategies that went beyond the cross-cultural variations that have been the focus of many previous studies.

Theoretical Background and Hypotheses

The approach we take here is to consider how the implications of the conventional SHRM framework might play out in the Korean setting. A significant issue in Korea, as well as elsewhere in East Asia, is the extent to which American-style high-involvement work systems might transfer to the Asian context. The driving force behind this concern is the impact of globalization on the efficacy of the low-cost, mass production-oriented business strategies that drove the first round of Asia's rapid, export-oriented economic development. Thus, it seems reasonable to build a model based on the established SHRM framework and empirically test it within Korean organizations. In doing this, we will consider how Asian cultural circumstances might impact the workability of such a system.

Market Forces, HRM Strategy, and Asian Culture

Authors contributing to the SHRM literature often take a configurational perspective, with strategies envisioned as "internally consistent bundles of human resource practices" (Dyer & Reeves, 1995: 656) that function as a unified system (MacDuffie, 1995). Many studies have provided typologies of HRM systems and strategies (Arthur, 1992, 1994; Begin, 1991; Dyer & Holder, 1988; Kochan & Katz, 1988; Miles & Snow, 1984; Osterman, 1987; Walton, 1985; Womack, Jones, & Roos, 1990; Wright & Snell, 1991). However, as Dyer and Reeves (1995) pointed out, these typologies tend to array strategies and systems in reasonably comparable continua, from those characterized by high employee participation, extensive training programs, and broad job designs to those characterized by low participation, limited training, and highly specialized jobs. We use the term "high-involvement HRM strategy" to denote the former approach and "traditional HRM strategy" to denote the latter.

Lepak and Snell (1999) proposed a framework that depicts various HR "architectures," with considerable discussion centering on internal development versus acquisition architectures (two of four basic architectures they identified). Internal development and acquisition correspond, respectively, to the high-involvement and traditional HRM strategies, though Lepak and Snell argued the relationships are more complex than suggested in relatively simple make-versus-buy arguments. As these authors observed, internal development has been linked to a number of desirable organizational effects, including greater stability and predictability of a firm's stock of human resources, higher commitment to an organization, and better coordination and control. Despite these advantages, certain organizations may choose an acquisition strategy. Internalization may have significant costs, and buying or externalization may have significant advantages, including cost reduction

and numerical flexibility enhancement regarding employment (Pfeffer & Baron, 1988).

Of course, firms can utilize multiple HRM strategies, and Lepak and Snell (1999) specifically noted that make and buy strategies are not necessarily mutually exclusive. However, Sonnenfeld and Peiperl maintained in their work that "each firm . . . should exhibit one modal type of system, which we would expect to be most closely connected with the base, or primary, business strategy" (1988: 597), a position the empirical literature in the strategic HRM field generally supports. Also, this particular study focused on front-line, nonsupervisory employees. Although the firms in question employed many types of workers in this category, it seems likely that HRM strategy will be rather more homogeneous for such workers than for say, managers or professionals.

The choice between traditional and high-involvement HRM strategies is a critical issue in contemporary Korea. In the initial stages of the country's export-oriented development strategy, and until quite recently, most Korean firms pursued fairly bureaucratic organizational strategies that supported low-cost production. But it was recognized even before the 1997 financial crisis that Korean *chaebols* required restructuring and that competitiveness needed to be encouraged among Korea's small and medium-sized firms, if the country's businesses were to deal with the increasing pressures of globalization (Ungson, Steers, & Park, 1997). In fact, the Korean term *seggyewha*, which means "globalization," has also come to be used as the byword for Korea's efforts at economic restructuring. Such restructuring has led to the introduction of what has been termed the "new human resource management" (NHRM) system in Korea (Bae, 1997). NHRM techniques correspond very much to American-style high-involvement HRM strategies. NHRM approaches involve greater reliance on teams, employee empowerment, and performance-based evaluation, pay, and staffing. Despite strong union opposition, Korean firms now have the right to terminate workers for economic reasons, thus enhancing flexibility. These changes are driven by the need for Korean firms to respond to the competitiveness and uncertainty created by global competition, particularly now that Korea does not enjoy the cost advantage it once did in world markets. Ungson and colleagues (1997) also pointed out that many Korean companies have been moving in the direction of implementing high-involvement HRM strategies, as well as reformulating organizational strategies and structures, to promote rapid responsiveness and organizational learning in competitive global markets.

Important cultural traits that may undermine the efficacy of high-involvement work systems, however, distinguish Korea (and most of East Asia) from the United States and other Western countries. In particular, Asian cultures tend to be more collectivist and hierarchical than Western cultures (Hofstede, 1991). Kirkman and Shapiro (1997) provided a theoretical analysis of the connections between these cultural traits and the effectiveness of

autonomous work teams (a cornerstone of high-involvement HRM strategies). The more collectivist a culture, the more likely workers are to accept such team-based work arrangements. But in hierarchical cultures, the empowerment aspects of high-involvement HRM strategies are generally not so readily accepted either by managers or their subordinates. Workers also tend to be more fatalistic in collectivist cultures and thus less prone to have the sense of self-efficacy requisite for independent action.

In Hofstede's (1991) study, Korea ranked as one of the most collectivist countries, with a value of 18 (in contrast to Japan's 46) on an individualism scale ranging between 0 and 100). Hence, group harmony based on social contracts, company loyalty, and commitment are highly valued. At the same time, Korea's relatively high value on Hofstede's power distance scale, which measures the extent to which members of a society legitimize hierarchical relationships, reflects the fact that authoritarian and paternalistic leadership, hierarchical structure, and a bureaucratic managerial style are traditional features of Korean organizational culture (Cho & Park, 1998; Chung, Lee, & Jung, 1997; Steers, Shin, & Ungson, 1989; Yoo & Lee, 1987).

On the surface, then, the ability to implement high-involvement work systems in Korea is seemingly limited by certain cultural traits. However, there are at least three reasons why high-involvement work systems could be implemented well in Korea. First, the country's traditional collectivism is well suited for high-involvement systems. Lee and Johnson argued this: "Managerial values of loyalty, cooperation, and harmony underlie most Korean firms' labor policy. These values mesh well with high-involvement work systems" (1998: 73). They also pointed out that several factors within the Korean context facilitate the adoption of high-involvement management, noting that Korean workers value education and are very open to obtaining the additional training required for effective high-involvement work systems.

Second, traditional East Asian cultures certainly have not, in general, been well situated to implement high-involvement work systems, primarily since such systems involve extensive worker empowerment. High-involvement work systems require some individualistic features, which seemingly contradict Korean collectivism. However, contemporary Korean culture is more complex than the traditional culture and can be characterized as a composite of Asian and Western values (Bae, 1997; Cho & Park, 1998; Koch, Nam, & Steers, 1995; Ungson et al., 1997). Ungson and his coauthors (1997) wrote that individualism and group spirit are both equally strong in Korea. Cho and Park also recognized that Korean corporate culture is multidimensional and paradoxical: "A mixture of harmony and change, face-saving and aggressiveness, and emotional community and impersonal achievement" (1998: 27). They labeled this hybrid of conflicting cultural traits "dynamic collectivism" (Chang & Chang, 1998: 27). These authors further observed that harmony-seeking collectivism and future-oriented optimism coexist in today's Korean business culture. Chang and Chang (1994: 47) also argued